

# **INTERNATIONAL COOPERATION IN THE FIGHT AGAINST TERRORIST FINANCING**

AN ANALYSIS OF THE OVERALL COMPLIANCE BY 46 JURISDICTIONS WITH  
THE INTERNATIONAL ANTI-MONEY LAUNDERING AND COMBATING THE  
FINANCING OF TERRORISM REGIME (AML/CFT)  
(2004-2006).

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**Cotutela 26 January 2006**

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**January 2008**

To my Parents: Matilde and Cristobal, in hope of a peaceful future.

“All States in every region - large or small, strong or weak - are vulnerable to terrorism and its consequences. They all stand to benefit from a strategy to counter it. They all have a role to play in shaping such a strategy “(Kofi Annan 2005)

These are the very flaws in the western financial system which are becoming a noose for it. (Osama Bin Laden 2.001)

Facts do not cease to exist because they're ignored (Aldous Huxley 1894-1963)

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## Acknowledgements

This PhD work took me a long process, from the first doctorate year (2003) at the University of Barcelona where I followed several courses in International Economics, Development and Economic Growth under Professor F.Granell supervision. Later, I spent the second doctorate year (2004-2005) in Università Bocconi attending all the courses related to the PhD in International Economic Law and it is there where the University of Barcelona and the Università Bocconi signed an agreement for the development of this dissertation. In the third year, I spent the spring term (2006) as a researcher at the European University Institute where I attended the International Organization, Compulsory Methodology and Europe in World Politics Seminars under Professor Pascal Vennesson supervision. The last step of my dissertation was completed at the Center of Studies and Responses to Terrorism –START- (University of Maryland-USA) in 2007, where I was focused on empirical analysis and methodology under Dr.Richard Legault and Professor Lafree . During all this process, the transformation of my ideas were very much helped of a wide range of persons. I hope I have not forgotten anyone.

My deepest thanks go to Professor Francesc Granell and Professor Giorgio Sacerdoti; throughout my Ph.D work, they set the standards for me in every aspect: immense academic knowledge, meticulous and professional rigor, and humane generosity. A special mention for Dr. Richard Legault (University of Maryland) for the guidance and assistance to understand Quantitative and Qualitative Methods.

I would also like to express my gratitude to Prof.Gary La Free (START-University of Maryland), Prof.Pascal Vennesson (European University Institute), Prof. Ernesto Savona (Transcrime), Prof. Peter Reuter (University of Maryland), Prof.Friedrich Kratochwil (European Institute), Prof.Donato Masciandaro (Bocconi ), Prof.Fabrizio Onida (Bocconi), Prof. Isabel Recavarren (Bocconi) , Prof. Carlo Altomonte (Bocconi), Professor Montserrat Millet (UB), Prof.Enrique López (UB), Prof. Patricia Garcia Duran (UB), Dr. Elisa Casanovas, Dr. Valsecchi (Bocconi) and the support of Mrs. Maria Luisa Justo, Mrs. Daniella Bertotti and Mrs. Eloisa Pérez.

In the course of my work, I benefited greatly from interviews with a range of experts. I would like to thank all the interviewees in United Nations, International Monetary Fund and the Council of the European Union for their comments and advice. In particular, Mr.Gilbert Guillaume (Former President of the International Court of Justice), Jesus Carmona (Council of the European Union), Alejandro Sanchez ( Spanish Ministry of Defense), LLuis Cervera( La Caixa), Mr.Eric Kiefel (Federal Reserve Bank of USA), Mr.Nadim Kyriakos (IMF), Mr.Paul Ashin (IMF), Mr.Richard Chalmers (FSA-United Kingdom), Coronel Bettini (Guardia di Finanza di Milano), Mr,Mikael Eriksson (IUE) and Mr.Patryk Pawlak (IUE) and Mrs.Graziella Farina.(EUI), Dr.Teresa Martin (CSIC) and Mr.Gonzalo Rivero (Instituto Juan March), Mr.Philip Dittmann , Mr.Rasmus Nielsen and Mrs.Juliette Kleemann.

I would also thank all those people working in the Libraries where I did my literature review: Institute Francaise de Relations Internationales du Paris, Servizio di Prestito Internazionale della Bocconi, European University Institute Library, Georgetown Lauinger Library as well as some University of Barcelona libraries.

Last but not least, I appreciate the unconditional love and support of Lenin –my husband-, Miguel-my brother-and all my friends with special mention to Ing.Nestor Castillo, Dr. Manuel Baselga, Dr. José Parras, Dra.Isabel Fachal , Mrs.Arantxa Mateo, Mrs.Montserrat Sánchez, Avv.Alessandra Masciadri, and Prof.Zulma Matos.

## List of Abbreviations

|           |   |
|-----------|---|
| AML       | Anti-Money Laundering   |
| AML/CFT   | Anti-Money Laundering and the Combating the financing of terrorism  |
| APG       | Asia-Pacific Group on Money Laundering  |
| APEC      | Asia-Pacific Economic Corporation   |
| ARS       | Alternative Remittance Systems  |
| ASISH     | Average Shadow Economy  |
| ATML      | Attractiveness to Money Laundering  |
| BPP       | Best Practices Paper  |
| BIS       | Bank of International Settlements   |
| BoP       | Balance of Payments (IMF)   |
| CDD       | Customer due diligence  |
| CFATF     | Caribbean Financial Action Task Force   |
| CFT       | Combating the Financing of Terrorism  |
| CIS       | Commonwealth of Independent States  |
| CO        | Control of Corruption   |
| COBAS     | Cross Border Assets/GDP   |
| COBLI     | Cross Border Liabilities /GDP   |
| CPIS      | Combined Portfolio Investment Survey (IMF)  |
| CPSS      | Committee for Payment and Settlement System   |
| CTC       | Counter-Terrorism Committee   |
| CTED      | Counter terrorism Committee Executive Directorate   |
| DNBPs     | Designated Non Business Professions   |
| EAG       | Euroasian Anti-Money Laundering Group   |
| EG        | Participation in Egmond Group   |
| ESAAMLG   | Eastern and Southern Africa Anti-Money Laundering Group   |
| EU        | European Union  |
| FATF      | Financial Action Task Force   |
| FATF 40+9 | FATF 40 Recommendations on Combating Money Laundering (2003) and the Special 9 Recommendations on Terrorist Financing |
| FS        | Failed States   |
| FinCEN    | Financial Crimes Enforcement Network  |
| FIU       | Financial Intelligence Unit   |
| FORE      | Formal Remittances/GDP  |
| FSAP      | Financial System Stability Assessment   |
| FSRB      | FATF-Style Regional Body  |
| FT        | Financing of Terrorism  |
| GAFISUD   | Financial Action Task Force on Money Laundering in South America  |
| GAO       | US Government Accounting Office   |

|                |   |
|----------------|---|
| GIABA          | Groupe Inter-gouvernemental d'Action contre le Blanchiment d'argent en Afrique Ouest              |
| IAIS           | International Association of Insurance Supervisors  |
| IG             | World Income Group  |
| ILEA           | International Law Enforcement Academy   |
| INRE           | Informal Remittances/GDP  |
| IMF            | International Monetary Fund   |
| INCSR          | International Narcotic Control Strategic report   |
| IOs            | International Organizations   |
| IPP            | Investment Portfolio Position   |
| MENAFATF       | Middle East Financial Action Task Force   |
| MI             | Participation in a multilateral or intergovernmental bodies/org                                   |
| ML             | Money Laundering  |
| MONEYVAL       | Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures |
| NCCT           | Non Cooperative Countries and Territories   |
| NBFIs          | Non Bank Financial Institutions   |
| NPO            | Non Profit Organisation   |
| OFCs           | Offshore Financial Centers  |
| OGBS           | Osffshore Group of Banking Supervisors  |
| R.(number)     | FATF Recommendation on Combating Money Laundering   |
| SARs           | Suspicious Activities Report  |
| SBFS           | Bank Deposits /GDP  |
| SFSD           | Financial System Deposits /GDP  |
| SLI            | Life Insurance/GDP  |
| SNLI           | Non Life Insurance/GDP  |
| STR            | Suspicious Transactions Reports   |
| SR.( + number) | FATF Recommendation on Terrorist Financing  |
| RATML          | Ratifications of International Convention on Money Laundering                                     |
| RATFT          | Ratifications of International Convention on Terrorism  |
| REFS           | Ratio of Net Exports of Financial   |
| RG             | World Region Group  |
| RITF           | Risk Terrorist Financing  |
| RQ             | Regulatory Framework Quality  |
| ROSC           | Report on Observance of Standards and codes   |
| WB             | World Bank  |
| WEO            | World Economic Outlook  |
| WCO            | World Custom Organization   |

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| YLEML  | Y Legal Recommendations on Money Laundering  |
| YLEFT  | Y Special Legal Recommendations on Terrorist Financing   |
| YPRML  | Y Preventive Recommendations on Money Laundering   |
| YPRFT  | Y Special Preventive Recommendations Terrorist Financing   |
| YINML  | Y Institutional Recommendations on Money Laundering  |
| YINFT  | Y Special Institutional Recommendations on Terrorist Financing   |
| YICML  | Y International Cooperation Recommendations on Money Laundering  |
| YICFT  | Y Special International Cooperation Recommendations on Terrorist Financing                                 |
| YOLE   | Y Total Overall compliance on Legal and Special Legal Recommendations                                      |
| YOPR   | Y Total Overall compliance on Preventive and Special Preventive Recommendations                            |
| YOIN   | Y Total Overall compliance on Institutional and Special Institutional Recommendations                      |
| YOIC   | Y Total Overall compliance International Cooperation and Special International Cooperation Recommendations |
| YOCAML | Y Total Overall compliance with AML/CFT  |
| YOCML  | Y Total Overall compliance on Money Laundering   |
| YOCFT  | Y Total Overall compliance on the Financing of Terrorism   |

## Glossary

In the dissertation the following abbreviations and references are used in accordance with the official terminology and glossary of the Financial Action Task Force FATF. (See Appendix 3)

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| <i>Accounts</i>                      | References to “accounts” should be read as including other similar business Relationships between financial institutions and their customers.  |
| <i>Agent</i>                         | For the purposes of Special Recommendation VI, an <i>agent</i> is any person who provides money or value transfer service under the direction of or by contract with a legally registered or licensed remitter (for example, licensees, franchisees, concessionaires). (This definition is drawn from the Interpretative Note to SR.VI. It is used in the criteria under SR.VI.)   |
| <i>Appropriate authorities</i>       | The term <i>appropriate authorities</i> refers to competent authorities, self-regulatory bodies, accrediting institutions and other administrative authorities.  |
| <i>Bearer negotiable instruments</i> | <i>Bearer negotiable instruments</i> includes monetary instruments in bearer form such as: travellers cheques; negotiable instruments (including cheques, promissory notes and money orders) that are either in bearer form, endorsed without restriction, made out to a fictitious payee, or otherwise in such form that title thereto passes upon delivery; incomplete instruments (including cheques, promissory notes and money orders) signed, but with the payee’s name omitted.   |
| <i>Bearer shares</i>                 | <i>Bearer shares</i> refers to negotiable instruments that accord ownership in a corporation to the person who possesses the bearer share certificate.   |
| <i>Beneficial owner</i>              | <i>Beneficial owner</i> refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.  |
| <i>Beneficiary</i>                   | For the purposes of Special Recommendation VIII, the term <i>beneficiaries</i> refers to those natural persons, or groups of natural persons who receive charitable, humanitarian or other types of assistance through the services of the NPO. For the purposes of the other FATF Recommendations, the term <i>beneficiary</i> is as follows. All trusts (other than charitable or statutory permitted non-charitable trusts) must have <i>beneficiaries</i> , who may include the settlor, and a maximum time, known as the perpetuity period, normally of 100 years. While trusts must always have some ultimately ascertainable beneficiary, trusts may have no defined existing beneficiaries but only objects of a power until some person becomes entitled as beneficiary to income or capital on the expiry of a defined period, known as the accumulation period. This period is normally co-extensive with the trust perpetuity period which is usually referred to in the trust deed as the trust period. |
| <i>Competent authorities</i>         | <i>Competent authorities</i> refers to all administrative and law enforcement authorities concerned with combating money laundering and terrorist financing, including the FIU and supervisors.  |



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| <i>Confiscation</i>                      | The term <i>confiscation</i> , which includes forfeiture where applicable, means the permanent deprivation of funds or other assets by order of a competent authority or a court. Confiscation or forfeiture takes place through a judicial or administrative procedure that transfers the ownership of specified funds or other assets to be transferred to the State. In this case, the person(s) or entity(ies) that held an interest in the specified funds or other assets at the time of the confiscation or forfeiture loses all rights, in principle, to the confiscated or forfeited funds or other assets. (Confiscation or forfeiture orders are usually linked to a criminal conviction or a court decision whereby the confiscated or forfeited property is determined to have been derived from or intended for use in a violation of the law.)                       |
| <i>Consider</i>                          | References in the Recommendations that require a country to <i>consider</i> taking particular measures means that the country should have made a proper consideration or assessment of whether to implement such measures.  |
| <i>Core Principles</i>                   | <i>Core Principles</i> refers to the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, the Objectives and Principles for Securities Regulation issued by the International Organization of Securities Commissions, and the Insurance Supervisory Principles issued by the International Association of Insurance Supervisors.   |
| <i>Correspondent banking</i>             | <i>Correspondent banking</i> is the provision of banking services by one bank (the “correspondent bank”) to another bank (the “respondent bank”). Large international banks typically act as correspondents for thousands of other banks around the world. Respondent banks may be provided with a wide range of services, including cash management (e.g. interest-bearing accounts in a variety of currencies), international wire transfers of funds, cheque clearing, payablethrough accounts and foreign exchange services.  |
| <i>Country</i>                           | All references in the FATF Recommendations and in this Methodology to <i>country</i> or <i>countries</i> apply equally to territories or jurisdictions.   |
| <i>Cross-border transfer</i>             | <i>Cross-border transfer</i> means any wire transfer where the originator and beneficiary institutions are located in different jurisdictions. This term also refers to any chain of wire transfers that has at least one cross-border element.   |
| <i>Currency</i>                          | Currency refers to banknotes and coins that are in circulation as a medium of exchange.   |
| <i>Designated categories of offences</i> | <i>Designated categories of offences</i> means: <ul style="list-style-type: none"> <li>• participation in an organised criminal group and racketeering;</li> <li>• terrorism, including terrorist financing;</li> <li>• trafficking in human beings and migrant smuggling;</li> <li>• sexual exploitation, including sexual exploitation of children;</li> <li>• illicit trafficking in narcotic drugs and psychotropic substances;</li> <li>• illicit arms trafficking;</li> <li>• illicit trafficking in stolen and other goods;</li> <li>• corruption and bribery;</li> <li>• fraud;</li> <li>• counterfeiting currency;</li> <li>• counterfeiting and piracy of products;</li> <li>• environmental crime;</li> <li>• murder, grievous bodily injury;</li> <li>• kidnapping, illegal restraint and hostage-taking;</li> <li>• robbery or theft;</li> <li>• smuggling;</li> </ul> |

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|   | <ul style="list-style-type: none"> <li>• extortion;</li> <li>• forgery;</li> <li>• piracy; and</li> <li>• insider trading and market manipulation.</li> </ul> <p>When deciding on the range of offences to be covered as predicate offences under each of the categories listed above, each country may decide, in accordance with its domestic law, how it will define those offences and the nature of any particular elements of those offences that make them serious offences.</p>   |
| <i>Designated nonfinancial businesses and professions</i> | <p><i>Designated non-financial businesses and professions</i> means:</p> <ol style="list-style-type: none"> <li>a) Casinos (which also includes internet casinos).</li> <li>b) Real estate agents.</li> <li>c) Dealers in precious metals.</li> <li>d) Dealers in precious stones.</li> <li>e) Lawyers, notaries, other independent legal professionals and accountants – this refers to sole practitioners, partners or employed professionals within professional firms. It is not meant to refer to ‘internal’ professionals that are employees of other types of businesses, nor to professionals working for government agencies, who may already be subject to measures that would combat money laundering.</li> <li>f) Trust and Company Service Providers refers to all persons or businesses that are not covered elsewhere under these Recommendations, and which as a business, provide any of the following services to third parties: <ul style="list-style-type: none"> <li>• acting as a formation agent of legal persons;</li> <li>• acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;</li> <li>• providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;</li> <li>• acting as (or arranging for another person to act as) a trustee of an express trust;</li> <li>• acting as (or arranging for another person to act as) a nominee shareholder for another person.</li> </ul> </li> </ol> |
| <i>Designated person</i>                                  | <p>The term <i>designated persons</i> refers to those persons or entities designated by the Al-Qaida and Taliban Sanctions Committee pursuant to S/RES/1267(1999) or those persons or entities designated and accepted, as appropriate, by jurisdictions pursuant to S/RES/1373(2001).</p>  |
| <i>Designated threshold</i>                               | <p><i>Designated threshold</i> refers to the amount set out in the Interpretative Notes to the Forty Recommendations.</p>   |
| <i>Domestic transfer</i>                                  | <p><i>Domestic transfer</i> means any wire transfer where the originator and beneficiary institutions are located in the same jurisdiction. This term therefore refers to any chain of wire transfers that takes place entirely within the borders of a single jurisdiction, even though the system used to effect the wire transfer may be located in another jurisdiction.</p>  |
| <i>Express trust</i>                                      | <p><i>Express trust</i> refers to a trust clearly created by the settlor, usually in the form of a document e.g. a written deed of trust. They are to be contrasted with trusts which come into being through the operation of the law and which do not result from the clear intent or decision of a settlor to create a trust or similar legal arrangements (e.g. constructive trust).</p>  |

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| <i>False declaration</i>      | <i>False declaration</i> refers to a misrepresentation of the value of currency or bearer negotiable instruments being transported, or a misrepresentation of other relevant data which is asked for in the declaration or otherwise requested by the authorities. This includes failing to make a declaration as required.   |
| <i>False disclosure</i>       | <i>False disclosure</i> refers to a misrepresentation of the value of currency or bearer negotiable instruments being transported, or a misrepresentation of other relevant data which is asked for in the disclosure or otherwise requested by the authorities. This includes failing to make a disclosure as required.  |
| <i>FATF Recommendations</i>   | <i>The FATF Recommendations</i> refers to the Forty Recommendations and to the Nine Special Recommendations on Terrorist Financing.   |
| <i>Financial institutions</i> | <p><i>Financial institutions</i><sup>60</sup> means any person or entity who conducts as a business one or more of the following activities or operations for or on behalf of a customer:</p> <ol style="list-style-type: none"> <li>1. Acceptance of deposits and other repayable funds from the public.<sup>61</sup></li> <li>2. Lending.<sup>62</sup></li> <li>3. Financial leasing.<sup>63</sup></li> <li>4. The transfer of money or value.<sup>64</sup></li> <li>5. Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money).</li> <li>6. Financial guarantees and commitments.</li> <li>7. Trading in: <ol style="list-style-type: none"> <li>(a) money market instruments (cheques, bills, CDs, derivatives etc.);</li> <li>(b) foreign exchange;</li> <li>(c) exchange, interest rate and index instruments;</li> <li>(d) transferable securities;</li> <li>(e) commodity futures trading.</li> </ol> </li> <li>8. Participation in securities issues and the provision of financial services related to such issues.</li> <li>9. Individual and collective portfolio management.</li> <li>10. Safekeeping and administration of cash or liquid securities on behalf of other persons.</li> <li>11. Otherwise investing, administering or managing funds or money on behalf of other persons.</li> <li>12. Underwriting and placement of life insurance and other investment related insurance<sup>65</sup>.</li> <li>13. Money and currency changing.</li> </ol> <p>When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering activity occurring, a country may decide that the application of anti-money laundering measures is not necessary, either fully or partially.</p> <p>In strictly limited and justified circumstances, and based on a proven low risk of money laundering, a country may decide not to apply some or all of the Forty Recommendations to some of the financial activities stated above.</p> |
| <i>FIU</i>                    | FIU means financial intelligence unit.  |
| <i>Foreign counterparts</i>   | This refers to the authorities in another country that exercise similar responsibilities and functions.   |
| <i>Freeze</i>                 | This means to prohibit the transfer, conversion, disposition or movement of funds or other assets on the basis of, and for the duration of the validity of, an action initiated by a competent authority or a court under a freezing mechanism.   |

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|   | The frozen funds or other assets remain the property of the person(s) or entity(ies) that held an interest in the specified funds or other assets at the time of the freezing and may continue to be administered by the financial institution or other arrangements designated by such person(s) or entity(ies) prior to the initiation of an action under a freezing mechanism.  |
| <i>Fundamental principles of domestic law</i>               | This refers to the basic legal principles upon which national legal systems are based and which provide a framework within which national laws are made and powers are exercised. These fundamental principles are normally contained or expressed within a national Constitution or similar document, or through decisions of the highest level of court having the power to make binding interpretations or determinations of national law. Although it will vary from country to country, some examples of such fundamental principles include rights of due process, the presumption of innocence, and a person's right to effective protection by the courts. |
| <i>Funds</i>  | Except in the case of Special Recommendation II, <i>funds</i> refers to assets of every kind, whether corporeal or incorporeal, tangible or intangible, movable or immovable and legal documents or instruments evidencing title to, or interest in, such assets.  |
| <i>Funds or other assets</i>                                | The term <i>funds or other assets</i> means financial assets, property of every kind, whether tangible or intangible, movable or immovable, however acquired, and legal documents or instruments in any form, including electronic or digital, evidencing title to, or interest in, such funds or other assets, including, but not limited to, bank credits, travellers cheques, bank cheques, money orders, shares, securities, bonds, drafts, or letters of credit, and any interest, dividends or other income on or value accruing from or generated by such funds or other assets.  |
| <i>Funds transfer</i>                                       | The terms <i>funds transfer</i> refers to any transaction carried out on behalf of an originator person (both natural and legal) through a financial institution by electronic means with a view to making an amount of money available to a beneficiary person at another financial institution. The originator and the beneficiary may be the same person.   |
| <i>Identification data</i>                                  | Reliable, independent source documents, data or information will be referred to as "identification data".  |
| <i>Intermediaries</i>                                       | <i>Intermediaries</i> can be financial institutions, DNFBP or other reliable persons or businesses that meet Criteria 9.1 to 9.4.  |
| <i>Investigations, prosecutions and related proceedings</i> | <i>Investigations, prosecutions and related proceedings</i> may be of a criminal, civil enforcement or administrative nature, and includes proceedings in relation to confiscation or provisional measures.  |
| <i>Law or regulation</i>                                    | <i>Law or regulation</i> refers to primary and secondary legislation, such as laws, decrees, implementing regulations or other similar requirements, issued or authorised by a legislative body, and which impose mandatory requirements with sanctions for non-compliance. The sanctions for non-compliance should be effective, proportionate and dissuasive.  |
| <i>Legal arrangements</i>                                   | <i>Legal arrangements</i> refers to express trusts or other similar legal arrangements. Examples of other similar arrangements (for AML/CFT purposes) include fiducie, treuhand and fideicomiso.   |
| <i>Legal persons</i>  | <i>Legal persons</i> refers to bodies corporate, foundations, anstalt, partnerships, or  |

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|  | associations, or any similar bodies that can establish a permanent customer relationship with a financial institution or otherwise own property.  |
| <i>Licensing</i>                           | For the purposes of Special Recommendation VI only, <i>licensing</i> means a requirement to obtain permission from a designated competent authority in order to operate a money/value transfer service legally.   |
| <i>Money laundering (ML) offence</i>       | References in this Methodology (except in R.1) to a <i>money laundering (ML) offence</i> refer not only to the primary offence or offences, but also to ancillary offences.   |
| <i>Money or value transfer service</i>     | <i>Money or value transfer service</i> refers to a financial service that accepts cash, cheques, other monetary instruments or other stores of value in one location and pays a corresponding sum in cash or other form to a beneficiary in another location by means of a communication, message, transfer or through a clearing network to which the money/value transfer service belongs. Transactions performed by such services can involve one or more intermediaries and a third party final payment.<br>A money or value transfer service may be provided by persons (natural or legal) formally through the regulated financial system or informally through non-bank financial institutions or other business entities or any other mechanism either through the regulated financial system (for example, use of bank accounts) or through a network or mechanism that operates outside the regulated system. In some jurisdictions, informal systems are frequently referred to as <i>alternative remittance services</i> or <i>underground (or parallel) banking systems</i> . Often these systems have ties to particular geographic regions and are therefore described using a variety of specific terms. Some examples of these terms include <i>hawala</i> , <i>hundi</i> , <i>fei-chien</i> , and the <i>black market peso exchange</i> . (This definition is drawn from the Interpretative Note to SR.VI. It is used in the criteria under SR.VI.) |
| <i>Non-profit organisations</i>            | The term <i>non-profit organisation</i> or <i>NPO</i> refers to a legal entity or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of “good works”.   |
| <i>Originator</i>                          | The <i>originator</i> is the account holder, or where there is no account, the person (natural or legal) that places the order with the financial institution to perform the wire transfer.   |
| <i>Other enforceable means</i>             | Other enforceable means refers to guidelines, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for noncompliance, and which are issued by a competent authority (e.g. a financial supervisory authority) or an SRO. The sanctions for non-compliance should be effective, proportionate and dissuasive.   |
| <i>Palermo Convention</i>                  | The 2000 UN Convention against Transnational Organized Crime.   |
| <i>Payable-through accounts</i>            | <i>Payable-through accounts</i> refers to correspondent accounts that are used directly by third parties to transact business on their own behalf.  |
| <i>Physical crossborder transportation</i> | <i>Physical cross-border transportation</i> refers to any in-bound or out-bound physical transportation of currency or bearer negotiable instruments from one country to another country. The term includes the following modes of  |

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|   | transportation: (1) physical transportation by a natural person, or in that person's accompanying luggage or vehicle; (2) shipment of currency through containerised cargo or (3) the mailing of currency or bearer negotiable instruments by a natural or legal person.   |
| <i>Politically Exposed Persons</i> ” (PEPs)               | <i>PEPs</i> are individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.   |
| <i>Proceeds</i>   | <i>Proceeds</i> refers to any property derived from or obtained, directly or indirectly, through the commission of an offence.   |
| <i>Property</i>   | <i>Property</i> means assets of every kind, whether corporeal or incorporeal, moveable or immovable, tangible or intangible, and legal documents or instruments evidencing title to, or interest in such assets.   |
| <i>Registration</i>                                       | For the purposes of Special Recommendation VI, <i>registration</i> means a requirement to register with or declare to a designated competent authority the existence of a money/value transfer service in order for the business to operate legally.   |
| <i>Related to terrorist financing or money laundering</i> | When used to describe currency or bearer negotiable instruments, the term <i>Related to terrorist financing or money laundering</i> refers to currency or bearer negotiable instruments that are: (i) the proceeds of, or used in, or intended or allocated for use in, the financing of terrorism, terrorist acts or terrorist organisations; or (ii) laundered, proceeds from money laundering or predicate offences, or instrumentalities used in or intended for use in the commission of these offences.  |
| <i>Risk</i>   | All references to <i>risk</i> in this Methodology refer to the risk of money laundering and/or terrorist financing.  |
| <i>Satisfied</i>  | Where reference is made to a financial institution being <i>satisfied</i> as to a matter, that institution must be able to justify its assessment to competent authorities.  |
| <i>Seize</i>  | The term <i>seize</i> means to prohibit the transfer, conversion, disposition or movement of funds or other assets on the basis of an action initiated by a competent authority or a court under a freezing mechanism. However, unlike a freezing action, a seizure is effected by a mechanism that allows the competent authority or court to take control of specified funds or other assets. The seized funds or other assets remain the property of the person(s) or entity(ies) that held an interest in the specified funds or other assets at the time of the seizure, although the competent authority or court will often take over possession, administration or management of the seized funds or other assets. |
| <i>Self-regulatory organisation (SRO)</i>                 | A <i>SRO</i> is a body that represents a profession (e.g. lawyers, notaries, other independent legal professionals or accountants), and which is made up of member professionals, has a role in regulating the persons that are qualified to enter and who practise in the profession, and also performs certain supervisory or monitoring type functions. For example, it would be normal for this body to enforce rules to ensure that high ethical and moral standards are maintained by those practising the profession.   |

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| <i>Settlor</i>          | <i>Settlers</i> are persons or companies who transfer ownership of their assets to trustees by means of a trust deed. Where the trustees have some discretion as to the investment and distribution of the trusts assets, the deed may be accompanied by a non-legally binding letter setting out what the settlor wishes to be done with the assets.  |
| <i>Shell bank</i>       | <i>Shell bank</i> means a bank that has no physical presence in the country in which it is incorporated and licensed, and which is unaffiliated with a regulated financial services group that is subject to effective consolidated supervision.<br><i>Physical presence</i> means meaningful mind and management located within a country. The existence simply of a local agent or low level staff does not constitute physical presence.  |
| <i>Should</i>           | For the purposes of assessing compliance with the FATF Recommendations, the word <i>should</i> has the same meaning as <i>must</i> .   |
| <i>S/RES/1267(1999)</i> | The term <i>S/RES/1267(1999)</i> refers to S/RES/1267(1999) and its successor resolutions. When issued, S/RES/1267(1999) had a time limit of one year. A series of resolutions have been issued by the United Nations Security Council (UNSC) to extend and further refine provisions of S/RES/1267(1999). By successor resolutions are meant those resolutions that extend and are directly related to the original resolution S/RES/1267(1999). As of February 2004, these resolutions included S/RES/1333(2000), S/RES/1363(2001), S/RES/1390(2002), S/RES/1455(2003) and S/RES/1526(2004).   |
| <i>STR</i>              | <i>STR</i> refers to suspicious transaction reports.   |
| <i>Subsidiaries</i>     | <i>Subsidiaries</i> refers to majority owned subsidiaries.   |
| <i>Supervisors</i>      | <i>Supervisors</i> refers to the designated competent authorities responsible for ensuring compliance by financial institutions with requirements to combat money laundering and terrorist financing.  |
| <i>Terrorist</i>        | For purposes of SRIII, the term <i>terrorist</i> is as defined in the Interpretative Note of SRIII.<br>Otherwise, it refers to any natural person who: (i) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and wilfully; (ii) participates as an accomplice in terrorist acts; (iii) organises or directs others to commit terrorist acts; or (iv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist act or with the knowledge of the intention of the group to commit a terrorist act.   |
| <i>Terrorist act</i>    | A <i>terrorist act</i> includes:<br>(i) An act which constitutes an offence within the scope of, and as defined in one of the following treaties: Convention for the Suppression of Unlawful Seizure of Aircraft (1970), Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1971), Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents (1973), International Convention against the Taking of Hostages (1979), Convention on the Physical Protection of Nuclear Material (1980), Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1988), Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation (1988), Protocol for the Suppression of Unlawful Acts against the |

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|                                       | Safety of Fixed Platforms located on the Continental Shelf (1988), and the International Convention for the Suppression of Terrorist Bombings (1997); and (ii) any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a Government or an international organisation to do or to abstain from doing any act.  |
| <i>Terrorist financing(FT)</i>        | <i>Terrorist financing (FT)</i> includes the financing of terrorist acts, and of terrorists and terrorist organizations   |
| <i>Terrorist Financing Convention</i> | The 1999 United Nations International Convention for the Suppression of the Financing of Terrorism  |
| <i>Terrorist financing offence</i>    | References in this Methodology (except in SR II) to a <i>terrorist financing (FT) offence</i> refer not only to the primary offence or offences, but also to ancillary offences.  |
| <i>Terrorist organisation</i>         | For purposes of SRIII, the term <i>terrorist organisation</i> is as defined in the Interpretative Note of SRIII.<br>Otherwise, it refers to any group of terrorists that: (i) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and wilfully; (ii) participates as an accomplice in terrorist acts; (iii) organises or directs others to commit terrorist acts; or (iv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist act or with the knowledge of the intention of the group to commit a terrorist act. |
| <i>Third parties</i>                  | <i>For the purposes of R.9 only, third parties</i> means financial institutions or DNFBP that are supervised and that meet Criteria 9.1 to 9.4  |
| <i>Those who finance terrorism</i>    | For the purposes of SR III only, the phrase <i>those who finance terrorism</i> refers to any person, group, undertaking or other entity that provides or collects, by any means, directly or indirectly, funds or other assets that may be used, in full or in part, to facilitate the commission of terrorist acts, or to any persons or entities acting on behalf of, or at the direction of such persons, groups, undertakings or other entities. This includes those who provide or collect funds or other assets with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out terrorist acts.                             |
| <i>Transactions</i>                   | In the insurance sector, the word <i>transactions</i> should be understood to refer to the insurance product itself, the premium payment and the benefits. For specific requirements with regard to record keeping of transactions in the insurance sector, see the IAIS Guidance Notes of January 2002.  |
| <i>Trustee</i>                        | <i>Trustees</i> , who may be paid professionals or companies or unpaid persons, hold the assets in a trust fund separate from their own assets. They invest and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes. There may also be a protector, who may have power to veto the trustees' proposals or remove them, and/or a custodian trustee, who holds the assets to the order of the managing trustees.  |
| <i>Unique identifier</i>              | For the purposes of Special Recommendation VII, a <i>unique identifier</i> refers to any unique combination of letters, numbers or symbols that refers to a specific originator.  |



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|--------------------------|--|
| <i>Vienna Convention</i> | The 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Pyschotropic Substances   |
| <i>Wire transfer</i>     | For the purposes of Special Recommendations VII, the terms <i>wire transfer</i> refers to any transaction carried out on behalf of an originator person (both natural and legal) through a financial institution by electronic means with a view to making an amount of money available to a beneficiary person at another financial institution. The originator and the beneficiary may be the same person.   |
| <i>Without delay</i>     | For the purposes of Special Recommendation III, the phrase <i>without delay</i> has the following specific meaning. For the purposes of S/RES/1267(1999), it means, ideally, within a matter of hours of a designation by the Al-Qaida and Taliban Sanctions Committee. For the purposes of S/RES/1373(2001), the phrase <i>without delay</i> means upon having reasonable grounds, or a reasonable basis, to suspect or believe that a person or entity is a terrorist, one who finances terrorism or a terrorist organisation. The phrase <i>without delay</i> should be interpreted in the context of the need to prevent the flight or dissipation of terrorist-linked funds or other assets, and the need for global, concerted action to interdict and disrupt their flow swiftly. |

# **CHAPTER 1**

## **Introduction**

## **Chapter 1. Introduction**

This dissertation is a cross-section analysis of the compliance by 46 jurisdictions with the Anti-Money Laundering and Combating of the financing of terrorism Regime (AML/CFT). The study is based primarily upon the results of jurisdictions' mutual evaluation reports provided by International Organizations such as the International Monetary Fund (IMF), World Bank (WB), Financial Action Task Force (FATF), and the FATF Style Regional Bodies (FSRBs). This first chapter explains the purpose of this dissertation, the importance of this study, and its significance for International Cooperation in the combating of terrorism financing. Moreover, the research questions, the rationale for this study, and the theoretical considerations taken into account are briefly presented. The chapter also describes the methodology used to answer the questions, as it justifies the general structure of this research while pointing out the limitations of the study.

### **1.1. The Purpose of the Dissertation**

The aim of this dissertation is to explore the role of International Organizations in the combating of the financing of terrorism, in addition to considering what the alternative strategies to tackle the financing of terrorism are. Terrorism is defined in this work as:

The Systematic use of murder, injury and destruction or threat of same to create a climate of terror, to publicize a cause and to intimidate a wider target into conceding to the terrorists aims".(Wilkinson 2005:9).The aim of terrorism is : "destabilizing or destroying the fundamental political, constitutional, economic or social structures of a country". (Reinisch 2004:143)<sup>1</sup>

This study addresses an extremely important element of the international financial system: the economic and political cooperation on the international Anti-Money Laundering and Combating the Financing of Terrorism Regime (AML/CFT). Terrorist Financing constitutes a global issue that touches upon many topics: Money Laundering, conflicts, corruption, and the integrity of the international financial system. The general problem posed by terrorist group attacks and their financing continues to affect International Organizations and people. Previous theoretical studies have found evidence

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<sup>1</sup> The quotation of August Reinisch can also be found in the EU definition of terrorism in Art.1 (1) Council Framework Decision on combating terrorism, 2002/745/JHA, OJ L 164/3, 22 June 22, and it agrees with the definition of "terrorist acts" in the Council Common Position of 27 December 2001 on the application of specific measure to combat terrorism (2001/931/CFSP).

for the problem of the effectiveness of the AML/CFT Regime in protecting the integrity of the financial system and in implementing international standards into legal national frameworks.

This study empirically examines the level of the overall compliance with the AML/CFT Regime, and the methodology proposed has permitted to test the accepted but few theories about compliance with the AML/CFT Regime. The study is such that any meaningful results would seem to be of value to policy-makers (practitioners). The sample chosen is sufficiently unique in that the study is likely to advance knowledge in the field. The methods chosen for the study have not been widely used in the field of international regulation efficiency so that my work will yield some useful methodological findings. The results suggest that combating Terrorist Financing requires a global cooperative system consisting of economic and political aspects due to the present anarchic situation.

## **1.2. The Importance of the Study**

It might be useful at this juncture to briefly describe the main motivation for writing this dissertation. The dissertation has been developed while terrorism is considered by the International Community as one of the main threats to international security<sup>2</sup>. The United Nations (2004) and NATO (1999) have realized that present day threats, such as terrorism, stem more from non-state elements than from States, and that terrorist acts endanger the security of human beings and States. Also the Commission on Human Security (2003) states that human security means to ensure political, economic, social, environmental, cultural and military systems that, when combined, provide people with the building blocks for survival, livelihood and dignity. Meanwhile, International Organizations are especially worried about the effectiveness of the international standards

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<sup>2</sup> For a more detailed analysis, see : Press Release NAC-S(99)64 regarding Washington Summit Communiqué in *NATO (1999)*. An Alliance for the 21st Century. Washington DC, Heads of State and Government (North Atlantic Council):14; *UN (2004)*. A more secure world: Our shared responsibility. New York, The Secretary-General's High-level Panel on Threats, Challenges and Changes: 60-67; and *Commission on Human Security(2003)*. Human Security Now. New York,: 1-14. See also : *UN (2001)*. SC Resolution 1377 of 12 november, 2001 ; *Société française pour le droit international (2004)*. Les nouvelles menaces contre la paix et la sécurité internationales = New threats to international peace and security : journée franco-allemande. Paris, A. Pédone; *Société française pour le droit international (2005)*. Les métamorphoses de la sécurité collective: Droit, pratique et enjeux stratégiques: journée franco-tunisienne. Paris, A.Pedone.

for combating the financing of Terrorism. This background makes empirical research not only more relevant but also more necessary.

In parallel, reports, statements, and other developments in the field of *International Cooperation against Terrorist Financing* made effectiveness of the AML/CFT Regime worth studying. The few existing theories on the AML/CFT compliance have not been tested, and there is also a lack of data that creates considerable gaps in the scholarly literature.

Thus, the decision has been taken to study *the factors affecting and limiting the capacity of the multilateral, regional and national systems to implement international Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT Regime) as well as to propose a new strategy to improve the current Regime.*

The difficulties international and national regulators face in dealing with this issue are apparent from previous empirical results and expert opinions. In addition, it is also evident why, despite multilateral and unilateral attempts to fight Terrorist Financing, regulators have had limited success in terms of deterring international terrorism.

The literature on Terrorist Financing has focused mostly on the mechanisms used by terrorists and dilemmas to control these mechanisms. The majority of the literature describes and explains the phenomenon of Terrorist Financing, but almost none has proposed how to introduce change in the Anti-Money Laundering and Combating the Financing of Terrorism Regime (AML/CFT) to make this Regime more effective and efficient. The main focus has been on particular policies and programs, and thus the literature in the field has been developed mostly by scholars working on terrorism, threat assessment, and threat management. *There is no comprehensive study that treats the subject of the level of compliance with the AML/CFT Regime in an empirical and scientific way.*

There are two publications on the subject. The first is, *The Anti-Money Laundering and Combating the Financing of Terrorism: Observations from the Work Program and Implications Going Forward* (IMF et al. 2005), but its focus has been mainly on the results of the 18 country assessments, while comparing only the use of the old and the new 2004 methodology for the mutual evaluation.

The other publication is *Following the Money Trail: Terrorist Financing and Government Responses in Southeast Asia* (Barlow 2007). This study compares the

effectiveness of counterterrorism in East Asian countries in addition to the causes of terrorism, but it does not review the overall implementation of the Anti-Money Laundering and Combating of the Financing of Terrorism Recommendations.

Much less work has been devoted to the empirical analysis of the level of compliance with the Anti-Money Laundering and Combating the Financing of Terrorism Regime, and virtually nothing has been written so far on a cross section analysis of national compliance with the Regime. Up until this point, nobody has tried empirically to analyze the implementation of this international Regime at the national level by national authorities. ***The empirical evaluation of the international measures at the national level has been completely neglected.***

Causal analysis of determinants has been investigated from theoretical viewpoints, but it has not been studied at the international level, and definitely not in the context of an empirical comparative perspective.

Concretely, Reuter and Truman (2004) pave the way my dissertation, when these authors state that the ***AML/CFT Regime can only make a modest contribution to controlling terrorism, corruption and Failed States and the efforts to control or prevent the flow of terrorist funds are hampered by differences in political will, legislation, rules and instruments across various jurisdictions.***

That while the goal in most money-laundering activities can be linked to some degree to the profit motive, in Terrorist Financing the profit motive (other than cost minimization) is largely replaced by non economic motives, particularly political ones. This may further hamper detection... and at present, there is no empirical base to assess the effectiveness of the current AML Regime in terms of suppressing Money Laundering and the predicate crimes that generate it.  
(Reuter *et al.* 2004:192)

Moreover, the authors have remarked the difficulties countering corruption when it involves officials who control the judicial system, and they highlighted the problem of failed states where the construction of an AML/CFT Regime is not really at the top of the policies.

It is necessary to point out that the report of International Monetary Fund (IMF): *Deterring the Abuse of the Financial System: Elements of an Emerging International Integrity Standard* also remarked that there is little work studying the costs and benefits of

implementing a robust Regime to prevent the abuse of the financial system (Johnston *et al.* 2005:7).

Finance Warfare<sup>3</sup> emerged as a major instrument of antiterrorist strategic operations almost immediately following the September 11 attacks in the United States. It drew upon legislative, regulatory, and policing instruments already in place. However, the strategy as a means of combating international terror, and its implementation and global integration seems to involve and continue to demand enormous efforts by political and financial authorities.

The main purposes of international cooperation in the field of the suppression of the financing of terrorism are to undermine their capability of sustaining terrorist campaign. To do so, international efforts have been focused on prevention and repression. Both prevention and repression involve the conclusion of legal instruments aimed at depriving Terrorist Financing of the amount of funds needed to carry out their activities. Nevertheless, multilateral and national attempts have had limited success in reporting suspicious transactions made by targeted individuals or groups and to deny them the access to the international financial system.

It is clear that warfare against Terrorist Financing has to be accompanied by targeted intelligence gathering, freezing of suspect assets, national law enforcement actions, diplomatic efforts and outreach, more intelligent regulatory scrutiny, an outreach to the financial sector, capacity building for governments and the financial sector through financial ministries, and other departmental technical assistance programs. Pure national actions are not enough to combat the financing of international terrorism. International cooperation is necessary, and it has implications for domestic law enforcement and action agenda.

The *War on Terror* takes many different routes toward its goal, and the effort by the global community to limit the flow of funds to terrorist organizations is one of the

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<sup>3</sup> Finance Warfare is defined as a form of economic warfare whose context is the global financial markets For the use of war terminology to describe the financial battle. See: *Navias, M. S. (2002). "Finance Warfare." The Political Quarterly* 73: 57-99. See also statements by Jimmy Gurule, Under Secretary of Treasury for Enforcement. According to Mr. Gurule, "The Treasury Dept, is now waging a multi-laterals battle to break the financial backbone of terrorist groups and their financiers...it is playing a key role in this new and unconventional war with respect to dismantling the maze of money that makes these acts possible.' The establishment by the proactive Treasury of the Foreign Terrorist Asset Tracking Center was described as ' a new proactive, representative strategy for waging financial war': Treasury's Gurule on Strategy to Fight Money Laundering', in US Department of State: International Information Programs, 22 Oct 2001.

cornerstones in this effort<sup>4</sup>. By tightening the flow of financial support, the international community hopes to weaken various groups around the world.

Until now, the fight against transnational finances has been carried out on two levels:

- The first one has been to control the sources which have fed terrorist networks
- The second is about the track followed by funds.

Despite the above mentioned efforts, the identification of the money linked with terrorism has presented two problems:

- The first problem is that illegal money generated through international crime has often been in kind, transported directly to the scene of the plot or using the networks for informal money transfer.
- The second one is that the use of legal money introduced in the financial system through shell companies and the offshore financial centers(OFCs) is impossible to detect.

