

IMF Publication

Anti-Money Laundering and
Combating the Financing of
Terrorism - Observations
from the Work Program and
Implications Going Forward

INTERNATIONAL MONETARY FUND

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**Anti-Money Laundering and Combating the Financing of Terrorism:
Observations from the Work Program and Implications Going Forward**

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ACRONYMS

AML	Anti-Money Laundering
APG	Asia-Pacific Group on Money Laundering
CAS	Country Assistance Strategy
CDD	Customer due diligence
CFATF	Caribbean Financial Action Task Force
CFT	Combating the Financing of Terrorism
CGAP	Consultative Group to Assist the Poor
DNFBP	Designated non-financial businesses and professions
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FATF	Financial Action Task Force
FIRST	Financial Sector Reform and Strengthening Initiative
FIU	Financial intelligence unit
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSRB	FATF–Style Regional Bodies
FSSA	Financial System Stability Assessment
FT	Financing of terrorism
GAFISUD	South American Financial Action Task Force
IAE	Independent AML Expert
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
ML	Money laundering
MONEYVAL	Council of Europe Group on Money Laundering
NBFI	Non-bank financial institution
NCCT	Non-Cooperative Countries and Territories
NPO	Non-profit organization
OFC	Offshore Financial Center
ROSC	Report on the Observance of Standards and Codes
RTAC	IMF Regional Technical Assistance Center
TA	Technical Assistance
UN	United Nations
UNCTC	United Nations Counter Terrorism Committee
UNODC	United Nations Office on Drugs and Crime

EXECUTIVE SUMMARY

This paper provides a summary of the IMF and the World Bank work programs on *anti-money laundering and combating the financing of terrorism (AML/CFT)* following the Fund and Bank Boards' decisions in March 2004 to endorse the revised FATF standard (2003 version) and methodology for the purposes of preparing ROSCs and to expand the areas of Bank/Fund responsibility to cover the revised FATF standard comprehensively. The paper draws lessons on what has worked well and the challenges. It discusses the work program going forward.

The revised FATF Recommendations set a new standard for jurisdictions with the potential for affecting their legal, regulatory, and institutional frameworks. The standard applies to more sectors and has become more rigorous with important consequences for assessments, technical assistance and policy development.

Since the March 2004 Board decisions, the Fund/Bank have completed field work for 12 assessments and the FATF/FSRBs for 13 assessments. Some general observations are emerging from these assessments. Overall compliance with FATF Recommendations in the revised standard is lower across all the assessed countries compared to the earlier 1996 standard. Compliance with the CFT special recommendations is particularly weak. Compliance with main AML/CFT preventive measures has become more difficult. Countries are just beginning to address AML/CFT obligations for designated non-financial businesses and professions (DNFBPs) and non-profit organizations (NPOs).

Staff have continued to increase assistance to countries and regional organizations. In the 18 months between January 1, 2004 and June 30, 2005, the Bank/Fund delivered some 210 TA projects, including 169 delivered in the field. TA coordination with external partners continues to be a key objective of Fund/Bank efforts. The demand for TA has increased inter alia because of the need to implement the new requirements and because of the increased awareness of AML/CFT issues.

Policy development work has been an integral part of the intensive AML/CFT work program. Initiatives include the need to document international practices in the new sectors covered by the standard, the approaches to be applied in the implementation of the standard, and economic effects on remittance flows and financial sectors.

Several aspects of the work program have worked well and are yielding results. The synergies between assessments, technical assistance, and policy development have enhanced the staff's ability to respond flexibly and to strengthen delivery of the work program. The assessment process is focusing country attention on AML/CFT issues. The extension of Bank/Fund responsibilities to comprehensively cover the standard has produced fully-integrated assessments of AML/CFT systems. The TA provided to countries has begun to show some positive and concrete results. Policy development work has broadened the knowledge base for effective assessments and technical assistance.

At the same time, certain challenges are apparent. Many countries are finding that their current regimes fall short of the revised standard. In addition, corruption, weak governance,

insufficient political commitment, resource constraints, and the extensive nature of the standard makes its implementation a challenge. As a consequence, the agenda for reform is demanding, calling for a sequenced approach and increased TA delivery. At the same time however, the resources available to the Fund through its administered accounts to support AML/CFT TA have already been substantially committed. Another challenge concerns the AML/CFT assessment process which is more complex than for all other financial sector standards.

While continuing to focus on assessments, TA and policy development, certain areas of the work program will require greater attention going forward.

- Harmonizing approaches with FATF/FSRBs to address issues of application and interpretation;
- Increasing outreach to raise awareness of parliamentarians and key decision-makers;
- Enhancing work on design and sequencing of AML/CFT regimes;
- Strengthening the link between assessment and TA work;
- Better integration of AML/CFT work in the context of the Fund's Article IV and of the Bank's country operations with particular emphasis on links with anti-corruption work at the Bank;
- Continuing to work with the donor community to commit additional resources to meet increasing TA needs for countries.

I. INTRODUCTION

1. **In March 2004, the Bank and Fund Boards decided that *anti-money laundering and combating the financing of terrorism (AML/CFT)* should continue to be a regular part of the work of the IMF and World Bank.**¹ The Fund and Bank Boards endorsed:

- **The revised FATF 40 Recommendations** for anti-money laundering (2003 version) and the revised assessment methodology (2004 version) for the preparation of *Reports on the Observance of Standards and Codes (ROSCs)*. The revised methodology incorporated the Special Eight Recommendations for combating the financing of terrorism;
- **An expansion of Bank/Fund responsibilities in both assessments and technical assistance (TA) to cover comprehensively the revised FATF standard**, including assessing the implementation of criminal justice measures and AML/CFT measures in non-macroeconomically relevant sectors (i.e., primarily those areas other than prudentially-regulated sectors);
- **Continued inclusion of AML/CFT assessments in all financial sector (FSAPs) and offshore financial center (OFC) assessments**, whether the AML/CFT assessment is prepared by the Fund/Bank or by the Financial Action Task Force (FATF) or the FATF-style Regional Bodies (FSRBs); and
- **The existing collaboration with the FATF and FSRBs** provided that the evaluation process is “uniform, voluntary, and cooperative.”²

2. **The Fund and the Bank have been delivering an intensive work program of assessments, TA, and policy development on AML/CFT in collaboration with FATF and FSRBs.** This paper provides a progress report on the AML/CFT work program under the revised standard, notes preliminary lessons learned, and discusses issues to be addressed in taking the work forward. The paper is structured as follows: Section II provides an update on the experience with assessments, technical assistance, and policy development. Section III discusses the lessons learned. Section IV discusses the work program going forward. A supplement provides background information on experience with assessments, technical assistance, and implementation of the standard in the areas of remittances, designated non-financial businesses and professions (DNFBPs), and non-profit organizations/charities.

