I. Introduction

1. At its September, 2000, meeting the International Monetary and Financial Committee (IMFC), requested that the Fund prepare a joint paper with the World Bank on their respective roles in combating money laundering and financial crime, and in protecting the international financial system. Moreover, the Fund was specifically asked "to explore incorporating work on financial system abuse, particularly with respect to international efforts to fight against money laundering into its various activities, as relevant and appropriate." (See Annex I). The purpose of this paper is to present background information prior to the forthcoming consideration of this requested joint paper with the World Bank.

2. The IMFC recognized that the Fund has to play its role in protecting the integrity of the international financial system from abuse through its efforts, *inter alia*, to promote sound financial systems and good governance.[1] The World Bank, consistent with its development mandate and areas of comparative advantage, plays an important role in assisting countries in legal reforms, often in the context of national anti-corruption programs, and in the design and implementation of capacity building programs (e.g., in the context of legal and judicial reform, establishing protection of shareholders' rights) and the promotion of governance and transparency principles and practices in the financial sector.[2]

3. This paper is organized as follows. Section II reviews current usage and suggests interpretations of various terms such as financial system abuse, financial crime, and money laundering. The empirical evidence on the macroeconomic impact of financial system abuse, focusing on money laundering, is discussed in Section III. The work of other relevant bodies on these issues, especially the Financial Action Task Force (FATF), is presented in Section IV.

---

[1] This encompasses, *inter alia*, the Fund's role in the promotion, development, and implementation of internationally agreed standards and codes (see *Assessing the Implementation of Standards: A Review of Experience* (SM/01/11, January 12, 2001), and promotion of sound financial systems (Summing Up by the Acting Chairman, *Financial System Assessment Program—A Review—Lessons from the Pilot and Issues Going Forward*, BUFF/00/190, December 14, 2000, and *Offshore Financial Centers—The Role of the IMF* (SM/00/136, June 23, 2000, and BUFF/00/98, July 14, 2000)). The Board paper on the *Review of the Fund's Experience in Governance Issues*, scheduled for Board discussion on February 14, 2001 reviews the operational experience with governance issues in the context of the framework and objectives of the 1997 Guidance Note on Governance.

[2] *The role of the World Bank Group in Promoting the Integrity of Financial Markets*, SecM-2000-566, September 21, 2000.

II. What is Financial Abuse and Financial Crime

4. While there seems to be broad agreement on the meaning of such concepts as money laundering, corruption, and tax evasion, the terms financial abuse and financial crime are far less precise, and in fact are sometimes used interchangeably. To assure clarity, including for the operational implications for the Fund and the Bank, definitions are provided below.

5. Usage of these terms (see Annex I) suggests that, among them, financial abuse has the broadest meaning, encompassing not only illegal activities that may harm financial systems, but also other activities that exploit the tax and regulatory frameworks with undesirable results (see Figure 1). When financial abuse involves financial institutions (or financial markets), it is sometimes referred to as financial sector abuse. Financial crime, which is a subset of financial abuse, can refer to any non-violent crime that generally results in a financial loss, including financial fraud. It also includes a range of illegal activities such as money laundering and tax evasion. Money laundering refers to activities involving the processing of criminal proceeds to disguise their association with criminal activities.

6. More precise definitions of financial abuse, financial crime, money laundering, and related concepts are presented below.

Figure 1. Concepts of Financial Abuse

Factors Contributing to Financial Abuse

- Poor regulatory and supervisory framework (e.g., excessive bank secrecy, lack of disclosure rules and effective fiduciary rules for investors and their agents).
- Harmful tax practices

Types of Financial Abuse

Financial Sector Crime

- Money laundering
- Financial fraud (e.g., check, credit card, mortgage, or insurance fraud)
- Tax evasion
- Circumvention of exchange restrictions
- Other

Other Financial Crime

- Sale of fictitious financial instruments or insurance policies
- Embezzlement of non-financial institutions
- Tax evasion
- Stock manipulation
- Other

Other Financial Abuse

- Tax avoidance
- Connected party lending
- Stock manipulation
- Other

Financial abuse

7. Usage of the terms financial abuse and financial crime, indicate that its meaning varies on different occasions.[3] To clarify usage, it is helpful to distinguish clearly between factors or incentives that facilitate or encourage financial abuse, such as poor regulatory and supervisory frameworks and weak tax systems, and activities that constitute financial abuse. Accordingly, the concept of financial abuse is interpreted in a very broad sense, as including illegal financial