***These two problems explain the lack of data on Terrorist Financing, and they also show one of the causes involving the low level of frozen funds during the last years.***

The total amount of the frozen funds worldwide since September 11, 2001 is detailed as follows:

In the year since September 2001, US\$112 million of terrorists' assets were frozen, 165 countries [under United Nations Security Council resolutions] ordered terrorist funds to be blocked and 288 legal persons were subject to blocking, more than 80 countries have enacted or will enact legislation dealing with the financing of terrorists. US\$34 million was frozen within the USA. US\$78 million was found outside the USA, and of this US\$39 million was frozen in Switzerland. Another updated this time from the US Department of the treasury and dated 16 January 2004-stated that, since September 2001:1447 accounts, containing more than US\$139.1 million in assets, have been frozen worldwide, including US\$36.7 million in the USA. US\$64 million in additional terrorist-related assets have been seized by authorities globally. 345 individuals and organizations have been listed as 'Specially

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<sup>4</sup> The U.S Justice Department is investigating possible criminal tax-law violations by a Boston private-equity firm that manages hundreds of millions of dollars for Muslim Investors in Europe and the Middle East, and is affiliated with a Swiss investment group. U.S Authorities suspect of financing Islamic Extremists.



Designated Global Terrorists (SDGTs)' under Executive Order 13224.  
(Campion 2002:10) as cited in (McCann 2006:221)

The IMF estimates that between US\$500 billion and \$1.50 trillion are laundered every year through the global system, that is, around 2-5% of World GDP (IMF 2001:10). Walker (1999) was the first analyst to make a comprehensive attempt to quantify Money Laundering, and the initial output suggests \$2.85 trillion . ***At this point, we can clearly observe the low level of terrorists frozen funds around the world in comparison with the estimated amount of the laundered funds.***

The most important issue that arises is questioned by Richard (2005), and it ***“is whether Terrorist Financing should be a central issue in the fight against terrorism if terrorist attacks can be pulled off quite inexpensively.”*** She argued that the terrorist attack in Paris in 1995 cost about \$100. The August 1998 attacks on US Embassies in East Africa cost approximately \$10.000, and the Bali Bombings in October 2002 cost about twice that amount. The September 11<sup>th</sup> hijackers spent between \$400,000 and \$ 500,000 over two years to plan and execute the attacks.

While it is true that ***any single terrorist incident can be staged inexpensively, a great deal more money is required for the creation and maintenance over months and years of terrorist cells and networks, planning for major strikes, attracting recruits, running training camps, and finding and preserving places to hide. Terrorists rely on the international financial system to carry out their operations*** (Koh 2006; Bell 2003 and Gillespie 2002).

This dissertation will argue ***how very important it is to tackle not only the financing of terrorism but also the corruption and the traditional organized crime due to the existing nexus between them.*** All of them are conducted in order to reap profits from crime: selling drugs, human trafficking fraud schemes, etc. The funds connected with corruption and terrorism are often not illegally derived. When a business uses its legally derived funds to bribe a local official or even head of state, a criminal act has not been committed until the bribe takes place. If a charitable association supports individuals in their political agenda, it is not committing a criminal act until those funds are used to manufacture a bomb or organize a hostage taking.

This nexus presents a unique challenge to law enforcement, regulators, private financial institutions, and financial intermediaries such as lawyers, notaries, accountants or

investment advisers. Indeed some experts believe that the movement of this money is not Money Laundering at all in its traditional sense. Nonetheless, one must emphasize that the majority of the literature shows the role of Money Laundering in Terrorist Financing, and the relationship of Money Laundering and Terrorist Financing (Koh 2006:27), i.e. the act of knowingly concealing the source of illegally derived funds or assets. *Thus, many of the tools designed to address the problem of Money Laundering in its traditional sense are useful in following the money of terrorism.*

Money Laundering, corruption and the financing of terrorism are all global in nature, and cannot be addressed by sporadic measures limited to a few countries. Moreover, the dynamics of international law enforcement co-operation are too complex to defy ready solutions. Unfortunately, governments and law enforcement machinery at times do not keep pace with shifts in criminal strategies and tend to be reactive rather than proactive. The results of the quantitative analysis carried out in this dissertation will show that 86% of the 46 countries sampled still do not have laws in place to deal with the core of the AML/CFT Regime. That is the system has been unable to apply the customer due diligence policy and it has been also unable to report suspicious transactions to financial intelligence units.

If money transactions are not regulated and controlled at the international level, criminals and terrorist groups will simply shift their activities to those countries that lack effective safeguards, and familiar problems will simply resurface elsewhere. The background of this study is summarized by three main issues:

- The problem of suppressing Terrorist Financing is part of the global effort to combat terrorism since 9/11, since it assumes an abuse of the financial system.
- There is a lack of theories explaining the effectiveness of the AML/CFT Regime, and there is no empirical analysis of the overall AML/CFT compliance.
- There are neither data nor transparency on illegal and legal flows of funds in terrorist hands.

### **1.3. The Research Questions and the Rationale for this Work**

The main research question of this dissertation is: How efficient has the implementation of the AML/CFT Regime been in countries and jurisdictions? This question will be answered through the following key research questions:

- *What level of overall compliance has the cooperative AML/CFT Regime achieved in countries?*
- *What economic and political factors are determinants for the level of overall compliance with the AML/CFT?*
- *What are the alternative strategies to tackle the financing of terrorism?*

To answer all these questions, the first thing is to establish a theoretical framework, in which the following will be addressed:

- How the International Organizations have understood the terrorists networks.
- How the International Organizations have responded to the Terrorist Financing challenge and the failures and constraints of this finance warfare.
- And how to best evaluate the effectiveness of the AML/CFT Regime?

#### **1.4. Theoretical Framework**

The theoretical framework relies upon three main groups as mentioned above, the goal of the theoretical framework is to establish the main assumptions and the hypotheses that will be tested with quantitative and qualitative methods.

##### *a) The Nature, Mechanism and Dilemmas of Terrorist Finances*

The starting point of this research is to know *whether the terrorist networks have been fully understood*. If they have not been understood, then the Regime could not possible contemplate it adequately. Chapter 2 includes:

- the specific issues that have received major attention in relation to the nature of the Terrorist Financing question:
  - How do groups using terrorism raise and move funds to support their activities?
  - How have they changed their patterns of financing in the wake of global regulatory efforts to control their activities?
- a critical overview of the most important research on the topic, including an evaluation of the most cited work.
- the issues related to Terrorist Financing mechanisms which require further study in the future and should be incorporated into the AML/CFT standards.

The chapter begins with an overview of the evolution of Terrorist Financing during the last three decades. The second section in the chapter includes an explanation provided by

scholars of the links between Money Laundering and Terrorist Financing, while paying attention to the connection between transnational crime and international terrorist groups. This section introduces the main assumptions and the basis of my dissertation. I will also show that the financial resources which fuel transnational terrorist groups, are both illegitimate and legitimate in their sources of income. As has been said by William Wechsler<sup>5</sup>:

Beyond the family inheritance of Osama Bin Laden, the Al-Qaeda network has raised funds from legal businesses and investments, criminal schemes (both large and small), direct solicitation, and also skimming off contributions to charitable organizations. The movements of funds has been facilitated by legal remittances through routine wire transfers, cash smuggling, direct shipments of gold and the largely unregulated hawala system.(Wechsler 2001:130)

The third part of the chapter describes countries attractiveness for Money Laundering purposes and its impact on Terrorist Financing. The chapter concludes with an emphasis on the study of Terrorist Financing Mechanisms and Policy Dilemmas posed to the AML/CFT Regime.

b) *The risk of Financial System abuse, and the need for an AML/CFT Regime*

The goal of this theoretical chapter is to introduce ***how the world has responded to the abuse of the financial system through the acceptance of a Regime evolving Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)***. The traditional challenges, facing financial market globalization, remain in place: There is a lack of transparency on financial data, even though the International Community has pushed hard over the last few years for the identification, development, and monitoring of international standards in the supervision and regulation of banking, insurance, and securities. It is not possible to determine whether there is an abuse of the financial system or not, if there is no data available to make assessments about abuse. It will be impossible to design an effective Regime to protect a financial integrity system if the size of the financial system is unknown.

The first section of this theoretical chapter introduces the interaction between global liberalization and financial crime, Money Laundering and Terrorist Financing, and

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<sup>5</sup> William Wechsler, a former US National Security Council and Treasury Department Official.

the difficulty of governments in taking action against this dark side of globalization. This part discusses how the market and non-state actors outgrow governments defended by (Bukkanin, Gilpin, Strange, Rosenau, Palan and Biersteker).

The second and third part will remark on the challenges posed by financial market globalization: the globalization of money, the lack of transparency of the global financial System, the impact of illegal global finances on the global governance and the link between the offshore and onshore centers and terrorist funds, as well as identified problems in onshore centers and lack of data in some particular financial centers. All of these characteristics have permitted terrorist groups and transnational organized Crime to abuse the financial system.

Finally, the last section introduces how a new global regulatory landscape was built for deterring the abuse of the financial system by financial crime, money launderers and terrorist financiers. An exploration will be made of the most accepted international integrity standards which attempt to standardize solutions for both the developed and developing countries including small islands and offshore centers.

*c) Is the AML/CFT deterring the abuse of the Financial System by transnational organized crime and Terrorist Financing?*

The way to determine if the AML/CFT is deterring the abuse of the financial system is through a measure of effectiveness. The effectiveness of international standards cannot be measured by the capacity of the Regime to deter transnational terrorist attacks or by the volume of international data sharing. It has been stated within this theoretical framework that ***the only way to ensure its effectiveness is through the implementation of the international regulations into national regulatory frameworks.***

The establishment of a robust AML Regime as a global public good is a challenge because of the differences in institutions, perspectives, and priorities among countries as well as within them. The goal of this chapter is to provide an overview of the main institutions and standards involved in the combating the financing of terrorism. This chapter reviews a number of significant international, regional, and national efforts undertaken both before and after September 11 to constrain the exploitation by terrorists of the international financial system.

The existing legal machinery<sup>6</sup> against the financing of terrorism, including for example the anti-Money Laundering Regime, the mandatory provisions in UN Security Council Resolutions, the regulation implemented by the European Union and some regional organizations, along with international Convention and ad hoc Recommendations adopted by specialized international bodies (such as the Financial Action Task Force) have been the most relevant instruments available to national authorities for fighting against Terrorist Financing. The main questions to be solved during this research are the following:

- Are the tools developed nationally and internationally as part of the anti-Money Laundering Regime efficient for being used in dealing with terrorism finances?
- What are the failures and constraints of the finance warfare?
- What is the effect in terms of facilitating detection of financing terrorism?
- What is the effect in terms of prosecutions and convictions, in terms of increasing the costs of doing business with the terrorists, and in terms of deterrence by removing the profits from terrorist activities?

Such a revision will permit us to summarize and assess the main benefits and weaknesses of the AML/CFT Regime in order to judge its effectiveness or applicability in which Terrorist Financing occurs.

### **1.5. The Mixed Methodology: A Quantitative and Qualitative Approach**

The effectiveness of the AML/CFT is measured when comparing the jurisdiction's compliance with AML/CFT Recommendations. Chapter 5 explains how the study of the overall jurisdiction's compliance with the AML/CFT Regime will be conducted. The Data and Analytical Methodology chapter defines the relevant variables and parameters utilized to answer the main question of this dissertation, and it also presents the methods of data collection. In this section, the research perspective, the research type, and the research methods in brief are presented. During the early stages of the present PhD project, the impression given was that a qualitative analysis would provide the results concerning the determinants of compliance with AML/CFT Regime.

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<sup>6</sup> For a review of the International Institutions involved in the fight against the financing of terrorism, see: *Fisher, J. (2002). "Recent International Developments in the Fight Against Money Laundering." Journal of International Banking Law 17(3): 67-72.*

After 15 interviews with relevant scholars, international bank officials, international organization officers, a judge, a law enforcement Official, and more than 100 emails asking them about the effectiveness of the AML/CFT Regime, the project shifted from a purely qualitative analysis method to a mixed quantitative and qualitative method approach. A list of interviewees and the people emailed is submitted in Appendix 1.

The first method used in the work was the quantitative analysis in order to conduct a preliminary exploratory analysis. This method has permitted the comparative assessment of the AML-CTF mutual evaluation reports from the end of 2004 to 2006. The Mutual evaluation Reports are published by FATF and Financial Style Regional Bodies (FSRBs), using the FATF 2004 Methodology. But only the years (2004-2006) are comparable since they are the only ones using the same methodology (FATF 2004 Methodology).

The purpose of the first step is to evaluate the level of the overall compliance of 46 jurisdictions from a comparative perspective. The comparative perspective by world income groups and the world region groups make it possible for us to approach the problem. In order to use quantitative methods, the qualitative scores of the mutual evaluations reports have been transformed into quantitative data, as is described in chapter 5.

The second kind of the analysis is developed in two parts:

- The first part empirically tests the most relevant theories highlighted in the introduction, chapter 2, 3, and 4 through the bivariate correlations method.
- The second part consists of modeling the causes of the compliance by 46 jurisdictions with the AML/CFT Regime through a multivariate regression analysis (OLS regression).

It is necessary to recognize the great difficulties one encounters when analyzing cross cultural and cross-country data, as each country display peculiarities in defining criminal behaviors, policies, implementation of international standards, recording and reporting suspicious activity records , which has made it very difficult for this aggregation to obtain a meaningful result. The objectives of the analytical method are as follows:

- To assess the degree of generalizability of the Financial Action Task Force Recommendations as a tool for fighting terrorist finances using the quantitative analysis.

- To establish the failures and weaknesses of the AML/CFT Regime through a qualitative analysis.
- To evaluate the capacity of states to implement the AML/CFT Regime using quantitative and qualitative analyses
- To analyze what determinants cause the level of compliance with the AML/CFT Regime. All the independent variables used in the model are fully described in chapter 5, both the qualitative and quantitative ones.
- To establish a list of better practices to be followed by the international community when combating the financing of terrorism.

### **1.6. The Structure of the Dissertation**

Putting together the theoretical framework and the analytical approach to address the research questions, the structure of the present is as follows:

- Chapter 1: Introduction
- Chapter 2: The Nature of the Terrorist Financing Questions
- Chapter 3: The Risk of the Global Financial System Abuse
- Chapter 4: The International Standards and Responsible Bodies in the Fight against Terrorist Financing and the Effectiveness of the Measures Taken
- Chapter 5: Data and Analytical Methodology
- Chapter 6: Main Findings and Results of the Research
- Chapter 7: Conclusions
- Bibliography
- Appendices

### **1.7. Limitations of this PhD work**

The study is subject to several limitations. First, the sample size of the 46 countries utilized in this study is quite small. However, this is a common problem of Money Laundering and Terrorist Financing research. Second, the Compliance of jurisdictions with AML/CFT was measured in this research, reusing the scores of mutual evaluation reports. It should be admitted that there always remains the possibility of making subjective measurement errors in mutual evaluation report scores. Another limitation to be noted is the lack of homogeneous data to evaluate the independent variables concerning the size of



the financial system in each country. Using mutual evaluations for the independent variable entailed a effort to collect the mutual evaluations published according with FATF 2004 methodology. Notwithstanding these limitations, the present study provides an original contribution to the literature in exploring the impact of various determinants on the overall compliance of countries with the AML/CFT Regime.

## **CHAPTER 2**

# **The Nature of the Terrorist Financing Question**

## **Chapter 2. The Nature of the Terrorist Financing Question**

The literature review is supposed to meet several objectives: to demonstrate researcher knowledge of the subject and excellent understanding of the main issues under debate, to present state-of-art research, and to focus on the literature closely related to the research question. This poses numerous challenges for any researcher working on Terrorist Financing. The body of literature related to Terrorist Financing and its mechanisms is diverse and rich, in addition to the dilemmas faced by International Organizations. However, it also became clear that there are many issues and problems related to the effectiveness of the AML/CFT Regime that are still unresearched.

The focus in this dissertation is on the contraction strategy as a means to analyze the literature, starting with a general overview of previous research on terrorism, the links with transnational crime, and the impacts on global financial integrity. Finally, the scope of the research overview was narrowed down in order to review the scholarly findings that are directly related to the specific questions presented in this dissertation.

This following chapter discusses the specific issues that have received major attention in relation to the nature of the Terrorist Financing question. Secondly the chapter presents the research conducted by the most frequently cited authors, and a description of the overall quality of this research. To conclude, the last section summarizes the issues related to Terrorist Financing mechanisms, which require further studies in the future and should be incorporated into the AML/CFT standards. This section introduces the main assumptions and the basis of this dissertation.

The chapter is organized as follows: It begins with an overview of the evolution of Terrorist Financing during the last three decades. The second section continues to discuss the explanations provided by scholars regarding the links between Money Laundering and Terrorist Financing, paying special attention to the connection between Transnational Crime and International Terrorist Groups. The third part of the chapter describes the effects of countries' attractiveness for money. The chapter concludes with the study of Terrorist Financing mechanisms as well as of the dilemmas of the financing of terrorism that challenge the AML/CFT Regime

## 2.1. The Evolution of the Terrorist Financing Questions

The capacity of transnational organizations to generate world panic and cause intensive damage to a nation is a well known phenomenon. The anarchist movements at the end of the nineteenth century are a good example. To summarize, the late 1960s and 1970s were characterized by the rise of secular ethno-nationalist/separatist and left-wing terrorist groups, and the early 1980s saw the dramatic emergence of “religiously motivated terrorism, more precisely that involving extreme Islamist movements”(Koh 2006:5).<sup>7</sup> The recent literature is influenced by Al Qaeda’s attacks on the World Trade Center and the Pentagon in September 11, 2001. These attacks proved that terrorist groups have both the capacity and the willingness to cause mass destruction and death. Furthermore, other attacks illustrate this point: the February 1993 bombing of the World Trade Center, the March 1995 sarin gas attack in the Tokyo subway, the April 1995 bombing of the federal building in Oklahoma City-seemed to signal the arrival of a new and deadlier kind of terrorism- in accordance with Enders and Sandler (2006); Napoleoni (2005,2007); Brechner (2007).

The emergence of terrorism as a viable and significant danger to the international community indicates that states are no longer the sole actors that can initiate a conflict.

In fact, what is new about writ large by the end of the twentieth century-and not just for the religiously motivated groups identified as part of the “new terrorism”-is the diversification of the sources of funding upon which they rely and the declining importance of state and popular support within their funding portfolios. (Giraldo *et al.* 2007:7)

While the origins of global terrorism<sup>8</sup> are multiple and complex, globalization has created preconditions whereby networked terrorism becomes super-empowered. Just as multinational corporations have evolved in responding

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<sup>7</sup> For further discussion of “religious motivated terrorism groups”, see: Koh, J.-m. (2006). Suppressing terrorist financing and money laundering. Berlin, Springer. She discusses the dramatic increase of identifiable religious terrorist groups from 1968 to 1992 based on other authors (Bruce Hoffmann), (Paul Wilkinson ),, *US Department of State (2003) The Patterns of Global Terrorism-2003*; *Introvigne, M. (2004). Fondamentalismi: I diversi volti dell' intransigenza religiosa*. Alessandria, Piemme:85-210; and *Laidi, A. et al. (2002). Le jihad en Europe : les filières du terrorisme islamiste*. Paris, Seuil:105-128.

<sup>8</sup> For further discussion of the cause of terrorism at the global level since the nineteenth century, see *Sedgwick, M. (2007). "Inspiration and the Origins of Global Waves of Terrorism." Studies in Conflict & Terrorism 30: 97-112*. See also: *Chaliand, G et al..(2004). Histoire du terrorisme : de l'antiquité à Al Qaida*. Paris, Bayard : 243-482.

to globalization by distributing functions and resources, transnational terrorist groups have followed a similar path.

Al Qaeda, for instance, has become one of the most infamous and powerful of all terrorist groups, because it has sufficiently generalized its strategy and architecture to enable individuals throughout the world to claim attacks in the name of Al Qaeda, occasionally with that group's assistance. This networked and distributed structure is one that is characteristic of transnational terrorism, which has made these movements more difficult to isolate and remove. As such, it is essential to define transnational terrorism:

Terrorism is transnational when an incident in one country involves perpetrators, victims, institutions, governments, or citizens of another country. If an incident begins in one country but terminates in another, then it is a transnational terrorist event, as is the case for a hijacking of a plane in country A that is made to fly to country B. An attack against a multilateral organization is a transnational incident owing to its multicountry impact... The toppling of the World Trade Center towers was a transnational incident because victims were from ninety different countries, the mission had planned abroad, the terrorists were foreigners, and the implications of the event (for example, financial repercussions) were global “. (Enders and Sandler 2006:7)

In the case of Bin Laden and Al Qaeda, his economic and financial empire constitute a transnational financial engine, a considerable section of which is composed of legitimate businesses as stated by Schneider (2003); Napoleoni (2005) and Comras (2005). Al Qaeda's controlled companies in Africa include the holding company Wasi al Aquq, a Sudanese construction firm, Al-Hiraj, an ostrich farm, and shrimp boats in Kenya. In the Middle East, the group has shares in the Al-Shamil Islamic Bank and large tracks of forest in Turkey; in Asia, it has agricultural holdings in Tajikistan; in Europe and the United States, holding companies, venture capital firms, banks, and import-export companies<sup>9</sup>. Further, the importance of the Al Qaeda network in terms of correspondent banking can be seen by examining the case of the Al Shamal Islamic Bank in Khartoum, in which foreign currency accounts were set up at Al Shamal for a number of the companies belonging to Bin Laden. Shamal's correspondent banking relationships were with a variety of reputable

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<sup>9</sup> See: *Shahar, Y. (2001)*. Tracing Bin Laden's money. [www.ict.org](http://www.ict.org). ; and *Mintz, J. (1998)*. Bin Laden's Finances are Moving Target. [The Washington Post](http://www.washingtonpost.com).

banks such as CityBank and others, which is why Al Qaeda was able to move money rapidly and without impediments around the world<sup>10</sup>.

Alternative remittance systems (ARS), i.e Hawala, were also important to Al Qaeda's ability to move finances as well as generate funds.

Al Qaeda is a terrorist network with international linkages that are generally focused on a number of theatres of operation (sometimes in different countries), where they have managed to have money available. Their operations are driven by a particular cause. Funding is generally specific, derived from sympathetic supporters, and especially from major crime. Contributions in the diaspora and monies from political and religious sympathizers are also important.

### 2.1.1. New Terrorism

There is a common agreement among scholars and policy makers to explain "*how the end of the Cold War marked a watershed moment in the nature of terrorist finances*" (Giraldo *et al.* 2007:9), and how the scholars draw attention to the fact that during the cold war some terrorist groups were dependent on state sponsors for their funding, but they began to be self sufficient during the 1990s<sup>11</sup>, relying on criminal and other self-financing methods: "*Terrorist Financing is driven more by the availability of opportunities than by a short fall in revenues from state sponsors.*" (Giraldo *et al.* 2007:10)

The high flow of funds to terrorists was substantial during the cold war, and scholars explain these flows as stemming from oil-rich Regimes that began to pump large sums of money into the terrorist financial system (e.g., Libya in the 1970s and Iran under Ayatollah Khomeini, beginning in the 1980s). Another important idea states that many of the Marxist-Leninist groups of the 1960s and 1970s relied on various criminal activities – particularly kidnapping, robbery, and extortion – to supplement their state funding. Other organizations including FARC in Colombia and Shining Path in Peru financed their activities through drug trafficking. The authors show us the case of Hezbollah as an

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<sup>10</sup> Rassastry, A. (2001). "Follow the Money and Follow it Fast, Findlaw's." FindLaw's.

<sup>11</sup> See, US. (1996). Patterns of Global Terrorism 1996

<http://www.state.gov/www/global/terrorism/1996Report/overview.html>. The United States actively promotes international cooperation in condemning state sponsorship of terrorism and in bringing maximum pressure to bear against state sponsors. The Secretary of State has designated seven countries as state sponsors of terrorism: Cuba, Iran, Iraq, Libya, North Korea, Sudan, and Syria. In particular, the compliance of Sudan and Syria with the AML/CFT recommendations will be analysed in this dissertation.

example of cultivating diaspora. Furthermore, the end of the cold war eliminated the last barriers of globalization, and it led to an excess of failed states and ungoverned regions.

Since the mid-1970, the size of the international financial flows has grown to hundreds of billions of dollars a day. *“These huge capital flows can easily overwhelm national economies, and this increasing integration of global financial markets has caused national governments to surrender a portion of their economic autonomy to global market forces.”* (Gilpin 2001:36). The same international financial system that allows commerce to flow freely between nations also provides terrorists with a way to move money around the globe within seconds. Transnational terrorism has become a global problem, and therefore the effort to disrupt its financing ought to extend beyond borders in order to block the money wherever it is hidden and track it down wherever it moves.

In the words of Seiichi Kondo (Deputy Secretary General of the OECD)<sup>12</sup>:

Globalization can pose problems, not just for individuals, but for governments as well. New opportunities are opened up for individuals and enterprises to engage in illegal activities such as hard core cartels, Money Laundering and tax abuses, which distort trade and investment flows...We must urgently address this dark side of globalization if we are to maintain broad political support for open markets and for the benefits that these can bring in terms of greater freedom and choice for citizens and enterprises worldwide.

Since the events of 9/11, the nation state and its security have been facing serious challenges from transborder flows, global forces, international Regimes, and complex networks such as Transnational Companies, NGOs, etc. From the point of view of good governance, terrorism has turned out to be one of the most significant threats to peace, international security and economic development according to Annan (2004), Solana (2005) and the IMF (2001), and these three global public goods are such that international, national and regional organizations should be able to guarantee as stated by Meter (2003).

During the past 35 years, the world had nearly 20,000 terrorist incidents, ranging from the hostage takeover during the 1972 Munich Olympics to the 2002 and 2005 tourist bombings in Bali. Terrorist incidents worldwide during this time period have resulted in more than 90,000 casualties or injuries. (Barth *et al.* 2006:5)

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<sup>12</sup> See further explanations of: *Kondo, S. (2001)*. Opening Speech at the High Level Consultation on OECD Harmful Tax Competition. Barbados.

Transnational terrorism is now perceived as a different threat compared to past dangers due to its transnational, non-state composition and its high capacity to destroy human lives and undermine states and international Regimes. Considering the huge financial flows in the hands of terrorist groups, one can argue that the forces of globalization<sup>13</sup> have created new opportunities for the private sphere in both the creation and enforcement of the influence of private power in the global political economy. In order to understand the forces in the world economy that have contributed to facilitate world terrorism, we may refer to the different sets of forces or processes that participate in the world economy in line with McGrew (2005).

- The main force is *internationalization*: understood as the increase in transaction among states as reflected in flows of trade, investment, and capital. The processes of internationalization have been facilitated and are shaped by inter-state agreements on trade, investment, and capital, as well as by domestic policies permitting the private sector to transact abroad.
- Internationalization came in association with the *technological revolution* regarding the way in which modern communications (Internet, satellite communications, high-tech computers) made possible by technological advances have reduced distance and made location less important factors not just for governments (even at local and regional levels) but also for such actors as firms or social movements.
- The technological revolution diminished the influence of territorial places and *detritorialization* appeared, with distances and boundaries no longer being important for the collective identity hitherto linked to countries or regions. This permits an expansion of global civil society but also an expansion of global criminal or terrorist networks.

Modern technology has provided new impetus not only to legitimate trade and commerce, but also to criminal business enterprises. Thus, mass communications have facilitated contacts with associates in other countries and continents, modern revolution in electronics has given criminal groups access to new tools enabling them to steal millions and to launder the huge illicit profits

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<sup>13</sup> Globalisation is variously defined in the literature: A historical process involving a fundamental shift or transformation in the spatial scale of human social organization that links distant communities and expands the reach of power relations across regions and continents.

For further explanations of globalization see: “*De-territorialization or the growth of supraterritorial relations between people*” (Scholte 2000:46) and “*The integration of the world economy*” (Gilpin 2001:364).



(The Impact of Organised Criminal Activities Upon Society at Large: Report of the Secretary-General, UN Doc. E/ CN.15/1993/3, 11 January 1993, p.4) in (Gilmore 2004:13)

All of these processes have reduced the role of the state in the economy in the same way as the dismantling of trade tariffs and barriers, the deregulation and opening of the financial sector to foreign investors, and the loss of control of the financial system in the way analyzed by Friedman (2005), while arguing that the world is flat.

### **2.1.2. Trends in Terrorist Financing**

The trend is considered in this dissertation as the evolution of a method of the financing of terrorism or typology of financing over time. While method or typology still refers to unique processes at a particular period in time, it is very difficult to identify trends in the ML/TF area, because the activity of ML/TF cannot be neither observed nor recorded in statistics. Intelligence, law enforcement investigations, and criminal prosecution try to identify or confirm trends in connection with ML/FT. According to the Money Laundering and Terrorist Financing Typologies 2004-2005 (FATF-GAFI 2005), the ML/FT activity could be classified by:

- The ML/FT stage.
- By predicate or other related offence.
- By country or region.
- By financial or other sector involved.
- By development stage of the financial market.
- By weak point or vulnerability in the AML/CFT system.

The 9/11 terrorists took advantage of the lack of a financial system control, which afforded them the ability to transmit and receive money with relative anonymity and to find the financial resources to carry out their plans. Al Qaeda and al Qaeda inspired groups and other contemporary terrorist organizations. The Terrorist Financing mechanisms that have emerged since September 2001 are characterized by “*The use of formal and informal global financial system that terrorists can manipulate with ease.*” (Giraldo et al. 2007:11).

### **2.1.3. Warning Indicators of Terrorist Financing**

According to the evolution of Terrorist Financing explained above, it has been said by Giraldo *et al.* (2007) and Wilson Park Conference Report (2007) that the intelligence process to fight against Terrorist Financing should combine expertise from different fields to face the warning indicators and trends in. The experts point out that the current indicators and trends of Terrorist Financing are the most important challenges that face international cooperation. The following list sums up the constraints presented by intelligence agencies to follow the money trail:

- The need for examining financial transactions will oblige national security intelligence personnel and law enforcement agents to deal with accountants and banking and financial experts if they want to follow the money trail.
- Recognizing that it is necessary to analyze the Suspicious Activities Reports collected as well as to share this information between Financial Intelligence Units.
- Information should be disseminated at a local level because terrorist organizations are engaged in organized crime networks.
- The intelligence process against Terrorist Financing requires the cooperation of multiple governments, and that of the multilateral institutions dealing with financial integrity and transnational intelligence.
- Thinking about the abandonment of the frozen funds strategy, because it makes terrorists hide their funds.

## **2.2. The relationship between Money Laundering and Terrorist Financing**

In this part, the definitions given by legal instruments linked to Money Laundering and Terrorist Financing will be explored (2.2.1), while the door will be opened to the analysis of the link between transnational terrorism and transnational organized crime (2.2.2).

### **2.2.1. Definitions and Explanations**

This section gives definitions on Money (ML) and Terrorist Financing (FT) according to the existing legal instruments.

### 2.2.1.1. Money Laundering

Among the definitions of Money Laundering, the following constitute the focus of this dissertation:

- The [1988] Vienna Convention (basis of AML/CFT Regime) that is the widely accepted and used definition in International Legal Instruments on this topic:

The conversion or transfer of property with the knowledge that such property is derived from a drug-trafficking offense for the purpose of concealing and disguising its illicit origin or assisting any person involved in a drug-trafficking offense to evade the legal consequences of his or her action.

The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property with the knowledge that the property was derived from a drug-trafficking offense.

The acquisition, possession, or use of property with the knowledge that the property is derived from a drug-trafficking offense. (This is not mandatory, but subject to each country's constitutional principles and basic concepts of its legal system).

- The [2000] Palermo Convention : This definition adopted in 2000 enlarges the previous one established by the Vienna Convention 1988 and it criminalizes Money Laundering further than drug trafficking offenses.

When committed intentionally: The conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offense to evade the legal consequences of this action:

The concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime. Subject to the basic concepts of its legal system.

The acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime.

Participation in, association with or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counseling the commission of any of the offenses established in accordance with this article.

- The European Community's Directive of 1991: The EEC adopted elements of the Vienna Convention in drafting its Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime (1990).

When the following conduct is committed intentionally it is Money Laundering:

The conversion or transfer of property derived from criminal activity for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity in evading the legal consequences of his action<sup>14</sup>.

- The United Nations' law model for Money Laundering (2003)<sup>15</sup>

A person commits the offence of money-laundering if:

The person acquires, possesses or uses property, knowing or having reason to believe that it is derived directly or indirectly from those acts or omissions

- Other definitions of Money Laundering from many scholars and many international bodies have attempted to define Money Laundering, while taking different elements of the question into consideration. From these efforts, the following institutions may be considered relevant: FATF (1996); International Monetary Fund and World Bank ()2004; Interpol (1995); IOSCO (1992); Savona (1997); Van Duyne (2003); Walker 1999; and Cuellar 2003.

As argued by Unger (2006), despite harmonizing efforts at both the European and International levels, national legislations criminalizing Money Laundering continue to differ. Most countries have criminalized serious offences but have, nevertheless, adopted different approaches to what constitutes a serious offences. The empirical results of chapter 6 show how difficult it is to harmonize the Money Laundering Concept in 46 countries. This reality introduces additional problems to my work in this dissertation, since every country has developed laws based on different concepts of Money Laundering.

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<sup>14</sup> Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of Money Laundering (Official Journal L166 OF 28.06.1991). Council Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering. (Official Journal L 344 of 28.12.2001).

<sup>15</sup> [http://www.unodc.org/pdf/lap\\_money-laundering-proceeds\\_2000.pdf](http://www.unodc.org/pdf/lap_money-laundering-proceeds_2000.pdf)

### **2.2.1.2. Terrorist Financing**

On October 30, 2001, the FATF agreed to a set of Special Recommendations on Terrorist Financing<sup>16</sup>: “*Each country should criminalize the financing of terrorism, terrorist organizations. Countries should ensure that such offences are designated as Money Laundering predicate offences*”.

[Terrorist Financing].....can be defined as the processing of property from any source (perhaps a legitimate one) to be used to finance terrorist activity that has been or will be committed and to use many of the same techniques as Money Laundering, and, therefore, many of the possible countermeasures are similar. Furthermore, several terrorist organizations are known to finance their activities out of the proceeds of crime. Nonetheless, Terrorist Financing differs from Money Laundering in several ways that affect public policy. It may be much more difficult to detect than Money Laundering because it is directed mainly at future activity: it is possible that the only offence that has been committed when the financing takes place is conspiracy to commit a terrorist act. (Aninat *et al.* 2002:44-45)

In order to overcome the problem of the diversity of concepts, the FATF definitions on Money Laundering and Terrorist Financing will be followed in this research.

### **2.2.2. Increasing the Nexus between Transnational Terrorism and Transnational Organized Crime**

Since terrorist groups are not relying on State sponsorship and the International Organization is constraining their flows, speeches and statements around the world have highlighted the dangers of transnational organized criminal activity and cited the growing nexus between terrorists, narcotics traffickers, and other international criminals that have been fostered by developments in international communications.

Over the past few years, leading intelligence services and law enforcement authorities have noted the growing threat created by the transformation and convergence of transnational organized crime and terrorists groups. Among the first organizations, the UN in the SC Resolution 1373, recognizes the link, it claims that there is a close relationship between terrorism and transnational organized crime even if there are some substantial differences between them:

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<sup>16</sup> See [http://www1.oecd.org/fatf/TerFinance\\_en.htm](http://www1.oecd.org/fatf/TerFinance_en.htm)

Note with concern the close connection between international terrorism and transnational crime, illicit drugs, money-laundering, illegal arms-trafficking, and illegal movement of nuclear, chemical, biological and other potentially deadly materials, and in this regard *emphasizes* the need to enhance coordination of efforts on national, sub regional, regional and international levels in order to strengthen a global response to this serious challenge and threat to international security. (UN 2001b:paragraph 4)

Relevant scholars, such as Picarelli *et al.*(2007) conclude that the linkages between terrorists and criminals are strongest in conflict zones, and they ask law enforcement to give more attention to the crime activities of groups emanating from the Balkans, the Middle East and the Afghan-Pakistan region:

Terrorists today use an increasing range of illicit activities to finance their activities and form links with criminals more frequently...While links between drug trafficking and terrorism draw the greatest attention, increasingly terrorists are diversifying their illicit activities to reduce risk and increase the dependability of financial flows...[This] occur[s] frequently in conflict zones and regions outside of the control of a central state.(Picarelli *et al.* 2007:52-53)

The link<sup>17</sup> between terrorism and transnational crime is also stressed by the leading scholar William Gilmore:

While terrorist groups may support themselves with funding from illicit and legitimate sources, they ‘process’ these funds -that is, move them from the source to where they will be used- in much the same way that non-terrorist

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<sup>17</sup> “Los islamistas están directamente relacionados con grupos delictivos extremistas de varios países que trafican armas y narcóticos, como se demostró en el 2001 cuando fueron apresados tres miembros del IRA que estaban en Colombia para entrenar las FARC. El caribe permite el ingreso de miembros de Al Qaida, Hamas o Hezbollah sin ninguna cautela gubernamental. La falta de legislación apropiada contra el terrorismo y el lavado de dinero, convierten el lugar en una adecuada base de conspiración. El artículo también habla de que algunos de los conspiradores contra el JFK Aeropuerto provenían de Guyana, Trinidad y Tobago. Otros terroristas han utilizado Surinam, Panamá y Honduras. For further discussion , see: *Brechmer, J. (2007). Un frente extremista cerca de Estados Unidos?: Terroristas del Caribe.El Comercio. Lima: A3.* Decreasing state sponsorship for terrorism in the post-9/11 environment has pressed terrorist groups to find alternative sources of financial support. Some groups have created their own "in-house" criminal capabilities, for example FARC, the LTTE, and Al Qaida. Several analysts have argued that this "mutation" in organizational form may lead terrorist groups to ally with organized crime, whereas others have suggested that distinct organizational and ideological differences between the two will preclude cooperation. Drawing on both accounts, it is argued in this article that the degree of a terrorist group's organizational capacity and need are key predictors of the types of crime they will engage in, while ideological (political) distinctiveness will preclude fully symbiotic cooperation between terrorists and organized crime groups. See, *Hutchinson, S. et al.(2007). "A Crime-Terror Nexus? Thinking on Some of the Links between Terrorism and Criminality " Studies in Conflict & Terrorism 30(12): 1095-1107.*

criminal groups launder funds...Experts continue to find that there is little difference in the methods used by terrorist groups or criminal organizations in attempting to hide or obscure the link between the source of the funds and their eventual destination or purpose (Gilmore 2004).

In the article, *Transnational Terror and Organized Crime*, the author introduced the idea of “*the growth of weak and failing states exacerbates this tendency [the nexus].*” (Sanderson 2004:51). The absence of the rule of law in places such as Somalia, Kosovo, and Afghanistan provides ideal conditions for the blending of criminal and terrorist activities.

In the article, *The Turbulent Nexus of Transnational Organized Crime and Terrorism: A Theory of Malevolent International Relations* the author describes the categories of the nature of interactions between organized crime and terrorism proposed by scholars (Mackarenko, Dishman, and Williams). Among the contributions of this paper, the following statement should be highlighted : “*Such groups are likely to focus on short-term marriages of convenience wherein potential mutual benefits outweigh increased exposure to risk.*” (Picarelli 2006:3)

The objections to the crime-terror nexus arise from international relations experts, and some political analysts (Hoffman, Naylor); both of them remain pessimistic about a nexus, stating simply that criminal groups commit economic crime to make money while terror groups see crime as one of a number of mechanisms for earning money.

#### **2.2.2.1. The Main Common Aspects of Transnational Crime and Terrorist Groups Financing**

Similarities between Transnational Crime and Terrorist Groups are fully described by Sanderson (2004); Schelley (2007), Wilkinson (2005); Makarenko (2002) and (2003).<sup>18</sup>

- Both are generally rational actors.
- Both use extreme violence and the threat of reprisals.
- Both use kidnappings, assassinations, and extortion.

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<sup>18</sup> See : Shelley, L (2005) "The Nexus between Terrorism and Organized Crime": 29-33; Makarenko (2003) ;and Sanderson, T. M. (2004). "Transnational Terror and Organized Crime: Blurring the Lines." *Sais Review* XXIV(1): 49-61.

- Both operate secretly, though at times publicly in friendly territory.
- Both defy the state and the rule of law (except when there is state sponsorship).

The issues of transnational crime, Money Laundering, and the financing of terrorism have the following common aspects:

- They can use wire transfers to move money through multiple jurisdictions.
- They engage in a variety of criminal activities: For me the line may separate drug traffickers, criminal syndicates, and terrorist groups. However, the line is now becoming less defined, since terrorists often resort to crime and cooperate with criminals in generating money, obtaining arms and explosives<sup>19</sup>, and when moving operatives. Criminals are not averse to using terrorism tactics and random violence in pursuits of revenues.
  - Trade based: Drug trafficking<sup>20</sup> arms trafficking, trading in precious stones and other commodities, trafficking in humans
  - Smuggled cash, cigarettes
  - Counterfeit money, goods
  - Extortion, kidnapping
  - Crime already committed
  - Money is proceeds and may be evidence
- They benefit from: Shell companies, offshore bank facades. I note here some examples of the methods the international terror organizations use to move money. Money Laundering experts<sup>21</sup>, for instance, say that both groups use a technique known as a ‘starburst’: A deposit of dirty money is made in a bank with standing instructions to wire it in small, random fragments to hundreds of other bank

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<sup>19</sup> Zuloaga, J et al. (2003). Un arrepentido de la Mafía Identifica a los etarras que iban a comprar armas a la "Camorra" a cambio de droga. La Razón Digital. and Antezana Debemos desarticular el narcoterrorismo. Expreso.

<sup>20</sup> “The most common criminal activity terrorist groups have been involved in is the illicit drug trade. Since the 1970s groups such as FARC, Basque Fatherland and Liberty (Euzkadi Ta Askatasuna - ETA), the Kurdistan Workers Party (Partiya Karkaren Kurdistan - PKK) and Sendero Luminoso have all been linked to the drug trade by well-documented evidence. Since the early 1990s additional groups such as Hizbullah and the IMU have also realised the financial utility of participating in the illicit drug trade. It is alleged that Hizbullah continues to protect heroin and cocaine laboratories in the Bekaa Valley; and evidence strongly indicated that the IMU - prior to the Afghan campaign - controlled drug trafficking routes into Central Asia from northern Afghanistan”. See: *Makarenko, T. (2003) "A model of terrorist-criminal relations." Jane’s Intelligence Review*.

<sup>21</sup> See: *Schnneider (2003); Savona (2001)and (2002); and Masciandaro (2003)*.



accounts around the world, in both onshore and offshore financial centers (OFCs)<sup>22</sup>. Tracking down the money becomes very difficult, since getting legal permission to pursue bank accounts in multiple jurisdictions can take years. Napoleoni explains, “You build a long chain of representative offices at the end of which there is a shell company register offshore. You are lucky if you get to the end of the chain. Financial investigations often run into a blind alley always through, somewhere, in a tiny offshore office” (Napoleoni 2005).

#### 2.2.2.2. The Main Differences between Transnational Crime and Terrorist Groups Financing

By being aware of the differences existing between them, it is possible to make a clear distinction in the roots and operational characteristics:

- Terrorist Financing

Relevant scholars explain terrorism through religion, development or socio-political causes, and even the economy is always important. (Napoleoni, Krueger)

Typical operational characteristics of Terrorist Groups are:

- Low costs/low technology of enabled some recent attacks with a great impact on human lives, States, and Economies (e.g., 9/11 New York, Madrid, Beslan, London, and New Delhi).
- Flexible and decentralized organizations with independent decisions and actions.
- Common ideology with indiscriminate targets (no purpose related to profit).
- Different offences, albeit using similar circuits according to SC Res 1373 (2001).
- Money is needed to plan and execute future terrorist attacks; there is a need to hide assets.

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<sup>22</sup> See: *Martin, P. (2006)*. El juez investiga pagos a ETA en paraísos fiscales. *El Periodico*. ; *Masciandaro, D. (2004)*. *Global financial crime : terrorism, money laundering and offshore centres*. Aldershot, Hants, England ; Burlington, VT, Ashgate.; and *Maurus, V. (2001)*. L' argent noir du terrorisme. *Le Monde*. Paris. p .13 le dossier includes *Pomonti, JC.*”L’ invisible présence d, AL-Qaida en Asie du Sud-Est”, p.12; *Follorou, J* ”L’ enquete sur la nébuleuse Ben Laden piétine”, p.12; *Sterm, B* “La communauté internationale démunie”, p.13 ; *Inciyan, E*, “Les talibans se privent des revenus de la drogue”, p.13; *Roche, M* “Des paradis exotiques épinglés”. Et “Rarotonga, refuge des escrocs”, p.14 ”Guernesey, l, arrière-cour de la City”, p.15,”La City FACE aux excès de l’islamophobie”, 16-17,” Des bureaux de change providentiels”, P17;*Ricard, P*, “Le Liechtenstein sous haute surveillance”, p.14 ; *Decamps, MC* “Gibraltar veut se blanchir”p.15: *Besson, S* ” La Suisse craint pour son secret”, p.16; *Stroobants, JP*, “Le Luxembourg joue les bons élèves”, p.17;*Lucien, G* ” Beyrouth n’est plus ce qu’elle était”, p.17; La lutte contre le blanchiment”, Interviews with *Fulgueras, AJ* (by J.Follorou), Colin Powell (by Roche, M) et de René Back (par Santi,P), p.18.