¹ See PIN 04/33 April 2, 2004

² At the time of the decision, the FATF indicated that it was not planning to conduct a further round of the Non-Cooperative Countries and Territories (NCCT) exercise, and it has not done so.

II. THE AML/CFT WORK PROGRAM—ASSESSMENTS, TA, AND POLICY DEVELOPMENT

3. **The revised FATF Recommendations set a new standard for jurisdictions with the potential for affecting their legal, regulatory, and institutional frameworks.** Some key modifications in the revised standard and methodology include:

- Establishing the suppression and prevention of terrorism financing as a central aspect of the FATF standard, which incorporates the relevant UN Conventions and Security Council Resolutions;
- Strengthening preventive measures for AML/CFT that apply to all financial sectors and introducing the concept of risk-based regulation and supervision;
- Expanding coverage of AML/CFT measures to DNFBPs such as lawyers, accountants, real estate agents, casinos, and others;
- Increasing the requirements for establishing operational financial intelligence units (FIUs);
- Setting detailed requirements for domestic and international cooperation; and
- Focusing enhanced attention on the overall legal and institutional environment, including public and private sector governance.

Accordingly, the revised FATF standard not only applies to more sectors but has also become more rigorous. The depth and breadth of coverage under the revised AML/CFT standard is reflected by the expansion in the assessment methodology. The revised methodology now comprises more than 250 assessment criteria, up from about 120 criteria under the earlier 2002 methodology, and places greater emphasis on assessing effectiveness of implementation.

4. **The FATF adopted an additional Special Recommendation in October 2004.** The newly adopted Special Recommendation IX (SR IX) requires that countries put in place either a declaration or a disclosure system to deter cross-border movements of currency and monetary instruments related to financing of terrorism (FT) and money laundering (ML) and to confiscate such funds. Subsequently, Recommendation 19 and the methodology, which require the reporting of domestic and international currency transactions, were revised. This updated standard and revised methodology is the current basis upon which assessments of AML/CFT regimes are being undertaken (see Annex I for further details as well as the full text of SR IX).

A. Experience with Assessments Using the Revised Standard and Methodology

5. **Since the March 2004 Board decisions, the Fund/Bank have completed field work for 12 assessments and the FATF/FSRBs have completed 13 assessments** (Table 1 and 2). Bank assessments commenced in September 2004, and the Fund assessments

commenced in December 2004. Three assessments have been finalized and ROSCs issued. The remaining nine are being finalized consistent with the FSAP/OFC schedules. FATF/FSRB assessments commenced in July 2004. Of the 13 FATF/FSRB assessments, 6 assessments are in conjunction with the FSAP/OFC program. The FATF/FSRBs have agreed to produce ROSCs for all their assessments. Eight of the 13 assessments have been completed and accepted by the respective plenaries.

Table 1. AML/CFT Assessments by the IMF and World Bank Using the Revised Standard
(as of end-August 2005)

	Completed	Draft Reports ^{1/}
Fund	Belarus Hungary	Bahrain Italy Greece Panama
Bank	Sudan	Madagascar Mauritania Rwanda Senegal Uganda
Total	3	9

Source: Fund/Bank Staff

^{1/} Finalization of draft reports requires a period of some 4–6 months following the on-site mission to allow for feedback from stakeholders to be taken into consideration. Reports remain in draft form until responses from assessed countries and other stakeholders are taken into account.

Table 2. AML/CFT Assessments by the FATF and FSRBs Using the Revised Standard
(as of end-August 2005)

Assessor Organization	Completed and Accepted by Plenaries	Assessments Commenced
FATF	Belgium Norway ^{1/}	Australia ^{1/} Ireland Switzerland
APG	Brunei India Nepal	
CFATF		Jamaica ^{1/} Trinidad ^{1/}
GAFISUD	Colombia ^{1/} Peru ^{1/}	
MONEYVAL	Slovenia	
Total	8	5

Source: Fund/Bank Staff ^{1/} Results of AML/CFT assessment to be included in context of an FSAP or OFC assessment.

Coordination arrangements for conducting assessments

6. **The coordination between the Bank/Fund and the FATF/FSRBs on assessments has been strengthened.** The main elements are:

- **Agreement to use a common core set of documents** in preparing assessments, in particular the assessment methodology but also the executive summaries, which for FATF/FSRB reports mirror the ROSCs;
- **Common training of evaluators.** The Fund/Bank and the FATF collaborated to prepare and deliver a common training program for evaluators. This training has been expanded to include a number of the FSRBs;
- **Mutual recognition of assessments.** The Bank/Fund have agreed to accept FATF/FSRB assessments in the context of the FSAP/OFC program, if the assessments are conducted using the common methodology in a timeframe consistent with the FSAP/OFC timeframe and following a pro forma review for consistency with the ROSC format. Similarly, the FATF/FSRBs accept the assessments conducted by the Fund/Bank for their mutual evaluation purposes under agreed procedures. The Fund/Bank have undertaken, when consistent with the FSAP timeframe, to present their draft assessments to the Plenaries of the FATF/FSRB, so that the comments of the Plenaries can be reflected prior to finalization of the reports; and

