

THE GLOBAL FRAMEWORK FOR FIGHTING FINANCIAL CRIME

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Abstract

There is growing consensus that the current global framework for fighting financial crime is not as effective as it could be, and that more needs to be done at the international, regional and national levels to help identify and stem the flow of illicit finance – an activity which supports some of the worst problems confronting society today, including terrorism, sexual exploitation, modern slavery, wildlife poaching and drug smuggling. Financial crime is both a contributor to societal ill and a threat to financial stability and financial inclusion, and its mitigation and prevention must be prioritised. While billions have been invested to tackle this type of criminality, greater emphasis needs to be placed on bolstering the efforts of law enforcement with the help of the private sector and ensuring the legal and regulatory framework and financial crime risk management toolkit are enhanced to enable stakeholders to achieve more effective outcomes. This paper sets out three broad areas of focus for both the public and private sector to consider; the systemic stability and societal effects of financial crime, limitations on the effectiveness of the global financial crime risk management framework and a way forward on improving that global framework.

Key words: *financial crime, systemic stability, societal effects, risk management standards*

INTRODUCTION

Financial crime is both a contributor to societal ill and a threat to financial stability and financial inclusion, and its mitigation and prevention must be prioritised. While billions have been invested to tackle this type of criminality, greater emphasis needs to be placed on bolstering the efforts of law enforcement with the help of the private sector and ensuring the legal and regulatory

framework and financial crime risk management toolkit are enhanced to enable stakeholders to achieve more effective outcomes.

This is not to say that progress has not been made in this area. The Financial Action Task Force (FATF), now in its thirtieth year, has led the way in internationally coordinated action to reduce cross-border financial criminality and continues to do so in new and dynamic areas. However, a combination of regulatory reform, cultural change, the introduction of new ways of working and the deployment of new technology could significantly enhance the work of governments, law enforcement and the financial services industry in tackling the threats posed on a global basis.

This paper sets out three broad areas of focus for both the public and private sector to consider; the systemic stability and societal effects of financial crime, limitations on the effectiveness of the global financial crime risk management framework and a way forward on improving that global framework. These are based around seven ‘enablers’, where reforms of a systemic or tactical nature would enhance overarching effectiveness and would allow incremental improvement at pace, in order to continue the global dialogue on meaningful change. Some are already under consideration or being acted upon through the FATF or in certain domestic or regional circumstances and some represent a new way forward, however, when taken together globally, these have the power to transform how society combats financial crime.

The effective and coherent application of global standards is one of the primary means by which the financial system can be safeguarded, and criminals can be thwarted in their attempts to profit from their crimes. Inconsistent application of standards can lead to conflict between rules and a breakdown in cooperation which contributes to inefficiencies, negative outcomes and the creation of loopholes that can be exploited by financial criminals. Factors such as reviewing the threats to financial stability from the fragmentation of rules globally, reviewing and improving the effectiveness of implementation of the FATF standards and guidance and increasing financial, logistical and structural support for domestic and multilateral Anti Money Laundering (AML) and Countering the Financing of Terrorism (CFT) organisations will assist in correcting imbalances which may give rise to systemic concerns on a global basis.

The management of financial crime risk can be improved by facilitating increased financial crime information sharing, both domestically and internationally. Such exchange is important to the proper functioning of AML/CFT and other financial crime prevention policies and is also

critical in addressing geopolitical priorities such as the prevention of proliferation finance. Yet issues such as inconsistent legal frameworks for data protection, management of Suspicious Activity Report (SAR) type information, privacy, and bank secrecy can present barriers that inhibit information sharing.

At the international level, the FATF are encouraged to continue to drive globally coordinated reform designed to improve effectiveness of its member states' information sharing regimes. Specifically, work should continue to enable information sharing; domestically and internationally at the financial institution groupwide level, financial institution-to-financial institution, financial institution-to-government and government-to-government (in both directions). Implementation of the current FATF framework for increasing the exchange of information should be expedited by the FATF member states and further changes to the FATF standards should be considered to ensure maximum international coherence and effectiveness.

1. GLOBAL SYSTEMIC IMPROVEMENTS FOR FINANCIAL CRIME RISK MANAGEMENT

The current rules for AML/CFT are largely based on a common set of Financial Action Task Force (FATF) standards,¹ however, their implementation can differ across jurisdictions, even when they are applied through a common compulsory national or regional regulatory framework. Issues that arise include; the inconsistent determination of which crimes constitute predicate offenses; inconsistent KYC requirements; barriers to data aggregation; different requirements on which risk factors to consider and how to assess them; varying SAR filing rules; inconsistent approaches to the establishment of beneficial ownership registries and access to information therein.