- Self-financing with possible criminal activities but also obtaining money from legal sources (e.g., donations and charity organizations). Terrorists turn to different sources of money, depending on their motivations, their mode of operations, and the resistance they face from law enforcement. If so, the money starts off clean, becoming 'dirty' only when the terrorist crime is committed later on. Furthermore, these flows may use the underground banking system. This makes it almost impossible for the authorities to trace or spot this money.
- Terrorist enterprises use clean money to commit crimes. The money sometimes consists of legally obtained resources that are used for a limited period of time and of smaller amounts of money to prepare attacks.
- Money Laundering
- The main characteristic of Money Laundering is to make dirty money appear legal. funding is derived from criminal activities, and it usually involves a very large sum of money. The investigations are launched in order to prosecute criminals and seize assets.

### **2.3. The Effects of the Country's Attractiveness for Money Laundering**

The major substantive research on the effects of the country's attractiveness for Money Laundering are summarized in (Unger 2006:136-137), in which she identifies 25 effects of Money Laundering in each country. Only those aspects that affect the country's attractiveness for Money Laundering and which are related to the link between Money Laundering and terrorism will be highlighted in this work.

#### **2.3.1. The Country's Attractiveness for Money Laundering**

There are several effects of country's attractiveness for Money Laundering on real sector, public sector, on monetary economy and financial sector, social effects, political institutions, and the effects on terrorism. The effects of Money Laundering that are the most relevant for the scope of this dissertation will be presented here.

- Money Laundering can be regarded as a multiplier of criminal activities, facilitates crime by capacitating crime groups and networks to self-finance, diversify, and grow (Levi 2002:183)and (Masciandaro 2004:135-163)
- Increasing in terrorism (Baldwin 2002);(Schneider 2003).

- Illegal business contaminates legal business. (Quirk 1997:4)
- Distortion of the investment in the real estate sector. The Real estate sector is the largest in value and highly non transparent, which makes it very susceptible to Money Laundering.
- Changes in imports and exports (it is very likely that criminal activities and Money Laundering mix with regular export and import business). This issue is broadly developed in section 2.4.4.2. Bartlett (2002); FATF-GAFI (2006a).
- Higher capital inflows and outflows in jurisdictions . (Walker)
- Changes in foreign direct investment.
- Risk for the financial sector, solvability and liquidity.
- Money Laundering promotes corruption and bribery not only in financial institutions. Laundering needs lawyers and notary publics who cooperate. These institutions and professions become an important to fight the financing of terrorism (Bartlett 2002:2); FATF-GAFI (2002a) , Schroeder (2001) and (Quirk 1997:8).
- Distortion of economic statistics. Some estimates on false statistics for a shadow economy are available but not for Money Laundering. Quirk (1997);(Tanzi 1997)
- Undermining political and democratic institutions. (Tanzi 1997:99)
- Undermining foreign policy. Backer (1999)

Regarding these important effects of countries' attractiveness for Money Laundering, the present dissertation considers testing the correlation between the level of overall compliance by jurisdictions with the AML/CFT Regime and the index of a Country's Attractiveness to Money Laundering. First Walker in 1999 and later Unger in 2006 developed an index of how attractive countries are for Money Laundering. The last index fits perfectly into my research for testing the aforementioned correlation. The index provided by Unger in the aforementioned study has been used as a measure of countries attractiveness for Money Laundering. For a further discussion of the Index of Country Attractiveness, see Chapter 5.

### **2.3.2. The Major Money Laundering Countries**

The best approach attempted to identify the major Money Laundering countries and provide specific information about each is the yearly International Narcotics Control Strategy Report (INCSR). These reports, representing a United States perspective,

nonetheless constitute the most comprehensive work to gather data on how countries have taken some actions related to Money Laundering.

During the conference presenting the 2006 International Narcotic Strategic Report, Ambassador Anne Patterson<sup>23</sup> emphasized: *"Today, the international community understands that drugs and crime are a problem which we all face and we also recognize the insidious links of the drug trade to Money Laundering, Terrorist Financing and organized crime."*

Every year the US government and its agencies that work with Money Laundering meet to assess the Money Laundering in 200 jurisdictions. The evaluation includes the assessment of financial transactions in the country's financial institutions that involve proceeds of serious crime, steps taken or not taken to address the financial crime and Money Laundering, each jurisdiction's vulnerability to Money Laundering, the conformance of its laws and policies to international standards, the effectiveness with which the government has acted, and the government's political will to take actions.

The second volume of the INCSR, devoted to Money Laundering and Terrorist Financing, describes the status of these activities in more than 130 countries, as well as these countries' efforts to improve anti-Money Laundering and counterTerrorist Financing Regimes. Of special interest is the jurisdictional table which divides 195 countries, including the United States, into categories of primary concern, concern and others. No official sanctions are taken against countries based on their designations, but many companies review the designations when considering future business relationships.

In this dissertation, The International Narcotic Strategic Country Report (US 2006) was chosen to get a first approach of the Money Laundering situation in 199 jurisdictions according to INCSR methodology. Due to the current ability of money launderers to perpetrate financial crime and to use the global financial system, this makes every jurisdiction a potential center for Money Laundering. First of all, a checklist of characteristics that makes the financial system vulnerable according to INCSR criteria will be provided below. It is very important to remark that a part of this list of vulnerabilities

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<sup>23</sup> See Anne W. Patterson, Assistant Secretary for International Narcotics and Law Enforcement Affairs; On-the-Record Briefing; Release of the 2006 International Narcotic Control Strategic Report. Washington, DC: <http://www.state.gov/p/inl/rls/rm/62413.htm>

are considered to be the core of FATF Recommendations. The vulnerabilities of jurisdictions to Money Laundering according the INCSR are summarized as follows:

- Failure to criminalize Money Laundering for all serious crimes or limiting the offence to narrow predicates.
- Rigid bank secrecy rules that obstruct law enforcement investigations or that prohibit or inhibit large value and/or suspicious or unusual transaction reporting by both banks and non-bank financial institutions.
- Lack of or inadequate “know your client” requirements to open accounts or conduct financial transactions, including the permitted use of anonymous, nominee, numbered or trustee accounts.
- No requirement to disclose the beneficial owner of an account or the true beneficiary of a transaction
- Lack of effective monitoring of cross-border currency movements.
- No reporting requirements for large cash transactions.
- No requirement to maintain financial records over a specific period of time.
- No mandatory requirement to report suspicious transactions or a pattern of inconsistent reporting under a voluntary system; lack of uniform guidelines for identifying suspicious transactions.
- Use of bearer money instruments.
- Well-established non-bank financial systems, especially where regulation, supervision, and monitoring are absent or lax.
- Patterns of evasion of exchange controls by legitimate businesses.
- Ease of incorporation, in particular where ownership can be held through nominees or bearer share or where off-the shelf corporations can be acquired.
- No central reporting unit for receiving, analyzing, and disseminating of information to the competent authorities on large value, suspicious or unusual financial transactions that might identify possible Money Laundering activity.
- Lack of regulatory controls of a weak bank, or failure to adopt or adhere to the Basel Committee’s Core Principles for Effective Banking Supervision, especially in jurisdictions where the monetary or bank supervisory authority is understaffed, under-skilled or uncommitted.

- Well-established offshore financial centers or tax-haven banking systems, especially in jurisdictions where such banks and accounts have minimal background investigations.
- Extensive foreign banking operations, especially where there is significant wire transfer activity or multiple branches of foreign banks, or limited audit authority over foreign assets.
- Jurisdictions where charitable organizations or alternate remittance systems, because of their unregulated and unsupervised nature, are used as avenues for Money Laundering or Terrorist Financing.
- Limited asset seizure or confiscation authority.
- Limited narcotics, Money Laundering and financial crime enforcement and lack of trained investigators or regulators.
- Jurisdictions with free zones where there is little government presence or other supervisory authority.
- Patterns of official corruption or a laissez-faire attitude toward the business and banking communities.
- Jurisdictions where the U.S dollar is readily accepted, especially jurisdictions where banks and other financial institutions allow dollar deposits.
- Well-established access to international bullion trading centers in New York, Istanbul, Zurich, Dubai, and Mumbai.
- Jurisdictions where there is significant trade in or export of gold, diamonds, and other gems.
- Jurisdictions with large parallel or black market economies.
- Limited or no ability to share financial information with foreign law enforcement authorities.

When furthering the explanations regarding the vulnerabilities to attract Money Laundering, the report provide us with three country classifications:

- Primary Concern Group: This concept involves, “the major Money Laundering countries includes all countries and other jurisdictions whose financial institutions engage in transactions involving significant amounts of proceeds

from all serious crime”. This analysis includes the significance of the amount of proceed laundered<sup>24</sup>.

- The two remaining groups are: Concern Group and Other Countries Group.

Within the 58 countries and jurisdictions considered of Primary Concern for Money Laundering in this report, the countries included in our cross section analysis represents 30% of the most vulnerable countries in the world when it comes to Money Laundering. The following list includes:

Australia, Spain, Switzerland, Turkey, Colombia, China, The Dominican Republic, Greece, Hungary, Italy, Latvia, Panama, Paraguay, Panama, Paraguay, United Kingdom, USA and Uruguay.

It should be mentioned that in the case of The United States and the UK, they can have comprehensive anti-Money Laundering laws on its books and have done important Anti-Money Laundering efforts, but in these cases the classification could be made as a function of the size of the economy. This dissertation takes into account the importance of the size of the economy in each country/jurisdiction in the implementation of anti-Money Laundering regulations. In this work, the size of the economy will be defined by indicators related to the size of the financial system and linked to areas of the financial system where the Money Laundering and Terrorist Financing have been taking advantage.

For this reason, independent variables capturing the size of the financial were included in this order to establish the correlation between the overall compliance by jurisdiction with the AML/CFT Regime and the size of the financial system of every country. Different indicators of the size of the financial system has been selected such as BankDeposits/GDP(SBFS), Financial System Deposit/GDP(SFSD) as well as the Life Insurance/GDP(SLI), Non Life Insurance/GDP(SNLI), Cross Border Financial Assets/GDP (2005) (COBAS), Cross Border Financial Liabilities/GDP (2005)( COBLI).

More explanations concerning the size of the financial system are presented in chapter 5.

The Money Laundering group '*concern*' has 63 countries in the official report. In our cross section analysis 14 of these countries are included, which comprise 22% of the total number of countries and jurisdictions considered by INCSR. These 14 countries are:

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<sup>24</sup> E.g., The United States and UK can have comprehensive anti-money laundering laws on its books and have done important Anti-Money Laundering efforts. In these cases, the classification could be done as a function of the size of the economy.

Albania, Bahrain, Belarus, Belgium, Bolivia, Chile, Gibraltar, Ireland, Jamaica, Peru, Syria, Vanuatu, Samoa and Slovakia.

Among the 81 countries and jurisdictions considered in the '*other*' countries group of the INCSR list, countries such as Brunei, Mauritania, Denmark, Fiji, Georgia, Iceland, Lithuania, Nepal, Norway, Slovenia, Sri Lanka, and Sweden, are included. These countries represent the 15% of the total other countries reported by INCSR.

To conclude, the results of the International Narcotics Strategy Country report provide the methodology that allows you to see which countries are least compliant, and what areas of Money Laundering that make it hardest to be compliant. A quantitative approach has been used to evaluate the actions taken by 199 governments in the 16 topics related to Money Laundering and Terrorist Financing, according to the International Narcotics Strategy Country Report 2006. (INCSR 2006)



Table 2.1. Actions Taken by Jurisdictions following the International Narcotic Country Strategy Report  
 .Profile of Overall compliance with Money Laundering Principles in 2006

| <b>Actions taken by government</b>                 | <b>N</b> | <b>Non Compliant</b> | <b>Non Compliant %</b> | <b>Compliant</b> | <b>Compliant %</b> |
|--|----------|----------------------|------------------------|------------------|--------------------|
| <b>Criminalized Money Laundering</b>               | 199      | 18                   | 9                      | 181              | 91.0               |
| <b>Criminalized Beyond Drugs</b>                   | 199      | 31                   | 15.6                   | 168              | 84.4               |
| <b>Record large Transactions</b>                   | 198      | 65                   | 32.8                   | 133              | 67.2               |
| <b>Maintain Records Over time</b>                  | 199      | 20                   | 10.1                   | 179              | 89.9               |
| <b>Report Suspicious Transactions (NMP)</b>        | 199      | 26                   | 13.1                   | 173              | 86.9               |
| <b>Financial Intelligence Unit</b>                 | 198      | 99                   | 49.7                   | 100              | 50.3               |
| <b>System for Identifying Forfeiting Assets</b>    | 198      | 35                   | 17.7                   | 163              | 82.3               |
| <b>Arrangements for asset sharing</b>              | 197      | 135                  | 68                     | 62               | 32.0               |
| <b>Cooperates w/ International Law Enforcement</b> | 193      | 44                   | 22.8                   | 149              | 77.2               |
| <b>International Transportation of Currency</b>    | 198      | 82                   | 41.4                   | 116              | 58.6               |
| <b>Mutual Legal Assistance</b>                     | 198      | 36                   | 18.2                   | 162              | 81.8               |
| <b>Non-bank financial Institutions</b>             | 199      | 60                   | 30                     | 139              | 61                 |
| <b>Disclosure Protection “Safe Harbor”</b>         | 197      | 47                   | 23.9                   | 150              | 76.1               |
| <b>State Party to 1988 UN Convention</b>           | 199      | 11                   | 6                      | 188              | 94                 |
| <b>Criminalized Financing of Terrorism</b>         | 199      | 78                   | 39.2                   | 121              | 60.8               |
| <b>Internat'l Terrorist Financing Convention</b>   | 198      | 58                   | 29                     | 141              | 71                 |

Source: Author's calculations using INCSR 2006 data

The quantitative analysis above permits us to show empirical evidence for the level of measures implemented. This first evaluation of general observance on Money Laundering and some actions on Terrorist Financing shows the existence of important loopholes of Money Laundering and Terrorist Financing in areas such as Financial Intelligence Unit, Arrange for asset sharing, Criminalized Financing of terrorism, and transportation of currency. The results of the exploratory research that will be achieved in this dissertation will make it possible to confirm these previous results.

## **2.4 The Terrorist Financing Sources, Mechanisms, and Policy Dilemmas**

This section describes the sources that financially feed terrorist networks as well as the mechanisms and the Dilemmas posed by them for the International Organization.

### **2.4.1. The Legitimate Sources of Terrorist Financing**

Not all the financing received by terrorist comes from illegal activities as stated in the previous section. The legitimate financing is related to completely legal activities conducted by charities, diaspora, and firms. The 9/11 commission pointed out a core number of financial facilitators involved in raising, moving, and storing the money Al Qaeda used for its raised funds – from donors primarily in the Gulf Region but also from other countries around the world. Using bogus and legitimate charities and businesses as covers to develop a substantial financial network (Comras 2007). Let us consider each in turn.

#### **2.4.1.1. State Sponsors**

Afghanistan (Drug Trafficking) and Sudan (it has been proven that the majority of companies and banks used by Bin Laden were located in Khartoum, Sudan such as Faisal Islamic Bank, Ladin International, Taba Investment Co. Ltd, Al Thamar Al Mubarak, Al Qudarat, Islamic Bank Al Shama) have been sponsoring Terrorist Groups. Here we could include the payments from the richest Arab countries (OPEC) to the poorest ones (Somalia, Sudan, Yemen) during the 80s<sup>25</sup>

"Au Moyen-Orient, dans le Golfe en particulier, Al-Qaeda jouit d'un soutien public, bien que caché, et reçoit l'aide pratique des philanthropes et des fondations islamiques, notamment aux Émirats arabes unis et en Arabie Saoudite. Dans les pays en voie de développement, sa stratégie d'infiltration est liée aux biens et aux services fournis aux musulmans locaux, alors que, dans les

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<sup>25</sup> En 1988, le versement net d' aide publique au développement des donneurs arabes (Arabie Saoudite, Koweït, EAU et autre donneurs arabes) s' est chiffrée à 2.3 milliards de dollars, en 1980 s' est chiffrée en 6.5 milliards de dollars. En 1988 toutefois, la Jordanie était encore de loin le plus important bénéficiaire des versements nets connus des pays arabes. Le Soudan se plaçait en deuxième position. Les autres bénéficiaires relativement importants des versements nets connus au titre de l' aide arabe bilatérale et multilatérale étaient :la Syrie, Yemen, l' Algérie, le Maroc, le Sénégal et les Palestiniens. La guerre du Golfe ayant pris fin et un effort majeur de reconstruction ayant été entrepris en Irak, il est vraisemblable que ce pays deviendra le principal bénéficiaire en 1989. See : ( OCDE 1989:213-216)

démocraties occidentales, Al-Qaeda collecte des fonds, ce qui lui donne aussi l'occasion de recruter" .(Gunaratna 2002:74).

#### **2.4.1.2. Private (individual and corporate) Donors**

Among the most important cases of the private donors involved in Terrorist Financing, here we can point out ‘ *Mr Al Rajhi and family members*’, “*they have been major donors to Islamic charities that are suspected by Western intelligence agencies of funding terrorism, according to CIA reports and federal-court filings by the Justice Department. (...)An endowment holding much of Saleh Al Rajhi’s wealth gives and indication of the scale. Its Web site details nearly \$50 million in direct donations within the kingdom to Islamic causes and at least \$12million in donations abroad. The overseas money went to aid embattle Muslims in Kosovo Chechnya and the Palestinian territories and to finance Islamic instruction.*”(Simpson 2007a:A10).

According to Simpson (2007b), the U.S. Justice Department is investigating possible criminal tax-law violations by a Boston private-equity firm that manages hundreds of millions of dollars for Muslim investors in Europe and the Middle East and is affiliated with a Swiss investment group that U.S authorities suspect of financing Islamic extremists. Some private corporate donors<sup>26</sup> have been cited in Morigi (2004), and furthermore, private individual and corporate donors could be related to those individuals or enterprises that recycled Petrodollars<sup>27</sup> in 1974.

#### **2.4.1.3. Diaspora/Ethnic Communities and Religious Financing**

Al Zaqat<sup>28</sup> is the factor explaining religious financing; it consists in a Coranic tax, explaining the support offered by from the richest to the poorest, and it is obligatory to pay this within the Islamic community, which constitutes the most important religion in the Middle East Countries and in much of Africa. Charity forms a very important part of

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<sup>26</sup> Cases of Private corporate donors related to Terrorist Financing can be found in: *Simpson, G. (2007b). U.S. investigating firm tied to Muslim investors. The Wall Street Journal: 1-2* ; and *Simpson, G. (2007a). U.S tracks Saudi Bank Favored by Extremists. The Wall Street Journal. New York: A10.*

<sup>27</sup> See further explanations of Petrodollars in: *Fried et al. (1975). Higher oil prices and the world economy : the adjustment problem.* Washington, Brookings Institution: 197-226 and *Chamorro, S. (1974). "El reciclaje de los fondos de los países de la OPEP." Información Económica Española 495: 37-39.*

<sup>28</sup> See further explanations of Al Zaqat in: *Warde,I.(2000). Islamic finance in the global economy.*Edinburgh, Edinburgh University Press.

Muslim law and tradition. Al Qaeda took advantage of it to solicit funds through collection boxes at mosques and Islamic centers (Comras 2007:119):

“Al Qaida est établi dans la plus part des pays à travers les communautés musulmanes indigènes ou inmigrées ; son infiltration est évidente là où vivent et travaillent des musulmans. Il est impossible d’opérer isolé, car le montage d’une opération terrorist exige soutien financier, technique et logistique qu’il faut souvent mettre en place des années à l’avance”. (Gunaratna 2002:74)

Also The Mosque Network seems to provide financial support for the Jihad, as remarked by Napoleoni:

“The Mosque Network is as efficient as ever and continues to be the main vehicle through which Islamist organizations, countries, state-shells, armed groups and their sponsors link up and do business with each others”. (Napoleoni 2005:133).

The CIA expressed the extent of NGOs and charities problem in April 2001.

#### **2.4.1.4. Charities**

Donations to NGO’s and charities are perfectly legal in major countries, but the problem arises when the objectives of a specific NGO are not legal or are linked to a diversion of some of the funds legally received for illegal activities, which will be demonstrated in the following section. Authors such as Raphaeli (2003) have highlighted how terrorist organizations have resorted to a variety of charitable as well as front and fraudulent organizations to mobilize resources for terrorists to carry out their campaigns. The author shows us the linkage between charity and terrorism in the case of Enaam Arnaout. Arnaout served in the office of an organization known as Maktab al Khidamat, run principally by Sheikh Abdullah Azzam and Osama bin Laden, for the purpose of providing logistical support to the Mujahideen (holy warriors) who were fighting the Soviet Union in Afghanistan.

He also exposes the purpose of the ‘Islamic Benevolence Committee or LBI, which was to raise funds in Saudi Arabia to provide support for the Mujahideen in addition to fighting in Afghanistan and covering fighters that were travelling in and out of Pakistan. The LBI was renamed ‘Benevolence International Foundation’ to make the organization more universal and to reduce scrutiny by authorities. Raphaeli presents a list of activities in which Arnaout and BIF were engaged between 1992-2001 according to the prosecutor:

- Delivering, assembling, and operating a satellite telephone to be used in Afghanistan.
- Producing videotapes depicting fighters in Bosnia-Herzegovina, eulogizing dead fighters, and soliciting donations.
- Delivering an X-ray machine and currency from the BIF to Chechen Mujahideen.
- Transferring approximately \$1.4 million from a Swiss Bank to the BIF checking account in the United States. These funds were commingled with donations.

In 1993, in conversations with former senior Al-Qaeda lieutenant Jamal Ahmed Al-Fadl, Osama Bin Laden identified several prominent international Muslim Charities as the primary sources of Al-Qaeda financial and fundraising activity.

Entire charities under the control of Al-Qaeda operatives....may have wittingly participated in funnelling money to Al-Qaeda...that such charities had provided significant cover...enabling Al-Qaeda operatives to travel undetected (US 2004-The 9/11 Commission Report-: 170-171).

In the work *The Role of Islamic Charities in International Terrorist Recruitment and Financing* the author notes that a number of sympathetic NGOs provided various kinds of assistance, which proved to be invaluable in the long term struggle and in explaining the roots of support of contemporary radicalisation.

The IHH is an NGO, but it was kind of a type of cover-up....in order to obtain forged documents and also to obtain different forms of infiltration for Mujahideen in combat. And also to go and gather (recruit) these Mujahideens. And finally, one of the last responsibilities that they had was also to be implicated or involved in weapons trafficking. ” (Kohlmann 2006:18)Following the 9/11 arrests and prosecutions<sup>29</sup> of senior leaders

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<sup>29</sup> According to *Eaton, L. (2007). U.S. Prosecution of Muslim Group ends in Mistrial. New York Times*. New York.: A federal judge declared a mistrial on October, 23 2007 in what was widely seen as the government’s flagship terrorism-financing case after prosecutors failed to persuade a jury to convict five leaders of a Muslim charity on any charges, or even to reach a verdict on many of the 197 counts. David D. Cole, a professor of constitutional law at [Georgetown University](#), said the jury’s verdict called into question the government’s tactics in freezing the assets of charities using secret evidence that the charities cannot see, much less rebut. When, at trial, prosecutors “have to put their evidence on the table, they can’t convict anyone of anything,” he said. “It suggests the government is really pushing beyond where the law justifies them going.”And Jimmy Gurulé, who was an under secretary of the Treasury when that agency froze Holy Land’s assets, described the outcome as “the continuation of what I now see as a trend of disappointing legal defeats” in terror-financing cases. Two previous cases, in Illinois and in Florida, ended with hung juries and relatively minor plea deals, he said.

from the Benevolence International Foundation (BIF) and other designated entity, the Global Relief Foundation (GRF) appears to have fatally crippled both of those organizations. Yet, the counter-example of former BIF Public Relations officer Halil Demir should serve to underscore that unless all of the significant bad actors present within a given NGO are prosecuted by authorities, remaining staff members are likely to immediately resurrect a would-be charity with a new identity and simply resume.

#### **2.4.1.5. Legal Businesses**

The truly transnational financial engine of the Al Qaeda terrorist group and its sympathizers continue to raise money through their own business activities. The legal business support to terrorist activities is noted by Napoleoni (2005), Guharatna (2002), Schneider (2004), and Comras (2007). The group consists of the following companies among others:

In Africa, a holding company, Wadi al Aqiq, a Sudanese construction firm, Al Hiraj, an ostrich farm and shrimp boats in Kenya; in the Middle East, shares in the Al-Shamil Islamic Bank and large tracks of forest in Turkey; in Asia, agricultural holdings in Tajikistan; in Europe and the United States, holding companies, venture capital firms, banks and import-export companies....The portfolio includes real estate in London, Paris and French Riviera; dairy businesses in Denmark; wood and paper industries in Norway; and hospital equipment in Sweden (Napoleoni 2005-167)

Some scholars paid attention to the use of trusts by terrorists groups: *"The use of networks of companies and shell companies, shell banks, and offshore trusts to raise money, hide assets, and protect their identity of other financial contributors."*(Comras 2007:124)

#### **2.4.2. The illegal sources of Terrorist Financing**

This section describes what kind of illegal sources are used by terrorist networks beyond drug trafficking.

#### **2.4.2.1. Drug Trafficking<sup>30</sup>**

In May 2002 the report called *Global overview of Narcotics-funded Terrorist and other extremist groups* was launched, prepared by the Federal Research Division of the Library of Congress and the US Department of Defence. The report examined connections between extremist groups and narcotics trafficking in the following regions of Latin America: Triborder Region (Argentina, Brazil, and Paraguay), Colombia, and Peru; the Middle East: Lebanon; Southern Europe (Albania and Macedonia); Central Asia: Kyrgyzstan, Tajikistan, and Uzbekistan and East Asia: The Philippines. All the groups under study have been designated foreign terrorist organisations by the U.Ss Department of State.

#### **2.4.2.2. Oil smuggling**

Oil Smuggling<sup>31</sup> is another business where terror, criminal, and legitimate economies interact according to Johnson (2001), Napoleoni (2005).

Other countries [further Iraq] where oil smuggling is a significant problem are Thailand, China, Russia, Cambodia, Iran and Tanzania. In all these countries oil smuggling means that valuable tax revenue is lost and smugglers and government officials earn for themselves significant profits, a substantial portion of which enters the laundering cycle. (Johnson 2001:123)

Oil smuggling is also related to arms trade and this relationship is described below.

#### **2.4.2.3. Arms-Diamonds Trafficking**

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<sup>30</sup> For further explanations of drug trafficking, see special reports provided by UN (2004b). Droga, crimine e terrorismo con approfondimenti su : Marocco, I paesi Andini, Afghanistan. Giornate per la Cooperazione Italiana, Milano, Office on Drugs and Crime.

<sup>31</sup> For further explanations of oil smuggling, see: Johnson, J. (2001). "In Pursuit of Dirty Money: Identifying Weaknesses in the Global Financial System." Journal of Money Laundering Control 5(2): 122-133

Drug trafficking, arms trafficking, and diamonds trade<sup>32</sup> are all some of the most important illegal sources of funding of terrorist groups. The illicit arms trade problem involves how comparatively easy it is to obtain false documentation accompanying arms shipments, especially end-user certificates. Inconsistent documentation requirements between states, and inefficient control in customs and port authorities in many states, have created an environment in which the illicit arms trade does not need to rely entirely on illicit arms trafficking.

Makarenko in her work *Tracing the dynamics of the illicit arms trade* shows:

- When a state is involved in supplying arms to an embargoed state, payments often come in the form of commercial payments, such as an oil-for-arms deals to avoid bank involvement.
- When an arms broker supplies an embargoed state or an insurgent/terrorist group, banks are often used because shipments are usually paid for in the form of letters of credit or by the direct transfer of hard-currency funds. In this case, Money Laundering becomes an important factor to ensure that the final arms destination is disguised. *“It is at this point that offshore banks play an important role because their facilities can ensure that any deposit or transfer is routed via several intermediary institutions; and deposits or transfers can be conducted in the name of a series of shell companies. Both of these techniques are used to hide the financial trail behind multiple administrative layers, giving much required additional security to the arms deal .”*(Makarenko 2003)

In situations where access to normal banking channels is very difficult (for example, as with most non-state actors), the financing of arms deals often takes a different form, most often through commodity exchanges. For example, illicit arms transfers to Liberia and Sierra Leone were often financed with diamonds and timber concessions. The Revolutionary United Front were believed to spend a vast proportion of the \$30-50

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<sup>32</sup> “Of further interest where transparency and accountability are concerned, is the question of who actually monitors imports and exports[diamonds] on behalf of the Belgian government. Oddly, this role is carried out largely by the HRD itself, the representative and lobbying institution for the Belgian diamond industry. In recent years there have been a number of judicial inquiries which have shown that the overall system violates almost any definition of neutrality, and is an invitation to corruption. Cases of fraud in the Antwerp diamond trade are legendary and Antwerp has become one of the primary world centres for Russian organized crime. (...)In 1997, DiamondWorks’ Sierra Leone country manager was seconded - as a ‘private citizen’ - to Sandline, in connection with a controversial arms shipment intended for the briefly exiled government of Tejan Kabbah.” See, *Smillie et al. (2000). The Heart of the Matter: Sierra Leone, Diamonds and Human Security*. Ontario, Partnership Africa Canada.



millions they earned from diamonds on arms imports - often as direct exchanges. Arms to Latin America, on the other hand, appear to be financed with coffee and minerals; however, they are often exchanged with cocaine shipments.

#### **2.4.2.4. Failed States Fuelling**

The weaker or more diluted counter-terrorism financing action is likely to be found in some failed states. Rotberg and Winer have expressed their concern about the relationship between failed states and terrorism. Despite the assertion that weak or failed states constitute fertile grounds for terrorism, some objections have been made by Newman (2007)<sup>33</sup>. He outlines that yet terrorist groups have nonetheless emerged from, and operated within, countries which have strong, stable states and a variety of systems of government. In accordance with him, terrorist organizations operate in weak and failed states but it is not necessarily the condition of weak or failed statehood which explains their presence. Moreover, it is not necessarily the weakest states which do host such groups; this condition is not a sufficient explanation for their presence. While weak or failed states might provide an enabling environment for certain types of terrorist groups to operate, additional explanatory variables need to be identified.

The link between failed states has been pointed out by The United Nations Monitoring Group (UNMG) states:

Efforts are still required to extend the measures to banks and financial institutions in many parts of the world with lack the resources, capability or political will to replicate such measures.....Al-Qaeda and other terrorist groups are adjusting to the new measures and have concentrated their activities in areas which still lack such effective controls. This includes, but is not limited to, the so-called list of failed or weak States. In fact, no terrorist assets at all have yet been located or frozen in a number of countries where Al-Qaeda is well established and known to operate (UN 2003 Monitoring Group:25).

“The linkages between terrorists and criminals are strongest in conflict zones”  
(Picarelli *et al.* 2007:55).

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<sup>33</sup> For further discussion on the objections against to the link between failed states and terrorism, see, Newman, E. (2007). "Weak States, State Failure and Terrorism." Terrorism and Political Violence 19(4): 463-488

Also, Napoleoni emphasizes that any type of weak state can provide the potential seed to provide tools for armed groups. She gives us examples of failed states such as Colombia, Sri Lanka, Sudan, and these are represented in the dissertation sample.

For this reason, it has been considered vital to establish the correlation between level of compliance with the AML/CFT Regime and a variable capturing the concept of Failed States. The index of failed states provided by ‘Foreign Policy’ in the article: *The states that failed us*” .Peace (2007) will be used to capture this concept. Other indexes were previously analyzed such as: the Polity IV (University of Maryland) and the Penn Index, but they did not fit well into the purpose of this research. For further description of the selected index see chapter 5.

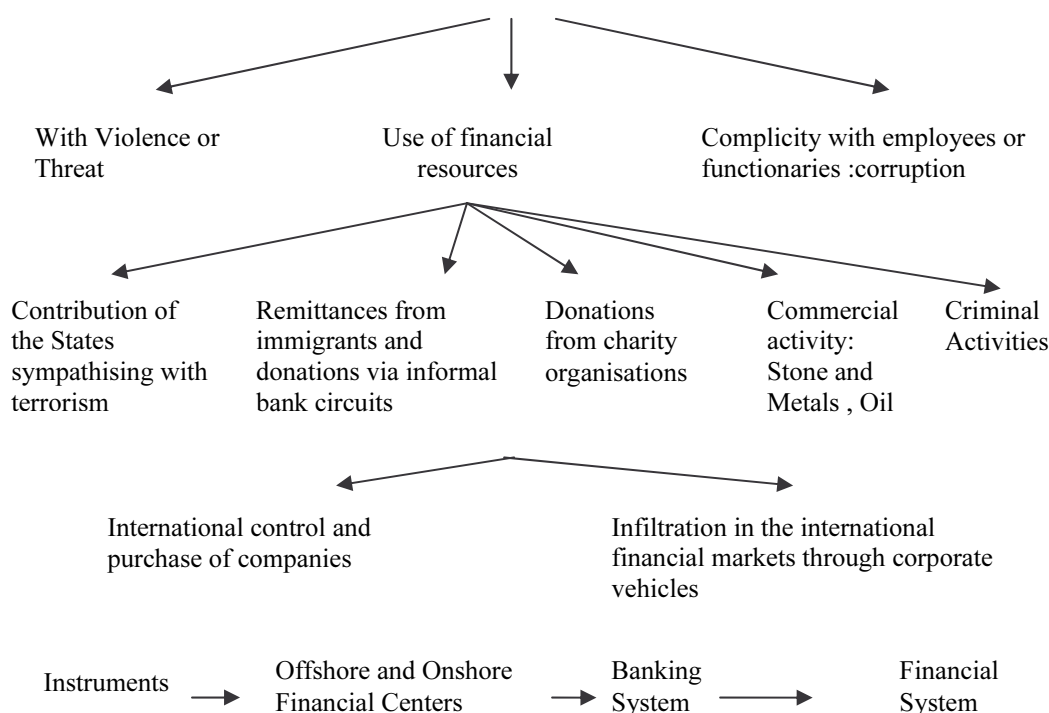
#### **2.4.2.5. Criminal Activities**

According to Williams, *“In some instances, criminal activities are used at a strategic level to provide the overall funding mechanism for the terrorist organization as a whole. Hezbollah supporters or its members have been involved in cross-state cigarette smuggling in the United States, sending the proceeds to the home organization.”* (Williams 2007:83)

Also in Napoleoni (2005), the author remarked the use of a car theft scheme operating in Canada to ship vehicles to Lebanon, which diverted 10 percent of the proceeds of crime to Islamist armed groups. She also emphasizes the ease with which terrorists can obtain false identification or credit cards and later to open accounts.

To summarize section 2.4.2., Figure 1 shows the infiltration of the Transnational Terrorism in the Economy according to the explanations provided in this chapter.

**Figure 1: Infiltration of the Transnational Terrorism in the Economy**



Source: Author

### 2.4.3. The Mechanisms: The Informal Transfer System

Especially during the 1990s, international concern grew over the ‘*underground banking*’ and its abuse by serious offenders. Some academic works by Williams(2007) and Savona (1997) and later Al-Qorchi(2003) have explained how informal systems operate, including their risks. The Informal Value Transfers Systems (IVTS) changes from region to region (Hawala, Hundi, BMPE, Padala, door-to door). Some scholars and IOs reports such as Passas, FATF-GAFI (2001), and FATF-GAFI (2003) contend that hawala is vulnerable to criminal abuse, and like the other financial institutions, there is evidence that money derived from drug trafficking, illegal arms sales, body part trade, corruption, tax evasion, and all kinds of fraud have indeed moved through Hawala networks. This still takes place even though there is a lot of literature about Hawala, such as Nikos Passas explanations in (IMF 2005a:10-12), concerning the need for a regulation of the Hawala system. He provides clear regulatory objectives and challenges and the risk of unsuccessful regulation.

The crime-control objectives are to:

- Achieve more transparency by identifying operators and clients and by enhancing the traceability of transactions, aiding.
- Provide a measure of deterrence and prevent abuses of funds from transfer networks.
- Prevent the financing of terrorist operations.
- Collect intelligence and monitor the activities of criminal groups and extremists.

The economic regulatory objectives aim towards:

- Diminishing the cost of remittances.
- The increase of the formal remittance options.
- Ensuring compliance on money transfer services.

Nikos Passas stresses the risks of an unsuccessful regulation of informal remittances. Here one should remark not only the collateral effects of the reduction of the positive economic effects of labour remittances, but furthermore, due to the strong effort of the international community on naming, shaming, and seizing the assets of suspected supporters, the fact that the criminals and terrorist could shift to less well known informal value transfer methods or get their funds through criminal activities, using uncontrolled informal transfer system to move funds

Since the use of informal systems has been highlighted as the trend in Terrorist Financing, it is very important to establish the correlation between the ratio of informal remittances/GDP in each country and the compliance with the AML/CFT Regime.

.Informal remittance is defined in this work as all types of money transfer services that do not involve formal contracts, and hence are unlikely to be recorded in national accounts. Formal channels include money transfer services offered by banks, post office banks, non-bank financial institutions, and bureaus and money transfer operators such as Western Union and Money Gram. Informal channels<sup>34</sup> include cash transfers based on personal

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<sup>34</sup>“Salgono i timori che i fondi al terrorismo transitino sui conti di trasferimento del denaro degli immigranti (...) L’ Ocse insiste per una maggiore attenzione verso le reti informali in partnership coi Governi”. “I trasferimenti transfrontalieri informali e occulti di denaro dai Paesi d’immigrazione verso i Paesi d’origine potrebbero addirittura rappresentare una cifra superiore ai 125 miliardi di dollari (dati Banca Mondiale) spediti nel 2005 per via ufficiale attraverso banche, poste e money transfer. Le rimesse clandestine pongono ormai un serio problema di sicurezza, come fonte eventualmente troppo facile di finanziamento per il terrorismo”. (*Castellaneta 2005: 5*)

“Italian authorities arrested seven people as part of an international operation to crack down on the laundering of drug money through an informal banking system used by immigrant workers (...) Italian police

relationships through business people, or carried out by courier companies, friends, relatives or oneself.

To estimate informal remittances by countries, the total amount of the remittances has been calculated according to the methodology proposed by Freund and Spatafora (2005). Suggesting that informal remittances in countries with well-functioning financial systems, large, regular users are sent through formal channels. In some countries, especially cash economies with large exchange-rate spreads, the informal sector may be much larger than average in formal economies. According to their model, the informality is most extreme in Sub-Saharan Africa, Eastern Europe, and Central Asia.

#### **2.4.4. Dilemmas**

This section reflects certain uncontrolled areas exploited by terrorist groups which entail a serious dilemma for the effectiveness of the combating the financing of terrorism strategy.

##### **2.4.4.1. Border Control**

To illustrate the dilemmas posed to security by the lack of customs modernization, border security, and export control legislation as integral components in wider counter terror campaigns, one should take into account some case studies such as Central Asia, Europe, and the South American Countries.

In the work, *Trade, Development, and Nonproliferation: Multilevel Counterterrorism in Central Asia*, McAllister *et al* (2007) shows the risks to security in Central Asia posed by radical or terrorists groups:

Uzbekistan is a central case [lack of border controls]. In the Ferghana Valley, where high population density, low average income, and the proximity of a multitude of permeable borders make it a simple matter to traffic in both legitimate and contraband commodities.....Tashkent has already launched efforts to strengthen security along the borders that cross the Ferghana, attesting to the government's awareness that border security is critical to counterterrorism (McAllister *et al.* 2007:446).

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also revealed what they believe is some of the strongest evidence yet that the Hawala system is being used to carry millions of dollars made from the sale of cocaine and heroine". (Michaels 2006:9).

Other transnational threats to Uzbekistan and Central Asia Security as pointed out by the authors are narcotics trafficking and its close links to radical sub-state organizations, which is evident from the following quote:

There have also been instances when border control forces, especially in the Ferghana Valley, one of the poorest areas in Uzbekistan, have succumbed to the lure of money guaranteed from facilitating the narcotics trade. Corruption among the enforcement agencies represents possibly the single greatest challenge to carrying out reform policies aimed at eliminating illicit trafficking. The lack of transparency endemic to corrupt economies undermines the rule of law and any sense of fairness among rank-and-file citizens. Fortifying perceptions that may lead them to extend hospitality to terrorist (McAllister *et al* 2007:448).

The European Union should also be mentioned. In particular, when the borders disappeared, organized crime groups became more aware of the growing possibilities to expand their illegal activities. It became clear to them that the enlargement of the European Union was a golden opportunity to penetrate new economies and abandon the single activity model used up until that moment: “*Traditionally, Organized Crime Groups tended to have one core criminal activity, however it is becoming apparent that some Organized Crime groups increasingly have a wider crime portfolio and a wider geographical spread where the profit potential is the prime mover.*”(Europol 2004:7)

#### **2.4.4.2. Trade**

It has been said that one of the main methods to move money for the purpose of disguising its sources and integrating it into the formal economy has been the physical movement of goods through the trade system. The research carried out in *Trade Based Money Laundering* (FATF-GAFI 2006a), Passas (2004) and Winer (2002) confirm that financial control will never work while trade remains non-transparent. As international trade continues to increase, and the international standards applied to interdict Money Laundering and terrorism finances in the formal economy, the use of trade-based Money Laundering channels can be expected to increase. The study mentioned above suggests that banking supervisors, tax authorities, financial intelligence units, law enforcement agencies, and customs agencies face important challenges to detect the techniques of trade-based Money Laundering.

The attractiveness of the international trade system is associated with:

- Abundant opportunities to transfer value across borders disguised in the enormous volumes of trade flow<sup>35</sup>.
- The complexity of multiple foreign exchange transactions and diverse financing arrangements.
- The limited exchange customs data between countries.
- The limited customs agencies resources to detect illegal trade transactions.

Trade-Based Money Laundering has been analyzed by Baker(2005), the Department of Homeland Security, US Immigration and Customs Enforcement (2005), and all of them point out that ‘Trade-Based Money Laundering’ is defined as the process of disguising the proceeds of crime and moving value crime through the use of trade transactions in an attempt to legitimise their illicit origin. This involves the proceeds of crime which is difficult to track (FATF-GAFI 2006a:3) unlike Tax Avoidance or Capital Flight<sup>36</sup>.

The techniques of trade based money are summarized as follows:

- Over-and-under-invoicing of goods and services can have significant tax implications. Under-invoicing exports are one of the most common trade-based Money Laundering techniques used to move money. It seems the customs agencies generally monitor exports less rigorously than imports.
- Multiple invoicing of goods and services.
- Over-and-under-shipments of goods and services.
- Falsely described goods and services. Research notes that the use of false description can also be used in the trade of services, such as financial advice, consulting service, and market research.
- Complex Trade-Based Money Laundering Techniques as Black Market Peso Exchange Arrangements.

Key findings of the research carried out by FATF revealed:

- Trade-based Money Laundering is an important channel of criminal activity, and it could be vulnerable to Money Laundering and Terrorist Financing.

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<sup>35</sup> See, International Trade Statistics 2005, World Trade Organization. The global merchandise trade exceeds more than US\$9 trillion a year, and global trade in services accounts for another US\$ 2 trillion.

<sup>36</sup> For further discussion about the differences between Capital Flight, Tax Avoidance, and Trade-Money Laundering, see FATF-GAFI (2006a). Trade Based Money Laundering. Paris, FATF.

For the services of this construction company, Al-Hiraj, [Bin Laden] he was paid by the government in sesame seeds, which were traded on the international market (Napoleoni 2005:167)

- Trade-based Money Laundering involves the movement of value through financial systems (e.g., cheques, wire transfers) and/or cash couriers. These transactions obscure the money trail and complicate its interdiction.
- Lack of trade data analyses and international sharing of trade data. The majority of financial intelligence units do not receive suspicious activity reports on trade.
- Most Customs agencies, law enforcement agencies, financial intelligent units, tax authorities, and banking supervisors reflect their more limited understanding of these techniques of Money Laundering.
- Most countries recognize the serious concerns when it comes to being vulnerable to the trade based Money Laundering. Most countries recognize the limited measures in place to mitigate these activities.

#### **2.4.4.3. Misuse of Corporate Vehicle**

The use of Shell Companies for Terrorist Financing is well pointed out by Napoleoni (2005) and Comras (2007). The shell companies are considered as corporate vehicles. There is extensive literature about the vulnerability of Corporate Vehicles<sup>37</sup> misuse for ML purposes, despite of the lack of universally accepted definitions or principles regarding control, beneficial ownership and related concepts. Among the main references, we can find the following:

- *Behind the Corporate Veil-OECD Report (2001).*
- *Transparency and Money Laundering-Savona Report (2001).*
- *OECD, Template and options for Obtaining Beneficial Ownership and Control Information 2002.*
- *US Money Laundering Threat Assessment (2005).*
- *US Government Accountability Office Report on Company Formations (2006).*

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<sup>37</sup> Corporate Vehicle: The term “corporate vehicle” as used here has the same meaning as the one provided by the OECD report in the “Behind the Corporate Veil”, embrace corporations, trusts, partnerships with limited liability characteristics, foundations, etc. For further explanations and definitions see the attached glossary in .FATF-GAFI (2006b). The misuse of corporate vehicles, including trust and company service providers. Paris, Financial Action Task Force/OECD.