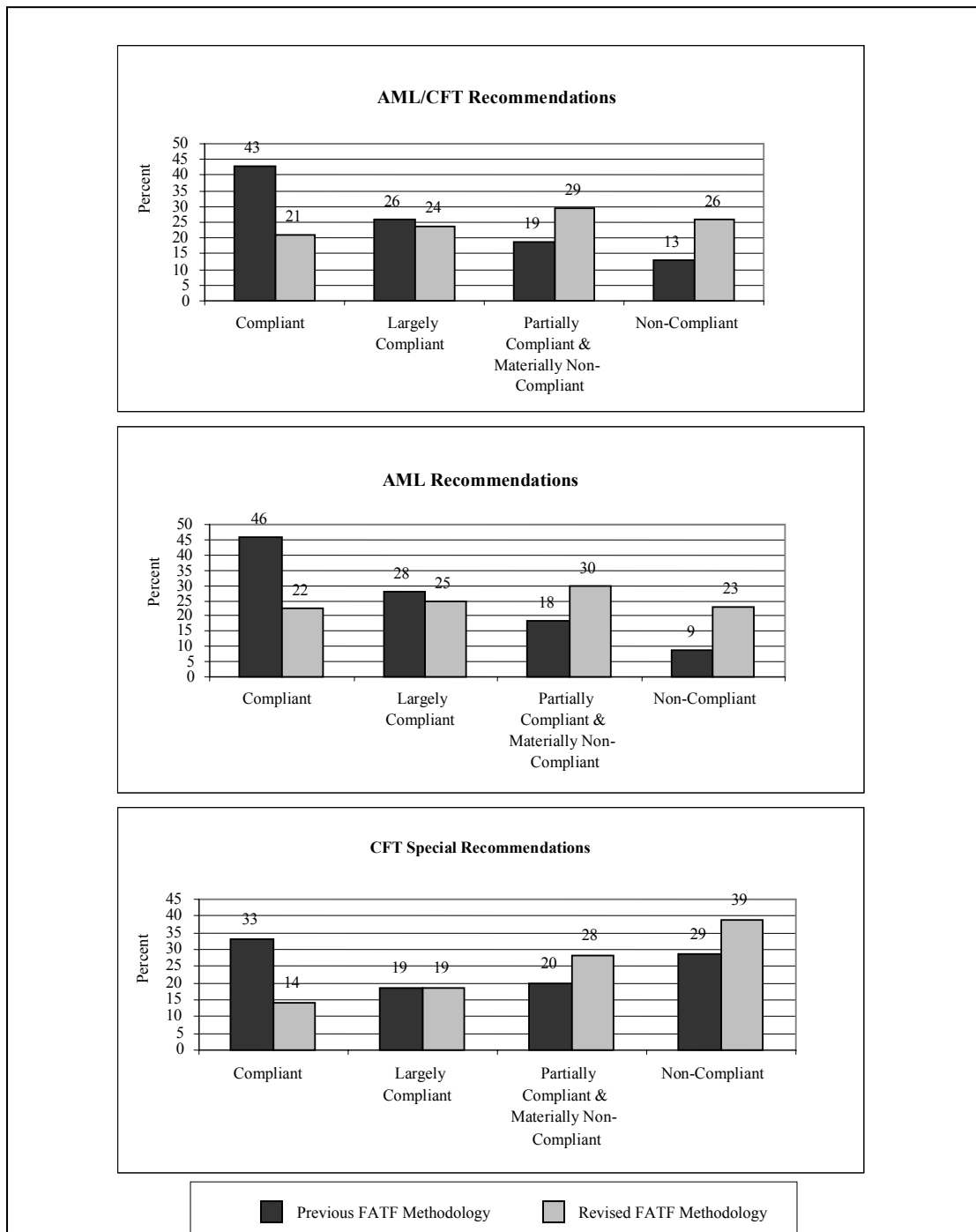
- **Coordination of assessment schedules to avoid duplication** of assessments and to achieve reasonable burden sharing. The FATF/FSRBs have agreed to conduct their mutual evaluations consistent with the FSAP/OFC assessment schedules and to prepare ROSCs. Similarly, the Fund/Bank agree with the FATF/FSRBs on the assessments of their members which would be accepted as mutual evaluations.
7. **Review of Quality and Consistency.** Good progress has been made in preparing the ex post review of the quality and consistency of the FATF/FSRB assessments. The Fund and Bank Boards requested this review of the FATF/FSRBs assessments conducted under the 12-month pilot program of AML/CFT Assessments. The review is underway with a panel of experts conducting the technical analysis of a sample of Bank/Fund and FATF/FSRB reports in close dialogue with the FATF/FSRBs. The panel of experts is expected to deliver a draft report on the technical review in early September 2005. Staff will prepare a policy paper for consideration by the Bank/Fund Boards in early 2006 following consultation with the FATF/FSRBs.

Findings from assessments³

8. **Some general observations are emerging from assessments analyzed** to date which, while limited, cover a range of income groups including high-, middle-, and low-income countries.
- **Overall compliance with the Recommendations in the revised FATF standard is lower across all the assessed countries** than for assessments conducted against the earlier standard—45 percent of Recommendations were found compliant or largely compliant compared to 62 percent for the assessments conducted under the 12-month pilot program (see Figure 1). This lower level of compliance can largely be attributed to the broad scope of revisions to the standard, the enhanced precision of the revised methodology, and the need by countries for sufficient lead time to implement the requirements imposed by the revised standard.
 - **Overall compliance is better for the AML Recommendations than the CFT Special Recommendations.** For the AML Recommendations, 47 percent were rated either fully or largely compliant. By contrast, only 33 percent of the CFT Special Recommendations were rated fully or largely compliant. All assessed countries

³ This section surveys the compliance in 18 assessments for which ratings were available, supplemented by more detailed review for the 12 Bank/Fund conducted assessments. Details of this analysis, which take account of the differences of the sample of countries assessed under the previous and revised standard, are provided in the supplement.

Figure 1. Comparison of Compliance Levels between the Previous & Revised FATF Standard



Source: Bank/Fund staff

- Under the previous methodology, 27 of the 40 and 7 of the 8 Special Recommendations were rated in the assessments, and under the revised methodology all AML/CFT Recommendations were rated in the assessments.

- The countries assessed under the previous methodology included 18 high-income, 18 middle-income, and 5 low-income countries; the countries assessed under the revised methodology included 7 high-income, 5 middle-income and 6 low-income countries. (See supplement for further analysis).

showed weakness on the freezing and confiscation of terrorist assets and on instituting a legal requirement for reporting transactions where terrorist financing is suspected. Despite these flaws in the legal framework, the majority of assessed countries have instituted transitional measures to implement UN Security Council Resolution 1267 and successor resolutions on financing of terrorism.⁴

- **Achieving compliance with the main AML/CFT preventive measures has become more difficult because the requirements of the revised FATF standard have become more comprehensive.** For customer due diligence (Recommendation 5), 33 percent were considered largely compliant (and none were fully compliant), compared with 67 percent fully or partially compliant with the comparable recommendation under the old methodology. For suspicious transaction reporting, only 28 percent were considered fully or largely compliant, compared with 58 percent before.
- **For all assessed countries, there was a low level of compliance in the extension of AML/CFT obligations to DNFBPs.** Countries are just beginning to address measures for DNFBPs and non-profit organizations. Within these sectors, casinos and notaries have faced fewer problems in meeting AML/CFT obligations. However, implementing the standard that requires lawyers to report suspicious transactions under certain circumstances has proven to be problematic.
- **There were some areas where compliance was higher.** These included investigatory powers of competent authorities, ensuring that bank secrecy laws do not inhibit AML/CFT investigations, and ratification of conventions.
- **The level of compliance differs greatly among assessed countries.** The assessed high- and middle-income countries had an AML/CFT framework in place at the time of the assessments, though countries were at different stages of implementation. For the assessed low-income countries, AML/CFT systems are still at an early stage and the development of AML/CFT regimes mostly began after 2001 and, in some cases, as recently as 2004.
- **For assessed high- and middle-income countries, higher overall levels of compliance were found in the Recommendations dealing with core legal aspects of the AML regimes.** Some shortcomings, however, persist in the scope of criminalization and in the frameworks relating to seizure and confiscation. Core legal aspects remain substantially lacking in the assessed low income countries.
- **Implementation of AML preventive measures for the assessed high and middle income countries is uneven across the prudentially-regulated sectors.** For

⁴ UNSCR 1267 requires the freezing of assets associated with Al Qaeda and Taliban groups.

assessed low-income countries, where preventive measures are in place, they generally apply only to banks, which dominate the financial sector.