---

[3] Annex I provides examples from international usage. As regards national usages, the Edwards Report, commissioned by the United Kingdom in 1998, discusses money laundering, tax evasion, drug trafficking, and fraud as well as illegal capital flight under the general title of financial crime and money laundering. (See Home Department, *Review of Financial Regulation in the Crown Dependencies*, Command Paper, November 1998, Chapters 14 and 15.) The International Narcotics Strategy Report of the U.S. Department of State discusses money laundering along with other financial crimes and tax evasion, and stresses that excessive bank secrecy laws make financial systems vulnerable to abuse from criminal activities, ranging from terrorism to tax evasion. (See U.S. Department of State, Bureau for International Narcotics and Law Enforcement Affairs, International Narcotics Control Strategy Report, Money Laundering and Financial Crimes, March 1999.)

activities, many of which have the potential to harm financial systems, and legal activities that exploit undesirable features of tax and regulatory systems.

8. Countries also have different legal characterization of specific acts, such as money laundering, corruption, and tax evasion. For example, considerable variation exists among countries as to which crimes may give rise to proceeds that may be laundered. The concept of corruption is also not uniformly defined. For example, in some countries so-called "facilitation" or "grease" payments given to induce foreign public officials to perform their functions are not illegal, while in others, these are treated as illegal bribes.[4] Agreement is also absent as to other types of financial crime. Some countries consider very low tax rates as abusive or harmful tax competition while others do not.[5] Differences also exist on what is "excessive" in "excessive bank secrecy."[6] Differences exist among jurisdictions as to what acts constitute crimes, which raise questions as to which domestic laws one country may help another in enforcing. For example, some countries maintain a broad range of exchange controls (e.g., capital controls), violations of which are financial crimes. These financial crimes may not, however, be crimes in other countries.

Financial crime

9. No internationally accepted definition of financial crime exists.[7] Rather, the term expresses different concepts depending on the jurisdiction and on the context. This paper interprets financial crime in a broad sense, as any non-violent crime resulting in a financial loss. When a financial institution is involved, the term financial sector crime is used.

[4] This difference among jurisdictions is reflected in the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Officials in International Business Transactions ("OECD Anti-Bribery Convention"), which in requiring signatories to make the bribery of foreign public officials a crime excludes facilitation payments. See Article 1, OECD Anti-Bribery Convention (entered into force February 15, 1999); Article 1, Commentaries on the OECD Anti-Bribery Convention (adopted by the Negotiating Conference on November 21, 1997).

[5] See Annex II for the OECD concept of harmful tax competition.

[6] Bank secrecy or customer confidentiality is rightfully expected by bank customers and normally is protected by law. It embodies some level of protection of confidentiality of information on individual and business affairs from others, including from government. However, bank supervisors normally have access to such information but cannot share it with government agencies. Banks separately provide information on interest income to tax authorities.

[7] Annex III surveys the evolving forms of financial crime.

10. Financial institutions can be involved in financial crime in three ways: as victim, as perpetrator, or as an instrumentality.[8] Under the first category, financial institutions can be subject to the different types of fraud including, e.g., misrepresentation of financial information, embezzlement, check and credit card fraud, securities fraud, insurance fraud, and pension fraud. Under the second (less common) category, financial institutions can commit different types of fraud on others, including, e.g., the sale of fraudulent financial products, self dealing, and misappropriation of client funds. In the third category are instances where financial institutions are used to keep or transfer funds, either wittingly or unwittingly, that are themselves the profits or proceeds of a crime, regardless of whether the crime is itself financial in nature. One of the most important examples of this third category is money laundering.

11. Financial institutions can be used as an instrumentality to keep or transfer the proceeds of a crime. In addition, whenever a financial institution is an instrumentality of crime, the underlying, or predicate, crime is itself often a financial crime.[9] There is a growing perception in many key jurisdictions that the most rapidly growing category of predicate crimes are financial, although illegal drug trafficking remains a major predicate crime. Although the circumstances vary from country to country, the preeminence of financial crimes as predicate offenses is found mainly: (i) in major financial centers, and (ii) in the location of a financial institution (e.g., where the criminal profits are laundered) which may be a different location from where the predicate crime was committed.

Money laundering

12. As noted above, money laundering is frequently referred to as a financial crime.[10] It is generally defined as "transferring illegally obtained money or investments through an outside party to conceal the true source."[11] This activity may prevent law enforcement from

---

[8] Those entities whose main activity is financial intermediation are considered financial institutions. This includes a broad range of institutions such as banks, insurance companies, securities firms, brokers, and pension funds. Governments also can be involved in financial crime, when they suffer a loss of revenue, or, on the contrary, facilitate evasion of other countries' taxes.