Corporate vehicles may be used for multiple purposes in the different phases of the Money Laundering process. According to the report *The misuse of corporate vehicles, including trust and company service providers* (FATF-GAFI 2006b:9), the results of this report show that the majority use of corporate vehicle is found when dirty money is inserted into the financial system (placement phase of ML), followed by the second phase when money is moved through various bank accounts. Furthermore, the use of corporate vehicles, the use of specialised intermediaries, and the use of foreign jurisdictions. The most important common issues that arise in the misuse of corporate vehicles in ML from this report are:

- Multi-jurisdictional and/or complex structure of corporate entities and/or trusts.
- Foreign payments without a clear connection to the actual activities of the corporate entity.
- Use of offshore banks accounts without clear economic necessity.
- Use of nominees.
- Use of shell companies.
- Tax, financial and legal advisors were generally involved in developing and establishing the structure.

In this report, despite many different types of corporate vehicles, the results show the legal entity commonly misused is a private limited company with share capital combined with activities in a jurisdiction other than the jurisdiction where the entity was created.

It seems clear that prevention of corporate vehicle misuse for ML and TF could be significantly reduced if the information referred to the ultimate owner, knowledge of the source of assets, and the business objective of the company or if a trust within a structure were readily available. IOSCO and OECD have highlighted that it is very important for competent authorities to be able to co-operate with other competent authorities within and outside their own jurisdiction to share relevant information on beneficial ownership (FATF-GAFI 2006b:17). The best tools to fight against the corporate vehicle misuse seem to be:

- The quality of available information.
- The quality of the “gateway” through which that information can be obtained.

Whether the existing AML/CFT standards are sufficient to discourage the misuse of corporate vehicles shall be revised with the results of the exploratory research in chapter 6. Also, the overall implementation of the specific FATF Recommendations 12, 16, and 24 by 46 countries will be explored to verify if these tools are sufficient as a basis for deterring the corporate vehicle misuse.

#### **2.4.4.4. Risk of Terrorist Financing**

The world security agenda has changed radically since the 1980s. There is no longer a military and State centered perception of security. Fear of armed conflict between countries has been gradually replaced by new concerns such as terrorism and organized crime. In the field of countering terrorism, we are facing a global problem. As stated by Kofi Annan, “All States in every Region - large or small, strong or weak - are vulnerable to terrorism and its consequences”.

Due to the current situation of global terrorist attacks, this makes every jurisdiction a potential victim of Terrorist Financing, from Spain, Germany, London, USA to Sri Lanka, Colombia (,etc).

Furthermore, with the increasing globalization of markets, terrorist groups and organized crime gradually acquire more professional methods and evolve into more complex forms. The result of this mutation translates into a bigger difficulty in detecting illegal activities and in controlling the movements of these groups.

The fact that menaces have varied through time can lead us to affirm that the security environment has objectively changed and that certain elements that used to exist and produce specific effects no longer do so. The fact that any information on the environment that surrounds us is always dependent on the agent’s perceptions of those threats, entails risks.

It would be pertinent to point out the difference in how countries reacted to terrorism on the home front. Following the September 11 attacks, a new policy area – “the homeland security” – comprising intelligence, justice and law enforcement, border and transportation security, infrastructure protection, detection, early warning, anti-terrorism research, and emergency preparedness and response took shape within some countries. This leads us to say that, in fact, security should be seen as a relative concept: if “security

is broadly about the pursuit of freedom from threat”<sup>38</sup>, then security depends greatly on what threat is. Furthermore, the concept of threat contains already in itself an interpretation of reality based on the agent’s perception.

There are many problems within society that are generally considered as public problems, but that never reach the agenda of some governmental or supranational body. According to James E. Anderson, “*a problem can be defined as a condition or situation, which produces a human need, deprivation, or dissatisfaction. It becomes a public problem when many people become involved in it or perceive themselves as being affected by it*” (Anderson 1976: 8). The word “perceive” is key in this definition, as a problem in society will not be automatically recognized as a public problem, and even less as an issue to be put on a political agenda. The definition of agenda adopted here will be the one by John Kingdon: “*The agenda (...) is the list of subjects or problems to which governmental officials, and people outside of government closely associated with those officials, are paying some serious attention at any given time*” (Kingdon 1995:2). “*Problem recognition, generation of policy proposals, and political events*” (Kingdon 1995:18) does Terrorist Financing and international crime, as an agenda issue, a favour to the re-election of governments.

It is also important to underline that a political agenda is always evolving in time. In this sense, it would also be interesting to try to understand not only how certain topics came to be considered relevant, but also which factors lead to change within political agendas. This would later bring us to another interesting topic, which is how the different actors influence the European Union’s agenda. Every European institution has a different agenda, even if they are quite harmonized, and so do the Member States. If we consider that the global European Union’s agenda is formed, not only by these actors but also by many others, such as lobbying groups, the media, political parties, and the general population, this becomes an extremely complex process.

The question here is how Terrorist Financing and Money Laundering is considered a risk within countries? The Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing: High Level Principles and Procedures clarifies this issue.

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<sup>38</sup> For further discussion on the link between threat and security, see: *Waever et al. (1993). Migration and the new Security Agenda in Europe*. London, Pinter Publishers Ltd.

Adopting a risk-based approach implies the adoption of a risk management process for dealing with Money Laundering and Terrorist Financing. This process encompasses recognising the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks.

A risk analysis must be performed to determine where the Money Laundering and Terrorist Financing risks are the greatest. Countries need to identify the main vulnerabilities and address them accordingly. Institutions will need to identify higher risk customers, products and services, including delivery channels, and geographical locations. These are not static assessments. They will change over time, depending on how circumstances of the financing of terrorism are changing. (FATF-GAFI 2007:2)

The guidance suggests that there are no universally accepted methodologies that prescribe the nature and extent of a risk-based approach. This work was developed before the abovementioned report. The lack of a universal methodology, assessment or database related to Country Terrorist Financing Risk, forced me to elaborate the level of risk for each country. Hence, identifying a level of country risk was considered. The choice was made to use the concept of country/geographic risk. The higher risk include the countries subject to sanctions, embargoes, countries in conflict or providing funding or support for terrorist activities or with high levels of corruption.

The risk of Terrorist Financing provided by this study coincides with the current definition of country/geographic risk provided by FATF-GAFI (2007). In order to evaluate the risk of Terrorist Financing, all the mutual evaluation reports have been taken into account, the above mentioned INCSR 2006 and the reports of GAO (US Government Accountability Office Reports on Sanctions and Terrorist Groups Lists). More explanations about the score of the country risk of Terrorism Variable are given in chapter 5.

#### **2.4.4.5 The Use of Humanitarian Aid**

Some scholars emphasize how the humanitarian aid is used to fuel terrorist groups. *“Economic resources given to the displaced in the south to promote their self sufficiency have invariably ended up in the hands of exploiting groups as it is the case of Sudan”.*(Napoleoni 2005:189)

#### 2.4.4.6. Maritime Terrorism and Crime

Some experts (e.g., Meldrum 2007) have pointed out the vulnerability risk in relation to the “Maritime Sector” and the financing of terrorism and crime. In her work, she emphasizes the lack of transparency in the maritime sector, which means that it is vulnerable to exploitation for both criminal activities and terrorism-related financial operations. The techniques of maritime crime have in the past been exploited by terrorist groups for fundraising and weapons transportation, and the way to obstruct Terrorist Financing has not been significantly addressed in the maritime sector, which may even have made the sector more attractive as an environment for illicit fundraising.

She argues that that more than 50 percent of the world's fleet is registered in Flags of Convenience countries (FoC), and this figure continues to increase. There are currently 32 FoC or 'open-registry' countries, the six dominant ones being Panama, Liberia, Bahamas, Malta, Cyprus, Bermuda, and Tonga <sup>39</sup>. Many Flags of Convenience countries are small or developing countries, and some are rather unlikely flag states, such as landlocked Bolivia and Mongolia. Some of these countries are studied in this research such as (Cyprus, Panama and Bolivia).

According to experts, the key concept in the Maritime Sector is the question of secrecy, a concept that is promoted as desirable by the Flag of Convenience registries. Under the system, the registered owner of most ships is a shell company set up for the sole purpose of owning that one ship. That registered owner is often, in turn, owned by another company which may itself be registered in a country with very liberal company laws. This setup allows a ship owner the ability to disappear completely from any accountability that may be attached to them through owning the ship.

However, measures to improve the financial transparency of the shipping industry and its underlying corporate structures have stalled, owing to a lack of

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<sup>39</sup> Tonga has already experienced problems due to some of their registered vessels being involved in criminal activities. In January 2002, Israeli commandos boarded a Tongan-flagged ship called the *Karine A* and found 50 tons of weapons on board. Two more Tongan vessels, the *Sara* and the *Twillinger*, were caught later that year with illegal Pakistani immigrants on board carrying large quantities of cash, maps, and false passports. Following the *Twillinger* incident, Tonga's registry was closed, citing "diplomatic, financial, business and legal considerations", including "international terrorism and an increase in people smuggling". Meldrum, C. (2007) "Murky waters - Financing maritime terrorism and crime " *Jane's Intelligence Review Volume*, DOI:

genuine will to change the status quo. There are huge, and understandable, vested interests at stake (Meldrum 2007).

## 2.5. Are the Terrorist Groups Fully Understood?

To summarize the chapter, one should revise the goal of this section, which raises the question of whether or not Terrorist Financing networks are fully understood. The resulting conclusion is that International Organizations know the terrorist methods well in terms of how they raise and move funds to support their activities from legal business to criminal activities using both formal and informal financial systems, despite the lack of empirical data. The intelligence community is forced to extrapolate from current information to fill in the gaps in our knowledge.

International Organizations have learned much since 9/11 about some transnational terrorist groups, such as Al Qaeda. Detainees have confirmed the basic lines of financing of Al Qaeda funding and methods of transferring money. But evidence shows:

[e.g., In the case of the Al Qaeda terrorist group] Al Qaeda adapts quickly and effectively, creating new difficulties in understanding its financial picture. Intelligence challenges remain and are likely to continue, although the picture is clearer today than ever before. As Al Qaeda becomes more diffuse – or becomes essentially indistinguishable from a larger global jihadist movement – the very concept of al Qaeda financing may have to be reconsidered. Rather than the Al Qaeda model of a single organization raising money that is then funnelled through a central source, we may find we are contending with an array of loosely affiliated groups, each raising funds on its own initiative (Staff Report to the Commission on Terrorist Attacks Upon the US: 29)<sup>40</sup>.

In the article, *Financing of Terrorism: Sources, Methods and Channels* (Raphaeli 2003:80) noted in a quotation that a leading French investigative judge who is in charge of investigating acts of terrorism has observed that terrorist cells increase in a disorderly

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<sup>40</sup> For further discussion of the emergence of self starter groups affiliated to Al Qaida goals, see Kirby, A. (2007). "The London Bombers as "Self-Starters": A Case Study in Indigenous Radicalization and the Emergence of Autonomous Cliques." *Studies in Conflict & Terrorism* 30: 415-428. After the London attacks, the autonomous behaviour of the London bombers became more evident even though the act was in line with the goals of Al Qaida and Bin Laden. The British officials remain concerned that "the home-grown threat and the radicalization of British Citizens were not fully understood or applied to strategic thinking". This development must be recognized as a vital challenge.

fashion like viruses. Accordingly, the International Community knows how groups have changed their patterns of financing in the wake of global regulatory efforts to control their activities through illegal activities (e.g.: when it comes to trade, migration, and taking advantage of lacking border controls).

After comparing Terrorist Groups and Organized Crime, the following generalizations can be made: Although often considered to be distinctive threats with incomparable effects, transnational terrorism and transnational crime are both illicit activities perpetrated largely by non-state actors across or beyond the political borders of a single state. Most transnational crime is economically motivated and involves some form of smuggling, piracy, or illegal financing including illegal cross-border flows of arms, banned psychoactive substances (such as heroin and cocaine), people (migrants, sex workers, babies, body parts), assorted other commodities, and toxic waste. These cross-border flows challenge the ability of states and international actors to assess and manage economic activities around the world.

The most important assumptions taken into account in this dissertation are:

- Organized Crime and Terrorism Groups can intersect in practice, such as the smuggling of arms, narco-trafficking, and how terrorists use the transnational criminal activities to fund terrorist attacks.
- Al-Qaeda and other terrorist groups are adjusting to the new measures and have concentrated their activities in areas that still lack such effective controls. This includes, but is not limited to, the so-called list of failed or weak States. The black market arms trade can provide ‘rogue’ states and other actors, such as terrorists, with the weapons needed to launch lethal attacks against military combatants and civilians alike.
- The most important vulnerabilities to Money Laundering following INCSR (2006) are as follows:
  - Failure to criminalize Money Laundering for all serious crimes or limiting the offence to narrow predicates
  - Rigid bank secrecy rules that obstruct law enforcement investigations or that prohibit or inhibit large value and/or suspicious or unusual transaction reporting by both banks and non-bank financial institutions.

- Lack of or inadequate “know your client” requirements to open accounts or conduct financial transactions, including the permitted use of anonymous, nominee, numbered or trustee accounts.
- No requirement to disclose the beneficial owner of an account or the true beneficiary of a transaction.
- The use of bearer instruments.
- Trade-based Money Laundering is an important channel of criminal activity, and it could be vulnerable to Money Laundering and Terrorist Financing that involves the movement of value through the financial system (e.g., cheques, wire transfers) and/or cash couriers for instance. These transactions obscure the money trail and complicate its interdiction. There is a lack of trade data analyses and international sharing of trade data. The most of financial intelligence units do not receive suspicious activity reports on trade. Most Customs agencies, law enforcement agencies, financial intelligent units, tax authorities, and banking supervisors reflect their more limited understanding of these techniques of Money Laundering, and they express their concerns about limited Export controls and lack of modernization of customs and border security.
- It seems clear that prevention of corporate vehicle misuse for ML and TF could be significantly reduced if the information referred to the ultimate owner, knowledge of the source of assets, and the business objective of the company or a trust within a structure were readily available.
- Humanitarian aid and Maritime Shipments seem to be sectors vulnerable to the Money Laundering and the Terrorist Financing sector.
- There is no public assessment/rating of countries’ risk of Terrorist Financing. A risk analysis must be performed to determine where the Money Laundering and Terrorist Financing risks are the greatest. Countries need to identify the main vulnerabilities and address them accordingly. Institutions will need to identify higher risk customers, products and services, including delivery channels, and geographical locations. These are not static assessments.

In this chapter, important causal explanations have been established between some explanatory variables (the country attractiveness for Money Laundering, size of the financial system, informal remittances and cash economies, vulnerability to the financing



of terrorism and the vulnerability of failed states) and the dependent variable (the overall compliance by jurisdictions with the AML/CFT). In the present dissertation, bivariate correlations between the jurisdiction's compliance with the AML/CFT Regime and all the variables listed below shall be tested:

- The correlation between the Index of the Country Attractiveness to Money Laundering and the overall jurisdiction's compliance with the AML/CFT.  
The correlation between indicators of the Size of the Financial System and the overall compliance by jurisdictions with the AML/CFT.
- The correlation between the Index of Failed States and the overall jurisdiction's compliance with the AML/CFT.
- The correlation between the score of the Risk of Terrorist Financing and the overall jurisdiction's compliance with the AML/CFT.
- The correlation between compliance with the AML/CFT with the ratio of Informal Remittances/GDP2004.

## **CHAPTER 3**

# **The Risk of Global Financial System Abuse**

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After September 11<sup>th</sup>, much of the discussion about the negative or dark side of financial market globalization returns to its capacity to facilitate the transfer of funds that support global terrorism and transnational crime. The work also describes the economic and legal conditions that have allowed huge capital flows to fall into the hands of transnational terrorist networks. Emphasis is also placed on how transnational terrorism has become a factor in international disorganization.

This chapter explores both how the global financial system can be abused by organized crime, terrorist networks and corruption, and how this has created the need to develop a cooperative Regime to deter its abuse.

This chapter examines the mechanisms that have allowed the abuse to take place and how the abuse is perpetrated both in offshore and onshore centers. In particular, this section of the research concentrates on two analyses. Firstly, it shows how the main characteristics of financial globalization have facilitated the access to financial resources on the part of transnational terrorists groups from the 70s up to now.

Finally, it highlights the role played by offshore and onshore centers and how vulnerable the developing countries are to this abuse.

### **3.1. Characteristics of the Global Financial System Facilitating Financial Crime, Money Laundering, and Terrorism Financing**

This section identifies the weaknesses in the global financial system that have allowed huge capital flows into the hands of terrorists networks.

#### **3.1.1. When Market and Non-State Actors Outgrow Governments**

In the 30s, authors such as Vladimir Lenin (1933) and Nikolai Bukharin (1929) described imperialism as the highest stage of capitalism characterized by monopolies, finance capital domination, and the export of capital. Lenin in his work *Imperialism, The Highest Form of Capitalism* highlighted that the fusion of banking capital with industrial capital, and the creation, over the basis of this financial capital of a financial oligarchy and the capital exports, a difference of good exports acquire an exceptional importance”<sup>41</sup>.

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<sup>41</sup> See further discussion on imperialism in *Vidal, J. M. (1976). Teorías del Imperialismo* Barcelona, Anagrama.

In the 70s, leading scholars such as Eipzig (1964), Klopstock (1968), and Magdoff (1970) pointed out how at the beginning of the 1960s, governments began to lose control of the world monetary transaction when the Eurodollar market stimulated increasing financial activities, such as taking deposits, extending loans, dealing in bonds, notes or commercial paper denominated in a currency other than the currency of the jurisdiction in which the institution is located.

In particular, some contributions have been selected to explore the role of the Eurodollar in the financial intermediation market.

[...]El mercado de eurodólares está dominado por la actuación de bancos con gran actividad exterior y frecuentemente con oficinas en el extranjero, y de grandes empresas también con proyección internacional. Con tales sujetos económicos, los controles aplicables en unos pocos países o a un grupo limitado de instituciones financieras, sólo resultan parcialmente eficaces, y la rigidez de los tipos de interés en los mercados nacionales origina frecuentes movimientos de fondos contrarios a los objetivos de las autoridades, pese a la existencia de prohibiciones y medidas restrictivas (Varela 1969:228).

La existencia del mercado de eurodólares se ha traducido para la banca participante-principalmente europea-en un nivel mayor y/o más rentable de actividad y para la banca americana en un nivel menor y/o menos rentable de actividad. Para muchos bancos europeos el mercado de eurodólares ha significado la posibilidad de realizar un volumen de operación que hubiera estado fuera de sus posibilidades empleando la propia moneda nacional (Varela 1969:487).

In line with the previous contributions, Susan Strange also insisted on the issue of the Eurodollars, because the Eurodollar market had started well as a good servant but soon transformed into a “bad master”, having a largely negative effect on the capacity of governments to discharge their responsibilities in terms of either financial supervision or international monetary management.

Regarding the idea of market outgrow governments, the work *The Global Political Economy. understanding the international order* (Gilpin 2001:271) paid special attention to the controversy over the regulation of international finance. He explained how American Economists believed that international flows perform a crucial role, and the prevailing opinion of the United States is that markets rather than governments or

International Organizations should govern the international financial system. But when the East Asian financial crisis caused some impact on the Global Economy, American economists and governments started to show concern for the devastating impact on international financial movements. Bhagwati, Stiglitz, Krugman and Sachs favoured freedom of capital movements along with greater IMF surveillance.

Friedman, Wriston, Schultz and Simon recommended reliance on the market.

In addition, Susan Strange pointed out that the world was changing and something was happening to states. She had more to say on this than others because she was among the first to recognize the importance of the changes which were taking place in the world political economy from the early 1960s and onwards. Referring specifically to the domain of financial markets, she remarked that the monetary and financial order was the centerpiece of the global political economy, and what happened to the global monetary and financial system would have repercussions for the rest of the system. She was concerned about the role of large firms and power and also considered the role of other non-territorial sources of authority, such as organized crime networks and non-governmental organizations. Referring to the abuse of the financial system by drug trafficking, she noted that:

Perhaps laundering illegal drug money is not really the most serious kind of lawbreaking to be made easier by the international financial system. There are other kinds of serious financial crime that have received much less public attention....It will be argued that, from the point of view of damage and risk to public confidence in the international political economy, Money Laundering is much less serious an issue than, for example, tax evasion, private fraud or public embezzlement. Why these are overlooked or even tolerated is one of those questions that political economists are right to pose and that economists for the most part do not even consider (Strange 1998:123).

Strange focused her criticism on the dominant International Relations theories and argued that it was too state-centric. She stressed the importance of also considering markets, firms and other non-state actors, and the need to focus on the key power structures (finance, technology, security and production) in the international financial system. She argued that the realm of authority of the state was retreating in the face of the advancing tide of the market.

Strange remarked that structural changes in the global financial and monetary order have led to a wider pattern of changes in the global economic system. Most particularly market integration in the domain of production and trade (or lack thereof) have been integral to these developments, which have conferred increasing power on non-state actors, particularly firms and other market players, but also on private networks and systems especially related to the growth of international markets.

Strange also stressed that the rise of unregulated offshore capital markets introduced a growing element of short-term capital mobility to the global monetary system, which eventually overwhelmed the capacity of states to manage fixed exchange rates in relation to the emerging balance of payments disequilibrium and differences in monetary policy objectives.

The international monetary system is thus, for Strange, the infrastructure on which trade and production, in short the market, depends. The shift from state authority to market authority has been largely as a result of state policies (Strange 1996). In the last work of Strange, she associated the rise of global markets and non-state actors with the consequent erosion of state power in the global system.

Furthermore, Gilpin has written at length about the globalization of the world economy as well as its implications for the international political economy due to the tensions and interactions between politics and economy. I agree with the idea that the underlying problematic globalization governance relies on two issues. First, it becomes harder to maintain the boundaries which are necessary for the efficient packaging of public or collective goods into national policy approaches and, indeed, economically efficient outputs. In the second place, it becomes harder to determine what people actually want in the way of public or collective goods.

A useful model for understanding the impact of globalization lies in Bobbitt's work *The Shield of Achilles*, in which he demonstrates that the nation-state is undergoing a difficult and dangerous process of transition towards a new form of governance. The Shield of Achilles makes a historically detailed case that the bureaucratic nation state is in an inevitable transition to a more competitive form called the "market-state." "*The cause for the creation of this market-state is the loss of the core legitimacy of the nation –state its ability to provide for the welfare of its people*" (Bobbitt 2002). According to the

framework provided by Bobbit, nation-states are in the midst of shifting their legitimacy to a new basis.

In line with the lack of global financial regulation, Biersteker also states “*that financial deregulation and liberalization policies at the national level in the 1980s and 1990s not only increased the flow of capital across national boundaries, but also decreased the monitoring and regulatory capacity of many states*” (Biersteker 2002:77)

Once an elaborate system of licensing and controls has been dismantled, it is difficult to replace it with a robust regulatory system at relatively short notice. At this point, the question that arises is whether sovereignty is necessary to deter terrorism financing. The answer to this question will be given in chapter 4.

After September 11, 2001, much of the discussion about the negative or dark side of financial market globalization turned away from its distributional effects and tendency toward periodic instability and began to consider how it facilitated the transfer of funds that enabled global terrorism and transnational crime. The recognition of the negative impact of the huge ‘dirty money’ flows in Financial Systems was remarked by Vito Tanzi (1996) and Biersteker (2002)

The International laundering of money has the potential to impose significant cost on the world economy by (a) harming the effective operations of the national economies and by promoting poorer economic policies, especially in some countries; (b) slowly corrupting the financial market and reducing the public’s confidence in the international financial system, thus increasing risks and the instability of that system and (c) reducing the rate of growth of the world. (Biersteker 2002:74-84)

Despite the practical impossibility of estimating the money flows of Transnational Crime Activities and Terrorist Groups with any precision, the indications are that it is enormous. In 1990, FATF estimated these flows to be US\$85 billion dollars that could be annually available for laundering. In 1998, the US State Department Bureau estimated this to be somewhere between US\$300 and US\$500 Billion. Regarding the situation, it could be stated that Global finance is obviously not “controlled” in the sense of being ruled by a sovereign world government. Nevertheless, these activities are subject to imperfect

governance<sup>42</sup>. Money Laundering and Terrorist Financing have been taking advantage of this lack of governance of the financial system.

In both Money Laundering and Terrorist Financing, criminals and terrorists exploit loopholes or other weaknesses in a legitimate financial system to launder criminal proceeds to support terrorism and ultimately hide the actual purpose of their activity. Both Money Laundering and Terrorist Financing work in permissive environments with lax supervision from relevant banking authorities, poor risk-based customer due diligence process, lack of understanding on financial and non-financial indicators generated by suspicious transactions or activities, and the exploitation of banking system loopholes. (Gunaratna 2006:2)

### **3.1.2. The Boom of Capital Movements and the Lack of Transparency**

The last few decades have seen substantial growth in global capital flows. In the emerging market economies alone, the net inflows of foreign capital have now reached about USD 150 billion a year, despite a contraction following the wave of emerging market crises in 1997-1998. The financial flows between the advanced market economies are of an even higher order. Moreover the turnover in the international markets is substantially higher than the net flows, exceeding global real economic activity many times over.

One of the most important indicators which permit us to discuss the global financial integration is the flow of the foreign exchange across national boundaries, which at present exceeds \$ 1.3 trillion per day, a quantity which surpassed the foreign exchange holdings of the central banks of all of the OECD countries combined. But more important than the increase in the flow of funds across boundaries is the shift that took place within institutional actors from individual currency traders and portfolio according to Bierstecker (2002).

Developments at the national level to deal with the criminal aspects of financial deregulation did not keep pace with liberation of the markets, leaving law enforcement agencies and supervisors reliant on traditional crime-solving methods. Furthermore, *“the territoriality concept and the lack of cooperation between states rendered those methods ineffective wherever transnational crime and terrorism financing was involved”*.(Pieth 2004:4).

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<sup>42</sup> Scholte (Governing Global Finance)



### 3.1.2.1. The Boom of Capital Movements

Before globalization, both money and the banking system were local; carrying out transactions outside state boundaries was a slow, costly process. Regulators were able to control the local financial services, and border tariffs preserved national sovereignty.

After globalization, money has become a “global commodity”<sup>43</sup>, the banking system becoming international, and terrorists can invest wherever the opportunities are the best, for example, in Jakarta, New York or Moscow<sup>44</sup>. Correspondent banking systems clearly evidenced the vulnerability of Western national banking to external penetration. Whenever the local regulation is inconvenient, it is avoided, which leads to tax havens. Tax havens have been consolidated by virtue of their efficiency, and because they reduce transaction costs. Local regulators cannot control international institutions; supervision is not too effective in those cases in which local authorities control the activities of offshore financial institutions. There is also a high degree of impunity in unregulated financial activity jurisdictions.

Since the mid 1970s, financial deregulation and the creation of new financial instruments, such as derivatives, and technological advances in communications have contributed to a much more integrated international financial system.

In the mid-1980s, a revolution in international economic affairs as multinational firms (MNCs) and foreign direct investment (FDI) began to have a profound impact on almost every aspect of the world economy. Most importantly, MNCs led the way in the internationalization of both services and manufacturing.

The volume of foreign exchange trading (buying and selling national currencies) in the late 1990s reached approximately \$1.5 trillion per day, an eightfold increase since 1986. In addition, the amount of investment capital seeking higher returns has grown enormously. Moreover, the significance of these huge investments is greatly magnified by the fact that a large portion of foreign investments are made with borrowed funds. Finally, derivatives or repackaged securities and other financial assets play an important role in

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<sup>43</sup> Alan Greenspan. Round table Euro 50, Washington, DC, 30 November 2001. “In the international arena (.....) no overarching sovereign exists to decree what is money. Instead, a myriad of private agents must somehow reach the agreement”.

<sup>44</sup> For a detailed treatment of the development of global finances development in the twentieth century, see Michael D. Bordo, Barry Eichengreen and Douglas A. Irwin, “Is globalization today really different than Globalization a Hundred Years Ago? In Brookings Trade Forum, vol.2 (Washington, DC, Brookings Institution Press, 1999), p.1-50.

international finance. Valued at \$360 trillion (larger than the value of the entire global economy), they have contributed to the complexity and the instability of international finance. It is obvious that international finance has a profound impact on the global economy.

The immense scale, velocity, and speculative nature of financial movements across national borders have made governments more vulnerable to sudden shifts in these movements.<sup>45</sup> At present, national regulators are too permissive with capital movements when they should think of operational controls to avoid cross-border disasters. Here, one shall deal with some cases of traders who made bad bets such as that of the banking world's most present shocking disclosure in France, where Mr Kerviel has cost the Société Générale \$7.2 billion making huge unauthorized trades that he had hidden for months by hacking into computers. The incident at the Société Générale raises the question on how to improve the ability of regulators to deal with crises at cross-border banks and financial operations which do a large portion of its business outside national jurisdiction and take deposits around the world.

Basel 2, which came into effect for European banks at the end of 2007, tries to place more onus on banks to manage their own risks, as regulators have relied more on the institutions they are regulating. Nonetheless, there is a lesson to be learned after a fraud like that which occurred in France and that is regulators should supervise financial institutions procedures in depth and likewise with the personnel beyond only the matter of merely supervising their numbers.

A report of The Financial Action Force on Money Laundering: Report on Money noted:

The securities sector on a global scale is characterised by its diversity, the ease with which trading can now take place (through electronic trading for example), and the ability to perform transactions in markets with little regard to national borders. These characteristics make securities markets attractive to the ordinary investor looking for a good return on his or her money. These same characteristics, along with the sheer volume of transactions in many markets,

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<sup>45</sup> For more details of this fraud, see: *Gauthier-Villars et al. (2008)*. One trader's loss at SocGen:\$7.2billion. *The Wall Street Journal Europe*. **XXV**: 1 and 31.

also make the securities sector a potentially inviting mechanism for the laundering of funds from criminal sources (FATF-GAFI 2003:2).

The figure 3.1 shows the increasing volume of cross border activity in financial markets from the 1999 to 2006.

Figure 3.1 Cross Border Activity in Financial Markets (1999-2006)

| <b>BIS</b>   | <b>Dec 1999</b> | <b>Dec 2.002</b> | <b>Dec 2006</b>  |
|--|-----------------|------------------|------------------|
| International bonds and notes by type, sector and currency                 | \$5,111 billion | \$8,757 billion  | \$17,571 billion |
| International debt securities-all issuers by residence                     | \$5,361 billion | \$9,195 billion  | \$18,446 billion |
| External positions of banks in all currencies vis-à-vis all sectors Assets | \$9,940 billion | \$13,374 billion | \$26,476 billion |

Source: Table 2A, 11 and 14 Bis Quarterly Review (June 2001, March 2004, September 2007)

The present dissertation will study the correlations between the overall compliance with the AML/CFT Regime and the cross border assets by jurisdictions (COBAS), taking into account the literature pointing out how cross border financial activity makes a potentially inviting mechanism for the laundering of funds and the financing of terrorism. The correlation between the overall compliance with the AML/ CFT Regime will also be calculated and the cross border liabilities by jurisdictions (COBLIS). The method to calculate COBAS and COBLIS is broadly described in chapter 5.

### **3.1.2.2. The Lack of Transparency**

In September 2001, basically no country had taken steps of any kind to implement the anti-Money Laundering Regime. Some countries like Bahrain, Yemen, Malaysia, Indonesia,

China, the Philippines, Nigeria, and Somalia offered full secrecy, and there were no effective limits to depositing money of anonymous origin.

Meanwhile, large amounts of money were utilized by Islamic NGOs to finance military resistance in Bosnia, Kosovo, Kashmir, and Chechnya. This money came from powerful Muslim donors from the Gulf Region under the Al Zakat designation<sup>46</sup>.

According to Winer (Pieth 2002) and Johnson (2001), the main reasons for this lack of transparency were:

- The fragmented supervision of financial markets, which is based on local regulation, the banking secrecy law, which stops judicial and investigation bodies from sharing information in some countries, the insufficient attention paid to Money Laundering offences.
- The lack of international rules: international business companies, financial bodies within tax havens, the lack of transparency of extracting companies. Little “Due Diligence” in the training of agents.
- The lack of control over licenses or new financial institutions.
- The lack of universality and uniformity of the legislation regarding the international financial system.
- The number of countries that have been establishing activities, such as offshore financial centres (OFCs). Internet Gaming and other electronic services have been increasing during the last years. The level of compliance with international standards of those OFCs due to the data paucity and unavailability in the public domain are difficult to assess.
- New possibilities to dodge and evade taxes. Globalization has thus opened up new approaches for global players to dodge national tax obligations. And this in turn is serving to erode the nation-state’s tax base. Financial market liberalization has subverted most of the controls on capital movements in place at the national level. And more and more possibilities have also emerged to transfer funds in ways that circumvent national taxes. At the same time, most nation-states are actively engaged in cutting taxes on corporate profits, capital gains, and large assets. As a means of attracting capital into their own economies, many governments have seen fit to boost their locational attractiveness by cutting taxes for investors.

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<sup>46</sup> For further discussion, see *Winer, J. (2002). Globalization, Terrorist Finance, and Global Conflict-Time for a White List? Financing terrorism Dordrecht ; Boston, Kluwer Academic Publishers.*

- Globalization-related locational competition is fuelling a race to cut taxes that is taking on increasingly perverse forms of tax dumping. Transnational corporations (TNCs) have ways to distribute their profits and losses across locations most favourable to them in terms of taxes. Using procedures like transfer pricing, these corporations are also able to generate artificial profits or losses. One approach used here is for a parent corporation to charge a subsidiary excessively high or low prices for intermediate products, services, and patents.
- Organized crime and terrorist networks have raised funds from legal businesses and investments, criminal schemes Wechsler (2001).
- Some territories have non-transparent international financial structures, specializing in financial services that are not totally controlled.
- Some countries and territories have legal practices that are allowing transactions out of international control.
- Some offshore centers are the main creators of Anonymous International Business Companies.
- Some offshore centers have created world centers housing corporations that conceal the real property of the funds.
- Some offshore centers have specialized in Money Laundering for arms trafficking connected to the civil wars in Liberia and Sierra Leone.
- Some jurisdictions have provided financial services and transborder trade to unstable Middle East and Mediterranean countries. During the 70s, they have developed a financial and bank secrecy Regime that was much used by drug traffickers, the Italian mafia, the Soviet communist party, and also by Al Qaeda and by the illicit financing sources that supported the control of Yugoslavia by Milosevic.

### 3.1.2.3 How Is Money Laundered?

This section explores how money is laundered in sectors such as the financial and real estate sector. FATF points out through its yearly Money Laundering Typologies Reports how money can be put into the financial sector through different channels (FATF), Unger (2006), Winer (2002). The money is laundered in the financial sector through the following channels:

- Capital market Investments: Shares and bonds are used to invest money into financial assets. Regarding bearer securities and other negotiable instruments, it appears that the general ease of transferability and the ability to conceal ownership are the primary characteristics that make such instruments attractive to money launderers (FATF-GAFI 2001-2002:28).
- Bank Transactions: The launderer deposits small accounts of cash into a bank account (smurfing). These funds are used to be transferred to different countries where there is a high level of bank secrecy (layering).
- Correspondent Banking: The role correspondent banking relationships play in facilitating certain Money Laundering schemes is a complex issue. Correspondent banking is the provision of banking services by one bank (the “correspondent bank”) to another bank (the “respondent bank”). Respondent banks facilitate a wide range of service through the correspondent relationship such as travelers’ cheques, bank cheques, collective accounts, payable through accounts, and E-cash. Especially in instances where a respondent bank serves as a correspondent for other financial institutions, shell banks, certain offshore financial institutions and banks from non-cooperative countries and territories (NCCTs), it is difficult to establish control. (FATF-GAFI 2001-2002:28).
- Loan at low or no interest rates.
- Insurance market (FATF-GAFI 2003-2004:28).
- Wire transfers: The experts conclude that this was a mechanism to support some terrorist organizations. The fact that many cross border transfers do not include full identifying information on the originator is a key obstacle in determining those links (FATF 2003-2004:28).
- On-line banking.
- Black market of foreign currency.

- Exchange Bureau.

As stated in Chapter 2, money is also laundered in the real sector, trade, gems market, and so forth. According to the literature, it should be remarked that Money Laundering is also committed in:

- Gambling and casinos.
- Real estate acquisition.
- False contracts and documents.
- Fictitious sales and purchases.
- The gold and the diamond market: The inherent high-value of the substances, their ability to retain their value despite the form, and ease of convertibility, along with their compact and relatively easily transportable nature, make them very attractive to the money launderer (FATF-GAFI, 2003).
- Purchase of high-value or luxury items in cash (FATF-GAFI, 2001).
- Falsification of foreign trade prices (FATF-GAFI, 2006a).
- Currency smuggling.
- Underground banking, informal money transfer networks (see, 2.4.3)
- Shell companies: Despite their legitimate use and very long tradition in many jurisdictions, trusts, along with various forms of corporate entities, they are increasingly perceived as an important element of large-scale or complex Money Laundering schemes (FATF-GAFI, 2001)

Whether the existing AML/CFT standards are sufficient to discourage the use of the financial system to Money Laundering and the financing of terrorism shall be revised with the results of the exploratory research in chapter 6. Also, the overall implementation of the specific preventive FATF Recommendations by countries to avoid the use of the financial institutions and NBFP's will be explored to verify if these tools are sufficient as a basis for deterring the Money Laundering and financing of terrorism in the channels listed above.

### **3.1.3. The Volume of the Dark Side of Globalization**

*“It’s impossible to judge the size of the dark side of globalization given its secretive nature”* (Johnson 2001:122) and (Quirk 1997:7-9). *“The size of Money Laundering was estimated from US\$ 300 Billion to US\$ 1000bn. The IMF has estimated the size of laundered funds around 2-3%GDP. Around US\$ 400 Billion a year are generated by the illegal drug trade”* (Jonhson and Lin 2002:7). The first question to be solved is whether it is possible to estimate how much money is being laundered annually across the world. Of course the information provided by suspicious activity from reports and investigations into Money Laundering is insufficient to use these data for estimating the size of this problem.

### **3.1.4. The Impact of Corruption**

In the 1990s, there was an increasing awareness about the connection between organized crime and corruption. During the conference of European Ministers of Justice, held in Prague in June 1997, the relationship between the above mentioned topics was remarked as follows: “In many cases....corruption is indeed one of the basic accompanying phenomena of organised crime. Organised crime tries, through corruption, to obtain the information it seeks, to minimise the risk of being arrested.”

Transparency International (TI)<sup>47</sup>, an international non-profit organization devoted to fighting corruption worldwide, has been among the first bodies to measure corruption and its achievement has been to disseminate the phenomenon of corruption around the world. It has been publishing its index of corruption since 1993. As some countries of the sample are not include in the 2006 TI- Index of Corruption-, the present researcher has selected the index of corruption provided by Kaugmann.

According to Tanzi (2000), corruption is the abuse of public power for private benefit and the classification through different categories described below. This corruption can be: Bureaucratic (or petty) or political corruption by bureaucracy or by political leadership, cost- reducing (to the briber) or benefit-enhancing, briber-initiated or bribee-initiated, coercive or collusive, centralized or decentralized, predictable or arbitrary, involving cash payments or not. In this dissertation in order to establish the link between

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<sup>47</sup> Transparency International (TI), an independent organisation formed in 1993 to focus attention on corruption, regularly publishes a Corruption Perception Index (CPI) which ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians.



illegal global finances and corruption, it is important to understand which factors directly promote corruption.

Tanzi describes how, especially in developing countries, the role of the state is often carried out through the use of many rules or regulations and authorizations. The author considers licenses, permits, and authorizations of various sorts to be required for keeping an open business, borrowing money, investing, engaging in foreign trade or obtaining foreign exchange. Getting a passport when going abroad and so on requires specific documents or authorizations. In my understanding, this kind of monopoly of power plays an important role when talking about controlling terrorist finances or Money Laundering, because most of these non-transparent policies can facilitate the success of transnational crime and terrorism financing.

Taxation is also considered by Tanzi as a factor promoting corruption, and I would emphasize the major problem posed for controlling Money Laundering and terrorism financing when there is a lack of taxations in customs administrations and informal money transmission service. The risk posed by weak state control over the agents could be considered dangerous in the case of failed states, when the corrupted system cannot control any movement of merchandise or persons. Institutional controls created inside the institutions as honest and effective supervisors, good auditing offices and clear rules on ethical behaviour seem to be effective to reduce corruption in some countries.

Other important contributions have been done in the Corruption Field: Rose Ackerman proposes *commitment from the top of the governments, international institutions and the international business community, and a willingness to follow the anticorruption efforts*. (Rose-Ackerman 1999:225).

December 15<sup>th</sup>, 2005 marked the entry into force of the UN Convention against Corruption. Fifteen years ago there was no international agreement on corruption, and some countries even argued erroneously that corruption was acceptable in some cultures. Today, this new comprehensive global treaty put the corruption issue openly on the International Organization Agenda and it will continue to develop effective anticorruption programs.

Considerations have been made to evaluate the correlation between the index of corruption in a country with the compliance of the AML-CFT Regime. At the beginning, the corruption index provided by Transparency International has been taken into account.

Finally, the Control of Corruption indicator calculated by the World Bank has been selected to calculate the correlation between the control of the corruption variable and the overall compliance with the AML-CFT Regime.

### **3.2. The Impact of Illegal Globalized Finances on the Governance of the International Financial System**

The integration of a global network payments system gained momentum in the 80s and started to be effective for private operators in the mid-90s. The benefits linked to integrated payment systems for international businesses and travelers are immeasurable. But these benefits have been exploited by the dark side of globalization.

Global banking has provided technical services to a wide range of destabilizers. Currently, numerous scandals linked to Money Laundering, diamond trafficking, official corruption, and terrorism have reached the press, and they have been connected to a wide number of financial institutions through which the funds in question have moved or have been maintained. Prestigious international banks have been involved in scandals involving Money Laundering, for instance: the Bank of America, Bank of New York, Barclays Bank, J.P Morgan Chase, CityBank, Credit Lyonnais, Credit Suisse, Daiwa, DeutscheBank, Swiss Bank Corporation, and the Union Bank of Switzerland<sup>48</sup>

There is a group of Financial institutions connected to the laundering of illegal finances, including small international business companies, which have been set up and established in convenient jurisdictions, bank accounts in local financial institutions, having banking relations with the main banking groups. The latter move uncontrolled funds around the world without any attention being paid to the origin of the funds.

Some of those financial institutions acted unknowingly and negligently; in other cases, they acted due to a lack of regulation within the international financial system.

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<sup>48</sup> The Bank of America was linked to money laundering for an Antigua financial institution, the Bank of New York was linked to Benex Funds, laundered billions of dollars from Russia, including some from organized crime. Barclays dealt with financial Al Qaida Funds, J.P Morgan Chase and CityBank have dealt with money from drug trafficking. Credit Suisse was connected to money stolen by Ferdinand Marcos and Sani Abacha. See Winer 2002, op cit p.264.

### **3.2.1. Fraud in the Export-Import Scene Has Become Key for an Understanding of Illicit Diamond and Wood Trade**

The illegal exploitation of natural resources is a common experience for those illegitimated and unable governments where over invoicing and under invoicing techniques have been used to conceal exports from illegal activities. The Case of Sierra Leone is the best known example of a war prepared to help businesses linked with diamonds, drug, and arms trafficking<sup>49</sup>.

### **3.2.2. Money from Drugs and Illegal Conflicts**

The link between armed conflicts and the production and trafficking of illicit drugs has been noted in the previous chapter, and recent research indicates a link between natural resources, including narcotics, and conflict duration. Studies of nine major narcotics producing areas indicate a strong support for this nexus. Rather than generating or being generated by drug cultivation, armed conflict qualitatively and quantitatively transforms existing drug cultivation. The trafficking of the two main killer-drugs, heroin and cocaine, makes it possible for me to show the ways in which large-scale terrorist and insurgent organizations depend on drug and crime-related revenues to fund their operations. For many years, the UNODC has promoted common policies to control the cultivation and trafficking of illicit drugs.

In 2005, over 400 tons of heroin came out of Afghanistan for an estimated export value of about \$2.7 billion. Drugs from Afghanistan travel to foreign destinations (mainly Europe and Russia) across regions controlled by scores of warlords with multiple loyalties, insurgents affiliated with the Taliban, Al Qaeda, Hiz-e-Islami and extremists from Central Asia and Pakistan. These groups impose transit and protection fees on drug cargos. Indeed, drug trafficking<sup>50</sup> has provided funding for insurgency and terrorist violence in transit regions like the Balkans (especially Kosovo, with the KLA), Myanmar (different armies), the Philippines (Abu Sayyaf), Somalia (Aba warlords), Sri Lanka (LTTE), Turkey (Pkk), the Middle East (Hizbollah), Russia (Chechens) and Central Asia (IMU), to mention just a few.