B. Experience with Technical Assistance

9. **Since the last report to the Bank and Fund Boards, staff have continued to increase assistance to countries and regional organizations.** The IMF/WB routinely provide assistance on (i) the design of the institutional framework (e.g., regulatory frameworks for covered sectors); (ii) legislative drafting; (iii) supervision of financial institutions; and (iv) financial intelligence units. An increasing number of requests are for assistance in the supervision of AML/CFT for the new sectors (DNFBPs, NPOs, etc.), legislative drafting for CFT, building capacity of FIUs according to the new standard, and developing monitoring and regulatory regimes for remittance systems.

10. **The Fund and the Bank have become central sources for TA.** In the 18 months between January 1, 2004 and June 30, 2005, the Bank/Fund delivered some 210 TA projects, including 169 delivered in the field. Additionally, 10 workshops were organized to train FSRB evaluators in the revised standard and methodology. Table 3 provides a breakdown of the TA delivered by type of activity and by region.⁵

11. **A key objective of Bank/Fund staff efforts continued to be close TA coordination with external partners.** Staff have stepped up coordination activities in conjunction with the plenary meetings of the FATF and FSRBs, which are becoming a key channel for planning technical assistance delivery. In addition, there are periodic meetings with other organizations, strategic partners (e.g., the UNCTC and UNODC), and key bilateral donors to collaborate on TA activities. The Bank's partnership with UNODC in supporting a regional mentor in Central Asia has been effective in expediting AML/CFT reforms in the region. The success of this approach has been facilitated by the mentor delivering TA programs jointly with the Fund and other multilateral and bilateral providers.

⁵ In the Bank, 14.7 staff and expert years of technical assistance were delivered in FY2005 compared to 9.3 years in FY2004. The Fund delivered 19.8 staff and expert years of technical assistance up from 16.5 person years in FY2004. However, the pace of Fund TA had to be cut back in the latter part of FY2005 as the resource intensive assessment program got underway.

Table 3. Bank/Fund TA Projects: January 2004 to June 2005

Projects by Topic and Modality of Delivery						
Category	Bilateral Mission	Bilateral HQ	Regional HQ	Bilateral Workshop	Regional Workshop	Total
Institution Building	59	3	0	4	9	75
Legal framework	25	26	2	3	8	64
Supervision and Regulation	22	0	0	3	9	34
Financial Intelligence Units	24	0	0	2	1	27
Global Dialogue Series	0	0	10	0	0	10
Total	130	29	12	12	27	210

Projects by Topic and IMF Region of Beneficiaries						
Category	Africa	Asia and Pacific	Eastern Europe	Middle East and Central Asia	Latin America and Caribbean	Total
Institution building	16	27	8	15	9	75
Legal framework	15	18	7	12	12	64
Supervision and Regulation	2	8	5	2	17	34
Financial Intelligence Units	2	7	6	2	10	27
Global Dialogue Series	2	1	0	3	4	10
Total	37	61	26	34	52	210

Source: Fund/Bank Data – further details in the supplement.

Category Definitions:
Institution Building: Comprehensive capacity building on multiple areas of the AML/CFT system, including the design of institutional, legal, and regulatory frameworks, the training of government officials on several AML/CFT specialties, and the assessment of countries' needs.

Legal Frameworks: Adapting legal systems to the revised FATF standard.

Supervision & Regulation: Strengthening the AML/CFT aspects of supervisory practices in financial and non-financial institutions.

Financial Intelligence Units: Creation and strengthening of FIUs.

Global Dialogue: Regional video-conference for TA coordination and lessons learned.

12. **The demand for AML/CFT TA has increased due to several factors:**

- **The standard has become more rigorous and extensive.** With the revised standard, countries have sought TA to improve compliance.
- **Countries have become more aware of AML/CFT requirements** reflecting in part: (i) the inclusion of AML/CFT assessments in Fund/Bank operational work, especially the FSAP and OFC program; and (ii) difficulties in maintaining relationships between

correspondent banks and between financial institutions and remittance service providers.

- **Referrals from agencies to the Bank/Fund for assistance.** As examples, the UN Counter Terrorism Committee (UNCTC) directs members to the Fund and the Bank for TA to meet relevant obligations under Resolution 1373; the FATF/FSRBs similarly look to the Fund/Bank to deliver training. In addition, the establishment of new FSRBs has resulted in TA requests for training.

The Fund/Bank were able to increase the delivery of TA as a result of the FY2005 assignment of additional resources to AML/CFT, greater utilization of trust funds/administered accounts, coordination with bilateral partners, and adjustments in modalities of delivery (see paragraph 28). However, efforts by Fund staff to encourage donor countries to commit additional resources to fund an enhanced program of TA delivery have not been successful (see paragraph 37).

C. Experience with Policy Development

13. **Staff have been active in the research and analysis of international practices in implementing AML/CFT regimes as a basis for provision of policy advice and TA.**

These activities have been closely coordinated with the FATF/FSRBs. This policy analysis is also synergistic with assessment work, which provides important information about implementation issues and challenges. The results of this work provide useful benchmarks for assessors and for training of assessors. Outputs include publications and policy documents (see supplement).

14. **The need to document international practice is especially acute as regards DNFBPs, remittance systems, and non-profit organizations.** AML/CFT obligations were extended to these sectors under the revised standard. Countries are still exploring how best to implement AML/CFT measures in these sectors. Staff has studied the oversight mechanisms in countries that have already taken the first steps in extending the standard to these sectors.

15. **The Bank/Fund have been particularly active in the area of remittances.** Given the developmental impact of the large financial flows, the Bank has undertaken extensive work in the remittance area including conducting a survey of remittance markets and fee structures; as well as studying remittance corridors. In addition, the Bank initiated the Task Force on Remittance Payment Systems which is chaired jointly by the Bank and the BIS, and where the Fund is actively involved. The 2006 Global Economic Prospects will draw on the results of the Bank's work on remittances. The Bank and the Consultative Group to Assist the Poor (CGAP) are also exploring ways of better integrating the handling of remittances in the business models of microfinance and rural finance institutions. Reflecting the importance of remittances in the balance of payments, the Fund's work has focused on improving the measurement of remittance flows and on the effective regulation of such flows. Regulatory measures involve finding the correct balance to reduce the potential for abuse without impeding the flows of remittances, driving remittance systems underground, or

limiting access to financial services. Overall, Bank/Fund work has focused on reducing transfer costs, improving access to payment systems, strengthening data collection, and developing regulations to protect the integrity of these flows.