There is also a lack of a common approach to the level of sanctions applied for breaches of the law.² Though national competencies must be recognised, financial institutions, regulators,

¹ In addition, other international standard setting bodies, including the Basel Committee and the CPMI play a role in shaping financial crime related rules in prudential supervision and in the supervision of payments systems and market infrastructures.

² We note that in the European Commission's report on its assessment of recent money laundering cases involving EU credit institutions (European Commission, Report on the assessment of recent alleged money laundering cases involving EU credit institutions) (European Commission, Report on the assessment of recent alleged money laundering cases involving EU credit institutions).

supervisors and law enforcement authorities need to trust that the rules and penalties for non-compliance are congruous. This would eliminate one of the incentives criminals have to channel their operations through jurisdictions they know are less resilient than others.³ This inconsistent application of oversight powers by regional and national financial crime supervisory bodies can lead to conflict between rules and a breakdown in cooperation which can contribute to inefficiency and negative outcomes. For example, the European Commission recently recognised that minimum harmonisation of rules at European Union (EU) level coupled with the lack of integration of AML/CFT concerns in prudential supervision, especially in cross-border situations , has led to gaps in the oversight and enforcement regime.⁴

There is also serious global deficiency in the efficacy of financial crime regimes. The FATF assesses the extent to which a country achieves a defined set of outcomes that are central to a robust AML/CFT system and analyses whether a country's legal and institutional framework is producing the expected results.⁵ According to the FATF assessment published in September 2019,⁶ 75% of the 76 countries reviewed were found to need fundamental improvements when measured against the key goals that an effective AML/CFT system should achieve.⁷ Though the level of technical compliance with the FATF Recommendations showed better results overall,⁸ the shift from a technical compliance assessment to one assessing effectiveness ,and the subsequent findings of a lack of effectiveness in the implementation of what are the truly fundamental building blocks of a financial crime risk management system , emphasises the global urgency for reform.

institutions, July 2019), the lack of effective, proportionate and dissuasive sanctioning powers was recognised as a flaw in the EU-wide framework.

³ There are also examples of the lack of congruity in standards outside of the enforcement area. For instance, the adoption of poorly regulated investment-linked or “Golden” national passport regimes may allow for illicit finance to then find its way into the regulated system.

⁴ European Commission, Communication: Towards a better implementation of the EU's anti-money laundering and countering the financing of terrorism framework, July 2019.

⁵ The FATF and its nine FATF-Style Regional Bodies (FSRBs) conduct peer reviews on an ongoing basis to assess how effectively their respective members' AML/CFT measures work in practice, and how well they have implemented the technical requirements of the FATF Recommendations. The consolidated assessment ratings covered jurisdictions across EMEA, APAC and the Americas.

⁶ FATF (September 2019) ‘Consolidated assessment ratings’.

⁷ The table collected the results for 76 jurisdictions that were subject to a twofold assessment: (1) an evaluation of the effectiveness of the AML measures against a set of 11 immediate outcomes, which represent key goals that an effective AML/CFT system should achieve; and (2) a technical evaluation reflecting the extent to which a country has implemented the technical requirements of the FATF Recommendations.

⁸ Out of the 76 jurisdictions evaluated, 39, just over 51%, were found to be non-compliant (indicating major shortcomings) in respect of one or more of the FATF Recommendations.

Building a better global framework to fight financial crime is a business and societal imperative. To this end, a rebalancing needs to occur, shifting the emphasis away from treating regulatory compliance as an end, but rather as the primary means by which the financial system is safeguarded, and criminals can be thwarted in their attempts to profit from their crimes. The money which flows illegally through the regulated financial services industry gives rise each day to activity which puts citizens worldwide at risk. As noted, there are serious gaps in the system and the public and the private sectors have an essential role to play in addressing these problems. This could be achieved through a better means of tackling risk management for money laundering and terrorist financing and other aspects of financial crime and by reviewing systemic effectiveness:

Countries and relevant regional/national bodies around the world should examine the effectiveness of implementation of the FATF standards and guidance in their jurisdictions and ensure relevant authorities establish up to date mechanisms to uphold the highest standards and implement those standards in an internationally consistent way.⁹ Elements of broader financial crime risk should form part of the Financial Stability Board's (FSB) ongoing analysis of market fragmentation to review gaps in the international consistency of measures designed to mitigate threats to stability that may arise from unchecked cross-border financial criminality, such as issues arising from data localisation.¹⁰ Findings of inadequacies through the FATF Mutual Evaluation processes must dealt with as a matter of urgency and consideration should be given to further risk-based global assessments in specific areas, such the examination by the FATF of all countries at the same time on such issues as information exchange and access to beneficial ownership information. Concurrently, the FATF should review and build on its methodology for assessing effectiveness and consult closely with the private sector on how the FATF assessments could do a better job of promoting effective action by supervisors, banks and other stakeholders. Further work should also focus on the need for education, training and technical assistance across all measurements of effectiveness, including for public and private sector stakeholders. The challenge today is not necessarily the absence of standards but rather making improvements to standards where necessary and effectively implementing those standards. This can be improved by education, training and supporting the FATF in holding countries to account.

⁹ Regulatory coherence is discussed in greater detail in section 6 of this White Paper.

¹⁰ For further information see Institute of International Finance (January 2019) Addressing Market Fragmentation: The Need for Enhanced Global Regulatory Cooperation.

The G20 has called for increases to the structural support for the FATF. However, given the central role the FATF plays in tackling financial crime, and the importance of coordination with their associate members and observer organisations, the funding, staffing levels and availability of public sector assessors for the organisation should be regularly reviewed to give adequate additional assistance to their important work. This should be coupled with efforts to ensure the correct level of international cooperation is being achieved between the FATF and ancillary regional and domestic AML/CFT bodies and the private sector.¹¹ In addition, national governments and regional supervisory authorities should regularly assess the funding levels and structural, staffing and technological competencies of relevant financial crime authorities, national Financial Intelligence Units (FIUs) and crossborder organisations such as Europol and Interpol to add funding and resources where required and to ensure national and international cooperation is effective.¹²

2. IMPROVING CROSS – BORDER AND DOMESTIC INFORMATION SHARING

The management of financial crime risk can be improved by better sharing of financial crime related information, both domestically and internationally. Such exchange is important to the proper functioning of AML/ CFT and other financial crime prevention policies which fulfil the goal of protecting global finance from criminal incursion. Information sharing is also critical in addressing specific threats that arise from terrorism and proliferation finance. Without adequate insights by financial institutions, law enforcement, and intelligence agencies into the funding of these activities, efforts to stop terrorists and rogue states from inflicting further damage globally will be inhibited. In the context of the ongoing global dialogue on ‘de-risking’,¹³ if banks in a

¹¹ . In this regard, we are encouraged by statements by FATF President Xiangmin Liu that the FATF is committed to ensuring that authorities have the tools and expertise to assess new technology in financial services and to promote responsible innovation and that the FATF will hold forums to share expertise between supervisors on good practices in this area: Remarks by FATF President Xiangmin Liu at the Queen Mary – HSBC Annual Lecture on Financial Crime, London, September 10, 2019.

¹² For example, European Commission recently cited the need for appropriate resources for supervisors and FIUs. However, it notes that in some cases, member state supervisors are critically understaffed (European Commission, Supranational Risk Assessment report, July 2019, p. 15). The FATF has also highlighted deficiencies in FIU staffing in some Mutual Evaluation reports. FIU staffing is discussed in greater detail in section 5 of this paper.

¹³ De-Risking is a global phenomenon leading to the decline in correspondent banking relationships, which may impact the ability to send and receive international payments, or drive some payment flows underground, with potential adverse consequences on international trade, growth, financial inclusion, as well as the stability and integrity

correspondent banking relationship cannot provide additional information on customers and specific transactions due to legal and regulatory restrictions on information exchange, correspondent banks may have no alternative but to restrict, limit or even terminate correspondent relationships.

This can further exacerbate financial exclusion for those most in need in emerging markets and limit law enforcement's ability to track illicit money flows. To overcome these challenges, further efforts are needed to address issues which block operative sharing of financial crime information, including mitigating such issues as inconsistent legal frameworks for data protection, management of SARtype information, privacy, and bank secrecy, across different jurisdictions.¹⁴ As noted, improved information sharing is also critical to PPPs. While PPPs offer clear opportunities to improve the collective response to financial crime, a notable feature, (with the exception of the multilateral Europol Financial Intelligence Public Private Partnership),¹⁵ is that all operate on a domestic basis. Even where international banks are members, those banks are bound by local laws and regulations, severely limiting the type of information they can share outside of their institution and across borders. The limitations imposed by existing information sharing rules are entirely at odds with the realities of criminal operations, which are not bound by – and indeed actively exploit – international borders to evade civil and criminal sanctions. This undermines law enforcement's ability to build a picture quickly and comprehensively, even where established channels such as the Egmont Group¹⁶ or mutual legal assistance exist, and it

of the financial system. Please see Financial Stability Board, FSB action plan to assess and address the decline in correspondent banking: Progress report, May 2019.