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<sup>49</sup> See: *Smillie (2000) op cit.*

<sup>50</sup> See: *Costa, A. M. (2005). Drugs, Crime and Terrorism Financing. Breaking the links. Conference on Combating Terrorists Financing. . Vienna, UNODC:1-7*

The magnitude that characterizes this sort of Terrorist Financing can be wide-ranging. Even a revolutionary tax of a few percentage points on drug cargoes valued in the aggregate at billions of dollars generates an annual income to terrorists that is much greater than the money frozen worldwide by means of FAFT and other Money Laundering controls.

### **3.3 The Link between the Financial Abuse and Offshores, Onshores, and Developing Countries**

This section pays attention to the risk of financial abuse posed by offshores, onshores and developing countries.

#### **3.3.1. The Myths of the “Offshore”**

The potential risk posed by offshore centers to other financial systems have been raised in several international forums, including the Financial Stability Forum (FSF), the Financial Action Task Force on Money Laundering (FATF), the Organization for Economic Cooperation and Development (OECD), and the IMF.

As pointed out by McCann, *“60 per cent of the world’s money may be located ‘Offshore’-which is the home of US\$ 6.5 trillion of assets. Some 50 per cent of all financial transactions take place ‘Offshore’. Some reports have assured that various offshore jurisdictions play a role in over US\$ 1000 BN of business annually”*. (McCann 2006:xi).

Business in OFCs is booming: OFCs holdings now run to \$5 trillion - \$7trillion, five times as much as two decades ago, and make up perhaps 6-8% of worldwide wealth under management, according to Jeffrey Owens, head of fiscal affairs at the OECD. (Economist 2007:4)

The offshore world<sup>51</sup> has been attracting much attention after research into the gains of dictators, from Idi Amin Dada of Uganda to Ferdinand Marcos of the Philippines and General Abacha of Nigeria, followed by criminal investigations into corporate abuse by Enron or Tyco. Following the terrible events of September 11<sup>th</sup>, the OECD published a

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<sup>51</sup> Definitions of Tax Havens and Offshore World can be found in Palan (2003) and also in Azomé (2007).

black list of countries<sup>52</sup> that entail an important risk for the international transparency system.

The April 2000 Financial Stability Forum (FSF) report on offshore centers highlighted prudential and market integrity concerns stemming from factors in OFCs that impede effective supervision. In 2000, the FATF undertook an initiative to identify non-cooperative countries and territories in the fight against Money Laundering. The FATF's first review (2000) named 15 jurisdictions, including 12 OFCs, as having critical deficiencies in their anti-Money Laundering systems. In 2000, the OECD identified 47 countries (35 OFCs) with potentially harmful preferential tax Regimes. In 2002, the OECD made public a list of 7 uncooperative tax havens that include 6 OFCs.

In May 2002, the OECD Council at Ministerial Level stated that (page 2):

Poorly regulated financial markets not only open up new opportunities for financial crimes but also threaten the stability of the international financial system. As new technologies reduce the importance of physical proximity to major on-shore financial centers, so a new generation of Offshore Financial Centers (OFCs) has emerged. Remote jurisdictions bereft of natural resources and too isolated to benefit significantly from the global economy have established OFCs characterized by strict bank secrecy, criminal penalties for disclosure of client information and a policy or practice of non-cooperation with regulatory, supervisory and law enforcement agencies of other countries. This new generation of OFCs has succeeded in attracting brass plate banks, anonymous financial companies and asset protection trusts...

Offshore centers appeared as a catalyst for Terrorist Financing<sup>53</sup>, "*because mechanisms of financing terrorism and laundering criminal capital can function in such weak 'nodes' or 'black holes' represented by offshore financial centers (OFCs)*".(Masciandaro 2003:249)

The interconnectedness of the laxer, less regulated banking and finance frameworks in OFCs with the more complex ones in Europe and North America confirms that, at an international level, the financial system was vulnerable to penetration by worldwide

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<sup>52</sup> The list and all the documents linked with the offshores centers considered by OECD as a non cooperative countries can be found in [http://www1.oecd.org/fatf/NCCT\\_en.htm](http://www1.oecd.org/fatf/NCCT_en.htm), also in McCann, H. (2006). *Offshore finance*. Cambridge, UK ; New York, Cambridge University Press.

<sup>53</sup> The theme of the potential vulnerability of the world financial network due to the presence of OFCs has been explored with various methodological approaches in (Masciandaro 2003).

terrorist operations, including operations in areas where financial control was thought to be rigorous.

The literature on “Offshore Centers” (Masciandaro 2004, McCann 2007, Palan 2003) has noted that there is no consensus regarding the ‘Offshore Concept’. The OECD has identified thirty-seven tax havens; IMF lists forty-four names, whereas the Offshore Group of Banking Supervisors (OGBS) gives less than twenty.

According to Zoromé<sup>54</sup>, the creation and growth of offshore centers is caused by the combination of restrictive regulatory Regimes onshore and business opportunities abroad caused by the full convertibility of nonresident assets in Europe, which has facilitated the increase in the volume of their financial activities offshore.

- The origin for OFCs lay in the efficient response of international banks to the attempt by sovereign governments in many advanced countries in the 1960s and the 1970s to control capital flows through the imposition of restrictive domestic regulations. The OFCs grew parallel to Eurocurrency centers to exempt the investors from such restrictions.
- The establishment of capital controls with a view to reduce unsustainable balance of payment deficits recorded primarily by the United States in the late 1950s and also by many OECD countries in the 1960s.
- The imposition of high taxes, coupled with a tightening of monetary policy, in an attempt to curb balance of payment deficits resulting from fiscal imbalances, particularly in some OECD countries.
- The removal in 1958 of foreign exchange restrictions on the conversion by nonresidents of current earnings in Western Europe.
- The fact that U.S banks’ interest in conducting business transactions in foreign currencies and to extend their research to new territories was caused by the Glass-Steagall Act of 1933, which barred commercial banks from entering the investment banking business.

Offshore financial centres provide a number of legitimate and important services such as banking, insurance, securities and non-financial institutions activities summarized as follows: “*Business conducted in OFCs covers a wide range of financial sectors, such as banking, insurance, and securities, and some non financial activities, such as shipping*

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<sup>54</sup> Zorome (2007) "The Concept of Offshore Financial Centers: In Search of an Operational Definition." working paper **Volume**, DOI: WP/07/87.

*registries. Multinational corporations and high-net-worth persons are some of the most frequent users of OFCs .”(Darbar, Johnston et al. 2003:33), which can be broadly grouped into these categories according to:*

- Banking is the most important business, the majority of banks are branches or subsidiaries of international banks.
- Private Investments in which investments are managed in order to minimise potential tax liabilities and maximise protection granted under statutory confidentiality provisions. Collective investment schemes (mutual funds and hedge funds) are also domiciled in OFCs.
- Asset protection in which the use of an international jurisdiction separate from the client’s residence allows for the protection of income and assets from political and legal risks. According to the IMF (2003), a large number of special purpose vehicles (SPV) used by financial and non-financial corporations, are registered in OFCs. OFCs are attractive places to register SPVS because of the tax advantages and the facilitating regulatory Regime.
- Estate planning in which the administration of assets is done.
- Foreign Exchange trading.
- Pension arrangements.
- Non-bank services, such as custodian and trustee services.

The services described are often undertaken through international business companies (IBCs or exempt companies) and trust arrangements. In many offshore centers, the costs of setting up IBCs are minimal, and their activities are generally exempt from taxes.

Also, IMF in its role to promote financial stability has been noting the following: *“When standards for supervision are inadequate and comprehensive risk analysis is hampered by a lack of reliable data on activities in OFCs, there can be risks to financial stability.”* (Darbar, Johnston et al. 2003:34)

The discussion is that some structural features and recent trends in financial systems have important implications for the financial sector regulation as the weaknesses underpinning regulatory systems. International capital mobility makes the transfer of criminal and terrorist funds easier, particularly since these transactions can be concealed by tax evasion. Liberalization reduces the transaction cost of the use of OFCs through the

incorporation of offshore holding companies. The number of “Tax Agreements” has increased over the last years; the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters ensures that information on such holdings is shared between OECD members, but not with non-members.

Also the Financial Stability Forum has tried since 2000 to address the issue of OFCs from the point of view of systemic instability in international capital markets. Some of these centers are unable or unwilling to adhere to international supervisory standards of cooperation. On the other side, banks have moved away from direct lending towards the management of capital market assets. So there is a lack of financial information available in bank transfers and an absence of capital control, because operators prefer the more attractive unregulated transfer system to the high transaction costs implicit in formal international banking.

Most jurisdictions considered as OFCs<sup>55</sup> had some elements of AML/CFT Regimes in place, and many are in the process of broadening and strengthening them. Nevertheless, some basic weaknesses in these Regimes are identified, such as the failure to ratify and implement international agreements, inadequate customer identification policies and failings in supervisory systems and international cooperation.

### **3.3.2. The Identified Problems “Onshore”**

Literature has pointed out that in the playing field of international financial services business, one team is the ‘Offshore’ and the other team is the ‘Onshore’. OFCs have repeatedly expressed their view that “OECD countries must be forced to adopt the standards that they are trying to impose on others” .(McCann 2006:480)

Historically, OFC jurisdictions have been associated with one or a combination of the following: low or zero taxation, moderate financial regulation and supervision, and secrecy or anonymity in financial dealings. These features, of course, are also found in some onshore jurisdictions. According to PriceWaterhouseCoopers, the Offshore environment is losing business to “Onshore”<sup>56</sup>.

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<sup>55</sup>On the regulation profile of the Offshore Financial Centres (OFC) see Masciandaro, D. (2006). "Offshore Financial Centres and International Soft Laws: Explaining the Regulation Gap." 19.

<sup>56</sup> For further explanations of Onshore Centers see McCann, H. (2006). Offshore finance. Also in The Economist, On or Off (page 7), OFCs are defined as any financial center that takes in a large chunk of foreign funds, in other words much of the business conducted in New York, London or Hong Kong. Britain



OFCs are often portrayed as financial parasites that survive by diverting tax and other revenues from “real” economies, offering a haven for tax cheats and money launderers. Some of this undoubtedly goes on-but it goes on in big onshore economies as well. ( The Economist 2007:4)

*“Onshore Finance Centers are not in business to assist individuals or corporations to evade tax or to launder money. They are in business to promote their jurisdiction as credible places to transact business and the most effective way to do that.”* (McCann 2006:487). Finally, in order to overcome the lack of a practical definition of Offshore Financial Centers , the definition of Zoromé (IMF), who developed a statistical method to differentiate between OFCs and Non OFCs, has been selected for the purposes of this dissertation. His methodology distinguishes OFCs based strictly on their macroeconomic features and avoids subjective definitions on their activities or regulatory frameworks.

According to Zoromé :

An OFC is a country or jurisdiction that provides financial services to nonresidents on a scale that is incommensurable with the size and the financing of its domestic economy. The receipts of these exports consist of financial services billed to non-residents by entities domiciled offshore (bank fees for advisory services and financial engineering; intermediary service fees, such as those related to lines of credit, financial leasing, foreign exchange, commissions on funds administration, and on securities transactions, including brokerage, placements of issues, underwritings, arrangements of swaps, options, hedging instruments, services related to asset management and security custody services), registration/renewal fees for licensed entities (offshore banks, insurance companies, collective investment vehicles, international business companies, trusts and estates).(Zoromé 2007:7).

Zoromé<sup>57</sup> research identified 80 percent of the OFCs in the study sample that also appear in the a priori list used by the IMF to conduct its OFC program. According to his specific findings, twenty-two countries have been identified in the study as offshore

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is one of the most important personal tax havens in the world. America, for its part, soaks up huge amounts offshore cash because it taxes little of the money held in its banks by non-resident foreigners.

<sup>57</sup> OFCs identified by Zoromé: Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands, China, Hong Kong, Cyprus, Guernsey, Ireland, Isle of Man, Jersey, Latvia, Luxembourg, Malta, Mauritius, Netherlands Antilles, Panama, Singapore, Switzerland, United Kingdom, Uruguay, Vanuatu.

financial centers. This research will take into account that Zoromé's study identifies OFCs countries such as Latvia, United Kingdom, Uruguay, Vanuatu, Switzerland, Panama, Ireland, Cyprus, China, and Bahrain, and all of them are included in our research sample.

The majority of low-and middle income countries and jurisdictions are net importers of financial services, while the majority of countries and jurisdictions in the high-income group are net exporters.

Shortcomings remain in the supervisory systems in the supervisory agencies located in OFCs with lower per capita income. The review of AML/CFT concludes that 40% of the jurisdictions had deficiencies in AML rules and procedures applied to branches and subsidiaries located abroad and 35% of jurisdictions did not pay sufficient attention to transactions with higher risk countries and needed to strengthen measures to ensure that adequate AML programs were implemented in all supervised financial institutions. According to *Offshore Financial Centers: The Assessment Program-AndUpdate* (IMF 2004:1-24)

Despite the fact that in recent years many OFCs have reformulated the legal standards with technical assistance from the IOs, bank confidentiality and treatment of offshore banking remains a concern. According to the literature, OFCs provide a number of legitimate and important services – banking, insurance, securities and non-financial institutions activity – some of them with poor supervisory systems. The use of the aforementioned definition of OFCs will permit the researcher to establish the correlation between the Ratio of Net Export Services and the overall compliance with the AML/CFT Regime by countries and especially OFCs. This correlation will show how financial intermediary countries have implemented the AML/CFT, and whether there are still loopholes in the list of countries within the sample which are not committed to implement the FAFF Recommendations on international cooperation for the purpose of the detection of Money Laundering and Terrorist Financing.

### **3.3.3. The Problem of Information on Particular Jurisdictions**

The problem that arises is the significance of OFC Activities in the International Financial System, that is, the lack of worldwide statistics and the limitations inherent in OFC data collection and the available statistics indicates that offshore banking business remain unsizeable.

Maria Zephirin studied the Participation in International Statistical Collections of Economies with International Financial Centers (SEIFiCs)<sup>58</sup>. Regarding this work, I would remark that currently, there is still a lot of IMF Members, U.K overseas Territories, U.K crown Dependency Part of China, Part of the Netherlands and associates with New Zealand that do not provide the following information:

- Contribution of Financial Service to GDP (in percent).
- Number of Companies (International Business Companies), Banks, Insurance Companies, Mutual Funds, Trust Companies or Company Service Providers.
- Discussions held on statistics.
- Participation in Coordinated Portfolio Investment Survey.
- Participation in BIS International Locational Banking and Statistics.

### **3.3.4. The Vulnerability of Developing and Developed Countries**

The literature also suggests that the acceleration of developing countries' transitions has led to the creation of favorable conditions for the appearance of instability and criminality<sup>59</sup>.

Most important, developing countries need effective governments, with strong and independent judiciaries, democratic accountability, openness and transparency and freedom from the corruption that has stifled the effectiveness of the public sector and the growth of the private. What they should ask of the international community is only this: the acceptance of their need, and right, to make their own choices, in ways which reflect their own political judgements about who, for instance, should bear what risks. They should be encouraged to adopt bankruptcy laws and regulatory structures adapted to their own situation, not to accept templates designed by and for the more developed countries (Stiglitz 2002:251).

The associated cost of the abuse of poor regulatory frameworks which may contribute to financial crises or undermine confidence in financial system are even more

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<sup>58</sup> SEIFiCs are economies with international financial centres with Gross Domestic Product of US\$ 10 billion or less.

<sup>59</sup> *Kaldor, M. (1999). New and old wars : organized violence in a global era. Stanford, Calif., Stanford University Press:78*

difficult to identify. It seems that only developed countries with a well established government have the possibility of implementing international standards.

On the other hand developed countries<sup>60</sup>, in order to maximise profits and shareholder values, have used the same dirty money structure used by drug lords and terrorist groups. Baker *et al.* (2005) point out that “ *over the past four decades or so, a structure has been perfected that facilitates illegal cross-border financial transactions. This ‘dirty money’ structure consists of tax havens, secrecy jurisdictions, abusive transfer pricing, dummy companies, anonymous trusts, hidden accounts, solicitation of illgotten gains, kickbacks and loopholes left in the laws of western countries that encourage incoming criminal and tax-evading funds. (...) Today, perhaps half of cross-border commerce involves parts of this system, often used to generate, shift and hide illicit proceeds. Many multinational companies and banks regularly use this structure, which functions by ignoring or skirting customs, tax, financial and money laundering laws. The result is nothing less than the legitimisation of illegality.*” (Baker *et al.* 2005:15)

### **3.4. The Attempt of Creating a Global Regulation Landscape. Detering the Financial System Abuse:**

The previous sections have demonstrated how ML and FT threaten economic and financial systems in many countries and how it is necessary for the international financial community to strongly support anti-laundering and the combating of the financing of terrorism. Fighting both is now a priority for countries and it would not be incompatible with the financial market liberalization.

#### **3.4.1. The Need for Efficient International Financial Regulation and Global Supervision**

The concept of Financial Abuse can be defined as: “*all activities potentially liable to harm financial systems, and legal activities that exploit undesirable features of tax and regulatory systems*” (IMF 2001:5).

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<sup>60</sup> “Isle of Man with help from Bank of America Corp., two Texas entrepreneurs sheltered more than \$100 million, or roughly € 80 million, from U.S. taxes on this small island between Ireland and England for a decade starting in 1992.” See, *Simpson, G. (2005). Isle of Man Tax Shelter is probed by U.S.Officials. The Wall Street Journal: A5.*

- Financial Sector Crime: Includes Money Laundering, Financial Fraud (e.g., check, credit card, mortgage, or insurance fraud), Tax evasion, Circumvention of exchange restrictions, and Corruption.
- Other Financial Crime: Sale of fictitious financial instruments or insurance policies, embezzlement of non-financial institutions, tax evasion, and stock manipulation.

Lots of citations have highlighted the Financial System Abuse:

- IMFC Communiqué of September 24, 2000
- The G-7 Communiqué of Septembre 23, 2000
- The Managing Director's Report on Progress in Strengthening the Architecture of The International Financial System and Reform of the IMF of September 19, 2000
- Secretary Summers' Statement to the IMFC of September 24, 2000
- The G-20 Communiqué of October 25, 2000
- The G-24 Communiqué of September 23, 2000
- The Board's Conclusions on the OFC Discussions, BUFF/00/98 of July 14, 2000

The key issue in the financial regulation of terrorism lies in the need for more information on the identity and activities of transactors and the ability to freeze or confiscate their assets. *“The evidence is clear that terrorist organizations are using our own financial institutions against us, and we need to understand our vulnerabilities and take new measures to protect ourselves from similar abuses down the road.”* (US Senator Carl Levin).

The regulators must face the problem of large unregulated flows generated by legal activities such as those coming from tax evasion as well as migrant remittances which shelter crime-related transactions<sup>61</sup>.

The FATF – historically concerned with the integrity of the international banking system – has also expressed its concern about the Hawala System because of the regulatory problems that it raises, the difficulties to guarantee the traceability of the funds, and it is unclear how to regulate them: lack of records, customer identification and potential use by terrorists and organized crime. Robinson (1994), for example, has shown that the Hawala network operating between London and Punjab and Kashmir has served not only to

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<sup>61</sup> See: Johnson (2001).

channel finance in relation to drug trafficking, but also to support Sikh and Kashmiri independency<sup>62</sup>

Figure 3.2 summarizes the international economic conditions that permitted terror revenues as well the legal and financial conditions that help to develop legitimate business not considered illegal per se, illegal revenues from criminal activities, profits from companies or state controlled by armed groups, donations from charities and wealthy donators.

Figure 3.3 summarizes the abuse of financial system by financial crime, terrorist groups as has been discussed in chapter 2 and 3. The figure shows the complexity<sup>63</sup> of the ML and TF scheme. The figure tries to clarify the relationships between Money Laundering and the Financing of terrorist groups, and presents a schematic figure of misgovernance of the global financial system and the effects on development. In particular, this figure pointed out all the typologies and methods to finance attacks used by terrorist financiers to date, according to the issues described in this dissertation.

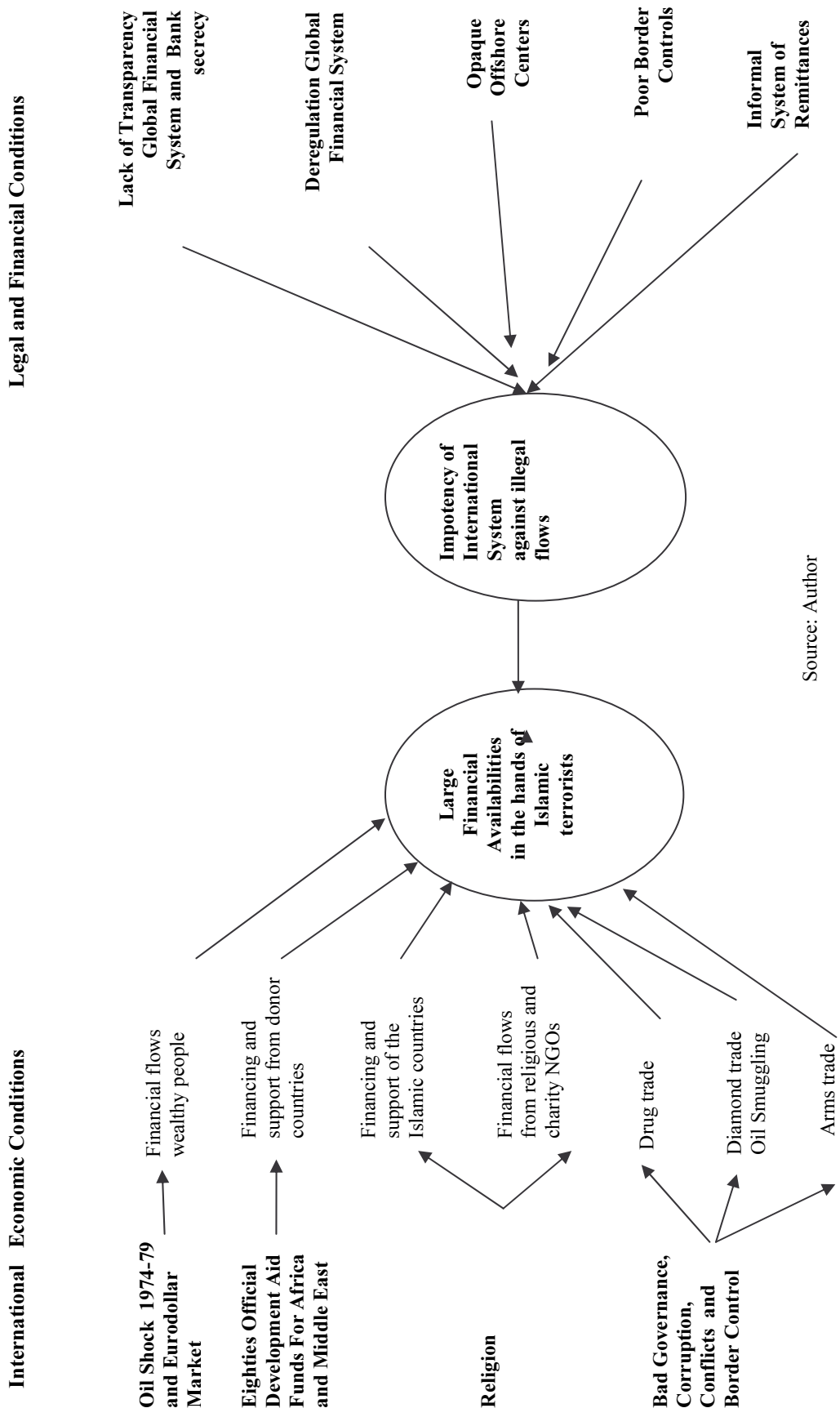
The goal of these two figures is to clarify what the risks and current abuses of the financial system are before the discussion in the following section.

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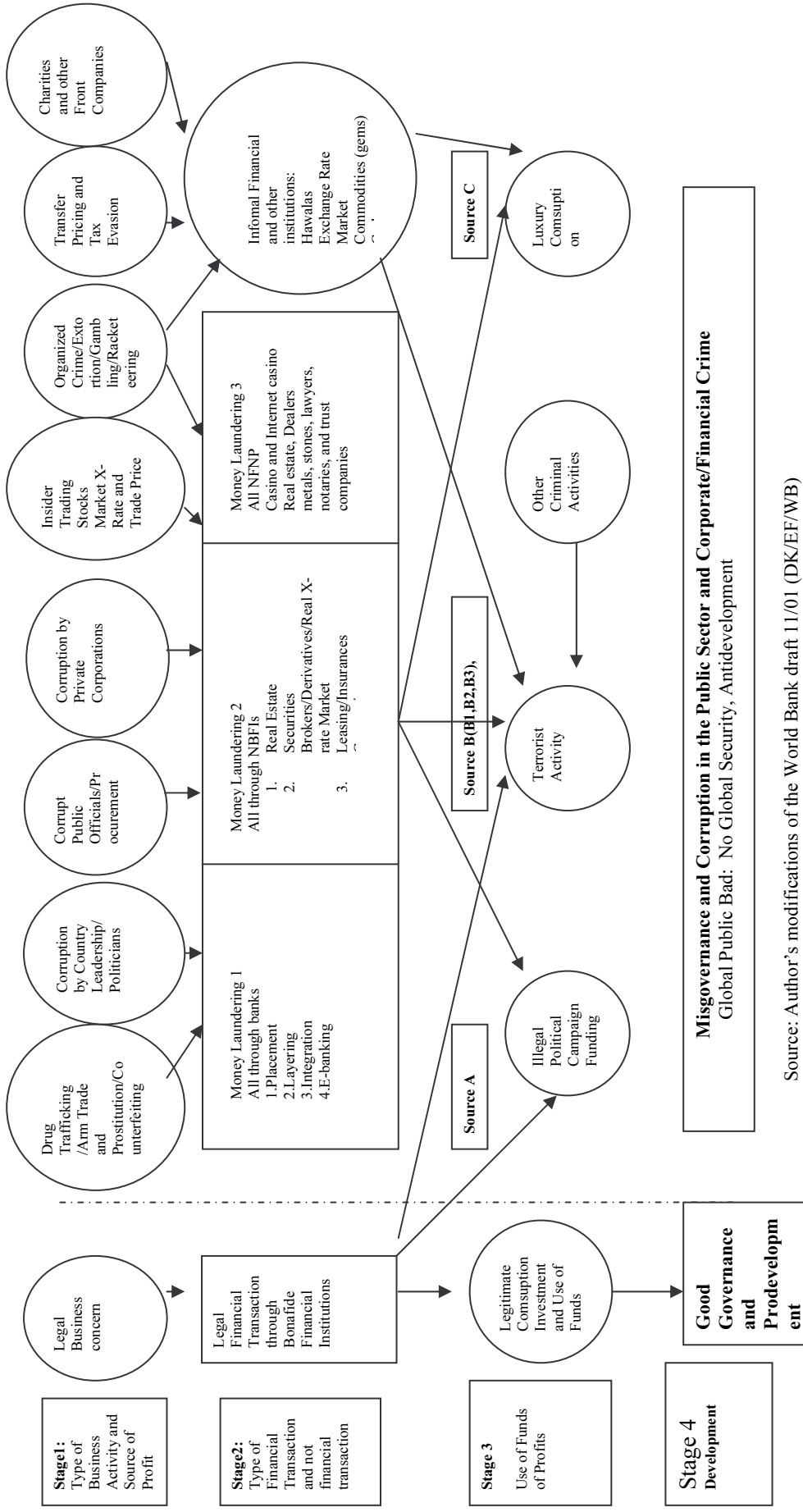
<sup>62</sup> *Robinson, J. (1994). The Laundrymen-Inside the World's Third Largest Business. . London, Simon and Schuster.*

<sup>63</sup> *"Jueces, fiscales y policías tienen cada vez más problemas para descubrir el fraude, que ha pasado del maletín a los 'brokers'". See, Urbano, A. (2006). El blanqueo de dinero se profesionaliza. El Mundo. Madrid: 44.*

**Figure 3.2 Background of Islamists Terrorist Financing**



**Figure 3.3 Far from a Simple Laundromat: ML and FT within a Broader Perspective-A Schematic Figure Misgovernance, Money Laundering and Terrorism**





### 3.4.2. Elements of an Emerging International Integrity Standard

The sections above in this chapter have described the factors contributing to Financial Abuse:

- Poor regulatory and weak supervisory framework and policies: (e.g., bank secrecy, lack of disclosure rules and the misuse of corporate vehicles).
- Jurisdictions with harmful tax practices.

In order to avoid the Economic Effects of Financial Abuse, the IOs have promoted the international cooperation to deterring the abuse of the Financial System. The emerging International Standards against Money Laundering and Terrorist Financing consolidate an international Regime that offers several solutions for creating favorable conditions to strengthen the legal, financial, and regulatory infrastructure capacity of countries around the world to better secure the international financial system.

The literature defines International Regimes as principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area. As a starting point, Regimes have been conceptualized as intervening variables standing between basic casual factors on the one hand and outcomes and behavior on the other.

Keohane (2005) defines Regimes<sup>64</sup> as “sets of governing arrangements that include networks of rules, norms, and procedures that regularize behavior and control its effects”. Jervis (2005) argues that the concept of Regimes “implies not only norms and expectations that facilitate cooperation, but a form of cooperation that is more than the following of short-run self-interest”. Keohane maintains that “Regimes can make agreement easier if they provide frameworks for establishing legal liability” (even if these are not perfect) also the egoistic self-interest is also regarded as an important determinant of Regimes by several other authors.

The IO has committed to improve the AML-CFT since September 11, 2001. OECD, WB, and IMF are the main institutions that have focused on these issues because of their concern to defend the integrity of the international financial system.

Money Laundering and Terrorist Financing are not typically linked to financial instability, but they should be...The most serious dangers arise when important

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<sup>64</sup> Regimes are also identified by Krasner (1983:2) as “sets of implicit or explicit principle, norms, rules, and decision-making procedures around which actors’ expectations converge in a given area of international relations”.

financial institutions are controlled by criminals, because in these circumstances the integrity and operations of the whole financial system can be compromised. For some countries and jurisdictions, the economic and financial impact could be significant. Once the integrity of an institution or financial center is brought into question, its long-term viability is at risk, with potentially serious economic consequences. Moreover, where there is a lack of integrity in financial systems, decisions on the allocation of resources are corrupted and investment is misallocated, dampening economic growth. (Aninat *et al.* 2002: 44)

IMF has approved the FATF Recommendations as the applicable international standards for AML/CTF. IMF assesses member compliance with financial sector codes and standards, including the supervisory for banking (Basel Committee), securities (IOSCO), and insurances (IAIS). An increasing emphasis is being given to the elements for protecting the integrity of the financial system as well the role of the ‘*soft law*’ to fight against the financing of terrorism as noted in the following quotation: “*IOs have been essential in developing antiMoney Laundering Regimes. In particular, IOs have elaborated “soft law”, which albeit not technically binding, has served as a precursor to “hard law”, and the UN has played a vital role in this respect*”. (Jordan 2001:138).

The AML/CFT consists of a series of Recommendations to be applied in countries and jurisdictions to deter the abuse of the Financial System by Organized Crime and Terrorist Networks.

Financial Integrity is explored in Johnston, Abbot *et al.* (2005) where the authors argue that the need to protect the integrity of the financial system is due to the warming links between organized crime and terrorist groups. The success against terrorism would result in part from important international engagement and cooperation. International understanding, collaboration, and capability are clearly necessary in this effort given the global nature of both the financial system and terrorism. Several international bodies, either public or private, implemented, over the last few years, a number of regulations and recommendations for preventing and reducing risks arising from increasingly complex and sophisticated crimes, and for protecting the stability of States and their markets. The reference points for ‘Integrity Standards’ are summarized by authors as follows:

- *FATF 40+9 Recommendations on anti-Money Laundering and combating the financing of terrorism.*

- *The Basel, IOSCO and IAIS Cores Principles, as well as the revised Basel Capital Accord or Basel II.*
- *The OECD Principles of Corporate Governance.*
- *Recent national legislation: The Sarbanes-Oxley in the Act in United States, and the U.K Financial Services and Markets Act (2000) and the proceed of crime Act (2002).*

The goals for this global scheme must include:

- The central goal is to reduce a range of financial crime, Money Laundering and terrorism financing and to protect the integrity of the core financial system. This Regime should make it harder and costlier for Terrorist Groups and other Transnational Crime groups to move money around the world and have built more stringent barriers in the international financial system to prevent its abuse.

The goals of reducing crime should be accompanied by the following:

- Removing profit from the crime through confiscation.
- Detecting Crime by following the money trail.
- Targeting third-party or professional launderers who, through their services, allow criminals to retain the proceeds of their crime.
- Targeting the upper echelons of the criminal organization.
- Removing dirty money from circulation.
- The second goal is to protect the integrity of the financial system and attain the transparency and accountability of the international financial system.
- To strengthen the legal, financial, and regulatory infrastructure capacity of countries around the world to better secure the international financial system against abuse by transnational actors, such as terrorist groups and their supporters.

Much of the initial focus of the global AML Regime was to implement legal and preventive Recommendations to monitor the core financial system, that is, particularly banks, since the banking system plays a central role in the collection and movement of funds. While the principal objective was to make it more difficult and expensive for criminal offenders to launder the proceeds of their crimes, an important subsidiary objective has been to protect the integrity of the financial system itself. The initial AML had to extend its initial scope to non financial institutions due to the evolution of Money Laundering Typologies and the Terrorist Financing Trends. The central policy question is

whether the anti-Money Laundering Regime needs to expand further to deter the abuse of the financial system by corruption and kleptocracy.

To reach the multiplicity of objectives which are also described by Carrington (2006) and Gunaratna (2006), it seems necessary for IOs to provide the following:

- Technical Assistance to strengthen legal and financial systems.
- Control of various jurisdictions with an uneven pace of progress.
- Convince countries of necessary improvement on international cooperation.

Other relevant is the impact of weak AML/CFT Frameworks on Financial Stability.

This research will discuss if the strategy on combating the financing of terrorism improves the cost-benefit ratio for states for participating in the CFT Regime. It will also discuss the benefits that states obtain when cooperating with international counter-terrorism norms and whether there is a cost for non-compliance with the AML/CFT for countries.

The research will also analyze whether IOs have paid greater attention to funding regional CTF enforcements mechanisms.

### **3.5. How Have International Organizations Responded to the Financial System Abuse?**

This chapter has discussed how the IOs responded to the financial system abuse by outside parties such as terrorist and money launderers through a cooperative AML/CFT Regime jointly with other standards for supervision of financial institutions. This Regime attempts to make it harder and costlier for Terrorist Groups and transnational crime groups to move money around the world as there are more stringent barriers placed to prevent this. The goals of the AML/CFT Regime are summarized as follows:

- To reduce financial crime, Money Laundering and Terrorist Financing.
- To protect the integrity of the international financial system, by achieving transparency and accountability.
- To strengthen the legal, financial, and regulatory infrastructure capacity of countries around the world to better secure the international financial system against abuse by transnational actors such as the terrorist groups and their supporters.

This chapter has also pointed out how variables such as: the ratio of the financial net exports, the cross border assets and liabilities and corruption could be explanatory factors of the overall compliance by jurisdictions with the AML/CFT Regime

The present dissertation will study the correlations between the overall compliance with the AML/CFT Regime and the cross border assets by jurisdictions (COBAS), taking into account the literature pointing out how cross border financial activity makes a potentially inviting mechanism for the laundering of funds and the financing of terrorism. The correlation between the overall compliance with the AML/ CFT Regime will also be calculated and the cross border liabilities by jurisdictions (COBLIS).

The use of the aforementioned definition of OFCs will permit the researcher to establish the correlation between the Ratio of Net Export Services and the overall compliance with the AML/CFT Regime by countries and especially OFCs. This correlation will show how financial intermediary countries have implemented the AML/CFT, and whether there are still loopholes in the list of countries within the sample which are not committed to implement the FAFI Recommendations on international cooperation for the purpose of the detection of Money Laundering and Terrorist Financing.

Also, considerations have been made to evaluate the correlation between the index of corruption in a country with the compliance of the AML-CFT Regime

Taking into consideration all the elements exposed in this chapter, the following chapter summarizes and assesses the main benefits and weaknesses of the AML/CFT Regime. This dissertation is focused on reviewing the FATF Recommendations' effectiveness to prevent banks, financial institutions, and non financial institutions from laundering the proceeds of criminal activities – in particular drug trafficking, organized crime activities, and manipulation of markets by insiders in order to judge the AML/CFT's effectiveness in combating the financing of terrorism.

## **CHAPTER 4**

# **The International Standards, Responsible Bodies against Money Laundering and Terrorist Financing, and the Effectiveness of the Measures Taken.**

## **Chapter 4. The International Standards, Responsible Bodies against Money Laundering and Terrorist Financing, and the Effectiveness of the Measures Taken.**

The goal of this chapter is to point out the failures and constraints of the combating of the financing of terrorism strategy as well as to propose the best way to evaluate the effectiveness of the measures taken. The beginning of this chapter explores the relevant initiatives in the sphere of combating the financing of terrorism strategy as well as their evolution. The second section pays special attention to the main constraints pointed out by scholars such as the problem of the multifunctional concept of AML/CFT, the legal challenge of the international soft law, the failure of preventive approaches, the different domestic agendas and national attitudes to preserve sovereignty, and the necessity to improve regulatory cooperation and information exchanges. To conclude, this chapter also examines how to evaluate the effectiveness of the AML/CFT Regime.

### **4.1. The International Bodies Responsible of the Fight against Terrorist Financing**

The solution to the international Money Laundering and Terrorist Financing problem must be sought via international mechanisms: both are global problems requiring a global solution. Money Laundering (ML) and Terrorist Financing (FT) is based on the exploitation of financial institutions, non-financial business professions, and the differences in the regulations of jurisdictions across the world. The solution to eliminating the purposes of ML and FT must be found in the international Recommendations that reduce these regulatory and legal differences between countries.

While domestic Money Laundering can often be fought at the national level by each country acting with determination and good policies, an effective solution to the Money Laundering [and Terrorist Financing] problem can be found only at the international level. (Tanzi, 1997:99)

In particular, the world has responded to the Terrorist Financing challenge with an important proliferation of norms after the events of September 11, UN Security Council Resolutions, European Union Directives and Regulations standards, statements and principles. This huge normative production notes the multiplicity of actors involved in the rule-making process. Indeed, numerous actors of a different legal nature have taken part in this development, from the UN Security Council, regional inter-governmental organizations such as the European Union, States (either ratifying international treaties, or

by implementing supranational measures) to such actors such as the FATF, an intergovernmental body, informal fora like the Basel Committee on Banking Supervision, the IOSCO, the IAIS, the Wolfsberg Group and the Egmond Group.

#### 4.1.1. The United Nations

Terrorism is regarded by the United Nations (UN) as a pervasive and pernicious threat to global security and order. The UN has become one of the key international entities in addressing a wide variety of complex problems of a global character. The UN has the broadest range of membership and the ability to adopt treaties or international Convention that have the effect of law in a country once signed and ratified, depending on a country's constitution. The United Nations (UN) was the first international organization to undertake significant action to fight Money Laundering on a "truly world-wide basis"<sup>65</sup>, and operates the Global Programme against Money Laundering (GPML)<sup>66</sup>.

Since the mid 1980s the need for a modern anti-money-laundering strategy has become widely accepted internationally. The negotiations of the 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances have been seen as the starting point of this trend. Progress in the area has actually become a critical tool in fighting organized crime, corruption, the financing of terrorism and in maintaining the integrity of financial markets.

The efforts realized by the UN against Money Laundering (ML) and Financing of Terrorism (FT) are the following:

- *The 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (The Vienna Convention):*<sup>67</sup>

The first call upon countries, deals with provisions to fight the illicit drug trade and related law enforcement issues. This Convention is limited to drug trafficking as a predicate offence and does not address preventive aspects.

Although it does not use the phrase Money Laundering, it defines the concept of Money Laundering and this definition has become the most widely accepted one.

The Convention came into force on November 11,1990.

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<sup>65</sup> United Nations, there are currently 191 member states of the UN from throughout the world. See "List of Members," [www.un.org/overview/unmember.html](http://www.un.org/overview/unmember.html)

<sup>66</sup> See: <http://www.imoling.org/imoling/gpml.html>

<sup>67</sup> See: <http://www.incb.org/e/conv/1988>, as of December 2005. See, [http://www.unodc.org/unodc/treaty\\_adherence.html](http://www.unodc.org/unodc/treaty_adherence.html) and The Vienna Convention Article 3(b) and (c)



In line with the role of Vienna Convention, Savona (1997) and Koh (2006) state: *“The Ratification of the Vienna Convention is becoming virtually an indicator of responsible membership in the anti-drug and anti-Money Laundering world community”*.(Savona 1997:68). *“In the international arena, the 1988 Vienna Convention for the first time established Money Laundering as ‘an independent criminal offence’ although it confined its application only to drug-related proceeds”*. (Koh 2006:43).

- *The 1999 International Convention for the Suppression of the Financing of Terrorism*<sup>68</sup>

The Convention is based on the assumption that *“the financing of terrorism is a matter of grave concern to the international community and that the number and seriousness of acts of international terrorism depend on the financing that terrorists may obtain”*.(Radicati and Megliani 2004:378).

The Convention requires ratifying countries to criminalize terrorism, terrorist organizations, and terrorist acts. Under this Convention, it is unlawful for any person to provide or collect funds with the intent that the funds be used for, or knowledge that the funds be used to conduct terrorist activities. The Convention encourages states to implement measures that are consistent with the FATF. It came into force in 2002.

This Convention<sup>69</sup> enhanced the cooperation between states in adopting effective measures while not being able for agree on a specific typological definition of Terrorist Financing. It called state parties to adopt domestic measures for the purposes of identifying, detecting, freezing or seizing funds used for (defined) terrorist offenses, ensure that financial institutions within their territories adopt efficient measures for the identification of clients and suspicious transactions. It recommended states to prohibit the opening of accounts by unidentified holders and asking for the licensing of all money transmission agencies.

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<sup>68</sup> <http://www.un.org/law/cod/finterr.htm> and UN(2006). Ratification, Accession, Succession or Signature of the Universal Instruments related to the Prevention and Suppression of International Terrorism, by date. New York, United Nations: 1-20.

<sup>69</sup> International Convention for the Suppression of the Financing of Terrorism, United Nations General Assemle Resolution 54/109 of 9 Dec.1999

- *The 2000 International Convention Against Transnational Organized Crime (The Palermo Convention)*<sup>70</sup>

The strategy of this Convention is to undermine and disrupt organised crime groups by focusing on their finances. The approach is well illustrated in Article 7 (1)(a) and 7(3)

Article 7(1a) shall institute a comprehensive domestic regulatory and supervisory Regime from banks and non-bank financial institutions and, where appropriate, other bodies particularly susceptible to money-laundering, within its competence, in order to deter and detect all forms of money-laundering, which Regime shall emphasize the requirements for customer identification, record-keeping and the reporting of suspicious transactions.

Article 7 (3) then calls upon participating countries “ to use a guideline” as remarked again by Gilmore; the referred guideline is FATF standards.

It came into force in September 2003. The Palermo Convention compels ratifying countries to criminalize Money Laundering via domestic law and typify all serious crimes as Money Laundering predicate offenses, whether committed within or without the country, and permit the required criminal knowledge or intent to be inferred from objective facts<sup>71</sup>.

Two further criteria for application are the most important contribution of the UN Convention against Transnational Organised Crime:

- The offence involves ‘an organised criminal group’
- And the offence is ‘transnational in nature’

Furthermore, it establishes regulatory Regimes to deter and detect all forms of Money Laundering, including customer identification, recordkeeping, and reporting of suspicious transactions; authorize the cooperation and exchange of information among administrative, regulatory, law enforcement, and other authorities, both domestically and internationally; consider the establishment of a financial unit to

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<sup>70</sup> [http:// www.undcp.org/adhoc/palermo/convmain.html](http://www.undcp.org/adhoc/palermo/convmain.html) and Gilmore, W. C. (2004). Dirty money : the evolution of international measures to counter money laundering and the financing of terrorism. Strasbourg, Council of Europe Pub.

<sup>71</sup> The Palermo Convention, Article 6

collect, analyze and disseminate information; and promote international cooperation.<sup>72</sup>

- Security Council Resolutions 1267 and 1390

Adopted in October 15, 1999 and January 16, 2002, respectively, They compel member states to freeze assets of individuals and entities associated with Ossama Bin Ladin or members of Al Qaeda or the Taliban that are included in the consolidated list maintained and regularly updated by the UN 1267 Sanctions Committee.

- Security Council Resolution 1373<sup>73</sup>

Unlike international Convention, a Security Council Resolution passed in response to a threat to “International Peace and Security “ under Chapter VII of the UN<sup>74</sup>. This SC resolution was adopted in September 28, 2001, in direct response to events of September 11, 2001. It compels countries to criminalize actions to finance terrorism and deny all forms of support for it ; freeze funds or assets of persons, organizations, or entities involved in terrorist acts; prohibit active or passive assistance to terrorists; and cooperate with other countries in criminal investigations and sharing information about planned terrorist acts.