16. **Policy development initiatives geared toward the financial sector have focused on several key topics.** Papers have been developed on the impact of terrorism on the financial markets and on integrating AML/CFT into a broader framework that aims to protect the integrity and stability of financial systems, e.g., by drawing out the relationship between operational, regulatory, and reputational risks that can impact the soundness of financial institutions and AML/CFT compliance failures. More recently, staff have begun developing a paper addressing the complexity of the risk-based approach to AML/CFT. The risk-based approach is of great interest to many countries because it allows a targeted assignment of regulatory resources to higher-risk areas.

17. **Work has been initiated to better understand the ML/FT risks of financial flows through non-profit organizations.** Similar to remittances, the developmental, balance of payments, and fiscal significance of NPO flows require striking a balance between safeguards for potential abuse by terrorist financiers and facilitating national and global charitable contributions.

18. **Bank staff are working on increasing awareness and understanding of AML/CFT risks in micro-finance institutions.** It is recognized that compliance with international standards presents special issues of customer identification that needs to be addressed given the unique nature of micro-finance institutions. Work is ongoing with the Consultative Group to Assist the Poor (CGAP) as are discussions with FATF on appropriate approaches for the application of customer-identification measures by service providers catering to low-income customers.

19. **Research is also ongoing on legal and institutional approaches to implement seizing, freezing, and confiscation measures.** Whereas AML/CFT measures serve to deprive criminal and terrorist organizations from their ill-gotten assets, the amount actually seized and confiscated is very limited. In addition, UN resolutions on the freezing of terrorist assets have created a new enforcement legal framework that many countries are not equipped to implement. This research is aimed at providing countries with the tools to improve and facilitate the confiscation of criminal and terrorist assets.

III. LESSONS LEARNED

20. **There are several implications for the work program stemming from the experience thus far with assessments, TA, and policy development.** This section discusses what has worked well and the key challenges going forward.

A. What has Worked Well

21. **The synergies between assessments, technical assistance, and policy development have enhanced the staff's ability to respond flexibly and to strengthen delivery of the work program.**

22. **Integration within wider Bank and Fund operations.** Intensified collaboration within the Bank's Financial Sector Network (FSE) and between the regions and country offices has resulted in greater synergy in Bank activities on AML/CFT and other Bank operations. Accordingly, Country Assistance Strategies (CAS), other Bank strategy and lending instruments, and TA programs are increasingly incorporating AML/CFT issues.⁶ AML/CFT policy development work is also carried out in collaboration with Bank experts from other departments. In the Fund, in addition to incorporating AML/CFT assessments in FSAP and OFC program, Fund staff circulated to members a voluntary questionnaire on AML/CFT in the context of Article IV consultations. To facilitate country responses, the questionnaire was focused on the existence of core legal and regulatory provisions, rather than issues of implementation. Ninety-three countries responded to the questionnaire (the majority were received in 2002). These responses improved the understanding of AML/CFT systems at that time and helped to bring AML/CFT issues into Article IV consultations.

Assessments

23. **The assessment process has increased awareness of, and global compliance with, the revised FATF standard.** Since 2002, some 92 countries have been assessed of which 58 were by the Fund/Bank. The inclusion of AML/CFT assessments into regular Bank/Fund work has helped to create a global, uniform, and cooperative environment for the implementation of the standard.

24. **Coordination between Bank/Fund and FATF/FSRBs continues to work well,** underpinned by a uniformity of approach and the use of a common comprehensive methodology. This has reduced duplication in assessments and permitted a better use of scarce resources. Through this coordination, either Bank/Fund or FATF/FSRB assessments are prepared in the context of all FSAPs and OFC assessments.

25. **Countries have generally displayed commitment** to the success of the assessment process and have adopted a transparent and cooperative approach. They have taken the assessment findings seriously, which has encouraged reforms. In addition, the assessment process provides a useful vehicle to share technical expertise and knowledge on AML/CFT systems.

⁶ For the period from January 2004 to June 2005, 54 CAS have included AML/CFT issues, of which 14 involved Bank lending programs with an AML/CFT component.

26. **The extension of Bank/Fund responsibilities to comprehensively cover the standard has produced fully integrated assessments of AML/CFT systems.**⁷ Bank/Fund assessment teams were expanded, including specialized experts as needed, to evaluate non-macroeconomically relevant financial intermediaries, DNFBPs, and law enforcement aspects of the standard.

Technical Assistance

27. **TA provided to countries has begun to show some positive and concrete results as indicated below:**

- 37 countries have either adopted or are in the process of enacting AML/CFT legislation, while a number of others are in various stages of drafting legislation.
- 15 countries have adopted or are developing AML/CFT supervisory guidelines or inspection procedures.
- At least four countries have used the new inspection procedures to conduct on-site examinations of financial institutions.
- Nearly 1,000 officials from 111 countries have been trained on the various aspects of AML/CFT regimes, including legal, FIU, and supervisory issues.

28. **Within the allocated resource envelope, staff has increased TA delivery** by adjusting the modalities of work, changing the mix of the staff expertise, and increasing coordination with other TA providers. Specifically, this included:

- **Developing strategic and more targeted TA programs.** This involved assisting countries to identify gaps in their AML/CFT frameworks and thereafter to design corrective action plans. Where political will and ownership are present, staff is successfully delivering multi-phased TA programs.
- **Building core teams of experts with the necessary operational knowledge.** This was achieved by recruiting experts with substantial operational experience and by intensifying the Fund and Bank research activities.
- **Adapting tools to increase cost efficiency while maintaining effectiveness.** This has included regional training programs, training-the-trainer efforts, mentoring programs, distance learning, leveraging existing training infrastructures (e.g., RTACs, Bank and Fund training institutes).

⁷ In March 2004, the Boards agreed that the Bank/Fund would become responsible for assessing all areas covered by the standard, including assessing the implementation of criminal justice measures and AML/CFT measures in non-prudentially regulated sectors.

- **Leveraging the synergy from joint Bank/Fund TA operation.** Effective coordination, joint projects, and sharing of expertise between the Bank and the Fund have enhanced the quality and timeliness of TA delivery.
- **Intensifying partnerships with other TA providers.** This entails collaboration and coordination on all aspects of TA, including design, delivery, sharing of experts, and funding. Staff have worked closely with UN, other international financial institutions, specialized organizations (e.g., Egmont Group), and key bilateral providers.

Policy Development

29. **Bank/Fund work has broadened the knowledge base necessary for effective assessments, policy advice and technical assistance**, especially in the areas of the DNFBPs, NPOs, and remittance systems (see supplement). Staff expertise is routinely tapped by research institutions, private sector organizations, and universities. For example, staff work on remittances has been widely disseminated and recognized as an important contribution to understanding the dynamics of this sector.