[9] Predicate crimes are crimes whose proceeds are laundered (see Annex IV).

[10] Because money laundering involves an attempt to evade confiscation of the proceeds (as well as any monetary fines that might also be levied), and may involve tax evasion as well (see also Annex II).

[11] Definitions of money laundering have been adopted in common vocabulary, see Oxford English Dictionary, Second Edition, 1989, p. 702. With the exception of what constitutes a specified unlawful activity, there are no significant differences in the definition of money laundering across institutions. FATF defines money laundering as "the processing of criminal proceeds to disguise their illegal origin" and the International Organization of Securities Commissions (IOSCO) as "a wide range of activities and

(continued…)

uncovering or confiscating the proceeds of crime, or using the proceeds as evidence in a criminal prosecution.[12] Such processing may involve disguising the beneficial owner of either the actual criminal proceeds or of other property that might be subject to confiscation. Money laundering can be done with or without the knowledge of the financial institution or counterparty to financial transactions, although to be guilty of the crime of money laundering, actual or implied knowledge is required.

13. The number and variety of transactions used to launder money has become increasingly complex, often involving numerous financial institutions from many jurisdictions, and increasingly using non-bank financial institutions (e.g., bureau de change, check cashing services, insurers, brokers, traders). In addition, because predicate crimes are often financial crimes, laundered proceeds may not be cash but other financial instruments.[13] Also, the use of non-financial businesses and markets for laundering appears to be

---

processes intended to obscure the source of illegally obtained money and to create the appearance that it has originated from a legitimate source." (See, FATF, 1996, The Forty Recommendations (see www.oecd.org/fatf/40Recs_en.htm), and IOSCO Technical Committee, 1992, *Report on Money Laundering*, October, No. 25.)

[12] The majority of countries already have in place or are in the process of preparing anti-money laundering legislation. According to the United States State Department International Narcotics Strategy Report for 1999, 110 out of 164 (67 percent) governments or jurisdictions surveyed had criminalized money laundering of illegal narcotics activities.

[13] This implies that traditional money laundering that starts when cash (often from narcotics trafficking) is deposited in one or more banks may no longer be the most common. Increasingly, other institutions and mechanisms are involved, sometimes at different stages of the money laundering process. These include not only businesses that provide bank-like services such as bureau de change, check cashers and money transmission services, but also securities and commodities brokers and life insurance companies.

increasing, including not only illegitimate institutions such as shell companies created as laundering instrumentalities, but legitimate companies where illicit funds are intermingled with legitimate funds. Money laundering methods are diverse and are constantly evolving. They range from trade-related operations to on-line banking. Money launderers may also operate outside financial systems, for example, through alternative remittance systems.[14]

14. Other financial crimes can be associated with, or exist in parallel with, money laundering, for example, corruption, fraud, or the control of a financial institution by organized crime. Upon the receipt of criminal proceeds, criminals may seek to launder them through the financial system. This, in turn, may also require a series of fraudulent activities such as counterfeiting invoices and the corrupting of bank employees. Thus, a whole chain of criminal or illegal activities may culminate in the flow of criminal money through the financial system.[15] Tax evasion, a form of financial crime, is facilitated by the existence of jurisdictions that have low tax rates, maintain relatively lax financial regulations and practices and that do not share information on client accounts with the tax authorities of relevant jurisdictions.

III. THE ECONOMIC EFFECTS OF FINANCIAL ABUSE, FINANCIAL CRIME, AND MONEY LAUNDERING

15. Financial system abuse has potentially negative consequences for a country's macroeconomic performance, impose welfare losses, and may also have negative cross-border negative externalities. Globalization and financial market integration in particular facilitates financial abuse. This section briefly reviews the very limited empirical and indirect evidence on the magnitude of financial system abuse, financial crime, and money laundering.[16]

16. Trust underpins the existence and development of financial markets. The effective functioning of financial markets relies heavily on the expectation that high professional, legal, and ethical standards are observed and enforced. A reputation for integrity—soundness, honesty, adherence to standards and codes—is one of the most valued assets by investors,

[14] For example, black market peso exchange system, the so-called hawala or hundi system of informal banking found in South Asia, and East Asian system originally based on chits or tokens (see FATF, *Report on Money Laundering Typologies*, 1999-2000, February 3, 2000).