- The 2003 United Nations Convention against Corruption

This was not in force before 2005. This is the first legally binding multilateral treaty to address on a global basis the problems relating to corruption. As of July 11, 2005, only 29 countries had become parties to the Convention to enter into force. It requires parties to institute a comprehensive domestic regulatory and supervisory Regime for banks and financial institutions to deter and detect Money Laundering. The Regimen must emphasize requirements for customer identification, record keeping, and suspicious transaction reporting.

- Global Program Against Money Laundering (GPML)

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<sup>72</sup> Id, 7 (1) (a)

<sup>73</sup> The strict hard law in the strictest sense have been developed by the Security Council through S/RES/1267; S/RES/1373, para.1; UN, S/RES1390, para.2. These are the major standards to define hard law. However, the resolutions do not provide additional guidance for their implementation in a real situation . See, (Koh 2006:155).

<sup>74</sup> <http://www.un.org>

GPML is a research and assistance project offering technical expertise, training and advice to member countries on anti-Money Laundering and counter-Terrorist Financing upon request to raise awareness. It helps to create legal frameworks with the support of model legislation; develop institutional capacity in particular with the creation of financial intelligence units; provide training for policymakers, judicial authorities, law enforcement bodies, regulators agencies and private financial sectors, including computer-base training ; promote a regional approach to addressing problems, maintain strategic relationships and databases and performing analyses of relevant information<sup>75</sup>.

- *United Nations Model Terrorist Financing Bill, 2003*

This model law has been developed by the United Nations Office on Drugs and Crime (UNODC) for use in countries whose fundamental legal systems are substantially based on the common law tradition. Like any model, it will need to be adjusted to ensure both domestic legal validity (e.g., in terms of constitutional principles and other basic concepts of its legal system) and domestic operational effectiveness (e.g., in terms of implementing arrangements and infrastructure).

- *The Counterterrorism Committee (CTC)*

In a number of subsequent resolutions, the Security Council refers to best practices, codes and standards as tools that can assist States in their implementation of the resolution. In its *resolution 1377 (2001)*, the Council invites the Committee “to explore ways in which States can be assisted, and in particular to explore with international, regional and subregional organizations...the promotion of best-practice in the areas covered by resolution 1373 (2001), including the preparation of model laws as appropriate....” In its *resolution 1456 (2003)*, paragraph 4 (iii), the Council requests the Committee, in monitoring implementation of the resolution, “to bear in mind all international best practices, codes and standards which are relevant to the implementation of resolution 1373 (2001)” and in its *resolution 1566 (2004)*, paragraph 7, the Council requests the Committee “in consultation with relevant international, regional and subregional organizations and the United Nations bodies to develop a set of best practices to assist States in

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<sup>75</sup> Report by the Chair of the Counter-Terrorism Committee on the problems encountered in the implementation of Security Council resolution 1373 (2001).

implementing the provisions of resolution 1373 (2001) related to the financing of terrorism”.

After a CTC revitalisation in 2004, a Executive Directorate was created. The key functions of The Counter Terrorism Executive Directorate (CTED) are: to provide in-depth analysis of the implementation of resolution 1373 (2001) by states; to engage states in a dialogue through letters, direct conversations and visits on a flexible and tailored basis; to act as a facilitator or broker of technical assistance to countries where has been identified vulnerabilities in its counter-terrorism responses. It can link this country or a donor country or international agency that has the relevant expertise to help it overcome the problem; and to keep in touch with international, regional and sub-regional organizations.

At this point, it is appropriate to outline how the actions taken by countries to meet international standards and reporting has created a huge burden, particularly for those low-income countries without capacity and resources, according to some scholars.

Murthy (2007) highlights *“Lack of interest among poor countries (some of whom believe that terrorism is a problem of the Western Countries) is due to the absence of incentives in return for their cooperation. (...) there is a huge deficit in the desired level of cooperation and coordination between regional/sub-regional organizations and the CTC”*. (Murthy 2007:8)

Ward (2003) points out that post 11 September, *“the council sets out certain mandatory measures to prevent and suppress international terrorism, including reporting to the CTC on actions taken to implement the resolution 1373(2001), no state met all the requirements, and it created a tremendous burden, particularly for those of a lesser degree of capacity and resources”*.(Ward 2003:289)

Here, it is likewise relevant to state the lack of resources and coordination between bodies and organizations in keeping with the works of several scholars.

Luck (2005) remarked that some operational areas including the Security Council as well the CTD *“remain understaffed and under-funded”* , and *“the proliferation of international of international counter-terrorism efforts raises worrisome questions about coordination and coherence, even as it should quell*

*claims that this is a simple choice between unilateralism and multilateralism, between going it alone and working with others”.*( Luck 2005:25)

Similarly to Koh(2006), the present researcher considers that the question of sanctions deserves great attention as a strategy to make the AML/CFT campaign effective. When a country, upon assessment is found to be non-compliant with the AML/framework, the international community might impose sanctions on that country. The CTC has not applied its chapter VII powers to impose sanctions on states which are not compliant with the requirements of Resolution 1373. At present, CTC only reports a list of states who are late in submitting state reports in accordance with Resolution 1373

Regarding the impact of corruption on Money Laundering and Terrorism issues, two more Convention have been taken into account for the scope of this research:

- *The 2003 United Nations Convention against Corruption*

By its resolution 58/4 of 31 October 2003, the General Assembly adopted the United Nations Convention against Corruption. In accordance with article 68 (1) of the aforementioned resolution, the United Nations Convention against Corruption came into force on 14 December 2005. The Convention is also concerned with the links between corruption and forms of crime in particular, organized crime and Money Laundering. In the timeframe of this dissertation, few parties have ratified this important Convention.

- *1987 OECD Antibribery Convention*

This Convention has been included in the list of compulsory Convention to strengthen the legal system against Money Laundering and Terrorist Financing, because it was among the first International Convention to compel countries to implement anti-bribery laws, and tougher sanctions, and to improve international co-ordination and co-operation over the past decade. Angel Gurría states:

“‘Much more needs to be done to fight international corruption,’ some countries are still holding back on implementing the Convention. They have almost no investigations. They have brought no cases to court. They are not being proactive(...) ‘This needs to change,’ he said. Without credible action across a broad front, pressures will build on governments - even those who are currently strong performers - to go the other way. There is a big risk that countries will go back to doing ‘business as usual’, including corruption. The only way to prevent this is to

ensure that everyone plays by the same rules. We need practical measures, and, more importantly, we need political commitment." (OECD Secretary-General Angel Gurría, November 2007.Roma).

#### **4.1.2 .The Financial Action Task Force and the Mutual Evaluation**

The role of the FATF body relies upon what are technically '*non binding standards*' supported by a soft enforcement mechanism. The roots of Counter Terrorist Financing lie in the anti-Money Laundering initiatives adopted globally, regionally and nationally during the 1990s. The Forty Recommendations of the Financial Action Task Force (FATF) constitute the international standard for effective anti-Money Laundering and the combating of Terrorist Financing measures.

The FATF regularly reviews its members to check their compliance with these Forty Recommendations (as well as the Nine Special Recommendations on Terrorist Financing) and to suggest areas for improvement through periodic mutual evaluations. The FATF also identifies emerging trends and methods used to launder money and suggests measures to combat them. An extensive analysis of the funding methods of terrorist groups and of the financial resources supporting terrorist activities has been carried out by the Financial Action Task Force (FATF), as highlighted in chapter 2.

The FATF is an intergovernmental organization established in 1989 by the G7<sup>76</sup> country states, working as a policy-making group prepared for suggesting legislative and regulatory action to counter Money Laundering<sup>77</sup>.

The *Forty Recommendations*<sup>78</sup> issued in 1990 and updated in 1996 constitute a legal framework involving patterns of Money Laundering. These include requirements for states to criminalize Money Laundering activities, to adopt customer identification and record-keeping practices, and to commit themselves to cooperating with other states and International Organizations in anti-Money Laundering activities. This case of "soft law" responds to the logic of informal commitments, which States can spontaneously comply

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<sup>76</sup> The G-7 countries are Canada, France, Germany, Italy, Japan, the United Kingdom and the United States

<sup>77</sup> [http:// www.fatf-gafi.org/](http://www.fatf-gafi.org/). Membership of the FAFT includes 29 countries plus two regional organizations (EC and Gulf Cooperation Council), representing all the main financial centres in North America, Europe, Asia and the Middle East, who band together for the purposes of investigating means to combat money laundering in all its forms. The FAFT coordinates global anti-money laundering activities working together with a variety of regional and international organizations.

<sup>78</sup> The Forty Recommendations, [http://www.fatf-gafi.org/pdf/40Recs-2003\\_en.pdf](http://www.fatf-gafi.org/pdf/40Recs-2003_en.pdf)

with. In this case, the efforts undertaken by the FAFT constitute the general and main reference for international and domestic legislation.

The 2001 FAFT review identified a problem: Money Laundering is actively investigated and prosecuted in a limited number of countries, while elsewhere the offence is not frequently prosecuted. The UN General Assembly Resolution 51/210 of 17 December 1996 recognized the specific nature of Terrorist Financing, not only where it is linked to drug dealing, arms trafficking and other criminal methods, but also to legal and non-criminal institutions.

At an extraordinary plenary meeting on the financing of terrorism held in Washington (2001), the FAFT <sup>79</sup> decided to expand the function of the FAFT beyond Money Laundering. Eight Special Recommendations were appended to the existing Forty Recommendations. Thus, the list of potential legal sources of finance was expanded to include the collection of membership dues and/or subscriptions, sales of publications, speaking tours, cultural and social events, and examples of legitimate businesses supporting terrorism, including publishing, food production, building construction and computers.

The UN and FATF Recommendations set the root and direction for national efforts aimed at reducing the vulnerability of domestic financial systems to terrorist manipulation. Anti-Money Laundering legislation was finally especially extended to deal with Terrorist Financing. There should be little difficulty in expanding the scope of domestic and international anti-Money Laundering measures and other measures and legislation to cover the funding and Money Laundering activities of terrorist networks. But the key factors lie in 'legitimate sources', state financial sponsorship, donations and contributions from supporters which complicates the puzzle.

The lack of regulation of the financial system offering attractive opportunities to terrorists to achieve their criminal goals, enabling a profitable management of financial resources as well as their transfer through informal banking channels, adds complexity to the situation. For this reason, combating the financing of terrorism turns out to be more than combating an ordinary financial crime because of the involvement in the financing of terrorism of legitimate entities and legitimate financial resources, trade, humanitarian aid,

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<sup>79</sup> See : ( *FATF-GAFI 2001a*: 16-19).



etc... which use small amounts of money and the banking networks, to elude the existing monitoring and controlling schemes.

#### 4.1.2.1. Mutual Evaluation Assessment

This research is focused on determining the level of the overall compliance with the AML/CFT Regime by 46 countries. In the conclusion to the 1990 FATF report it was admitted that “*a regular assessment of progress realized in enforcing Money Laundering measures would stimulate countries to give to these issues a high priority.*” (Levi 2002b:96). FATF II decided to supplement a process of self assessment with a system of mutual evaluation, examined by selected other members of the FATF, according to an agreed protocol for examination and agreed selection criteria. Since the initial round of mutual evaluation, the major purpose of this mutual evaluation has been to assess the degree of formal compliance with the Recommendations.

Levi and Gilmore have underlined the international significance of the FATF precedent of the rise of Mutual evaluation processes:

That to submit to periodic on- site inspection by one’s peers, constituted a radical departure from the orthodoxy of international affairs, where considerations of autonomy and sensitivities about territorial sovereignty have traditionally dominated governmental thinking (Levi, 2002b :108).

They considered the FATF Recommendations are a form of ‘*soft law*’ and these Recommendations do not formally entail a matter of international law. Some Recommendations may have been implemented into customary international law but many are regarded as lacking in any mandatory legal effect.

In line with the use of mutual evaluation reports to evaluate the compliance with the FATF Recommendations by countries/jurisdictions, Savona (1997) points out that one of the most delicate problems of the anti-Money Laundering regulation and its control is that the enactment of legislation and issuance of regulations are obvious important steps, but their implementation is more important and more difficult to assess objectively. Official data on implementation, such as that provided though the mutual evaluation reports<sup>80</sup> of the

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<sup>80</sup> The present author when was researching how to obtain the information about mutual evaluation reports take into account the recommendations given by IOs officials. An UNODC official suggested looking through the websites of regional FATF-style bodies: “*there you will find reports and evaluation results of FIU and AMF/CFT regimes*” . Also a FATF official answered to the questionnaire that “*to find the statistics that you are looking for, I would suggest that you consult the FATF mutual evaluation*

FATF are essential for him. He also referred in his work to the difficulties in analyzing cross laundering data from different countries because every country will display peculiarities in criminal behaviours, policies, implementation, recording and reporting, which makes any kind of meaningful aggregation difficult.

Each member country is examined in turn by the FATF and FSRBs. These evaluations are based on the FATF 40+9 Recommendations and performed using the Evaluation Methodology of 2004. The scope and purpose of these evaluations<sup>81</sup> is to assess whether the necessary laws, regulations or other measures required under the standards are in effect and force. These evaluations also report whether the implementation of the measures has been effective.

The assessment involves an on-site visit conducted by a team of four to six selected experts in legal, financial and law enforcement fields from other governments, and led by two members of the secretariat. The purpose of each visit is to draw up a report assessing the extent to which the evaluated country has moved forward in implementing an effective system to counter Money Laundering and Terrorist Financing, and to highlight areas in which further progress may still be required. (FATF-GAFI 2006:6)

Considering that the mutual evaluation report is the best tool for evaluating the implementation of FATF Recommendations by countries, the dependent variable in this dissertation is represented by the overall compliance<sup>82</sup> with the FATF Recommendations by each country. This variable captures the jurisdiction's behaviour in conforming with the explicit FATF Recommendations and Special Recommendations. The scores of compliance with FATF Recommendations by 46 countries are the qualitative result of the implementation of the primary rule system provided by mutual evaluation reports. Speaking of compliance with FATF Recommendations, this concept captures the fact that

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*reports for FATF member countries that are published on our website at [www.fatf-gafi.org](http://www.fatf-gafi.org)". Furthermore, a Moneyval Official recommended to the author "to visit the FATF website [www.fatf-gafi.org](http://www.fatf-gafi.org), which contains many interesting documents, including evaluation reports, that might be useful for your research. Also a Reserve Federal Bank official recommended to the author to try the IMF/World Bank AML assessments for various countries. FATF started a third round of mutual evaluations for its members in January 2005.*

<sup>81</sup> *"Although the FATF does not have a formal binding enforcement mechanism, it has developed a non-compliance policy to ensure that all FATF member countries reach a satisfactory level of compliance with the Forty Recommendations. For the purpose of applying the policy, it has relied on a combination of the findings of both mutual evaluations and self-assessments exercises. The measures contemplated by this policy represent a graduated approach aimed at enhancing peer pressure."* (Koh 2006:162)

<sup>82</sup> Definitions of compliance, primary rule system, a compliance information system and a non-compliance response system can be found at Mitchell (2006:141-143).

countries/jurisdictions may well comply with some Recommendation while not comply with others.

In the view of the results of this research, it will be concluded whether '*the mutual evaluation*' report constitutes a '*consistent information system about compliance*' and also whether these mutual evaluation reports include a strong non-compliance<sup>83</sup> response system.

To date, the non-compliance policy responses have been active in order to subject FATF member countries to R21 whenever they are non-compliant with FATF Recommendations and, the imposition of a further step that has consisted of suspending the jurisdiction's membership of the FATF until the Recommendations have been implemented. The issue of non-compliance policy merits greater examination by this researcher in the sense of 'establishing the minimum compliance' that should be achieved among FATF members because at present the Recommendations permit a great discretion in their application.

#### **4.1.2.2. FATF Regional Bodies and Relevant Groups**

Compliance with AML/CFT assessments are conducted by the IMF and the World Bank in the context of the Financial Sector Assessment Program as well as by the FATF-Style Regional Bodies (FSRBs) in the above-mentioned process of mutual evaluations among their members. All AML/CFT assessments are carried out in accordance with the revised 2004 methodology. Reference to '*assessor bodies*' is therefore a reference to the IMF, the World Bank, FATF and all FSRBs. Currently, there are 8 FATF-Style Regional Bodies representing different regions of the world.

The ideal model for an FATF-style regional body would be: a local group exerting peer pressure among its members and whose mutual evaluation procedures had been endorsed by the FATF: one or several FATF members

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<sup>83</sup> The adoption of the non-compliance policy has employed in the following cases: Turkey and Austria (...) Turkey was found to lack the necessary laws to cope with money laundering (1997). Accordingly, the measures contained in Recommendation 21 were imposed, and it responded to this sanction by enacting the necessary laws and regulations, thus resulting in the lifting of Recommendation 21[ where such a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate countermeasures]. In the case of Austria, it adhered to its position with regard to anonymous passbooks for Austrian residents (...). FATF issued a public statement on 3 February 2000 which stipulated that the Austrian government would be suspended as a member of the FATF. However by 20 May 2000 the Austrian government took corrective actions.(...) Seychelles, as a non member, was subject to the measures of Recommendation 21 in 1996 due to its investment law. For further discussion on non compliance policy see: (Koh 2006:163-164); and (FATF 2001b:43-44).

present in secretariat which would liaise regularly with the FATF. Moreover the presidents/secretariats of each FATF-style regional body should become full members of the FATF. The FATF-style regional bodies should also be committed to the Forty Recommendations and to any other anti-Money Laundering principles they wish to endorse to reflect local problems. The main task of these bodies should include conducting mutual evaluations of their members and carrying out self-assessment surveys and regional typologies exercises.(FATF IX,PLEN/12.BIS.REV reproduced from (Koh 2006:178).

The FSRBs are voluntary and cooperative organizations. Membership is open to any country or jurisdiction within the given geographic region that is willing to abide by the rules and objectives of the organization. The FSRBs that are currently recognized by FATF are:

1. Asia Pacific Group on Money Laundering ( APG)<sup>84</sup>
2. Council of Europe (MONEYVAL)<sup>85</sup>
3. Easten and Southern Africa Anti-Money Laundering Group (ESAAMLG)<sup>86</sup>
4. The Caribbean Financial Action Task Force (CFATF)<sup>87</sup>

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<sup>84</sup> See, <http://www.apgml.org>. Member jurisdictions are: Australia, Bangladesh, Brunei Darussalam, Cambodia, Chinese Taipei, Cook Islands, Mongolia, Nepal, New Zealand, Niue, Pakistan, the Republic of Korea, Palau, Philippines, Samoa, Singapore, Sri Lanka, Thailand, the United States and Vanuatu. Observer jurisdictions are: Canada, France, the Lao People's Democratic Republic, Papua New Guinea, the Republic of Kiribati, Republic of Maldives, Republic of Nauru, Tonga, Myanmar, United Kingdom and Vietnam. Observer organizations are: Asian Development Bank (ADB), Asia Pacific Economic Cooperation (APEC), Association of South East Asian Nations (ASEAN), Caribbean Financial Action Task Force (CFATF), the Commonwealth Secretariat, Egmont Group, FATF, IMF, INTERPOL, Offshore Group of Banking Supervisors (OGBS), the Pacific Financial Technical Assistance Centre (PFTAC), Pacific Islands Forum Secretariat (PIFS), the World Bank, World Customs Organization (WCO) and United Nations (UN). International Drug Control Programme (UNDCP) and United Nations Office on Nations Office.

<sup>85</sup> See, <http://www.coe.int/moneyval/>. Members are: Albania, Andorra, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia Hungary, Latvia, Liechtenstein, Lithuania, Malta, Moldova, Poland, Romania, Russian Federation, San Marino, Serbia and Montenegro, Slovakia, Slovenia, Former Yugoslav Republic of Macedonia and Ukraine. Observer jurisdictions are: Canada, Holy See, Japan, Mexico, the United States. Observers organizations are: Commission of European Communities, Commonwealth Secretariat, European Bank for Reconstruction and Development (EBRD), FAF, IMF, Interpol, OGBS, WCO, UNODC. According to a Moneyval Official, *“the role of Moneyval is to evaluate and adopt reports on the performance of member states of the council of Europe, which are not members of the FATF in complying with the relevant international anti-money laundering and countering terrorist financing standards. As a result of the evaluation process, a report is adopted for each country. These reports under the 1<sup>st</sup> (1998-2000) and 2<sup>nd</sup> (2001-2003) round evaluation remain confidential but a summary is made public. As from the 3<sup>rd</sup> evaluation round (2004-2008) a country may authorise the publication of its report. Since November 2006 amended Rules of Procedure provide of automatic publication of mutual evaluation reports 3 months after adoption of evaluation reports. You may find the published evaluation and progress reports on the website.*

<sup>86</sup> See, <http://www.esaamlg.org/> Members are: Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Seychelles, Tanzania, Uganda, Zambia and Zimbabwe.

5. GAFISUD<sup>88</sup>.

6. Le Groupe intergouvernemental d'action contre le blanchiment de l'argent en Afrique (GIABA)<sup>89</sup>.

7. The Euroasian Group on Combating Money Laundering and the financing of terrorism (EAG)<sup>90</sup>.

8. Middle East & North Africa Financial Action Task Force against Money Laundering and Terrorist (MENAFATF)<sup>91</sup>.

9. The offshore group of banking supervisors (OGBS)<sup>92</sup>

FATF associate members are: APG, MONEYVAL, GAFISUD and MENAFATF.

FATF observer bodies are: CFATF, EAG, ESAAMLG, OGBS AND GIABA.

The sample selected for this research will show how many mutual reports are published by each FSRB. The results of the quantitative analysis will inform us about the overall compliance with the AML/CFT by FSRBs and show what level of commitment each FSRB has to combat Money Laundering and Terrorist Financing.

#### 4.1.2.3. Non Cooperative Countries and Territories (NCCTs)

With regard to non-member countries, the FATF also applies the measures of Recommendation 21 as it does with member countries. Nonetheless, the FATF can recommend broader countermeasures<sup>93</sup>. Non Cooperative Countries and Territories (NCCTs) exercise began in 1998 when the majority of the countries did not have AML

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<sup>87</sup> See, <http://www.cfatf.org/> Members are: CFATF members are Antigua & Barbuda, Anguilla, Aruba, The Bahamas, Barbados, Belize, Bermuda, The British Virgin Islands, The Cayman Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Republic of Haiti, Honduras, Jamaica, Montserrat, The Netherlands Antilles, Nicaragua, Panama, St. Kitts & Nevis, St. Lucia, St. Vincent & The Grenadines, Suriname, The Turks & Caicos Islands, Trinidad & Tobago, and Venezuela.

<sup>88</sup> See, <http://www.gafisud.org/> Members are: Argentina, Bolivia, Brasil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay

<sup>89</sup> See, <http://www.giabasn.org/> Members are the Community of West African States (ECOWAS), Benin, Burkina-Faso, Cote D'Ivoire, Guinea, Mali, Niger, Togo, Senegal, Gambia, Ghana, Liberia, Nigeria, Sierra Leone, Guinea Bissau and Cape Verde

<sup>90</sup> See, <http://www.eurasiangroup.org/> <http://www.eurasiangroup.org> Members are: Belarus, Kazakhstan, Russia, Uzbekistan, China, Tajikistan, Kyrgyzstan, Kazakhstan, Uzbekistan

<sup>91</sup> See, <http://www.menafatf.org/> Members are: Jordan, United Arab Emirates, Bahrain, Algeria, Tunisia, Saudi Arabia, Sudan, Syria, Republic of Iraq, Oman, Qatar, Kuwait, Lebanon, Egypt, Morocco, The Islamic Republic of Mauritania and Yemen

<sup>92</sup> See, <http://www.ogbs.net> Members are: Aruba, Bahamas, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Labuan, Macau (China), Mauritius, Netherlands Antilles, Panama, Vanuatu and Samoa (observer).

<sup>93</sup> For further discussion on these countermeasures that “*should be gradual, proportionate and flexible regarding their means and taken in concerted action towards a common objective*” see (FAFT 2002:6) as well as cited in (Koh 2006:164).

measures in place. The intent of this initiative is to secure the adoption by all financial centers of international standards to prevent, detect and punish Money Laundering, and to reach effective international cooperation in the global fight against Money Laundering and the financing of terrorism.

In February 2000, the FATF published the initial report on NCCTs, which included 25 criteria identifying detrimental rules and practices that impede international co-operation in the fight against Money Laundering. The exercise reviewed 47 jurisdictions in two rounds of reviews (31 in 2000) and (16 in 2001). A total of 23 jurisdictions were identified as NCCTs (15 in 2000<sup>94</sup> and 8 in 2001<sup>95</sup>). No additional jurisdictions have been reviewed under this process since 2001. (FATF-GAFI 2006)

In the last year the FATF agreed to THE removal of Nauru and Nigeria from the Non-Cooperative Countries and Territories (NCCT) list. The FATF is also ending a formal monitoring of countries de-listed prior to June 2005. The future monitoring of these countries will be conducted within the context of the relevant FSRBs and their evaluation mechanisms. Some of the countries within the sample have been pressured because of their being unregulated jurisdictions and have been included in the Non-Cooperative Countries and Territories (NCCT) list in 2000-2001, which includes countries such as Panama and Hungary. Special attention will be paid to the evolution of the AML/CFT implementation on these countries in this dissertation. Only Myanmar is still considered by the FATF to be an NCCT.

In the case of NCCT<sup>96</sup> countries, stronger measures should be put in place in accordance with FATF<sup>97</sup>, consisting in measures such as: actions to put an end to the

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<sup>94</sup> Antigua y Barbuda, Belize, Bermuda, British Virgin Islands, Cyprus, Gibraltar, Guernsey, Isle of Man, Jersey, Malta, Mauritius, Monaco, Samoa, Seychelles, St Lucia, Vanuatu, *Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts & Nevis, St Vincent & the Grenadines*. (The 15 jurisdictions identified as NCCTs at that time are in italics).

<sup>95</sup> Costa Rica, Czech Republic, Palau, Poland, Slovakia, Turks & Caicos Islands, United Arab Emirates, Uruguay, *Egypt, Grenada, Guatemala, Hungary, Indonesia, Myanmar, Nigeria and Ukraine*. (The 8 Jurisdictions identified as NCCTs at that time are in italics)

<sup>96</sup> Discussion on the controversy of a non-universal body seeks to enforce non-binding standards on non member countries (NCCT); see *Koh (2006)*; *Mitsilegas (2003)*; and *Jonhson et al (2002)*. It has been seen that FATF member countries consider the domestic policies and legal systems of the identified NCCTs to be undermining their legitimate national interest; in other words, the FATF members imposed a 'standardisation'. (e.g. In October 2007, the FAFT is concerned that the Islamic Republic of Iran's lack of a comprehensive (AML/CFT) regime represents a significant vulnerability within the international financial system. The FATF calls upon Iran to address on a urgent basis its AML/CFT deficiencies. The FAFT members are advising their financial institutions to take the risk arising from the deficiencies in Iran's AML/CFT regime into account for enhanced due diligence.

detrimental rules and practices, counter-measures designed to protect economies against money of unlawful origin; specific requirements for financial institutions in FATF members to pay special attention to or to report financial transactions conducted with individuals or legal entities having their account at a financial institutions established in a ‘non-cooperative jurisdiction’; conditioning, restricting, targeting or even prohibiting financial transactions with non-cooperative jurisdictions. Two failures of the NCCT criteria application have been found :

- Firstly, the list does not contain references to CFT requirements, “*if they included these [CFT] elements in the future, there could be secured a link to the binding resolutions of the Security Council (...). Security Council Resolution 1373 imposes binding obligations on all states to suppress the financing of terrorism and in this sense, there could be further justification for the NCCT initiative under the authority of Security Council .*” (Koh 2006:166).
- Secondly, The FATF members have imposed a standardisation of its standards to Non FATF members. When applying its Recommendation 21 measure for not observing is AML/CFT compliance, it has been rare for the FATF to inform the CTC of this fact. The present researcher agrees with Koh that this lack of initiative to list of a ‘non-compliant state twice’ by FATF and CTC, has decreased the effectiveness of AML/CFT strategy worldwide.

#### **4.1.3. Standards for Strengthening Financial Regulation**

This section will pay attention to the weaknesses in infrastructure underpinning regulatory systems linked to the integrity of the financial system such as the Basel Committee, IAIS, IOSCO. It should be noted at this point that the regulation relies on its members to implement its Recommendations within their respective countries. Reports on overall compliance with Integrity Standards found that regulators had a lack of authority to investigate, limited access to time-sensitive data needed for surveillance purposes, insufficient resources for inspection, surveillance and investigation, and often a limited enforcement mandate. The reports also underline that there is a clear need for more efficient methods to disseminate information to the public and to improve the quality of the information being released.

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<sup>97</sup>For further detail on counter-measures, see (FATF 2000:7-9)

Reports conclude that weaknesses in the implementation of many of the BCP, IAIS AND IOSCO principle were evident across a range of jurisdictions, although the most marked concerns were those related to assessments of developing and emerging markets. The implementation of these rules applicable to financial systems greatly differs among countries within the same region. For this reason, one should point out the necessity to supplement and emphasize effective regional '*surveillance*' mechanisms for the improvement of all integrity standards.

#### 4.1.3.1. The Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (Basel Committee) was formed in 1974 by the central bank governors of the Group of 10 Countries<sup>98</sup>. It has issued three documents covering money-Money Laundering issues:

- *Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering*. It contains 4 principles that should be used by banking institutions:
  - Proper customer identification
  - High ethical standards and compliance with laws and regulations
  - Cooperation with law enforcement authorities
  - Policies and procedures to be used to adhere to.
- *The 25 Core principles for effective Banking Supervision*, stipulating that bank supervision must determine that they have adequate policies and procedures in place, including strict know-your-customer (KYC) rules. Core principle 15 is linked to AML policies put in place.
- *A paper called 'Customer Due Diligence for banks'*, this paper provides extensive guidance on an appropriate CDD policy.

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<sup>98</sup> <http://www.bis.org/index.htm>.

The group of 10 countries is a misnomer, since there are 13 member countries. The Basel committee members, ( as well as the Group of 10) are: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States.

Also, a private initiative as the Wolfsberg Group has developed a Guidance on a Risk Based Approach for Managing Money Laundering Risks to support risk management and assist institutions in exercising business judgement with respect to their clients. The Wolfsberg Group consists of the following leading international financial institutions: ABN AMRO, Banco Santander, Bank of Tokyo-Mitsubishi-UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Société Générale, and UBS. See: [http://www.baselgovernance.org/fileadmin/docs/pdfs/Industry\\_standards/Wolfsberg\\_RBA\\_paper.pdf](http://www.baselgovernance.org/fileadmin/docs/pdfs/Industry_standards/Wolfsberg_RBA_paper.pdf)



Recent assessments<sup>99</sup> of compliance with these regulatory standards found that 45% of the evaluated countries (36) have inadequate or no legal framework to comply with the Core Principle 15. The report states the following:

Preconditions for effective banking supervision are generally in place in advanced economies. In developing countries, a number of shortcomings in the underpinning infrastructure were observed: transparency is rather low, at times due to opaque financial statements and problems in accounting and auditing. However, many emerging markets that recently experienced the transition to market economies face substantial challenges in making their accounting systems consistent with international practices, and the need to test and properly implement recent changes in their legal system.(IMF 2004:13)

#### **4.1.3.2.The International Association of Insurance Supervisors**

The use of insurance for the scope of Money Laundering has been discussed in previous chapters of this dissertation. The international Association of Insurance Supervisors (IAIS) established in 1994 represents the insurance supervisory authorities from 130 jurisdictions. The role of the IAIS is to:

- Promote cooperation among insurance regulators
- Set international standards for insurance supervision
- Provide training to members
- Coordinate work with regulators in the other financial sectors and international financial institutions.

In January 2002, the association issued the Guidance Paper No.5, Anti-Money Laundering Guidance Notes for Insurance Supervisors. This AML Guidance note should be implemented by jurisdictions taking into account, the particular kind of insurance business offered within and the characteristics of its financial and legal system.

Recent assessments of the IAIS Core Principles on Insurance Supervision on 42 countries concluded: “*that there is unclear jurisdiction of the insurance supervisory bodies*

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<sup>99</sup> The FSAP assessments and key cross sector structural and regulatory risk factors in 36 countries show that: in Africa, regulators and regulated at less than arm’s length distance and regulatory resources are inadequate, consolidated supervision is not in place, and regulatory cooperation are ill-defined; in Asia, regulation is still on single lines of activity, in Europe the financial systems are strongly exposed to internazionalization of capital flows; in Middle East and Central Asia, there is no instance of a unified regulator and there is a prevalence of Islamic financial principles; in Western Hemisphere, there is problem of disclosure and related party and intra-group transactions.

*over corporate governance issues, and the system depends on general corporate laws and regulations*". The report also shows: *"absence and deficiencies in the exchange of information with other supervisors "*. (IMF 2004:31).

#### **4.1.3.3. The International Organization of Securities Commissioner**

The use of the securities for the scope of the Money Laundering and Terrorist Financing has been discussed in previous cases. The International Organization of Securities Commissioners (IOSCO) passed a 'Resolution on Money Laundering' in 1992. The resolution provides that each IOSCO member should; consider customer identifying information record-keeping requirements; ensure monitoring and compliance procedures designed to deter and detect Money Laundering; and have appropriate powers to share information in order to combat Money Laundering.

Recent assessments of the IOSCO show that, assessors overall found that regulators had a lack of authority to investigate, had limited access to time-sensitive data needed for surveillance purposes, insufficient resources for inspection, surveillance and investigation, and often a limited enforcement mandate. With respect to issuers, there is a clear need for more efficient methods to disseminate information to the public and to improve the quality of the information being released. There is a need to address the lack of harmonization between international and domestic accounting and auditing standards.

#### **4.1.4. The Egmont Group of Financial Intelligence Units**

Few Financial Intelligence Units were created in 1990 in response to the lack of a central agency to receive, analyze and report the heterogeneous information to combat terrorism. The informal international association of The Egmont Group<sup>100</sup> had 95 members at the end of 2005, in 2003 the FATF included explicit Recommendations on the establishment and functioning of FIUs. Over the last years the IMF and WB have recognized the importance of an FIU in the anti-Money Laundering/combating the financing of terrorism (AML/CFT) and they have provided technical assistance to countries in the establishment and strengthening of FIUs.

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<sup>100</sup> For a broad explanations of the Financial Intelligences Units, see WB, I. a. (2004). Financial Intelligence Units: An Overview, International Monetary Fund ,149.  
see <http://www.egmontgroup.org/> and see [http://www.egmontgroup.org/statement\\_of\\_purpose.pdf](http://www.egmontgroup.org/statement_of_purpose.pdf).  
for list of FIUs See [http://www.egmontgroup.org/list\\_of\\_fius\\_062304.pdf](http://www.egmontgroup.org/list_of_fius_062304.pdf)

The existence of an FIU is justified due to criminal behaviour which is compared by contributors in a WB report like a *stream of water, following gravity and constantly prodding the banks for weak points through which it can spread further*. And this behaviour is the main challenge currently to be face by FIUs. “*FIUs currently face more specific challenges. The most important ones are the integration of the financing of terrorism in their work, the broadening of the suspicious transaction reporting obligation beyond the regulated financial sector, and the quest for improved international cooperation*”. (WB 2004:92)

Traditional FIUs have been used to deal with Money Laundering, but the strategy to fight against terrorism is different and it will force FIUs to integrate new functions (above all ) in those countries that never have faced terrorism.

The extension of the reporting in the case of the Designated non-financial businesses and professions: casinos (which also includes internet casinos), real estate agents, dealers in precious metals, dealers in precious stones, the accounting and legal profession have had and will have a wide implication for FIUs. I predict the FIUs will have to devote specialized resources to supervise the new types of reports coming from DNFB.

Section 4.3.4 details the specific challenge needed to improve the ability of FIUs to engage in international cooperation. One particular aspect of great importance is that of “*removing legal obstacles in the way of information sharing and developing and improving systems to ensure the confidentiality of exchanged information remain crucial challenges*”.(WB 2004 :93)

Against this background, it seems clear that the existence of an effective national FIU unit may help the effectiveness of the AML/CFT. For this reason, the existence of an FIU in a jurisdiction will be considered as an explanatory variable of the jurisdiction compliance with the AML/CFT Regime.

#### **4.2. The Goal of the AML/CFT: the Development of Legal System Requirements and the Preventive Measures**

This section analyzes the necessary requirements for a country’s legal framework against Money Laundering and Terrorist Financing. Under these requirements, each country is permitted to adopt laws that *‘are consistent with its own cultural circumstances, legal precepts and constitution, as well as international standards’*. All of the standards

described are based upon the forty Recommendations on Money Laundering and Nine Special Recommendations on Combating the Financing of Terrorism<sup>101</sup>.

#### **4.2.1. Legal System Aspects**

This section considers what are the legal aspects that countries should be implementing in their books to strengthen the regulatory framework against Money Laundering and Terrorist Financing.

##### **4.2.1.1. Criminalisation of Money Laundering, Terrorism and Terrorist Financing**

The starting point for a country to improve its AML framework is by considering Money Laundering a crime within that country. The act of criminalization has three functions:

- Force compliance with AML preventive measures
- Tie acts that may appear innocent to complete criminal activity
- Criminalization establishes a specific basis for greater international cooperation in this critical law enforcement function

- *Definition of Crime*

The criminalization of Money Laundering should be done in accordance with the United Nations against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) (Vienna Convention). Relevant provisions of this Convention are 3 (1) (b) and (c) and United Nations Palermo Convention. The Convention have been described in depth in chapter 2.2.1.1.

- *Scope of the Predicate Offense*

The current version of the The Forty Recommendations is much more widely developed than the 1996 version of the 40 Recommendations and include the widest range of predicate offenses such as Money Laundering predicate

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<sup>101</sup> For a detailed discussion of this section, see: Schott, P. A., World Bank., et al.. (2006). Reference guide to anti-money laundering and combating the financing of terrorism. [Washington, D.C.], The World Bank : International Monetary Fund. ;The forty Recommendations, *op cit.*, with the interpretative Notes . ; and Methodology on AML/CFT, [http:// www.fatf-gafi.org/pdf/Meth-2004\\_en.pdf](http://www.fatf-gafi.org/pdf/Meth-2004_en.pdf) and Appendix 3 of this dissertation.

offenses<sup>102</sup> cited in The Palermo Convention: **Designated Categories of offenses<sup>103</sup> means:**

- participation in an organised criminal group and racketeering
- terrorism, including Terrorist Financing
- trafficking in human beings and migrant smuggling
- sexual exploitation, including sexual exploitation of children
- illicit trafficking in narcotic drugs and psychotropic substances
- illicit arms trafficking in stolen and other goods
- corruption and bribery
- fraud
- counterfeiting currency
- counterfeiting and piracy of products
- environmental crime
- murder, grievous bodily injury
- kidnapping, illegal restraint and hostage- taking
- robbery or theft
- smuggling
- extortion
- forgery
- piracy and
- Insider trading and market manipulation

Contributors in the field as Schott (Schott, World Bank. et al. 2006:V-7) remarked three points concerning the description of predicate offenses:

- To criminalize the proceeds from the type of conduct described in the above list.

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<sup>102</sup> Palermo Convention, article 2 (a)

<sup>103</sup> See also the definition of “ designated category of offences” in the Glossary of The Forty Recommendations in the Introduction of this dissertation.

- Countries are provided with discretion on how to define the offenses in the above list and the nature of any particular elements of those offenses that make them Money Laundering predicate offenses.
- The FATF urges countries (in its nine Special Recommendations on Terrorist Financing ) to criminalize the financing of terrorism, terrorist acts and terrorist organizations and to designate these as predicate offenses of Money Laundering.

The criminalisation of Money Laundering and Terrorist Financing are considered as very important explanatory variables of the AML/CFT effectiveness. The criminalisation of predicate offenses according to the Vienna and Palermo Convention is remarked by AML legal Recommendations and CFT special legal Recommendations.

- *Cross Border Considerations for International Cooperation*

As previously noted, “*the FATF Recommendations establish a minimum category of offenses that must be predicate offenses for Money Laundering. The extent to which a country does so, however has implications for that country’s ability to cooperate internationally and exchange information with other national authorities*”(Schott, 2006:V-9).

According to Recommendation 1, countries may provide that the only condition for prosecuting Money Laundering is that the conduct committed in the other country would have constituted a predicate offense had it occurred domestically. In the view of the results of this research, we will state whether the FATF has encouraged countries to adopt dual criminality approach or the FATF has only encouraged countries to provide mutual legal assistance when dual criminality is absent (Recommendation 37).

- *State of Mind-Knowledge and Intent*

Countries have various options in determining the “state of mind” connected with a Money Laundering offense.<sup>104</sup>

The legislature of a country may decide that actual knowledge of the illicit origin of property, or that mere suspicion about that illicit origin of property, constitutes the requisite state of mind or mental element for obtaining convictions for Money Laundering,

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<sup>104</sup> Broad definitions of “state of mind” can be found in :OAS Model Regulations and UN Model Legislation

- Corporate Liability

Sometimes Money Laundering takes place through corporate entities. However the concept of corporate liability<sup>105</sup> varies among different countries. Common-law tradition countries subject corporations to criminal liability laws. Civil law countries may not be covered by criminal laws.

- Predicate Offense Perpetrator Liability for Laundering<sup>106</sup>

An important question is whether Money Laundering liability extends to the person who committed the predicate offense, as well as to the person who has laundered the ill-gotten proceeds. Many countries do not hold the perpetrator of the Money Laundering of the predicate offense liable for laundering the proceeds of his or her criminal actions, if he or she is not involved in the laundering activity.

#### **4.2.1.2. Seizure, Confiscation and Forfeiture**

For confiscating direct and indirect Proceeds of Crime, the FATF encourages countries to adopt laws permitting a broad interpretation of the confiscation of proceeds<sup>107</sup> of crime (R.3), as well to adopt laws that permit the confiscation of the laundered property, the processes of laundering and predicate offenses, and the instrumentalities used or intended for use in laundering and property of corresponding value.

For the enforcement of confiscated property, the FATF specifically recommends that banking secrecy laws or other privacy protection statutes, should be designed so that they do not create barriers to such disclosure or seizure for this purpose.

To address the question of Third Party Liability, the FATF and various agreements qualify the permissibility of such action by requiring countries to take measures to protect the rights of bona fide third parties. Also, creating cooperative mechanisms for enforcing cross-border confiscation orders is relevant. Countries may consider to establishing asset-sharing arrangements.

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<sup>105</sup>FATF, through Recommendation 2, recommends that corporations be subject to criminal liability whenever possible under the general country's legal system, and civil or administrative sanctions could be a sufficient substitute whenever the legal or constitutional framework does not subject corporations to criminal liability. On the other hand, the UN Model does not provide for criminal liability for corporations.

<sup>106</sup> UN Model Legislation, Article 1.1; UN Model Crime Bill sec 17; Palermo Convention, article 6(2)(f); Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (1990), article 6 (2)(b).

<sup>107</sup> Proceeds of crime are "any property derived from or obtained, directly or indirectly, through the commission of an offense" according to (Vienna Convention, article 1 (p); Palermo Convention, article 1 (d) as reproduced from Schott, 2006 V-16)

#### **4.2.1.3. Types of Covered Entities and Persons**

The FATF impose numerous requirements upon financial institutions and non-financial businesses and professions to prevent Money Laundering and Terrorist Financing (R5-R25).

- Financial institutions<sup>108</sup>  
Are defined according to FATF Recommendation as “Any person or entity who conducts as a business one or more of the following activities, or operations on behalf of a customer.  
This functional definition entails a risk , that is, when the financial activity is carried out occasionally or on a very limited basis, or the financial activity is strictly limited and under justified circumstances, such as there being little Money Laundering requirements; and a country may decide not to apply all, or indeed any, Money Laundering requirements.  
All in all, a lot of countries can be said to have a a low perception of ML and CF risk and lot of financial activity there is excluded or subject only to limited controls.
- Designated Non-financial Business and Professions<sup>109</sup>  
The requirements applicable to these entities and professionals are more limited and apply in more limited circumstances than financial institutions.
- Other Potential Covered Entities and Persons  
According to Rec 20, the FATF states that countries should consider applying the Recommendations to businesses and professions, other than those listed in the glossary, that pose a Money Laundering or terrorist financing risk.

#### **4.2.1.4. Supervision and Regulation Integrity Standards**

Integrity and licensing requirements help prevent such entities and individuals from participation in Money Laundering and Terrorist Financing efforts. The supervisory and

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<sup>108</sup> The list of Financial Institutions is provided in the glossary.

<sup>109</sup> The list of Designated Non-financial Business and Professions is provided in the glossary.



regulatory integrity standards have been fully developed in section 4.1.3. The institutions, i.e, banks, insurance companies and securities industry are subject to the principles<sup>110</sup> issued by the Basle Committee, IAIS and IOSCO. The requirements of the core principles should apply not only for prudential purposes but also for the purposes of AML/CFT controls, and supervision should include the authority to compel recording for determining compliance.