30. **Staff have also successfully developed important synergies between AML/CFT work and other areas of Bank/Fund expertise**, which has added value to international efforts to combat ML/FT. For example, the Bank staff's multi-disciplinary research efforts on business practices and risk profiles of micro-finance institutions facilitates the design of regulatory frameworks proportionate to the risks. Fund staff has been working to integrate financial institutions AML/CFT requirements within a broader operational risk management framework, e.g., closer integration with accounting, auditing, and internal control frameworks to prevent financial abuse.

B. Challenges and Areas for Improvement

31. **Countries face a variety of challenges in the development and implementation of AML/CFT regimes** (see Box 1). Many countries are finding that their current regimes fall short of the more rigorous revised FATF standard. In addition, many countries do not have the structural elements that FATF identifies as preconditions for effective AML/CFT regimes.⁸ As a consequence, the agenda for reform is extensive and will require a sequenced approach.

⁸ FATF structural elements include: general good governance, rule of law, efficient court systems, high-ethical standards for government functionaries, and strong anti-corruption measures.

Box 1. Key AML/CFT Implementation Challenges

Countries often confront the following challenges:

- Slow progress in implementing effective AML/CFT regimes;
- Insufficient coordination among national agencies;
- Obstacles to international cooperation;
- Underdeveloped tools for financial institutions to identify specific risks (including politically exposed persons, activities related to FT, and correspondent banking);
- Absence of AML/CFT obligations to DNFBPs;
- Lack of adequate training at many levels; and
- Difficulties in designing and implementing balanced regulations for remittance service providers and non-profit organizations.

In addition, countries with rudimentary AML/CFT systems often confront the following issues:

- Low awareness in both the public and private sectors;
- Inadequate support at the political level for the introduction of AML/CFT reforms;
- Greater prevalence of cash transactions;
- Weak customer identification mechanisms;
- Less developed financial systems;
- Inadequate legal and institutional frameworks, including lack of an FIU;
- Low supervisory capacity and limited resources (financial, human, and technological); and
- Lack of trained justice officials.

Assessments

32. The conduct of AML/CFT assessments is more complex than for all other financial sector standards and have become more so following the revisions to the standard.

- The coverage of assessments for AML/CFT is wider and includes the financial and non-financial sectors and criminal justice systems.
- The revised assessment methodology now calls for a more extensive review of the effectiveness of implementation.
- Authorities have experienced difficulties in completing the questionnaire and other prerequisites for the assessment. This in turn has increased the burden on assessors to gather key background information during the on-site visit.

As a consequence, assessing the revised standard requires three to five assessors, longer missions, and a more extensive schedule of meetings.⁹ Detailed assessment reports are

⁹ Assessments for insurance, securities, and payments principles usually require one assessor each, and the assessment of banking supervision principles usually requires two assessors.

(continued...)

significantly longer than under the 1996 standard. The FATF/FSRBs have had similar experience.

33. **Application and interpretation issues.** Despite substantial progress in developing common assessment tools, the initial assessments have identified areas for further clarification. Examples include differences between assessor groups:

- On how to measure and evaluate the effectiveness of implementation of laws.
- In aggregating ratings for recommendations that apply to multiple sectors (e.g., the rating for customer-due diligence recommendation is an aggregate of compliance in the banking, insurance, securities sectors).
- In assigning ratings where non-compliance with one Recommendation affects the compliance with others (“cascading effects” see supplement).

Fund/Bank staff will continue on-going work with FATF and FSRBs to strengthen the uniformity of approach of assessor groups.

Technical Assistance

34. Countries confront several challenges that hamper implementing TA recommendations:

- **Corruption and Weak Governance.** Corruption in some countries undermines the effectiveness of AML/CFT measures. There is a growing need to coordinate the efforts to fight corruption and money laundering.
- **Achieving sufficient political commitment.** In some countries, commitment at the technical level of supervisory and criminal justice authorities is hindered by a lack of political commitment of government and parliament to pass legislation and assign the necessary resources.
- **High start-up costs** to implement the revised FATF standard, regardless of country income level.
- **Low-income countries, in particular, face resource constraints** in implementing AML/CFT regimes given a host of competing demands for reform in other areas.

Assessments for Data Standards require 5 assessors and for Fiscal Transparency 3 assessors. The cost of each AML/CFT assessments is about 4 times that of IOSCO assessments and more than twice that of Basel Core Principles assessments.

35. **The need for sequencing in TA delivery and implementation.** Given the complexity of the standard, the high cost of implementation, the limited resources available, and the country-specific circumstances, countries and TA providers need to take a strategic approach to determine where to begin and how to order the reforms and the related technical assistance. Sequencing will need to be developed on a case-by-case basis.

36. **Staff have been adjusting the modalities of TA delivery to address the high demand.** The practice has been to respond to most requests for TA, but because of budget constraints, staff have had to modify and reduce the scope of the TA and/or defer its delivery. Resources have been leveraged by substituting headquarters review of laws for on-site visits, by shorter missions, back-to-back missions, phased delivery, and use of fewer external experts. While this approach has helped countries to identify gaps in their AML/CFT framework and to design action plans, full and timely implementation of reforms in the AML/CFT area will require a much more intensive TA program, with the requisite commitment of financial and expert resources.

37. **Mobilization of resources to support an intensive AML/CFT TA program has been a challenge.** The staff's ability to assist countries with implementing the revised standard is determined by available resources. The IMF's administered accounts to support AML/CFT have been substantially committed as has the funding from the FIRST Initiative for middle income countries. Efforts to mobilize external funding should be intensified to support increased multi- and bi-lateral assistance to the key areas described in Box 2. Earlier proposals by the Fund's staff for creation of funding vehicles through contributions by interested donors, including a trust fund, have not met with success. Given the clear and urgent need to support countries in the implementation of the more comprehensive revised standard, the staff would again request the donor community to commit additional resources.

Box 2. Key Areas of AML/CFT TA Needs

I—Outreach Seminars to Parliamentarians and High-Level Government Officials—The outreach seminars are key to achieving the buy in for developing an AML/CFT regime. The seminars would target parliamentarians, legislators, and high-level government officials responsible for establishing the AML/CFT regime in their respective countries. The main objective would be to provide necessary information and to raise awareness of AML/CFT issues affecting countries. The seminars would also strengthen the working relations between the officials so that they can play a more active role in enacting, developing, and establishing the required mechanisms for an effective AML/CFT regime.

II—Needs Assessment Reviews and Technical Assistance Missions—**Help to determine the TA needs** of the existing AML/CFT regime and to set priorities for implementing TA.

III—Assessors Training in Revised AML/CFT methodology—The training would provide instructions on the common interpretation of the revised standard and how to conduct effective assessments. The sessions would provide a very important context to strengthen the technical skills of participants and bring them up to date on the revised FATF standard.