[15] For example, a U.S. State Department's Report viewed bribery and corruption as "important factors in criminal exploitation of financial systems and institutions" (see The U.S. Department of State, Bureau for International Narcotics and Law Enforcement Affairs, International Narcotics Control Strategy Report, Money Laundering and Financial Crimes, March 1999).

[16] Tax competition, or harmful tax practices and their impact, will be addressed in a future staff paper.

financial institutions, and jurisdictions.[17] Various forms of financial system abuse may compromise financial institutions' and jurisdictions' reputation, undermine investors' trust in them, and therefore weaken the financial system. The important link between financial market integrity and financial stability is underscored in the Basel Core Principles for Effective Supervision and in the Code of Good Practices on Transparency in Monetary and Financial Policies, particularly those principles and codes that most directly address the prevention, uncovering, and reporting of financial system abuse, including financial crime, and money laundering.[18]

17. Financial system abuse may have other negative macroeconomic consequences. For example, it could compromise bank soundness with potentially large fiscal liabilities, lessen the ability to attract foreign investment, and increase the volatility of international capital flows and exchange rates. In the era of very high capital mobility, abuse of the global financial system makes national tax collection and law enforcement more difficult. Financial system abuse, financial crime, and money laundering may also distort the allocation of resources and the distribution of wealth and can be costly to detect and eradicate.[19] A common theme in research is that "if crime, underground activity and the associated money laundering take place on a sufficiently large scale, then macroeconomic policymakers must take them into account."[20]

18. Economic damage can arise not only directly from financial system abuse, but also from allegations that affect the reputation of a country, or from one country's actions against perceived financial system abuse in another economy. Such allegations or actions can through reputational effects affect the willingness of economic agents, particularly those outside the country, to conduct business in a given country (e.g., inward investment, banking correspondent relationships) with adverse consequences. One recent example includes the impact of the lists published by the FSF, FATF, and OECD, whether or not such listing was deserved. On the other hand, jurisdictions benefit from the economic activity and income attracted by lax regulatory and tax practices.

---

[17] Webster's Third New International Dictionary of the English Language, Third Edition, 1993, p. 1174.

[18] These would include the Basel Core Principles 14, 15, 18, 19, and 21. The guidelines on central bank internal governance and audit on the conduct of public officials, and on the accountability and assurances of integrity by financial institutions contained in the Code of Good Practices on Transparency in Monetary and Financial Policies. More generally, see *Experience with Basel Core Principles Assessments* (SM/00/77, April 12, 2000), for a discussion of the motivation and experience with Basel Core Principles Assessments (BCPA).

[19] Taxes and regulations also can distort the allocation of resources.

[20] Quirk, P., *Macroeconomic Implications of Money Laundering* IMF Working Paper, WP/96/66.

19. Activities underlying financial system abuse and financial crime are, by definition, concealed and therefore their direct observation by the macroeconomist or statistician is not possible. In the absence of hard statistical data and appropriate methodology, indirect methods have been used to estimate the potential volume of such activities. Estimates have used two different types of information—inference based on available macroeconomic data and direct information collected by law and tax enforcement agencies. Both approaches have problems and neither is particularly robust. Thus, an adequate measure of financial system abuse remains illusive.

20. The macroeconomic approach is not designed to arrive directly at an estimate of magnitude of money laundering or other forms of financial system abuse. Rather, it seeks to assess the magnitude of economic activities not generally counted in official GDP—the underground economy—encompassing a wide range of activities, both illegal and legal that go far beyond the likely scope of financial abuse (including activities where no money changes hands, activities concealed because they are against the law, and activities concealed because the resulting income is not declared to the tax or benefit authorities).[21] The size of underground economies has been estimated to range from 5 percent to 85 percent of official GDP, depending on the country and the methods used.[22] While proceeds from such activities could potentially be associated with financial system abuse, estimates of the underground economy overstate to an indeterminate extent the magnitude of financial system abuse, including money laundering.

21. Another approach to estimating the magnitude of financial abuse uses information about expenditures and prices involved in criminal activity that has been collected in the course of law enforcement (micro-data). The most publicized of such estimates have been for global money laundering by the FATF. On the basis of information about final sales of some illegal drugs (about US$120 billion a year in the United States and Europe in the late 1980s) and extrapolating worldwide and generalizing to include all drugs, and subsequently assuming that 50-70 percent of that amount would be laundered, the FATF estimated that money laundering could reach about 2 percent of global GDP. According to another micro-data based estimate, in one FATF member country, a law enforcement agency prosecuted 1,233 cases, with a total value of US$1.6 billion. A study of Australia estimated money

[21] This estimated discrepancy might also indicate deficiencies in statistical practices used by individual countries to estimate GDP rather than an estimate of the traditional underground economy.