#### **4.2.1.5. Laws consistent with Implementation of FATF Recommendations**

The most important issue is that countries should make sure that their financial institution secrecy laws do not inhibit implementation of the FATF Recommendations (see R.4). In particular, this dissertation will pay attention to the overall compliance of 46 jurisdictions with R.4 and R.13. The quantitative and qualitative will show which countries face the challenge to remove secrecy law.

#### **4.2.1.6. Cooperation among Competent Authorities**

Countries needs to ensure that there are effective mechanisms in place to enable its policy makers, FIU, law enforcement authorities, financial institution supervisors and other relevant authorities to cooperate with each other(see R.31).This requirement extends to coordinating the development and implementation of policies and activities to combat Money Laundering and Terrorist Financing.

#### **4.2.1.7. Investigations**

According to R.27, R.30 and R.32, each country should ensure that designated law enforcement authorities are responsible for Money Laundering and Terrorist Financing

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<sup>110</sup> See <http://www.bis.org/publ/bcbssc137.pdf>, at Preamble paragraph 6, at customer identification, and at compliance with laws.  
see <http://www.bis.org/publ/bcbssc30.pdf> at core principle 15, also <http://www.bis.org/publ/bcbssc61.pdf>  
Core Principles Methodology  
See <http://www.iaisweb.org> at Guidance Paper No.5, Anti-Money Laundering Guidance Notes for Insurance Supervisors & Insurance Entities, January 2002.  
See <http://www.iosco.org/iosco.html> and <http://www.iosco.org/pubdocs/pdf/IOSCOPD125.pdf> and <http://www.iosco.org/library/index.cfm?whereami=resolutions>.

investigations. Investigative endeavours, as with all competent authorities involved in the fight against Money Laundering and Terrorist Financing in a country, should receive adequate financial, staffing and technical resources, that shall meet high integrity standards. Finally, the effectiveness of a country's AML/CFT Regime depends on useful information. Thus, each country should maintain statistics on the effectiveness and efficiency of its investigations and other aspects of its Regime.

#### **4.2.2. Preventive Measures**

The Forty Recommendations on Money Laundering has established 21 preventive measures that a country should adopt in the AML area. These measures are applicable to all financial institutions and, on a more limited basis, to designate non-financial businesses and Professions. According to Schott: *“These preventive AML measures are equally applicable in combating the financing of terrorism (CFT).”* (Schott 2006:112). The preventive Recommendations are mandates for action by a country if that country wishes to be viewed as compliant with AML and CFT. Preventive measures are the Recommendations from R.5 to R.25 and Recommendations from SR.VI to SR.IX.

##### **4.2.2.1. Customer Identification**

Countries must assure that their financial institutions have appropriate customer identification<sup>111</sup> and due diligence procedures in place. These Recommendations apply to a financial institution's individual and corporate customers alike. As suggested in the Review of the FATF Forty Recommendations: Consultation Paper (2002), the 2003 Forty Recommendations provide guidelines for applying the customer due diligence process (CDD) such as: 1) what does the CDD process consist of 2) when does customer identification and verification need to be applied 3) And what should the obligations be when customer identification and verifications do not take place?

- The CDD process is fully revised in Recommendation 5 and is described as:  
The Customer identification, the verification of its identity, the beneficial owner, the purpose and intended nature of the business relationship and due diligence

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<sup>111</sup> See [http://www.fatf-gafi.org/pdf/SRecTF\\_en.pdf](http://www.fatf-gafi.org/pdf/SRecTF_en.pdf), also [http://www.fatf-gafi.org/pdf/Meth-2004\\_en.pdf](http://www.fatf-gafi.org/pdf/Meth-2004_en.pdf), the Core Principle 15 for Effective Banking Supervision and Customer Due Diligence for Banks in <http://www.bis.org/publ/bcbs30.pdf>. The Forty Recommendations, Rec.5, [http://www.fatf-gafi.org/pdf/40Recs-2003\\_en.pdf](http://www.fatf-gafi.org/pdf/40Recs-2003_en.pdf)

procedures employed by a financial institution must also apply to its branches and majority –owned subsidiaries

- The revised Recommendation 5 (R.5) indicates that the customer identification and due diligence should be take place when: establishing business relations or occasional transactions; there is a suspicion of ML and FT; or when financial institutions have doubts about the veracity/adequacy of the previously obtained customer data.

It should be highlighted that the 2003 Forty Recommendations pay special attention to those circumstances requiring increased due diligence and distinctive treatment of ‘political exposed persons’ (R.6) as well as the ‘intermediary or the third parties’ (R.9).

- Recommendation 7 requires countries to conduct ongoing due diligence when establishing cross-border corresponding banking. Corresponding banking relationship with institutions located in countries classified as ‘non cooperative countries and territories’ should be avoided.
- According to Recommendation 8 (R.8), financial institutions providing non face-to-face costumers services need to be aware that the risks of business’ relationships are increased via telephone and internet. Appropriate policies and procedures depend on each country.
- Recommendation 11 (R.11) draws attention on complex, unusual large transactions and unusual patterns of transactions while Recommendation 21 (R.21) recommends financial institutions to pay special attention to the transaction with non-compliant countries.
- The Special Recommendation 7 (SR.7) also requires financial institutions to include accurate and meaningful originator information on fund transfers and information remaining through the payment system (SR.7). The establishment of a declaration and disclosure system instruments’ (SR.9) is another way to improve costumer identification.
- The FATF recommends countries to consider implementing policies such as extending due diligence to vendors and others since many transactions have become complex and interconnected in the global economy.

- Although the requirements for customer due diligence as well as those related to record-keeping are also applied to Designated Non-Financial Business and Professions, they are applied in a limited manner.

According to the present researcher, the issues that still constrain the fight against ML and the FT lie in the discretion given to individual countries to assess the risk entailed in some accounts and transactions as well to define the measures for Designated Non-Financial Businesses and Professions. The interpretative notes for Recommendation 5 set out examples of customers where simplified or reduced CDD measures could apply.

#### **4.2.2.2. Record-Keeping Requirements**

The record-keeping requirements should permit the generation of a flow of substantial data from the private to the public sector. Maintaining records is one of the most important tools for preventing and detecting Money Laundering and Terrorist Financing. Record maintenance helps provide a money trail to assist law enforcement bodies and intelligence agencies in arresting the people involved. According to Recommendation 10, financial institutions should keep customer identity and transaction reports for a minimum of five years following the termination of an account. Insurance Sectors, securities sectors and DNBP's apply in the same circumstances as do the Customer Due Diligence and customer identification.

#### **4.2.2.3. Suspicious Transaction Reporting<sup>112</sup>**

According to Recommendation 13, if a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of criminal activity, or are related to Terrorist Financing, it should report its suspicions to the applicable financial intelligence.

This Recommendation outlines the importance of reporting and remarks the necessity of a financial intelligence unit. Throughout the quantitative analysis, it will be determined if the suspicious transaction reports have been sufficient to deter the financing of terrorism.

The suspicious transaction reporting involves those transactions which depart from normal patterns of account activity and that deserve further investigation. For this reason,

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<sup>112</sup> For a detailed description of what is involved in 'suspicious transactions, 'safe harbor' provision for reporting, fiscal crimes, the insurance and securities sectors, see (Scholte 2006: VI-20-22)

financial institutions should establish some risk limits and establishing them implies the necessity of new technology and more resources.

An important question to be outlined at this point is whether supervisors have been able to provide financial institutions with specific examples of suspicious activities to advise them of the risk and typology. After the literature review and the interviews, it seems that there is a lack of communication between supervisors and financial institution.

Financial institutions and their employees might be vigilant of suspicious transactions but for this task, the supervisors and financial intelligent units supporting them with some information are necessary.

In Recommendation 16, DNBP's are now also required to file suspicious transaction reports, but on a more limited basis than their obligation to identify customers and carry out due diligence. They are compelled to file an STR only when they engage in a financial transaction. The reporting is limited when trust or company service only provides advice or preparing a transaction is not reportable.

#### **4.2.2.4. Cash Transaction Reporting**

According to Recommendation 19, countries should consider reporting all cash transactions that exceed a fixed threshold. This Recommendation has privacy implications, and for this reason each country or jurisdiction has established its own reporting threshold based in its own circumstances. This situation opens the door to the use of some weak regulated countries to engage in multiple cash transactions and cross-border transfers of cash and the use of bearer negotiable where there are no reports on cash transactions or the fixed threshold is too high.

#### **4.2.2.5. Privacy Laws and Disclosure Requirements**

The FATF specially requests that financial institution privacy laws should be drafted so as not to inhibit the implementation of any of its Recommendations according to R.4 and R.28.

#### **4.2.2.6. Internal Control**

One important issue regulated by Recommendation 15 is that countries should require all financial institutions covered by their AML and CFT laws to establish and

maintain internal policies and procedures to prevent their institutions from being used for purposes of Money Laundering and Terrorist Financing.

There is evidence that internal policies and procedures vary great deal among institutions and countries, which makes the scope of AML/CFT very difficult. The analysis will show the level of internal control implemented among 46 countries.

#### **4.2.3. Institutional Measures**

The most important Recommendation of the institutional measures is Recommendation 26 (R26), the 2003 test provides for a state's obligation to establish its own FIU. Furthermore, it is also made obligatory for the private sector to submit a suspicious report to the FIUs.

The other important point is that states should provide their competent authorities with adequate powers, such as authority to gain access to records held by financial institutions as well as adequate financial, human, and technical resources.(R28 and R30)

#### **4.2.4. The Enhancement of International Cooperation**

It should be remarked, that the 2003 Forty Recommendations explicitly eliminate the fiscal offence exception (R36) and restrict financial institutions' secrecy rules in the context of international cooperation.

R.35 and SR.I compel countries to become a part of and to fully implement the International Convention of the Suppression of the Financing of terrorism (1999) and the political offence exception is also implicitly eliminated<sup>113</sup>. One of the most important Recommendations is R40 which opens a gateway for international cooperation beyond mutual legal assistance and extradition.

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<sup>113</sup> Gilbert Guillaume has written further of the relationship between terrorism and political offence exemption. For further discussion on the definition of terrorism see: Guillaume, G. (1989). *Terrorisme et Droit International*. *Academie de Droit International* La Hague, Martinus Nijhoff Publishers. tome 215: 303-307; Sorel, J. M. (2002). Existe-t-il une definition universelle du terrorisme? *Le droit international face au terrorisme : après le 11 septembre 2001* Paris, Pédone. *Cahiers internationaux* 17: 35-68

**4.2.5. Summary of the International Organizations, International Best Practices, Codes and Standards against Terrorist Financing (*This summary is made according to [http:// www.imolin.org](http://www.imolin.org)*).<sup>114</sup>**

**A. PREVENT AND SUPPRESS THE FINANCING OF TERRORIST ACTS**

This group includes the following international codes, standards and International Organizations:

- a. *Criminalization of financing of terrorism and associated Money Laundering***
- United Nations
    - *United Nations Model Terrorist Financing Bill, 2003*
  - Financial Action Task Force (FATF)
    - *40 Recommendations on Money Laundering*  
Scope of the criminal offence of Money Laundering (R.1, R.2)
    - *9 Special Recommendations on Terrorist Financing*  
On criminalizing the financing of terrorism and associated Money Laundering (SR I , SR II)
- b. *Freezing and confiscation of terrorist assets, provisional measures and confiscation***
- FATF
    - *40 Recommendations on Money Laundering*  
Provisional measures and confiscation (R.3)
    - *9 Special Recommendations on Terrorist Financing*  
SR III on the freezing and confiscation of terrorist assets

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<sup>114</sup> Other regional standards against FT are listed as follows:

**Baltic States**

Riga Declaration (November 1996)

**Caribbean Financial Action Task Force (CFATF)**

CFATF 19 Recommendations (Aruba, June 1990)

Kingston Declaration on Money Laundering (Kingston, November 1992)

**Council of Europe**

Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, (Warsaw, 16 May 2005)

European Treaty Series - No. 141: Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990)

Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the Purpose of money laundering and terrorist financing

Council Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering [91/308/EEC] (Brussels, 10 June 1991)

Directive 2001/97/EC of the European Parliament and of the Council amending Council Directive 91/308/EEC (Brussels, 4 December 2001)

**Organization of American States Comision Interamericana para el Control del Abuso de Drogas (OAS / CICAD)**

The Buenos Aires Declaration on money laundering (December 1995)

- Interpol Summary of Best Practices
  - Interpol-UN Security Council Special Notice: alert for law enforcement worldwide that an individual is subject to sanctions (inter-alia freezing of assets) of the 1267 Committee (Al Qaeda, Taliban).
- c. **Prevention measures to be taken by financial institutions and non-financial businesses and professions**
  - FATF
    - 40 Recommendations on Money Laundering
      - \* Customer due diligence and record-keeping (R.4, R.5, R.6, R.7, R.8, R.9, R.10, R.11, R.12)
      - \* Reporting of suspicious transactions and compliance (R.13, R.14, R.15, R.16)
      - \* Other measures to deter Money Laundering and Terrorist Financing (R.17, R.18, R.19, R.20)
      - \* Measures to be taken with respect to countries that do not comply or insufficiently comply with the FATF Recommendations (R.21, R.22)
      - \* Regulation and supervision (R.23, R.24, R.25)
    - 9 Special Recommendations on Terrorist Financing
      - \* SR VI on alternative remittance systems
      - \* SR VII on wire transfers
      - \* SR VIII on non-profit organizations
      - \* SR IX on Bearer Instruments
  - Bank for International Settlements: Basel Committee on Banking Supervision
    - Statement on prevention of criminal use of the banking system for the purpose of Money Laundering; Basel, December 1988.
    - “Customer due diligence for banks”; October 2001.
    - “General guide to account opening and customer identification” (attachment to Basel Committee publication No. 85 “Customer due diligence for banks”); 9 February 2003
  - International Association of Insurance Supervisors (IAIS)



- Guidance paper on anti-Money Laundering and combating the financing of terrorism; October 2004
- International Organization of Securities Commissions (IOSCO)
  - “Anti-Money Laundering Guidance for Collective Investment Schemes,” Report of the Technical Committee of IOSCO; October 2005

B. CRIMINALIZE THE WILFUL PROVISION OR COLLECTION, BY ANY MEANS, DIRECTLY OR INDIRECTLY, OF FUNDS BY THEIR NATIONALS OR IN THEIR TERRITORIES WITH THE INTENTION THAT THE FUNDS SHOULD BE USED, OR IN THE KNOWLEDGE THAT THEY ARE TO BE USED, IN ORDER TO CARRY OUT TERRORIST ACTS

C. FREEZE WITHOUT DELAY FUNDS AND OTHER FINANCIAL ASSETS OR ECONOMIC RESOURCES OF PERSONS WHO COMMIT, OR ATTEMPT TO COMMIT, TERRORIST ACTS OR PARTICIPATE IN OR FACILITATE THE COMMISSION OF TERRORIST ACTS; OF ENTITIES OWNED OR CONTROLLED DIRECTLY OR INDIRECTLY BY SUCH PERSONS; AND OF PERSONS AND ENTITIES ACTING ON BEHALF OF, OR AT THE DIRECTION OF SUCH PERSONS AND ENTITIES, INCLUDING FUNDS DERIVED OR GENERATED FROM PROPERTY OWNED OR CONTROLLED DIRECTLY OR INDIRECTLY BY SUCH PERSONS AND ASSOCIATED PERSONS AND ENTITIES;

- Interpol ‘Best Practices’ in Combatting Terrorism
  - *Interpol-UN Security Council Special Notice: alert for law enforcement worldwide that an individual is subject to sanctions (inter-alia freezing of assets) of the 1267 Committee (Al Qaeda, Taliban).*

D. PROHIBIT THEIR NATIONALS OR ANY PERSONS AND ENTITIES WITHIN THEIR TERRITORIES FROM MAKING ANY FUNDS, FINANCIAL ASSETS OR ECONOMIC RESOURCES OR FINANCIAL OR OTHER RELATED SERVICES AVAILABLE, DIRECTLY OR INDIRECTLY, FOR THE BENEFIT OF PERSONS WHO COMMIT OR ATTEMPT TO COMMIT OR FACILITATE OR PARTICIPATE IN THE COMMISSION OF TERRORIST ACTS, OF ENTITIES OWNED OR CONTROLLED, DIRECTLY OR INDIRECTLY, BY SUCH PERSONS AND OF PERSONS AND ENTITIES ACTING ON BEHALF OF OR AT THE DIRECTION OF SUCH PERSONS.

### 4.3. What Are the Failures and Constraints of the AML/CFT Regime?

This chapter argues the difficulties encountered by international and national regulators when dealing with money controlled by transnational terrorism and the reasons why, despite multilateral and national attempts to fight the financing of terrorism, these have met with limited success in reporting suspicious transactions made by targeted individuals or groups and denying them access to the international financial system.

Since the first the FATF in 1989 launched the process of standardizing anti-Money Laundering Regimes globally, despite all these massive national and international efforts, there have been many reports outlining that terrorist fund-generation capabilities remain in place. For example, there are indications that a number of hawalas are still able to function outside national control, while accounts and funds in various jurisdictions remain active.

The main conceptual problem is connected with the failure to identify categories of what constitutes terrorism<sup>115</sup> and to provide a global accepted list of terrorist groups<sup>116</sup>. Without an agreement, it is difficult to reach an effective cooperation on the level of financial matters.

The growth of international cooperation for information-sharing implies that the struggle against Terrorist Financing must be accompanied by targeted intelligence gathering, the freezing of suspect assets, national law enforcement actions, diplomatic efforts and outreach, smarter regulatory scrutiny, outreach to the financial sector, and capacity building for governments and the financial sector through financial ministries and other department technical assistance programs.

Pure national actions are not enough to combat the financing of international terrorism. International cooperation is necessary and it has implications for domestic law

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<sup>115</sup> See: *Guillaume (1987)op cit*; and *Sorel (2002)op cit*.

<sup>116</sup> In January 2007, when the present researcher was comparing four list of terrorist organizations such as the US list <http://www.state.gov/s/ct/rls/fs/2004/32678.htm>; the EU list provided by Council Common Position 2006/380/CFSP of 29 May 2006, updating Common Position 2001/931/CFSP on the application of specific measures to combat terrorism, and repealing Common Position 2006/231/CFSP; the UN list provided by <http://www.un.org/sc/committees/1267/consolist.shtml>; and the UK list provided by <http://security.homeoffice.gov.uk/legislation/current-legislation/terrorism-act-2000/proscribed-terrorist-groups?version=1>, it was observable that for example , the IRA is a terrorist group for the UK, but not for the US. Hezbollah is a terrorist for the US but not for the EU, etc. Also, after analyzing the legal basis, legal effect, terrorist list agreed upon the criteria for inclusion, definition of terrorism, decision-making procedures, democratic oversight and appeal mechanism for creating the list, one can observe that relevant different criteria have been used for elaborating these lists between them

enforcement and action agenda. Sovereignty is necessary to implement and strengthen legal frameworks but is insufficient due to the global characteristics of terrorism.

There is much debate on the question whether the strategies pursued in war against on terrorist finances have failed or succeeded. De Goede (2004) explains *how in 2002 the report by UN Monitoring group concluded that Al Qaeda continues to have access to considerable financial and other economic resources and the US Treasury was quick to denounce that the UN report was limited in scope, and affirmed that they are confident that our efforts are having real world effects.* (De Goede 2004:23). Levi has also referred to the difficulties in estimating figures of Money Laundering and terrorism financing:

Instead of overly ambitious global “data” and pattern estimates ...It may be better to build up from the ground more modest analyses of what can be plausibly know about money management.” (Levi 2003:118-119)

#### **4.3.1. Make the System of Legal Instruments Truly Universal**

Terrorism in different manners has been around the world for centuries. The United Nations began to deal with the problem of international terrorism in 1972. An important number of Convention and protocols previous to September 11 were adopted in reaction to international terrorism. As of December 1999, there were twelve international anti-terrorism negotiated instruments. Ward (2003) identified the twelve agreements<sup>117</sup> to combat terrorism:

- Convention on offenses and Certain Other Acts Committed on Board Aircraft (1963)
- Convention for the Suppression of Unlawful Seizure of Aircraft (1970)
- Convention for the Suppression of Unlawful Against the Safety of Civil Aviation(1971)
- Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents (1973)
- International Convention against the Taking of Hostages (1979)
- Convention of the Physical Protection of Nuclear Material (1980)

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<sup>117</sup> For further explanations of ratifications on terrorism see, (Ward 2003:290).

At present, there is one more UN Convention on Terrorism: International Convention for the suppression of acts of nuclear terrorism. This convention has not been taken into account in this research, because it was adopted in April 2005. Practically not one country has ratified this convention during the timeframe of this dissertation.

- Protocol on the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of civil aviation (1988)
- Convention of the Suppression of Unlawful Acts against the Safety of Maritime Navigation, 1988
- Convention for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf (1988)
- Convention on the Marking of Plastic Explosives for the Purpose of Detection (1991)
- International Convention for the Suppression of Terrorist Bombings (1997)
- International Convention for the Suppression of the Financing of Terrorism (1999)

The ratification of the aforementioned Convention is considered as very important explanatory variable of CFT effectiveness. The ratifications of International Convention on Terrorism capture the notion of political will to fight against terrorism and for this reason it will be taken into account when modelling which factors determine AML/CFT compliance. The difference in the number of ratifications by countries is a real problem and there is a need to recognize that terrorists may always try to act where they would not be pursued, in other words, in countries that have not ratified some of the Convention.

However, Murthy (2007) points out: “*Ratification of international Convention without proceeding to adopt internal enforcement measures has no practical effect.*”(Murthy 2007:7).

The most important review of the strengths and weakness of the international Regime against terrorism was held in Bangkok by the Committee II of the Eleventh United Nations Congress on Crime prevention and Criminal Justice (UN 2005). The conclusions are summed up as follow.

- The need to make the system of legal instruments truly universal, that is to enjoy universal application
- The importance of promoting international mutual legal assistance,
- The need to harmonize laws, and overcome obstacles that arose in areas of extradition and mutual legal assistance, which could undermine the work against terrorism.

- Existing Regime for international cooperation in criminal matters should be reinforced to avoid legislative loopholes and eliminate safe havens, by urging governments to establish and maintain effective mechanisms for international cooperation. Member States should be invited to follow a balanced approach when combating terrorism, without compromising on respect for the rule of law and the protection of human rights

Among the most important contributions, it should be necessary to take into account some statements which were made in the aforementioned conference. These statements show detailed weaknesses of the legal system to fight against the financing of terrorism. Some of them will be confirmed through the quantitative and qualitative analyses.

Mr Sollier<sup>118</sup>, stated that, prior to 11 September 2001, existing legal instruments regarding terrorism were quite complete. The 12 universal anti-terrorism Convention were in place, as were a number of regional Convention. He recognized “*the density and completeness of the legal Regime against terrorism, but also by the total lack of application*”.

As to the strengths of the system, he said “*the Security Council had created obligations that went a long way towards harmonizing and universalizing anti-terrorist law. It made binding the obligation to cooperate in providing information and facilitating extradition*”. All of that changed after 11 September, he said. The rising status of the Security Council, which almost became an international legislator, was a major event. It took fundamental decisions, such as resolution 1368, adopted on 12 September 2001, that qualified acts of terrorism as an attempt to undermine international peace and security. The Council was, thus, authorized to invoke Chapter VII of the Charter, which obliged Member States to comply with its decisions.

He said: *resolution 1373 (2001) “was a historic resolution that obliged States to apply a list of principles in their fight against terrorism” (...). There was also a follow-up mechanism for an implementation of the resolution: the Counter-Terrorism Committee and the Executive Directorate. The Committee was to monitor the implementation by Member States of the provisions of resolution 1373. It had involved a number of*

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<sup>118</sup> Joel Sollier is an Expert from the Counter-Terrorism Committee of the Security Council

*specialized organizations, as well as regional organizations that would develop new standards in their areas of expertise. Thus, anti-terrorism law had been translated into specific Recommendations concerning technical and financial matters.(...) Regional organizations had developed their own texts". As to the strengths of the system, he said "the Security Council has created obligations that went a long way towards harmonizing and universalizing anti-terrorist law.(...). The matter of double incrimination was resolved by referring to certain types of terrorist acts, such as financing of terrorism.(...) It made binding the obligation to cooperate in providing information and facilitating extradition."*

According to him: *"the existing anti-terrorist Convention are virtually universal and technical standards have been developed for the fighting against terrorism and new domestic legislation has also been adopted by a great number of States. However, International anti-terrorism laws have become living law on the ground in many countries".* The most important weaknesses for him are *"the inability to find a definition of terrorism, something that constrained the system"*.

Pornchai Danvivathana<sup>119</sup> affirmed *"terrorism was creeping towards the realm of transnational organized crime. He stated that "terrorism was a dynamic rather than static phenomenon" and paid attention to "international cooperation as a crucial element".* He introduced the idea of *"adopting a common understanding at the inter-regional and intraregional levels so that internationally recognized principles could be transposed into national legislation"*. Terrorism should become an exception to the rule concerning political offenses [the principle by which a country could refuse to extradite someone on the grounds that it thought that the act committed was of a political nature]. He said *"it was important to observe the principle of 'extradite or prosecute' (...) and no safe haven must be left for the perpetrators of terrorism to hide"*. Technical assistance concerning the development of relevant legislation should also be extended to parliamentarians.

Mr Slokar<sup>120</sup> recognized that *"Terrorism was no longer limited by borders " (...) given its complexity, regulatory and legal tools of States must be seen as only partial answers to the problem"*.

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<sup>119</sup>Pornchai Danvivathana is the Director of the Legal Affairs Division, Ministry of Foreign Affairs of Thailand

<sup>120</sup> Alejandro W.Slokar is the Undersecretary for Criminal Policy, Ministry of Justice and Human Rights of Argentina.

Mr Polimeni<sup>121</sup>, stated that, *“for a legal Regime of international anti-terrorism instruments to be effective, it should be universally applicable”*. He introduced a new characteristic of this Regime, that *“the fight against terrorism was a long-term one”*. The legal Regime should be conceived as a toolkit, and every effort should be made for universal ratification of the 12 Convention. The strengths of the international legal Regime against terrorism consisted in the absolute obligation of States to provide each other with the greatest possible measure of assistance. He stated that *“obligation was not accompanied by a detailed Regime in the 13 instruments. The absence of detailed normative schemes of legal assistance did not help and left opened for discrepancies”*

According to Mr Gattas, after 11 September, *“terrorism was seen as an international threat. Recognizing the threat, the Security Council had become a kind of quasi-legislator in the area of terrorism, although resolution 1373 had both strengths and weaknesses (...) States requesting extradition were often disappointed”*..

Mr Hattali pointed out that *“ratification of the international Convention against terrorism was very diverse”* (...) some had been ratified more than others. Therefore, *“the 12 instruments could not be truly called universal, as they were not universally ratified and accepted (...) the international legislative Regime against terrorism is characterized by diversity and fragmentation”*.

Congresses should recommend that ratification of the Convention and protocols should be promoted in order to make them truly universal despite of the enormous mass of international instruments that made it difficult to analyse the situation. He recommended that *“the congress work towards greater synergy between all the international, regional and other instruments (...) effective international cooperation could not be conceived without promoting the total initiatives that facilitated the work, such as seizure of assets, extradition, pulling together efforts of prosecution and security services, and mutual legal assistance, among other things (...) international cooperation against terrorism is still weak. Strengthening and consolidation is required”*.

He emphasized *“that coordination of work among states and various International Organizations working in the field of terrorism should become a priority “ (...) It should also be ensured that all States that had ratified the Convention had the resources to*

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<sup>121</sup> Mr Polimeni is the director of United Nations Interregional Crime and Justice Research Institute in Turin, Italy.

*implement them*". He hoped that *"the international community would rapidly reach an agreement on the definition of terrorism and a global Convention against terrorism"*.

Mr. de Jesus argued that, *"I had had trouble in applying the traditional principles of criminal law to new forms of crime such as terrorism. Traditional concepts simply did not apply to a globalized world as globalization and the desire of States to maintain sovereignty just did not mesh at times"*.

Mr. Benitez concurred with other representative regarding the complexity of the anti-terrorism Regime: *"That complexity was even more complicated by the fact that there was no true system to ascertain the level of commitment by various parties"*, he said *"as various parties to Convention had made a number of reservations"*. Over the last two years, the Council of Europe had reviewed the reservations with a view to starting a dialogue with the Parties that had made a reservation, asking them to withdraw them. He stated that *"The political exception clause in mutual legal assistance and extradition matters still constituted an obstacle to international cooperation."* The Amending Protocol to the European Convention on the Suppression of Terrorism had addressed that matter. In the past, States could refuse to extradite on the grounds of political exception without any explanation. Now, a 'duly motivated explanation' was necessary. He pointed out that there was now a possibility to refuse extradition or mutual legal assistance on the grounds that human or fundamental rights were at stake.

Mr. Sollier noted some Convention were more essential than others. The Convention for the Suppression of Terrorist Bombings covered around 80 per cent of all terrorist acts committed around the world, and that had been ratified by 134 States. *"The Convention for the Suppression of Terrorist Bombings and the Convention on the Financing of Terrorism, which had less than a dozen parties four years ago, now had close to 100"*. In some way, the Convention were universal, because they were negotiated in an organization where most of the States were represented. He emphasized that *"the system of Convention allowed States to have a common language, but agreed that once a Convention was ratified, work just began"*. Today, *"it was still not known how the Convention were applied. That would be demonstrated by reality in terms of mutual legal assistance, extradition and so forth"*.



#### **4.3.2. Preventive Challenge: The failure of the Risk Approach**

As described by M. Levi and W Gilmore in (Pieth 2002:40), the discourse of international bodies such as “ *FATF is primarily oriented not so much towards risk management as towards national and institutional obligation to reduce crime facilitation* ”. It is a crucial decision for a country to determine which entities and persons should be covered by which requirements. Sometimes the preventive measures are only applied to financial institutions and only applied to non-financial businesses and professions to on a more limited basis.

According to Pieth (2004), some large financial centres (UK and US) place more emphasis on an “early warning system” with the recording of everyday transactions and the reporting of unusual or suspicious circumstances for future strategic and tactical use by the police or similar authorities, whereas in other large financial centres (.i.e, Switzerland), the AML-system is far less oriented towards data collection for intelligence and law enforcement purposes.

In accordance with the idea of the failure of the risk approach, Freeland (2002) insists “*that despite the efforts done by BCB’s to respond to Terrorist Financing introducing a risk-based approach and also the FATF’s successful initiatives in its member countries, many countries still had no Know Your Costumer standards at all.*” (Pieth 2002:43). He is one of the most important contributors accentuating that terrorists will try to hide their true names behind anonymous accounts or ‘fronts’ making use of trusts, charities, nominees, corporate vehicles, profession intermediaries, and so on, and the present researcher agrees with him that the financial institutions (e.g banking) must make every effort to establish the beneficial owner(s) of all accounts and persons who conduct regular business with it.

He also argues:” *how conducting customer due diligence is not a simple task and is full of contradictions due to the culture of banking*”. In the case of offshore banks, the compliance officer or risk manager in charge of customer due diligence will be in constant conflict with the incentives provided to customer service units dedicated to personal private or offshore banking. Another difficulty providing customer due diligence in the fight against terrorism is the definition what constitutes a terrorist or a terrorism organization. The classification is a difficult issue on which the terrorist groups take advantage.

One of the best contributions related to the ‘domino effect’ of company law on other laws and regulation such as criminal, administrative and banking law is that of Savona. He argued, as well as Freeland, that “*the greatest obstacles to international co-operation for the prevention of Money Laundering are to be found in the area of ‘ Identification of the real Beneficial owner’*”(Pieth 2002:83). Also, he highlights that the main obstacle is a lack of regulation requiring full information regarding the real beneficial owner of a public or private limited company, especially when a legal entity is a shareholder or director, or the issuance of bearer sharer is permitted. Savona and Freeland contribute to the understanding of how corporate law could affect the opacity/ transparency of the financial system.

Ware (2004) states that responding to financial abuse and achieving stability of the global financial system through preventive measures seems to be more a crisis reaction than a rational policy. The AML/CFT is a standardized code applied in developing and developed countries without taking into account the preconditions of governance in each country, creating a wide gap between the developed world and the developing world because this kind of reforms will add cost and complexity to business transaction.

The question that arises here is whether the AML/CFT is a balanced solution that avoids unnecessary burdens on the globalized economy. In the next section the high start up and cost ongoing to implement an efficient AML/CFT Regime will be discussed. The international initiatives that run the risk approach only constitute a suitable remedy for countries with high-quality financial systems. In fact, it is unrealistic to establish regulations to be implemented by developing countries with unsatisfactory law enforcement structures, poor technology and a lack of financial culture.

De Goede (2004) in accordance with the idea of the social and political consequences of the war on terrorist finance, also points that “*the risk approach policy which seeks to define and classify suspicious transactions and leading intensive surveillance is exacerbating financial exclusion, through more stringent ‘know-your-costumer regulation’*”. Goede (2004) and Passas (2004) argue that the war on terrorist finance is affecting the communities sending informal remittance and that ‘cash’ is becoming suspect. The present researcher agrees with Goede that the combating of Terrorist Financing strategy seems to be a policy to reduce the use of cash worldwide.

The failure of the preventive measures seems to indicate the overall incapacity of jurisdictions to orientate the preventive Recommendations towards the risk approach goal rather than that of crime reduction. The preventive Recommendations and the risk approach have only constituted a good remedy for countries with high-quality financial systems and have also created high start-up and ongoing cost to developed and developing countries.

Two major challenges remain in place; firstly, in general, the preventive Recommendations have not been applied to all the groups of concerns such as financial institutions, insurance and securities sector and Designated Non-Financial Businesses Professions. The second is the harmonization of corporate law which impedes the identification of the beneficial owner in most countries.

All in all, it can be said that most countries have a low perception of ML and FT risk and lot of financial activity is excluded or subject only to limited controls. Consequently, low flow of information between public and private sectors can be, where the risk is considered not to exist.

#### **4.3.3. Institutional: Different Domestic Agendas and Attitudes**

According to the WB and IMF, the countries confront the following challenges in implementing the recommended reforms.

- *Achieving sufficient political commitment:* At the first stage, there is an absence of strong political commitment at the level of policy makers and legislators, which is a significant hindrance to the development and implementation of a robust AML/CFT framework. In some countries, the dedication of officials at the technical level of supervisory and law enforcement authorities is hampered by a lack of political commitment of both government and parliament to pass legislation and assign the necessary resources. The first step for a strong political commitment is the ratification of the International Convention related to terrorism and Money Laundering, as has been discussed in this chapter.
- *Corruption and Weak Governance:* Corruption in some countries undermines the effectiveness of AML/CFT measure as it has been broadly discussed in chapter 2. In environments where corruption is prevalent, legislators are less likely to enact

strong and effective AML/CFT laws, and key institutions (courts, law enforcement and supervisory agencies) may be hindered from carrying out their official duties in an effective manner. Development of an AML/CFT Regime in such an environment also requires the establishment of an effective anti-corruption framework. For this reason, it has been decided to include those Convention, such as the UN ratification related to Corruption and the OECD Bribery Convention, in the list of needed compulsory ratifications to strengthen legal systems against ML and TF.

According to the FATF: *“effective implementation of international AML/CFT standards requires not just appropriate legislative, regulatory and organisational structures but a robust system of governance to ensure the integrity of the systems in places”*.(FATF-GAFI 2006:7). Also the FATF points out that: *“The link between AML/CFT and corruption is two-fold. Firstly, the proceeds of corruption which may be considerable are susceptible to being laundered. Secondly, corruption, and poor governance arising from corrupt institutions (such as the judiciary, the police, or regulatory authorities) and/or individuals, can substantially blunt the effectiveness of an AML/CFT system.”*(FATF-GAFI 2006:7). Against this background, there is a critical need to develop a greater understanding of how weak governance and corruption damage the effectiveness of AML/CFT systems. The purpose of this dissertation is to determine how these factors explain the effectiveness of the AML/CFT Regime.

- *High start-up and ongoing costs to implement the AML/CFT standard*

Regarding to the cost<sup>122</sup> of adopting the fight against Money Laundering and terrorism financing, Cuellar and Rider point out:

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<sup>122</sup> “En el caso de España, donde el blanqueo de dinero mueve cerca de 15.000 millones de euros anuales, el Gafi ha llegado a solicitar el Gobierno que revise su sistema de supervisión sobre las entidades financieras y que se mejor la coordinación de las instituciones que llevan a cabo las inspecciones. De entre las razones que detecta el GAFI sobre las deficiencias en los controles de los bancos destaca una esencial: la falta de recursos del principal organismo encargado de vigilar los mecanismos de supervisión, el Servicio Español de Prevención de Blanqueo de Capitales e Infracciones Monetarias. El Sepblac solo cuenta con 77 profesionales de los cuales 8 son inspectores, 2000 inspectores persiguen el fraude a gran escala pero siempre es un personal muy reducido para supervisar bancos, inmobiliarias, promotoras, sociedades de inversión, joyerías, abogados, casinos y los más de 8000 alcaldes. See (Mazo 2006:1-2)

According to Kochan (2004) “The U.K government, for example, has advised banks an financial institutions to budget £120 million (182 million euros) collectively to comply with its money-laundering laws. ‘This is a gross underestimate’, says Martyn Bridges, director of Bridges and partners (...) ‘those figures, don’ t cover

For the most part, where jurisdictions change their laws and even regulations to conform to some standard such as the FATF's minimum standard the political authorities in the impacted jurisdiction retain control over budgets, enforcement policy, and prosecutorial discretion (i.e., Bussey-discussing the Bahamas apparent failure to prioritize anti-laundering enforcement, despite having signalled an interest in complying with emerging international norms condemning laundering). (Cuellar 2003:440).

A serious issue in the minds of many is the price the financial and banking system is required to pay for the strategy of taking the profit out of crime. The costs involved in establishing, maintaining and demonstrating compliance are considerable by any standard. What is clear is that policing the anti-Money Laundering laws and their regulations represents a considerable in-house cost within the financial services and banking industry." (Rider 2004:88)

▪ *The maintenance of the sovereignty on justice and police matters*

It cannot be denied that the participation in the fight against terrorism has also proven to be an institutional challenge for the EU<sup>123</sup>. This fact has had mainly technical, legal reasons. Most of these measures relate to the field of justice and police matters-core issues of national sovereignty-wherein the Union only slowly attains powers according to the complicated architecture of the Maastricht TEU. In accordance with Howell(2007) who elaborated *The EU's Efforts in the fight against Terrorist Financing in the context of the financial action task force's nine special recommendations and the EU Counter Terrorist Financing Strategy Report for the European Commission, the main results of his analysis are the following:*

- The EU pursues four parallel CT goals-Prevent, Protect, Pursue and Respond-along four axes, namely Strengthening national capabilities,

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*10% of the true costs. The cost to U.K banks would be £1 billion a year, assuming that everyone complied, which they won't'.* (Kochan 2004:A6)

<sup>123</sup> For detailed explanations of the EU fight against terrorist financing, see: EU(2005). Final Report: The evaluation of national anti-terrorist arrangements: Improving national machinery and capabilities. P. a. c.-t. coordinator, Council of Europe; and EU (2007). Fight against terrorism financing-six monthly report. C.-t. coordinator. Brussels, Council of the European Union: 10.

*"A tres años el 11-S y ochos meses del 11-M, un informe de la UE muestra graves incumplimientos y enormes lagunas. (...) según fuentes de la UE, los socios no dan signos de enmendar el mayor de sus pecados en el ámbito preventivo de la lucha antiterrorista, que es la falta de intercambio e datos policiales y de inteligencia: La información no fluye. Los Estados no se fían". See Garcia, F. (2004). Europa sigue atrasada en la lucha antiterrorista. La Vanguardia. Barcelona: 11*

See also, *"Secondo i dati di Bruxelles a intralciare il 'Piano d'azione" sono i cavilli burocratici e i conflitti di competenza"* Castellaneta, M. (2005). La lotta al terrore una questione europea. Il sole-24 ore el lunedì: 5.

Facilitating European co-operation, Developing collective capacity and Promoting international partnership. CFT is currently part of the Pursue goal. The Key elements of the strategy are a targeted intelligence-led approach, improved designation and listing, better tracing, ongoing monitoring, and support for Extra-Union activity.

- The report stresses the need for adequate resources, and EU bodies do not have the capacity to meet all the goals the EU has set itself; there is no baseline threat analysis and there is no means of monitoring policy effectiveness in detail and proactively.
- The EU can act directly under the First Pillar, but under the Second and Third Pillar there are limitations. There are divergent national approaches to AML/CFT on policy and operational levels.
- Analysis of compliance scores for 12 Member States<sup>124</sup> shows relatively high non-compliance with the 9 Special Recommendations regarding CDD, suspicious activity reporting, regulation and supervision, institutional matters and transparency. As compliance with the 9 Special Recommendations requires good compliance with the FATF 40, non-compliance with the FATF 40 weakens TF preventive capacity. Weaknesses are found on freezing obligations, the reporting of suspicious TF transactions as well as the regulation of NPOs and cash couriers. Some delays for remedial action are caused mainly by slow political and administrative processes and problems integrating new legislation into existing laws.
- The preventive effect of the recommendations can hardly be measured. Whilst the non-use of financial and other market systems for the financing of terrorism can be established, its being a result of the recommendations remains very difficult to prove.
- Part of the scarce information on effectiveness is not openly available.
- Within Member States cooperation in the CFT field on political and policy level is present in a number of countries, but insufficient or totally lacking in many others. In some instances there are problems deciding on a common

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<sup>124</sup> Belgium, Cyprus, Czech Republic, Denmark, Hungary, Ireland, Italy, Portugal, Slovenia, Spain, Sweden and Germany are included in the report.

policy as well as setting guidelines for the cooperation between ministries and executing institutions.

- At the EU level, practical cooperation between Member States in the field of TF is realized in informal ways using third parties. For example, FIU. NET still has to attain the breadth and depth of take-up originally foreseen, which is largely dependent on meeting its infrastructural needs. Eurojust is not mandated, nor does it have the necessary powers to coordinate or manage investigations. Europol has the same restrictions.
- Governments should establish a high-level interagency to coordinate and lead national AML/CFT efforts and policymaking, because the formulation and implementation of a national AML/CFT strategy is a critical step. This agency should represent the public sector: judicial authorities, law enforcement agencies, police, financial intelligence units and financial sector regulators and supervisors as well as private sector representatives. This is the way to develop a multidisciplinary approach to the national coordination but also the way to construct an efficient and constructive channel of information sharing. This agency should give priority to areas to be strengthened and identify the institutions at risk of Money Laundering and Terrorist Financing.

A quotation is proposed to summarize this section: *“There are three domestic factors that influence the development and implementation of CTF policy; 1) the perceptions held by domestic political leader of the costs and benefits of CFT policies; 2) the role of domestic political and social constituencies in influencing the formulation and implementation of CFT policies; and (3) the capacity of states to implement and enforce counter-terrorism finance prescriptions.”*(Giraldo et al. 2007:289)

#### **4.3.4. International Cooperation: Improving Regulatory Cooperation and Information Exchange**

This section underlines the critical importance of effective cooperation and information exchange in view of the increasing integration and internationalization of financial markets and service in the form of growing cross-border independency of financial institutions described in Chapter 3. In the above mentioned chapter, I pointed out the growing integration of world markets and financial services and the needs of deterring

the growing abuse of the financial system for criminal purposes. The previous section argued the importance of the political will to develop effective national regulation systems. The section draws attention on the importance of the political commitment and the support for the process of international cooperation. In line with the previous ideas, Levi and Gilmore point out:

It was never clear whether such monitoring and confiscation constitute a sufficient as well as necessary condition for success (nor how it would be identified if and when ‘ success’ was believed to require a major global infrastructure of compatible legislation and mutual legal assistance both for financial investigation and for proceeds of crime restraint and confiscation.(Levi 2002b :92)

At present, the differences of approach among jurisdictions are an important source of information exchange failure. Moreover, the differences in approach between regulators result in impediments for satisfactory, effective and timely exchange cooperation.

The International norms and standards on information exchange in criminal matters address the issue through three systems and provide them with the legal basis to set up the exchange the information requested.