IV—Legislative drafting and legal assistance—Providing governments with legal advice and drafting and reviewing AML/CFT legislation.

V—Training Supervisors in the prudentially-regulated sectors—The training would be directed to financial sector supervisors and focus on ML/FT preventive measures for financial institutions. The main objectives would be to guide participants in (i) conducting effective off and onsite supervision; (ii) putting in place a “risk-based approach” to AML/CFT; (iii) identifying, measuring, controlling, and monitoring ML/FT risks within financial products, services, and operations of the financial institutions they supervise; and (iv) raising awareness and standards within the industries they supervise.

VI—Training of Officials in the Supervision of the New Sectors—The revised methodology incorporates the assessment of preventive AML/CFT measures for DNFBPs, as well as non profit organizations, and alternative remittance systems. The training seminars are designed to provide the participants (supervisory agencies and/or competent authorities) with sufficient knowledge and a uniform process or mechanism for ensuring that these sectors have developed and established effective measures to prevent money laundering and financing of terrorism activities.

VII—Training of Criminal Justice Officials—The training would be directed to criminal justice representatives on the practical aspects of ML/FT crime. It would emphasize processes for (i) investigative and prosecutorial techniques; (ii) freezing, seizing, and confiscating proceeds of crime and other provisional measures such as monitoring and prevention measures; (iii) forfeiture of proceeds of crime from money laundering and funds linked to financing of terrorism; (iv) financial intelligence units and their interaction with the law enforcement/criminal justice authorities; and (v) specialized techniques to gather evidence and build a ML/FT case.

VIII—Long-Term AML/CFT Regional Advisors—To provide assistance both on a regional basis and for specific high-priority countries.

IV. THE WORK PROGRAM GOING FORWARD

38. **The work program going forward will continue to focus on the three key areas of assessment, TA and policy development.** The Fund/Bank staff are prepared to undertake 12–15 AML/CFT assessments against the revised standard during FY2006 and to deliver an appropriate program of technical assistance and policy development with remaining resources. In view of the lessons learned to date, certain areas of the work program will require greater attention.

39. **First—Enhanced collaboration with the FATF/FSRBs in the delivery of the global assessment program.** There is a need to (i) harmonize approaches to address issues of application and interpretation (see paragraph 33); (ii) update the assessor training materials and deliver training; and (iii) complete the review on quality and consistency (see paragraph 7).

40. **Second—Outreach to build support for implementation of the standard—**Staff experience is that outreach to governments, lawmakers, and industry is critical to achieve greater understanding and acceptance of the need to implement effective AML/CFT measures. There is, therefore, a need for a continuing intensive program of outreach to raise the awareness of senior government officials, parliamentarians, and regulators to achieve the necessary support for implementation of the revised FATF standard. Staff continues to partner with other organizations in the delivery of these outreach activities, and to support and participate in outreach events. There are limited resources available for this particular type of activity. Staff will continue to look for additional sources of external funding to support an intensified outreach and technical assistance program.

41. **Third—Enhance work on design and sequencing of AML/CFT regimes—**There is the need to focus on practical considerations, vulnerabilities, priorities, and sequencing in putting in place AML/CFT regimes. The work to date is indicating that it may take time and resources for many countries to come into compliance with the FATF standard. In the interim, significant ML/FT risks to the international financial system could remain unaddressed. This approach is intended to help on a case-by-case basis in the design and sequencing of reform programs by countries (especially those with rudimentary systems), and the assignment of scarce TA and national resources toward meeting high priority ML/FT risks. Such an approach should not detract from the objective of meeting the standard, and will seek to mitigate the key ML/FT concerns during the transition. Staff will work in close collaboration with FATF.

42. **Fourth—Additional research and policy work.** Fund staff will examine inter alia the effects of ML/FT on financial sector activities, e.g., the implications for international payment flows, correspondent banking and money remitters. The Bank staff will study the impact of AML/CFT requirements on micro-finance institutions. It will also study the potential abuse of reinsurance vehicles/entities in developing countries with a view to formulating a variety of regulatory approaches. The Bank will also study the application of AML measures in fighting illegal activities and corruption in the logging industry.

43. **Fifth—Strengthening the link between the assessment and TA work.** For countries with rudimentary AML/CFT systems, where the assessment is less burdensome, an additional output of the missions may be a sequenced TA action plan.¹⁰ Subject to availability of resources, a similar action plan can be prepared for requesting countries where an assessment is not scheduled.

44. **Sixth—Strengthen integration of AML/CFT into Article IV work.** The inclusion of AML/CFT issues in Article IV work could be reinvigorated and made more systematic to enhance the identification of significant ML/FT risks and to promote commitment to reforms. Staff could prepare updated guidance and a questionnaire on AML/CFT issues for Article IV consultations and advise Article IV teams on AML/CFT issues arising from assessments and TA work.

45. **Seventh—Developing greater synergy between AML/CFT and Anti-Corruption Efforts in the Bank.** Priority will be given to integrating AML/CFT work on policy and technical assistance with other Bank work on fighting corruption. In the revised standard, corruption is a predicate offence for money laundering and countries are expected to impose preventive measures. This AML measure could complement other existing anti-corruption instruments.

¹⁰ This approach will be consistent with the views expressed by the Fund and Bank Board that each ROSC include a prioritized list of key recommendations, along with an executive summary, and a principle-by-principle summary of observance of the standard. The action plan would draw on the prioritized list of key recommendations.

FATF Special Recommendation IX and consequential amendments to FATF Recommendation 19

The Objectives of FATF Special Recommendation IX:

46. FATF Special Recommendation IX was developed with the objective of ensuring that terrorists and other criminals cannot finance their activities or launder the proceeds of their crimes through the physical cross-border transportation of currency and bearer negotiable instruments. Specifically, it aims to ensure that countries have measures:

- to detect the physical cross-border transportation of currency and bearer negotiable instruments;
- to stop or restrain currency and bearer negotiable instruments that are suspected to be related to terrorist financing or money laundering;
- to stop or restrain currency or bearer negotiable instruments that are falsely declared or disclosed;
- to apply appropriate sanctions for making a false declaration or disclosure; and
- to enable confiscation of currency or bearer negotiable instruments that are related to terrorist financing or money laundering.

47. Measures to detect the cross-border transportation of currency and bearer negotiable instruments may include either a declaration system or other disclosure obligation.

48. Countries should implement Special Recommendation IX subject to strict safeguards to ensure proper use of information and without restricting either: (i) trade payments between countries for goods and services; or (ii) the freedom of capital movements in any way.¹¹

49. Recommendation 19, as consequentially amended, is also set out below. References to countries *considering* adopting systems of monitoring the physical cross border movement of cash or bearer instruments have been removed from Recommendation 19 as they now form part of the *requirements* of SR IX. Provisions on currency transactions remain in Recommendation 19.