[22] Macroeconomic estimates are based largely on money demand and electricity consumption methods to estimate the size of the underground economy. Annex V reviews the underlying methodologies and measurements of underground activity. Representative work in this area is far from convincing or conclusive.

laundering in 1995 at nearly US$3 billion or about ¾percent of GDP.[23] Given that law enforcement based estimates use actual data on reported crimes, and that reported crimes are a subset of all crimes, the real magnitude of money laundering is significantly underestimated.

22. Evidence on financial fraud is also limited. According to a study prepared for the European Commission, fraud in the European Union is estimated to range between 0.2 and 2 percent of GDP.[24] Serious cases of financial fraud, such as Barings, Drexel and Sumitomo and Daiwa cases, each involved losses exceeding US$1 billion. In some cases, there was damage to individual financial markets and the reputations of the companies, markets, and supervisors involved, although the macroeconomic impact was not significant.[25] Fraud by banks, as in the cases of BCCI and Meridien, contributed to considerable losses to depositors in a few countries, and seriously damaged the banking systems of some of the smaller African countries.[26]

23. The costs associated with other elements of financial system abuse, including the damage caused by abuse of poor regulatory frameworks which may contribute to financial crises or undermine confidence in financial system, are even more difficult to identify. The fiscal and output losses from financial crises have been extensively documented.[27] These losses relate to the total costs of the crises—usually caused by a combination of macroeconomic shocks and a fragile financial system—and it is not possible to disentangle the cost of abusing weak regulations on its own. Similarly, difficulties are encountered in

---

[23] See FATF, 1996-97 Report on Money Laundering Typologies, available on the website at: www.oecd.org/fatf/pdf/TY97_en.pdf

[24] *Fraud without frontiers*, 1997 study by Deloitte Touche for the European Commission.

[25] See for example Instefjord, N., Jackson, P., and Perraudin, W., in an article entitled *Securities Fraud* in Economic Policy No.27, October, 1998.

[26] See IMF staff background paper for the July 2000, Board discussion of *Offshore Financial Centers*, SM/00/136, Supplement 1.

[27] See for example Lindgren, C.J., et al, 1999, *Financial Sector Crisis and Restructuring—Lessons from Asia*, IMF Occasional Paper No. 188, (Washington: IMF); Sundararajan, V. and Baliño, T.J., *Banking Crises: Cases and Policy Issues*, IMF, 1991, and Lindgren. C.J., *Bank Soundness and Macroeconomic Policy*, IMF, 1996. Also see Klingebiel, B., and Klingebiel, D., *Bank insolvencies: cross-country experience*, World Bank Policy Research Working Paper 1620, 1996.

estimating the macroeconomic effects of tax evasion and harmful tax competition, and corruption.[28]

24. In sum, the empirical evidence on the magnitude of financial system abuse, financial crime or money laundering is limited but significant impact on individual countries cannot be ruled out. Measurements based on reported crimes underestimate the actual magnitude of financial system abuse, while estimates based on the underground economy clearly exaggerate it.

IV. Countering Financial Abuse and Crime: What Others Are Doing

25. Since the late 1980s, the growing concerns about drug trafficking and the uses made of globalization facilitated by the advancements in communication technology have led to direct and indirect approaches by different international institutions and the international community to combat financial crime and money laundering. The nature and activities of the principal multilateral organizations involved in countering financial system abuse are summarized below and presented in greater detail in Annex VI.

26. The FATF and affiliated regional organizations lead the international efforts in directly combating money laundering. Members of the FATF engage in annual self-assessments and in periodic mutual evaluations of members' anti-money laundering efforts. In June 2000, the FATF identified 15 non-member jurisdictions that it considers as "non-cooperative with international efforts against money laundering." Assessments are based on the review of compliance with the FATF's *Forty Recommendations* (a list of anti-money laundering measures, see Annex VII). Since the FATF is a voluntary task force and not a treaty organization, its recommendations do not constitute a binding international convention.

27. Fund staff has participated, as observers, in most FATF plenaries since 1980. At the request of the FATF, Fund staff made a statement at the June1996 FATF Plenary on the macroeconomic impact of money laundering, and the Managing Director made a statement at the February 1998 FATF plenary.[29] The FATF has recently agreed to share results from their exercises with Fund staff conducting financial assessments, in the context of FSAP and OFC

---

[28] See Tanzi, V., *Globalization, Technological Developments and the Work of Fiscal Termites*, IMF Working Paper, WP/00/181. On corruption, see Graf Lambsdorff, J., *Corruption in Empirical Research—A Review*, Transparency International Working Paper, November 1999.