¹⁴ In 2017, the IIF published a survey of its members on the legal and regulatory barriers that exist to effective information sharing on financial crime related matters. The survey included 28 individual financial institutions covering information concerning 92 countries across Europe, North America, Asia, Africa, Latin America and the Middle East. At the macro level, the survey found that the vast majority of banks identified restrictions on the ability to share information concerning financial crime related matters as an impediment to effective risk management, and that this issue is indeed global in nature. It also found that some countries are moving in the direction of restricting information exchange even further, which is why urgent, globally coordinated action is critical. The report can be found here: <https://www.iif.com/publication/regulatory-report/iif-financialcrimeinformation-sharing-report>.

¹⁵ Launched in December 2017, the Europol Financial Intelligence Public Private Partnership ('EFIPPP'), currently brings together investigators, regulators and officials from FIUs in seven European nations and the US, as well as senior compliance officers at global lenders with the aim of facilitating the exchange of operational or tactical intelligence associated with on-going investigations, subject to the relevant national legal regimes. The EFIPPP also addresses strategic objectives such as identifying ways in which the regulations relating to information sharing could be enhanced.

¹⁶ The Egmont Group is a united body of 164 FIUs that provides a platform for the secure exchange of expertise and financial intelligence to combat money laundering and terrorist financing. Notwithstanding the Egmont's Group's

undermines financial institutions' ability to fully understand their exposure to financial crime risk at a global level. The issues are doubly frustrating in the context of illicit finance as, unlike other crime types, it is often the case that all pieces of the intelligence jigsaw exist and are available in financial institutions, (inter alia, transactions and counterparties), but the dots cannot be connected.

CONCLUSION

A number of significant money laundering cases have been publicised in recent years, including, for instance, the Russian Laundromat, the Fortuna fraud, Mirror Trading and the Panama Papers. These cases, and others like them, illustrate both the scale and complexity of money laundering schemes and the ease with which the proceeds of crime can be transferred between jurisdictions. By way of example, the Moldovan laundrette scheme is assessed to have moved at least 20 billion USD³⁷ of illicit funds from Russia into the global financial system before it was revealed in 2014. The scheme employed a complex network of hundreds of shell companies, nominee directors and international bank accounts across a range of jurisdictions. Fictitious loan arrangements were created between shells incorporated in the UK but banked in the Baltic states. These loans were in turn guaranteed by further shell companies in other jurisdictions.

The loan agreements were then defaulted on with the subsequent dispute resolution played out in the Moldovan court system that could claim jurisdiction because Moldovan nationals were nominally in control of the shells involved in the dispute. The courts would find in favour of one side or the other and instruct that the loan be repaid by the overseas shell acting as the loan guarantor. The value of the loan, (sometimes hundreds of millions of dollars), would then be transferred to the Baltic bank account of the shell company assessed to have 'won' the dispute. The controllers of the network were able to use the adjudication of the Moldovan court to explain the source of wealth, and bypass CDD controls that may have been alerted by the incoming payment at the receiving bank in the Baltics.

Money was then transferred out into the global financial system through onward cash payments, trade-based money laundering schemes and investment in other financial products. While several jurisdictions have instigated investigations into these and other schemes, and in

efforts, significant challenges remain, notably that counterparty FIUs lack access to the specific information needed by the requesting FIU, and time limitations were not always met.

some cases, have affected law enforcement or regulatory action, there remains a stark imbalance between the scale of the alleged criminality and the scale and impact of the response. Of the billions that are alleged to have been moved, very little has been traced, restrained or seized, and very few arrests made, or prosecutions secured. While this may be dispiriting, it is not surprising. Money transferred through schemes such as these can move opaquely and rapidly through multiple jurisdictions in a single day, while tracing those flows can take years.

This creates an inequality of arms between law enforcement and criminals that can only be improved through substantial reform of international information sharing rules and the more effective exploitation and networking of siloed public and private sector data internationally. International policy making bodies such as the G20 must continue to drive such reforms.

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