¹¹ From FATF Interpretative Note to SR IX.

Text and Methodology for FATF SR IX and Amended Recommendation 19

Special Recommendation IX. Cash Couriers

Countries should have measures in place to detect the physical cross-border transportation of currency and bearer negotiable instruments, including a declaration system or other disclosure obligation.

Countries should ensure that their competent authorities have the legal authority to stop or restrain currency or bearer negotiable instruments that are suspected to be related to terrorist financing or money laundering, or that are falsely declared or disclosed.

Countries should ensure that effective, proportionate and dissuasive sanctions are available to deal with persons who make false declaration(s) or disclosure(s). In cases where the currency or bearer negotiable instruments are related to terrorist financing or money laundering, countries should also adopt measures, including legislative ones consistent with Recommendation 3 and Special Recommendation III, which would enable the confiscation of such currency or instruments.

Methodology for Special Recommendation IX

The essential criteria listed below should be read in conjunction with the text of Special Recommendation IX and its Interpretative Note.

Essential criteria

IX.1 To detect the physical cross-border transportation of currency and bearer negotiable instruments that are related to money laundering or terrorist financing, a country should implement one of the following two systems for incoming and outgoing¹² cross-border transportations of currency or bearer negotiable instruments¹³:

(a) A declaration system that has the following characteristics:

- (i) All persons making a physical cross-border transportation of currency or bearer negotiable instruments that are of a value exceeding a prescribed

¹² Countries can use one or both systems for incoming and outgoing cross-border transportation of currency or bearer negotiable instruments.

¹³ Countries should implement Special Recommendation IX without restricting either: (i) trade payments between countries for goods and services; or (ii) the freedom of capital movements in any way.

threshold should be required to submit a truthful declaration to the designated competent authorities; and

- (ii) The prescribed threshold cannot exceed EUR/USD 15,000¹⁴

OR

(b) A disclosure system that has the following characteristics:

- (i) All persons making a physical cross-border transportation of currency or bearer negotiable instruments should be required to make a truthful disclosure to the designated competent authorities upon request; and
- (ii) The designated competent authorities should have the authority to make their inquiries on a targeted basis, based on intelligence or suspicion, or on a random basis.

IX.2 Upon discovery of a false declaration/disclosure of currency or bearer negotiable instruments or a failure to declare/disclose them, designated competent authorities should have the authority to request and obtain further information from the carrier with regard to the origin of the currency or bearer negotiable instruments and their intended use.

IX.3 The designated competent authorities should be able to stop or restrain currency or bearer negotiable instruments for a reasonable time in order to ascertain whether evidence of money laundering or terrorist financing may be found:

- (a) Where there is a suspicion of money laundering or terrorist financing; or
- (b) Where there is a false declaration/disclosure.

IX.4 At a minimum, information on the amount of currency or bearer negotiable instruments declared/disclosed or otherwise detected, and the identification data of the bearer(s) shall be retained for use by the appropriate authorities in instances when:

- (a) A declaration which exceeds the prescribed threshold is made; or
- (b) Where there is a false declaration/disclosure; or
- (c) Where there is a suspicion of money laundering or terrorist financing.

¹⁴ Countries that implement a declaration system should ensure that the prescribed threshold is sufficiently low to meet the objectives of Special Recommendation IX. In any event, the threshold cannot exceed EUR/USD 15,000.

- IX.5 Information obtained through the processes implemented in Criterion IX.1 should be available to the financial intelligence unit (FIU) either through:
- (a) A system whereby the FIU is notified about suspicious cross-border transportation incidents; or
 - (b) By making the declaration/disclosure information directly available to the FIU in some other way.

IX.6 At the domestic level, there should be adequate co-ordination among customs, immigration and other related authorities on issues related to the implementation of Special Recommendation IX.

IX.7 At the international level, countries should allow for the greatest possible measure of co-operation and assistance amongst competent authorities, consistent with the obligations under Recommendations 35 to 40 and Special Recommendation V.

Examples of possible measures (drawn from the Best Practices Paper to Special Recommendation IX) include:

- Having cooperation arrangements with other countries which would allow for bilateral customs-to-customs information exchanges between customs and other relevant agencies on cross-border transportation reports and cash seizures.
- Ensuring that the information recorded pursuant to criterion IX.4 can be shared internationally with foreign competent authorities in appropriate cases.

IX.8 Countries should ensure that Criteria 17.1 to 17.4 (in R.17) also apply to persons who make a false declaration or disclosure contrary to the obligations under SR IX.

IX.9 Countries should ensure that Criteria 17.1 to 17.4 (in R.17) also apply to persons who are carrying out a physical cross-border transportation of currency or bearer negotiable instruments that are related to terrorist financing or money laundering contrary to the obligations under SR IX.

IX.10 Countries should ensure that Criteria 3.1 to 3.6 (in R.3) also apply in relation to persons who are carrying out a physical cross-border transportation of currency or bearer negotiable instruments that are related to terrorist financing or money laundering.

IX.11 Countries should ensure that Criteria III.1 to III.10 (in SR.III) also apply in relation to persons who are carrying out a physical cross-border transportation of currency or bearer negotiable instruments that are related to terrorist financing.

- IX.12 If a country discovers an unusual cross-border movement of gold, precious metals or precious stones, it should consider notifying, as appropriate, the Customs Service or other competent authorities of the countries from which these items originated and/or to which they are destined, and should co-operate with a view toward establishing the source, destination, and purpose of the movement of such items and toward the taking of appropriate action.
- IX.13 The systems for reporting cross border transactions should be subject to strict safeguards to ensure proper use of the information or data that is reported or recorded.

Additional elements

- IX. 14 Has the country implemented or considered implementing the measures set out in the Best Practices Paper for SR.IX?
- IX.15 Where systems for reporting the cross border transportation of currency are in place, are the reports maintained in a computerized data base, available to competent authorities for AML/CFT purposes?

Recommendation 19:

Countries should consider the feasibility and utility of a system where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerized data base, available to competent authorities for use in money laundering or terrorist financing cases, subject to strict safeguards to ensure proper use of the information.

Methodology for Recommendation 19

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 19.

Essential criteria

- 19.1 Countries should consider the feasibility and utility of implementing a system where financial institutions report all transactions in currency above a fixed threshold to a national central agency with a computerized data base.

Additional elements

- 19.2 Where systems for reporting large currency transactions are in place, are the reports maintained in a computerized data base, available to competent authorities for AML/CFT purposes?
- 19.3 Are the systems for reporting large currency transactions subject to strict safeguards to ensure proper use of the information or data that is reported or recorded?