[29] The background material for this statement has been subsequently published in Peter Quirk's paper, *Macroeconomic Implications of Money Laundering* IMF Working Paper, WP/96/66. At a February 1998 FATF Plenary, Michel Camdessus made a statement on the importance of international countermeasures to money laundering (see, IMF external website).

assessments. At a recent IMF Executive Board meeting, the possibility was raised that the FATF could be invited to prepare ROSC modules on Fund members' observance of the FATF's *Forty Recommendations*. Some members of the FATF have asked that the Fund's Article IV surveillance and program conditionality include anti-money laundering considerations.[30] The FATF President, in a letter to Fund management, suggested that the FATF *Forty Recommendations* be adopted as the anti-money laundering standard.

28. Annex VII shows in detail the relationship between the FATF *Forty Recommendations* and banking and other financial sector supervisory principles. As can be seen, anumber of the Recommendations relate to the supervisory principles of the Basel Committee on Banking Supervision, the IOSCO and the International Association of Insurance Supervisors (IAIS). The remaining Recommendations relate to the criminalization of money laundering, the freezing and seizure of the proceeds, and international cooperation in the investigation, prosecution and extradition of crime suspects.

29. Other direct efforts to counter financial crime are undertaken mainly by the International Criminal Police Organization (Interpol) and national financial intelligence units (FIUs).[31] The United Nations takes part in the direct efforts through the United Nation's Office for Drug Control and Crime Prevention Global Program Against Money Laundering (UNDCCP), which monitors weaknesses in global financial systems and assists countries in criminal investigations.[32]

30. Recently, the international community's awareness of financial system abuse has been heightened by the work of the FSF. In May 2000, the FSF classified 42 OFCs into three groupings, and called on the Fund to take the lead in assessing OFCs adherence to internationally accepted standards and codes.

31. Indirect efforts to counter financial system abuse focus on the preconditions for the proper functioning of financial systems and the formulation and enforcement of relevant laws. These efforts encompass general standards for the supervision and regulation of banks, securities markets, and insurance, as incorporated in the standards developed by the Basel Committee, the IOSCO, and the IAIS. The substance of relevant FATF recommendations is

[30] The possibility was raised that the FATF could be invited to prepare ROSC modules on members' observance of the FATF's Forty Recommendations. The mechanism exists to invite the FATF, or any other group, into the ROSC process, and this could be considered at the forthcoming Board discussion of the policy paper on financial system abuse. See also *Assessing the Implementation of Standards: A Review of the Experience and Next Steps*, scheduled for Board discussion on January 29, 2001.

[31] See Annexes VI and VIII.

[32] See also the United Nations Convention Against Transnational Organized Crime, adopted in December 2000.

incorporated in the principles of supervision of the Basel Committee and other international supervisory standard-setters.[33]

32. Banking, insurance, and securities markets supervisors are involved in both indirect and direct efforts to combat financial system abuse. Supervisors in different countries exchange information (often based on a network of memoranda of understandings) about individual banks, insurance companies, or agents in the securities markets, with a view to uncover unsound and illegal activities such as securities fraud, insider trading, or misreporting. Supervision is also exercised over the internal mechanisms to control risks, particularly operational risks, which also contributes to countering fraud and other forms of financial crime.

33. Out of concern over the potential impact of tax-induced distortions in capital and financial flows on welfare and on individual countries tax bases, the OECD initiated coordinated action for the elimination of harmful tax practices.[34] In May 1998, the OECD issued a report on Harmful Tax Competition including a series of 19 recommendations for combating harmful tax practices, established a Forum on Harmful Tax Practices, and proposed Guidelines for Dealing with Harmful Preferential Regimes in Member Countries (Annex II). In June 2000, OECD issued a list of countries it considers as engaged in harmful tax practices.

---

[33] Annex VII gives details of the relationship between the FATF *Forty Recommendations* and the financial supervisory principles and other relevant organizations.

[34] The Fund is not directly involved in the OECD work on "harmful tax practices." For information on this issue, see OECD, *Harmful Tax Competition, an Emerging Issue*, 1998; and subsequent developments listed on the OECD website www.oecd.org, including the June 2000 listing of 35 jurisdictions as tax havens. In December 2000, the list of these jurisdictions was revised.