- Informal communication channels
- The financial unit (FIU)
- The mutual legal assistance (MLA) mechanisms

Regarding the results of a Survey on Cross Border Cooperation and Information Exchange Among 74 Financial Sector Regulatory Authorities and agencies from 52 countries , the researchers O. Nedelescu and Mary Zefhirin conclude:

That advanced economies place more emphasis on formal arrangements, although the cooperation in emerging markets and developing countries is taking place at a more informal level.(...)There is a positive correlation between the volume of cross-border information exchange and the level of income and financial activity in the respondent jurisdiction. (IMF 2007-256)

Furthermore, the above-mentioned researchers accentuate that most of the information exchanged is within regulated financial businesses, but “*with relatively little information shared on their clients.*”



Among the total results of exchange of information, enforcement- related cooperation is described as the dominant one and the one that experiences the most difficulties. On the other hand, the results suggest that the most important barriers to the cooperation are:

- *Still secrecy laws or confidentiality provisions in the requested Authority*  
“The real problem experienced by 44 percent who referred to secrecy provisions, therefore, is not whether a secrecy law exists but whether the gateways allow cooperation to be given.” (IMF 2007:xix)
- *The Nature of information and Purpose for which it is sought*  
Banking and Insurance Supervisors seek information for licensing and supervision about regulated institutions. Securities regulators and FIUs are much more likely to seek information related to enforcement action about customers. It should be easier to share information about customers and this would demonstrate that the requested supervisor is aware of legal, reputational risks as well as the responsibilities to combat Money Laundering and Terrorist Financing.
- *Information about Regulated Businesses*  
The issue described below is emphasized in the IMF report The contributors agreed the most important problem arises in countries with a large proportion of the banking system controlled by foreign banks and whose activity is critical to the jurisdiction economic progress. The less effective the supervisors, the higher the possibilities for the activity of businesses (i.e. foreign banks)
- *Information about Customers for Enforcements*  
It has been noted that the information about customers required by law enforcement has become one of most important barriers to international cooperation. This confirms the failure of the risk approach strategy. The due process and the use of compulsory powers to collect information probably constitute the issue most linked to human rights. In most jurisdictions, mutual legal assistance arrangements insist on reviewing each individual case to determine that civil rights are not infringed. Also governments make case-by- case reviews to ensure that none of them affects national sovereignty. All of this implies more time and less efficiency for countering the financing of terrorism.
- *Other barriers to Cooperation*

In the case of FIUs, Gilmore remarked that the highly diverse institutional architecture of the FIUs act as the roots of some difficulties in International co-operation.

It is extremely difficult for an independent or administrative unit to share information with a unit that constitutes part of the police of another state. Such an exchange, without sufficient guarantees, would undermine one of the fundamental missions of independent units, that is to avoid to the greatest possible degree the communication of sensitive everyday information to law enforcement authorities.

On the other hand, independent units face problems in consulting foreign police data, as they 'do not fit' in the international police communication system. At the same time, it is sometimes impossible, even unconstitutional, for many police units to exchange information with independent, 'non-state' bodies in other countries.

As has been underlined in this chapter other barriers to cooperation are : lack of information exchange between financial system regulators (BCP, IAIS, IOSCO), the ineffective system used by regulators to examine the requests case-by-case, dual criminality, diagonal information sharing, reciprocity, availability of information-collecting powers and the lack of proactive information exchange.

The conference on Cross Border Cooperation and Information Exchange held at IMF headquarters on July 2004 paid attention to the following barriers that should be removed

- Finding ways to share information while protecting legitimate rights to privacy and taking account of supervisors' confidentiality obligations<sup>125</sup>.

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<sup>125</sup> Regarding the barriers for information exchange, it is important to pay attention to the 'SWIFT' case. SWIFT is a private company created in 1973 for the exchanges of financial messages. Their clients are nearly 8,000 financial institutions in 205 countries, including banks, brokers/dealers and investment managers, along with their market infrastructures in payments, securities, treasury and trade, with a figure of 904,826,708 messages/year. Integrity and the confidentiality of its customers is at the core of their business. Since shortly after Sept.11, 2001, the U.S. Treasury department has been secretly tracking suspected terrorist financing through a far-reaching program that gives it access to records from the network that handles nearly all international financial transfers. Under this program, U.S. counterterrorism analysts query Swift's vast database of billions of financial transactions for information on activity by suspected terrorists.(Simpson 2006:10).

This disclosure has created relevant controversy in Europe. In Octobre 2001, the US SWIFT Branch received subpoenas from the US Treasury Department in relation with the tracking of terrorism financing. The compulsory subpoenas required SWIFT to transmit a limited subset of its stored message data to the US Treasury in connection with the US's ongoing terrorist finance investigations. SWIFT had ensured that its compliance with the US Treasury subpoenas was legal, limited, targeted, protected, audited and overseen. SWIFT also did its utmost to comply with the data protection principles of proportionality, purpose and oversight. The Belgian Data Privacy Commission advisory reports that SWIFT had not fully respected Belgian and European data protection laws. The question that arises here is the necessity for a removal of

- Sharing information among supervisors of different sectors (e.g.between banking and securities regulators).
- Sharing information for regulatory, compliance, and law-enforcement purposes
- Solving the complexity of multiple gateways for information exchange
- Addressing possible differences in the treatment of information exchange among the standards.

Along with the problems of international cooperation, Pillar<sup>126</sup> warns that, “*global cooperation against terrorism is already fragile*” and that “*foreign cooperation will become more problematic as the issue moves beyond Al Qaeda.*” (Pillar 2004 :106).In accordance with the previous ideas, Gillespie also pointed out that “*tracing of Terrorist Financing is more an intelligence exercise than a legal procedure and insists that it should strengthen the international information exchange.*” (Gillespie 2002 :68)

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EU-US dialogue on the issue of developing an improved framework to reconcile data privacy concerns with today’s pressing security concerns.

<sup>126</sup> Paul R.Pillar former Deputy Chief of he CIA’s counterterrorist Center

#### **4.3.5 Summary of the Main Weaknesses of the AML/CFT**

This section states that the main weaknesses and constraints of the implementation of the AML/CFT Regime are the following:

- A failure to ratify and implement international Convention on ML and TF in some countries.
- Inadequate customer identification policies in countries in all income groups.
- A failure to provide resources to supervise anti-Money Laundering programs and institutions.
- A need to enhance mutual legal assistance, information sharing and cooperation with national sectors and across borders.

Through a mixed method approach, these statements will be confirmed in chapter 6.

Furthermore, it shall be remarked that the global regulatory framework on ML and FT is not homogeneous since some regions have developed their own guidelines. The international standards on ML and FT are not specifically designed on the basis of the regions' different nature. Also, there is a lack of specialized supervision on AML/CFT issues as well as a lack of rating mechanisms applicable to financial entities; there are no rates linked to the financial entities' compliance with regulations on the prevention and control of money laundering and terrorism financing.

In this chapter, important causal explanations have been established between some explanatory variables; (ratifications of the international Convention on ML and FT , the criminalisation of Money Laundering, Terrorism and Terrorist Financing, institutional factors of governance such as regulatory quality framework, control of corruption, and the participation in the Egmond Group);and the dependent variable( the overall compliance by jurisdictions with the AML/CFT).

In this present dissertation, bivariate correlations between the jurisdiction's compliance with the AML/CFT Regime and all the variables listed below shall be tested:

- The correlation between the Ratifications of international Convention on ML and criminalisation of Money Laundering and the overall jurisdiction's compliance with the AML/CFT.
- The correlation between the Ratifications of international Convention on FT and the criminalisation of Terrorist Financing, and the overall jurisdiction's compliance with the AML/CFT.

- The correlation between some “Indicators of governance” and the overall jurisdiction’s compliance with the AML/CFT.
- The correlation between the” EG” and the overall jurisdiction’s compliance with the AML/CFT.

#### **4.4. How to Best Evaluate Effectiveness?**

To answer the question about effectiveness would require reviewing the goals of the AML/CFT. According to Schott “*Money cannot be laundered, nor terrorism financed, without the involvement of financial institutions, certain business entities and certain persons.*”(Schott 2006:V-23). To control all of them, “*the AML/CFT pretends to reach a multiplicity of objectives.*” (Carrington 2006:2).

Much of the initial focus of the global AML Regime was to implement legal and preventive Recommendations to monitor the core financial system, that is, particularly banks, since the banking system plays a central role in the collection and movement of funds. While the principal objective was to make it more difficult and expensive for criminal offenders to launder the proceeds of their crimes, an important subsidiary objective has been to protect the integrity of the financial system itself. Initial AML had to extend its initial scope to non financial institutions due to the evolution of Money Laundering Typologies and the Terrorist Financing Trends.

The evolution of the AML/CFT goal makes the evaluation of the effectiveness very difficult.

#### **4.4.1. By Reducing predicate crimes**

In order to calculate the effectiveness of the AML/CFT in reducing predicate crimes, we should remember again that the AML/CFT is a multifunctional concept and FATF Recommendations on Terrorism Finances are an extension of the initial AML Regime. To calculate the effectiveness of the AML to reduce crime, Pieth proposes: “*the effectiveness of the AML/CFT on reducing crime should be calculated according to the data narrowest to the traditional meaning relating to drugs and organize crime*” (Pieth 2004:415). He also points out the difficulties found in the method to calculate the effectiveness to reduce drugs and crime due to the poor existing data on convictions and confiscation around the world. The calculation of the effectiveness of AML/CFT on reducing terrorism financing presents the same difficulty because is almost impossible to find public, homogeneous and aggregate data on Terrorism Financing prosecutions and convictions.

The quantitative and qualitative analysis will show whether data are available on Terrorist Financing prosecutions, and Terrorist Financing suspicious activity reports.

#### **4.4.2. By Protecting the Integrity of the Financial System, Improving Transparency and Accountability**

The evidence shows systemic characteristics of the international financial system, which makes the reduction of Terrorist Financing very difficult. The best way to notice whether the AML/CFT Regime has protected the integrity of the financial system, improving its transparency, is through the analysis of the information provided about the size of the financial system. Chapter 5 describes the financial system variables taken into account to evaluate the transparency of the financial system. Also, the conclusions of the IMF reports undertaken on ‘Integrity Standards’ will help to state whether the AML/CFT has been helpful to protect the integrity of financial systems .

#### **4.4.3. By Strengthening Legal and Financial system**

As for evaluating the effort of the countries to strengthen their regulatory frameworks, the best way to do this is to evaluate the overall compliance with the AML/CFT by 46 jurisdictions.

That means reviewing the sum of the total scores of the mutual evaluation reports. The following chapter develops the methodology used to measure the overall compliance with 40 Recommendations and 9 Special Recommendations on ML and TF.

#### **4.4.4. Has the AML/CFT Effectively Monitored the Financial System to Prevent Future Acts of Terror?**

With the growth of the Internet and the increasing deregulation of the banking industry, it is more difficult for banks to detect suspicious transactions. In addition to this, offshore financial centers with high secrecy and minimal records have a clear comparative advantage. It is difficult to ensure compliance by non-OECD states.

The nature of bank secrecy makes the tracking of transactions difficult even within a highly regulated institutional structure.

In order to determine if the AML/CFT effectively provides information to law enforcement authorities, intelligence agencies, military personnel, assisting them to identify and locate the individuals, organizations, and states which are responsible for supporting and carrying out acts of terror, this research will pay special attention to the results of the statistics provided by mutual evaluation reports and the remarks of the interviews with Police and Intelligence Officials.

The results of this research will show whether countries have developed legal frameworks that permit an efficient flow of information as has been proposed by Carrington.

The challenge is likely to be on-going, in part because of the dynamic nature of financial sector activity and the widening of the AML/CFT net to cover non-financial institutions. Setting aside these two variables, success in this regard however will still depend on the ability of countries to develop frameworks that create an environment in which relevant and good quality information can flow efficiently through the AML/CFT chain. Countries need to create legal frameworks that promote the easy availability of relevant and useful information, remove obstacles to the flow of such information, develop pathways through which such information can efficiently flow and the promote a culture of cooperation across all private and public sector entities and persons that play a role in AML/CFT Regimes.(Carrington, 2006:46)

#### **4.4.6. The Effect of AML/CFT in Terms of Deterring Transnational Terrorism**

The question is whether the FATF Special Recommendation improves the world fight against terrorism, that is, reduces the terrorist attacks or the Terrorist Financing. This question will be evaluated through the statistics of MIPT a database focused on attack incidents perpetrated by International and National Terrorists. During this research, it has been noted that the terrorist networks, despite a variation in the availability of resources and their willingness to combat terrorism, continue to face problems of international and interagency coordination and cooperation.



## **CHAPTER 5**

### **Data and Analytical Methodology**

## Chapter 5. Data and Methodology of Analysis

The purpose of this chapter is to establish the variables and methods that will make it possible to answer the main research questions of this research. This section also details the mixed methods used to collect both qualitative and quantitative data. This section describes the research design, including a description of the research type carried out, the theories and the hypotheses to be tested, the quantitative and qualitative methods applied, as well as the statistical procedures utilized in this dissertation. This chapter develops the rationale for mixing different kinds of data at different stages of research.

Table 5.1 shows a brief summary of the research design described in this chapter.

Table 5.1 Research Design

| Variable Name  | Research Question  | Research Type   | Methodology   | Statistical Computer program |
|--|--|---|---|------------------------------|
| <p>Dependent variable<br/><i>YOCAML</i><br/>(Country/Jurisdiction Overall compliance with AML/CFT score)</p> | <p>1) What level of Overall compliance has the cooperative AML/CFT Regime achieved in countries?</p> <p>2) How efficient has the implementation of the AML/CFT been?</p> | Exploratory Research                                  | <p><u>Quantitative Methods</u></p> <ul style="list-style-type: none"> <li>▪ <i>Descriptive Statistics (Frequencies)</i></li> <li>▪ <i>Bivariate Correlations</i></li> </ul> <p><u>Qualitative Methods</u></p> <ul style="list-style-type: none"> <li>▪ <i>Analysis of factors underlying rating of compliance for each Recommendation</i></li> <li>▪ <i>Email discussion and Interviews analysis</i></li> </ul> | SPSS                         |
| <p>Independent Variables<br/><i>Legal</i><br/><i>Economic</i><br/><i>Institutional</i></p>                   | <p>1) What legal, economic and institutional factors are determinants for the level of Overall compliance with the AML/CFT?</p>  | Testing Hypotheses stated in the theoretical chapters | <p><u>Quantitative Methods</u></p> <ul style="list-style-type: none"> <li>▪ <i>Bivariate Correlations</i></li> <li>▪ <i>OLS</i></li> </ul> <p><u>Qualitative Methods</u></p> <ul style="list-style-type: none"> <li>▪ <i>Interviews analysis</i></li> </ul>   | SPSS and STATA               |

## 5.1. Introduction

The literature on Terrorist Financing has focused mostly on the mechanisms used by terrorists and the dilemmas faced in controlling them. As summarized previously, most of the literature describes and explains the phenomenon, but few authors have attempted to make suggestions on how to introduce change in the AML/CFT Regime, so as to make these measures more effective and efficient. The main focus has been on particular policies and programs, and thus the literature in the field has been developed mostly through research on terrorism, threat assessment, and threat management.

As has been explained in this dissertation, there is no comprehensive study treating the subject of the level of compliance with the AML/CFT Regime in a consistent and scientific manner. Two publications on the subject so far, one of them being *Anti-Money Laundering and Combating the Financing of Terrorism: Observations from the Work Program and Implications Going Forward* (IMF and WB 2005) but this work is only focused on comparing comparing the different results of the overall compliance obtained between the old and the new 2004 methodology. The other of the two publications, the only that has compared the national implementation of international standards is *Following the Money Trail: Terrorist Financing and Government Responses in Southeast Asia* (Barlow and Croissant 2007). This work used only variables provided by the general International Narcotics Strategic Country, but this work did not study the implementation of the FATF Recommendations on Money Laundering and Terrorist Financing.

Nothing has been written so far on the empirical evaluation of determinants for compliance with the AML/CFT. The analysis of compliance has been approached theoretically, but it has not been investigated at an empirical level – and certainly not from a comparative cross-sectional perspective. Clearly, the field of the determinants for compliance has only been investigated theoretically.

Another study, “*Has the Financial Action Task Force Made a Difference*” (Jonhson and Lin 2002) has contributed with the following statement:

*“At the root of the problem [of Money Laundering] are governments’ attitudes towards Money Laundering, which dictate its level of acceptance and the extent of the involvement of the banking sector in this activity. Governments must recognize that Money Laundering*

*poses a serious threat to democracy and to the soundness of the financial system”.*

A good indicator of governments' attitude is their participation in global anti-Money Laundering initiatives and their willingness to adopt anti-Money Laundering legislation. The FATF is one of the most important organizations in the fight against Money Laundering and Terrorist Financing. The 40 Recommendations and 9 Special Recommendations are regarded as a comprehensive set of international standards for anti-Money Laundering policies and procedures for their applications and development. The FATF's process of mutual evaluation gives increased credibility to its anti-Money Laundering and Terrorist Financing mechanisms.

In the working paper, *“Financial Sector Regulation: Issues and Gaps-Background Paper”* (IMF 2004), the authors found that the relationship between preconditions and implementation can also be illustrated by the correlation between governance indexes and average levels of regulatory standards implementation. To illustrate this point, an index of average implementation of three standards- BCP, IAIS and IOSCO core principles- was used for 36 Fund member countries. In these countries, an evaluation was undertaken across banking, insurance, and securities sectors in the context of the joint Bank-Fund Financial Sector Assessment Program (FSAP).

All three standards classified the level of implementation of individual principles into four categories, denoted as compliant, largely compliant, broadly compliant, and non compliant. Each of the categories was assigned a numeric value, from 4.0 compliant to 1.0 (noncompliant). The rule of law and overall government effectiveness compiled by Kaufmann, Kraay and Mastruzzi (2003) were used as a measure of preconditions of governance. In this aforementioned case, the data shows a clear positive relationship between the rule of law and government effectiveness on one hand and the average level of standards implementation on the other hand.

## **5.2 Variables: Data Collection and Variables Description**

This section describes the process of collecting and describing data regarding variables.

### **5.2.1 Dependent Variable: Jurisdiction's Overall Compliance with AML/CFT**

According to the conclusions in the previous chapter, the effectiveness of the AML/CFT Regime can only be tested in relation to the implementation of the AML/CFT to strengthen the legal, financial, and regulatory infrastructure capacity of countries.

In this research, the dependent variable is the score achieved by a country/jurisdiction in relation to its Overall compliance with the AML/CFT Regime (YOCAML).

This section describes the methods and instruments used to collect the dependent variable data. Furthermore, this section also presents how the data was organized, reduced, and presented.

#### **5.2.1.1 Sample**

Determining the sample for the study was based solely on acquiring the requisite data on the variables of interest as specified in my hypotheses. A total of 46 countries met the particular requirements of a complete public mutual evaluation report on the AML/CFT implementation on June 15<sup>th</sup>, 2007. The sample consists of a diverse number of both developed and developing countries, and a mixture of countries differentiated by different kinds of regulatory frameworks, levels of corruption, and political will.

#### **5.2.1.2 Data Description**

Cross-Country data for the study has been collected from FATF, FSRBs, IMF and WB. A comprehensive description of the findings concerning Overall compliance with the FATF 2003 and SPECIAL RECOMMENDATIONS 2001 with the revised methodology 2004 in 46 countries can be found in appendix 3.

As has been argued in chapter 4, the IMF and the WB have taken a leading role in the development of the methodology for assessing compliance with AML/CFT standards and its subsequent endorsement by the FATF and a number of the FSRBs. Financial Action Task Force on Money Laundering (FATF) regional groups or FATF-Style Regional Bodies (FSRBs) have been very important in the implementation of anti-Money Laundering (AML) as well as combating the financing of terrorism (CFT) standards within

their respective regions. The FSRBs develop the same objective as FATF; they encourage and evaluate the implementation of FATF's Recommendations and the nine Special Recommendations on Terrorist Financing (Special Recommendations). Not only providing information, trends and techniques, these FSRBs administer the mutual evaluation of their members.

After the general agreement that FATF's 40 Recommendations + 9 Special Recommendations would be recognized as the appropriate standard for combating Money Laundering and Terrorist Financing, the AML/CFT Methodology is designed to guide the assessment of a jurisdiction's compliance with the AML/CFT standards. While the methodology is based primarily on the FATF 40 and the FATF Nine Special Recommendations on Terrorist Financing, it also includes relevant elements from United Nations Security Council Resolutions and international Convention and from supervisory and regulatory standards for the banking, insurance, and securities sectors as well as from the Egmont Group. The mutual evaluation presents the findings concerning Overall compliance with the FATF (2003) and Special Recommendations (2001) according to the revised 2004 methodology

The 2004 methodology contains over 200 essential criteria, 20 sub criteria and 35 additional criteria as compared to 120 criteria under the 2003 methodology. For further explanations regarding the AML/CFT methodology, see appendix 3. The AML/CFT methodology lists a series of criteria for assessing the legal and institutional framework as well as the supervisory mechanisms in place in all relevant sectors, including the banking, insurance and securities sectors where applicable. The 46 countries evaluated in this work have been assessed by the revised 2004 methodology. This methodology has permitted assessors to determine whether the FATF Recommendations have been fully and properly implemented. All the reports included in this work have been evaluated along the following four areas, reflecting an effective AML/CFT system adequate with the legal and institutional framework:

- Laws that create Money Laundering (ML) and Terrorist Financing (FT) offences and provide for the freezing, seizing, and confiscation of the proceeds of crime and terrorist funding.

- Laws, regulations, or, in certain circumstances, other enforceable means that impose the required obligations on financial institutions and designated non-financial businesses and professions.
- An appropriate institutional framework and laws that provides competent authorities with the necessary duties, powers, and sanctions.
- Laws and other measures that give a country the ability to provide the widest range of international cooperation.

Secondary sources rather than primary sources were used because the opportunities and resources available for doing primary research in this confidential field are extremely limited. The results of the mutual evaluations reports have been reused. The first step following the guidelines for assessing the re-usability of qualitative data sets (Heaton 2004)<sup>127</sup> was to evaluate the accessibility, quality, and suitability of the data.

The source of the mutual evaluation report is formal data, obtained through the meetings of assessor committees with national officials, and it explains the level of compliance with the Regime. The data was only available for the 46 countries; the mutual evaluation reports are public, and they are published by IMF, WB, FATF and FBR. The information is available on the internet. The primary investigators cannot be consulted. The nominal score represents the jurisdiction compliance with the compulsory essential criteria for each Recommendation.

Referring to the quality of the data consistency, the reports *Review of the Quality and Consistency of Assessment Reports* (IMF 2006) and *Effectiveness of Coordination and Anti-Money Laundering and Combating the Financing of Terrorism: Observations from the Work Program and Implications Going Forward* (IMF 2005) point out that:

- Assessors often base their judgment of effectiveness on statistical information which is open to divergent interpretations.
- Some Recommendations such as those relating to customer due diligence or supervision require single aggregated rating for compliance but the aggregated includes a lot of information.

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<sup>127</sup> Heaton, J. *Reworking Qualitative Data*. Sage publications, 2004.

- The great variety in the operational rules and guidelines adopted by countries in the implementation of the AML/CFT measures of DNBPs should require assessors to review the matter case by case.
- Strengths or weaknesses observed under one Recommendation can have an effect on the ratio of other Recommendations.
- Some features of the AML/CFT Regime are rated under more than one Recommendation.
- Some criteria also appeared to be difficult to assess in largely cash-based economies.

Despite these issues, the scores of the mutual evaluation reports are considered reasonably complete and adequate for the purposes of this study. The selected countries, year of evaluation, and organizations in charge of the mutual evaluation reports are presented in the following table:



Table 5.2: Countries Included in the Analysis <sup>128</sup>

| Country                       | FATF or FSRB in charge of mutual evaluation | Year of Evaluation |
|-------------------------------|---|--------------------|
| Albania                       | MONEYVAL                                    | 2005               |
| Australia                     | FATF  | 2005               |
| Bahrain                       | MENAFATF                                    | 2005               |
| Belarus                       | IMF   | 2004               |
| Belgium                       | FATF  | 2005               |
| Bolivia                       | GAFISUD                                     | 2006               |
| Brunei                        | APG   | 2005               |
| Chile                         | GAFISUD                                     | 2006               |
| Colombia                      | GAFISUD                                     | 2004               |
| Cyprus                        | MONEYVAL                                    | 2005               |
| Denmark                       | FATF  | 2006               |
| Dominican Republic            | CFATF                                       | 2005               |
| Fiji                          | WORLD BANK                                  | 2006               |
| Gibraltar                     | IMF   | 2006               |
| Hungary                       | MONEYVAL                                    | 2005               |
| Iceland                       | FATF  | 2006               |
| India                         | APG   | 2005               |
| Ireland                       | FATF  | 2005               |
| Italy                         | FATF  | 2005               |
| Jamaica                       | CFATF                                       | 2005               |
| Latvia                        | IMF   | 2006               |
| Lithuania                     | MONEYVAL                                    | 2006               |
| Mauritania                    | MENAFATF                                    | 2005               |
| Nepal                         | APG   | 2005               |
| Panama                        | CFATF                                       | 2005               |
| Paraguay                      | GAFISUD                                     | 2005               |
| Peru                          | GAFISUD                                     | 2005               |
| Portugal                      | FATF  | 2006               |
| Samoa                         | APG   | 2006               |
| Slovakia                      | MONEYVAL                                    | 2005               |
| Slovenia                      | MONEYVAL                                    | 2005               |
| Spain                         | FATF  | 2005               |
| Sri Lanka                     | APG   | 2006               |
| Sudan                         | WORLD BANK                                  | 2004               |
| Sweden                        | FATF  | 2005               |
| Switzerland                   | FATF  | 2005               |
| Syria                         | MENAFATF                                    | 2006               |
| Turkey                        | FATF  | 2006               |
| Uruguay                       | GAFISUD                                     | 2006               |
| US                            | FATF  | 2006               |
| Vanuatu                       | APG   | 2006               |
| United Kingdom <sup>129</sup> | FATF  | 2006               |
| Greece                        | FATF  | 2006               |
| China                         | FATF  | 2006               |
| Georgia                       | MONEYVAL                                    | 2006               |

The scores results for Recommendation 31 and Special Recommendation 9 show a lot of missing data or data non available. These Recommendations have not been taken into account in the model. Some data for Slovenia and Slovakia have been modified to avoid an

<sup>128</sup> See details of Mutual evaluations in each FATF Style Regional Bodies websites:

<http://www.imf.org>, <http://www.worldbank.org>, <http://www.fatf-gafisud.org>, <http://www.cftaf.org>, <http://www.apgml.org>, [http://www.coe.int/T/E/Legal\\_affairs/Legal\\_co-operation/Combating\\_economic\\_crime/Money\\_laundering](http://www.coe.int/T/E/Legal_affairs/Legal_co-operation/Combating_economic_crime/Money_laundering), <http://www.gafisud.org>, <http://www.menafatf.org>

<sup>129</sup> The mutual evaluation report referred to England, Scotland, Wales, and North Ireland. The U.K overseas and Crown Dependency are not included.

absence of data, where missing was replaced by 0 according to some explanation given by mutual evaluation reports. In the methodology, the timeframe of the data set is appropriate for describing the present level of jurisdictions compliance with AML/CTF. The countries included in the sample have been evaluated from the end of 2004 until mid- 2006.

The data set is sufficient for the purposes of evaluating the jurisdictions' compliance with the AML/CFT. In line with the The mutual evaluation reports seem to be well executed by assessors who maintain their independence in every evaluation and follow the 2004 Methodology. The limitation of this analysis is the level of subjectivity that relies on a number of Mutual evaluations Reports.

The sample selected and the scores resulting from these mutual evaluation reports fit for the purposes of the proposed research. The sample represents more than 20% of the total countries and jurisdictions around the world. The GDP represented in this sample is more than 40% of the total World GDP (2005), and the Portfolio Investment represented in this sample is more than 45% of the World Portfolio Investment (2005).

For the dependent variable, the nominal data from Mutual evaluation were not compatible with quantitative methods. The first step was to changing the data codes from letters to numbers that represent the ordinal nature of the data.Changes in Y are summarized in the following table:

Table 5.3 Changes in Dependent Variable Scale Score

| <b>Mutual evaluation Score: Level of Compliance AML/CFT</b> | <b>Study Score: Level of Compliance AML/CFT</b> |
|---|---|
| Compliant (C) :   | 3   |
| Largely Compliant (LC)                                      | 2   |
| Partially Compliant (PC)                                    | 1   |
| Non Compliant (NC)  | 0   |

The second step was to discard the variables R31 (Legal Arrangements) and SR 9 (Bearer Instruments), as the variables had too many values that were not available. In addition, Recommendation 4 (secrecy law) presents a high level of compliance among the countries in the sample, and was also discarded because no comparative analysis was possible as a result thereof.

### 5.2.1.3 Describing the Data

A major operational difficulty is that of defining a score for the overall compliance with the AML/CFT. To resolve this difficulty, this dissertation makes the following theoretical assumptions, already pointed out by many scholars and international bodies:

- “There is a nexus between transnational organized crime and Terrorist Financing”. This theoretical explanation is broadly developed in section 2.2.2.2 and 2.3.1
- Money Laundering can be regarded as a multiplier of criminal activities, which facilitates crime by capacitating crime groups and networks to self-finance, diversify, and grow (IMF and WB 2005:183). Money Laundering increases crime so more Money Laundering will take place (for further explanation see section 2.3.1).
- Country attractiveness for Money Laundering: Increases terrorism . (see section 2.3.1 for further explanation ) and undermines foreign policy and institutions.

Based on these three assumptions, it is not sufficient to be compliant with 9 Special Recommendations on Terrorist Financing (to fight against Terrorist Financing), it is also necessary to be compliant with the 40 Recommendations on Money Laundering.

The necessary condition of being compliant with all the AML/CFT Recommendations suggests that the sum of all Recommendations and Special Recommendations scores are a good measure of the jurisdictions' compliance with the AML/CFT Regime. Every Recommendation has the same weight in the sum. The sum of the total scores is a linear combination of each Recommendation.

The dependent variable (Y) is represented in the study by Y Overall compliance with AML/CFT score (YOCAML). The measure is based on a sum of 4 subgroups, where the subgroups are:

- Subgroup of overall FATF legal Recommendations scores (AML/CFT)  
Y Overall legal scores AML/CFT (YOLE) = the sum of legal Recommendations scores on ML (YLEML) + the sum of legal Special Recommendations scores on FT (YLEFT).
- Subgroup of overall FATF Preventive Recommendations scores (AML/CFT)

Y Overall preventive scores AML/CFT (YOPR) = the sum of preventive Recommendations scores on ML (YPRML) + the sum of preventive Special Recommendations scores on FT (YPRFT).

▪ Subgroup of overall FATF Institutional Recommendations scores (AML/CFT)

Y Overall institutional scores AML/CFT (YOIN) = the sum of institutional Recommendations scores on ML (YINML) + the sum of institutional Special Recommendations scores on FT (YINFT).

▪ Subgroup of overall FATF International Cooperation Recommendations scores (AML/CFT)

Y Overall international cooperation AML/CFT (YOIC) = the sum of international cooperation Recommendations scores on ML (YICML) + the sum of international cooperation Special Recommendations scores on FT (YICFT).

Table 5.4 Subgroups and Concepts of AML/CFT Compliance

| <p style="text-align: center;"><b>CONCEPTS</b></p> <p style="text-align: center;"><b>SUBGROUPS</b></p> | <p style="text-align: center;"><b>Overall compliance on Money Laundering score</b></p> <p style="text-align: center;"><b>(Sum of the elements in this column)</b></p> | <p style="text-align: center;"><b>Overall compliance on Financing of Terror score</b></p> <p style="text-align: center;"><b>(Sum of the elements in this column)</b></p> |
|--|---|--|
| <p><b>Overall FATF Legal Recommendations score (sum of elements of this row) (YOLE)</b></p>            | <p>Sum of FATF Legal Recommendations scores on ML (YLEML)</p>   | <p>Sum of FATF Legal Special Recommendations scores on FT(YLEFT)</p>   |
| <p><b>Overall FATF Preventive Recommendations score (sum of elements of this row) (YOPR)</b></p>       | <p>Sum of FATF Preventive Recommendations scores on ML (YPRML)</p>  | <p>Sum of FATF Preventive Special Recommendations scores on FT(YPRFT)</p>  |
| <p><b>Overall FATF Institutional Recommendations score (sum of elements of this row)</b></p>           | <p>Sum of FATF Institutional Recommendations scores on ML(YINML)</p>  | <p>Sum of FATF Institutional Special Recommendations scores on FT (YINFT)</p>  |

|  |  |  |
|--|--|--|
| <b>(YOIN)</b>  |  |  |
| <b>Overall FATF International Cooperation Recommendations score (sum of elements of this row) (YOIC)</b> | Sum of FATF International Cooperation Recommendations scores on ML (YICML) | Sum of FATF International Cooperation Special Recommendations scores on FT (YICFT) |

This analytical approach was utilized to achieve a better understanding of the Overall compliance of FATF Recommendations by grouping the Recommendations and concepts (ML and TF). The sum of the scores of all Recommendations belonging to the same group allows us to maintain a linear combination, and it also fits well with the theoretical assumptions.

Table 5.5 summarizes the subgroups of Recommendations<sup>130</sup> and concepts included in the dependent variable.

Table 5.5 Dependent Variable by Subgroups and Concepts

| <b>Y Overall compliance score with AML/CFT by concepts and subgroups (YOCAML)<sup>131</sup></b> | <b>Sum of the overall Legal subgroup scores (YOLE)</b> | <b>Sum of overall Preventive subgroup scores (YOPR)</b>          | <b>Sum of overall Institutional subgroup Scores (YOIN)</b> | <b>Sum of overall International Cooperation subgroup scores (YOIC)</b> |
|---|--|--|--|--|
| <b>Sum of 40 Recommendations scores on ML concept (YOCML)</b>                                   | Sum of (R1, R2 R3) scores (YLEML)                      | Sum of (R5 - R25) scores (R4 and R9 have been excluded) (YPRML)  | Sum of (R 27- R34) scores (R 31 has been excluded) (YINML) | Sum of (R 35-R40) scores (YICML)                                       |
| <b>Sum of 9 Special Recommendations scores on FT concept (YOCFT)</b>                            | Sum of (SRI,SRII,SRIII) scores (YLEFT)                 | Sum of (SR VI,VII,VIII) scores (SR IX has been excluded) (YPRFT) | SR IV scores (YINFT)                                       | SR V scores (YICFT)  |

<sup>130</sup> The description of each recommendation and special recommendations can be found at <http://www.fatf-gafi.com>

<sup>131</sup> YOCAML= YOCML+ YOCFT; YOLE= YLEML+YLEFT  
YOPR= YPRML+YPRFT; YOIN=YINML+YINFT; YOIC= YICML+YICFT

## **5.2.2 Independent Variables**

According to IMF (2005), the theoretical framework developed in previous chapters and the issues pointed out by the interviewees, the overall jurisdiction compliance with the AML/CFT Regime could be explained by the list of variables below.

Where possible, data for independent variables are computed for the year 2005, to be consistent with the timeframe of the dependent variable, because the majority of the mutual evaluations were done in 2005.

### **5.2.2.1. Ratification of International Money Laundering Conventions (RATML)**

In some cases the simple ratification of the international Convention often does not imply compliance because of a lack of developments in domestic laws. According to statements in chapter 4, ratification is a necessary element so it has been included in the model. This also applies to the following independent variable (Ratification of International Financing of Terrorism (RATFT)).

The first commitment made by a jurisdiction is the ratification of International Convention linked to terrorism and Money Laundering, as was explained in Chapter 4. In this work, RATML is measured on the basis of the information provided by the INCSR (2006), UN 2006, and OECD 2006. RATML is based on the sum of scores of the following Convention and the criminalization of Money Laundering beyond drugs.

- Vienna Convention
- Palermo Convention
- Convention on Corruption 2003
- OECD Bribery 1987
- Criminalize Money Laundering Beyond Drugs

A score of 1 is given if a country has both ratified each Convention and has criminalized Money Laundering beyond drugs. Otherwise a score of 0 is assigned.

### **5.2.2.2. Ratification of International Terrorism Convention (RATFT)**

Ratifications on Terrorism Convention are a necessary element to be included in my model, because it is the first commitment of a country against this predicate offence. In this work, RATFT is measured on the basis of the information provided by the INCSR

(2006), UN 2006, and mutual evaluations reports. A score of 1 is given for each Convention ratified, otherwise the score is 0.

The RATFT variable is based on the sum of scores of the following Convention and criminalization of TF:

- Convention on offences and Certain Other Acts Committed on Board Aircraft (Aircraft-Conv-1963).
- Convention for the Suppression of Unlawful Seizure of Aircraft (Unl Seiz Conv 1970).
- Convention for the Suppression of Unlawful Against the Safety of Civil Aviation 1971.(Unl Civil Aviation 1971)
- Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents (CA Conv 1973).
- International Convention against the Taking of Hostages (HT Conv 1979).
- Convention of the Physical Protection of Nuclear Material (N. Mat Conv 1980).
- Protocol on the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of civil aviation (Airport Conv 1988).
- Convention of the Suppression of Unlawful Acts against the Safety of Maritime Navigation, 1988 (Nav conv 1988).
- Convention for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf (FP Conv 1988).
- Convention on the Marking of Plastic Explosives for the Purpose of Detection (PE Conv 1991).
- International Convention for the Suppression of Terrorist Bombings (TB Conv 1997).
- International Convention for the Suppression of the Financing of Terrorism (TF Conv 1999).
- Criminalisation of the Financing of Terrorism

### **5.2.2.3. Indicator of Regulatory Quality Framework (RQ)**

Six dimensions of governance have been measured by *Kaufmann, Daniel, Kraay, Aart and Mastruzzi, Massimo, "Governance Matters VI: Governance Indicators for 1996-2005"* (WB 2005). The set of indicators includes:

- Voice and accountability
- Political stability
- Absence of violence
- Government effectiveness
- Regulatory quality framework
- Control of corruption

This work will assess the correlations between the Overall compliance with the AML/CFT Regime and all the governance indicators above. The best correlation is expected with the regulatory quality framework and the control of corruption indicators.

The indicator is a measure of the ability of governments to formulate and implement sound policies and regulations that permit and promote private sector development.

The group of indicators reflects the preconditions of good governance and political commitment at the level of policy makers and legislators to develop and implement a robust AML/CFT framework. In some countries, the dedication of officials at the technical level of supervisory and law enforcement authorities is hampered by a lack of the political commitment of the government and parliament to pass legislation and assign necessary resources.

This set of indicators is measured on the basis of the Governance Indicators provided by the World Bank and published in the abovementioned study. These indicators are chosen because they explain the preconditions of governance of a country.



#### **5.2.2.4. Indicator of Control of Corruption (CO)**

Corruption as discussed in Chapter 3 undermines the effectiveness of the AML/CFT Regime in some countries. In environments where corruption is prevalent, legislators are less likely to enact strong and effective AML/CFT laws, and key institutions (courts, law enforcement, and supervisory agencies) may be hindered from carrying out their official duties in an effective manner. Development of an AML/CFT Regime in such an environment also requires the establishment of an effective anti-corruption framework.

In this study, the Control of Corruption indicator is taken as the extent to which public power is exercised for private gain, including both petty and large-scale corruption, as well as “the capture” of the state by elites and private interests. Control is measured on the basis of the Governance Indicators provided by the World Bank and published in the above mentioned study.

#### **5.2.2.5. Participation in Egmont Group (EG)**

The Egmont group is a group of FIUs (Financial Intelligence Units) set up for the stimulation of international cooperation. The importance of both the existence of a Financial Intelligence Unit in every country and the international cooperation of FIUs is broadly discussed during this dissertation. This variable captures the aforementioned idea. The variable is measured by means of a dummy variable (1 if a country has become a member of the Egmont Group, 0 otherwise) based on information gathered from the Egmont Group Web Page.

#### **5.2.2.6. Index of Attractiveness to Money Laundering (ATML)**

This Index of Attractiveness to Money Laundering (ATML) variable captures how a country is attractive for Money Laundering. In chapter 2, the effects of a country’s attractiveness to Money Laundering was pointed out on diverse aspects, including the financing of terrorism.

The data was taken from Unger (2006). Countries with a stable a government, that are relatively rich, and have well-developed financial services are the most attractive for Money Laundering. The model includes foreign countries which have a tolerant attitude towards Money Laundering and who will attract a greater proportion of monies than more intolerant countries: Tolerant Countries are those with banking secrecy laws or

uncooperative government attitudes towards Money Laundering. In addition, high levels of corruption and or conflict in a country will deter money launderers from laundering money in that country because of added risks.

#### **5.2.2.7. Volume of Informal Remittances /GDP 2004 (INRE)**

Chapter 2 provides an explanation of the use of informal remittances to transmit terrorist funds. The objective of this variable is to capture the volume of informal remittances per GDP by country and its correlation with the level of Overall compliance with the AML/CFT Regime. This variable is an indicator of the cash economies.

According to Freund and Spatafora (2005), we can define informal remittances as all types of money transfer services that do not involve formal contracts, and are hence unlikely to be recorded in national accounts. Formal channels include money transfer services offered by banks, post offices, non-bank financial institutions, and foreign bureaus of exchange and money transfer operators like Western Union and Money Gram. Informal channels include cash transfers based on personal relationships through business people, or carried out by courier companies, friends, relatives or even individuals themselves.

To estimate informal remittances, a model by Freund and Spatafora is used, which gives total amounts of informal remittances by regional groups of countries and as a percent form of official flows. In countries with well functioning financial systems, large, regular users tend to send remittances through formal channels. In some countries, especially those with large exchange-rate spreads, the informal sector may be relatively large. According to the model, the informality is most extreme in Sub-Saharan Africa, Eastern Europe, and Central Asia. Formal remittances have also been gathered from the World Bank Database (2004) to compare volumes of formal and informal sectors.

#### **5.2.2.8. Ratio of Cross Border Assets/GDP (COBAS)**

This variable is chosen because it represents an indicator of the financial cross border activity. The calculations of this variable are made following the Mary G. Zephirin methodology (IMF) in her paper related to Economies with International Financial Centers. The sources of data are the national authorities, the BIS, and the Fund's CPIS database. Cross Border Assets are the Portfolio Investment assets as reported in the 2005 CPIS plus

loans/deposits with banks abroad at the end of 2005 derived from partner country (creditor) sources as reported to the BIS, relative to GDP.

#### **5.2.2.9. Ratio of Cross Border Liabilities/GDP (COBLI)**

Following the same methodology mentioned above, the Portfolio Investment liabilities are derived from partner country (creditor) sources as reported in the 2005 CPIS plus Loans/Deposits from banks abroad at the end of 2005, derived from partner country (debtor) sources as reported to the BIS.

#### **5.2.2.10. The Ratio of Net Financial Services Exports (REFS)**

In recent years, Offshore Financial Centers (OFCs), and some onshore centers, have captured a significant proportion of global financial flows, and, due to competition, have little incentive to comply with regulatory and supervisory standards.

Zoromé (2007) proposed an operational and measurable indicator of OFCs. This variable tries to capture the features characteristic of OFCs: “a country or jurisdiction that provides financial services to nonresidents on a scale that is incommensurate with the size and the financing of its domestic economy” and leads to a list of countries/jurisdictions that could be classified as OFC’s.

The ratio of net exports of financial services to GDP was estimated for countries and jurisdictions that did not provide one. Using 2003 as the base year- the most recent year with the best data coverage of all databases- Zoromé elaborated a sample of all the countries and jurisdictions (77) that provided data on financial services (IMF, Balance of Payments Statistics Yearbook) and nominal GDP at market prices (IFS)<sup>132</sup>. This variable is chosen as an indicator of the OFC activity.

The correlation between the Overall compliance with the AML/CFT Regime and REFS will be tested to confirm the theory that states that OFCs are less compliant than non OFCs with the AML/CFT.

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<sup>132</sup> Zoromé confirmed the researcher through an email that the “ ratio of net services exports could be constant in short term (2 to 3 years)

#### **5.2.2.11. Index of Failed States**

The complex phenomenon of state failure incorporates a range of adverse Social Indicators: Mounting Demographic Pressures, Massive Movement of Refugees or Internally Displaced Persons creating Complex Humanitarian Emergencies, Legacy of Vengeance-Seeking Group Grievance or Group Paranoia, Chronic and Sustained Human Flight

Economic Indicators: Uneven Economic Development along Group Lines, Sharp and/or Severe Economic Decline Political Indicators: Criminalization and/or Delegitimization of the State, Progressive Deterioration of Public Services, Suspension or Arbitrary Application of the Rule of Law and Widespread Violation of Human Rights, Security Apparatus Operates as a "State Within a State", Rise of Factionalized Elites, Intervention of Other States or External Political Actors. The data is provided by Peace (2007) in "The states that failed us".

This index is a scale of each jurisdiction in line with the characteristics aforementioned. This variable is chosen to test the theory which states that failed states are the least compliant jurisdictions with the AML/CFT.

#### **5.2.2.12. The Average of the Shadow Economy**

Even if the relation between shadow economy<sup>133</sup>, criminal activity and Terrorist Financing has not been completely established, it is interesting to try to measure the correlation between the shadow economy and country compliance with the AML/CFT Regime. One of the best approximations for shadow economies is the one proposed by Schneider (2004). He presented the estimated shadow economy for 145 countries and concluded that the shadow economy had reached a remarkably large size in developing countries and transition countries.

It would also be interesting to estimate a proxy of illegal economies. Masciandaro attempted to calculate it through crime rates (Johnson & JM D Lin, 2002). However, it is

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<sup>133</sup> For a detailed discussion of the shadow economy, see the table 1: A taxonomy of underground economic economies Schneider, F. and D. H. Enste (2000). "Shadow Economies: Size, Causes and Consequences." *Journal of Economic Literature* XXXVIII: pag 79; Bhattacharyya, D. K. (1999). "On the Economic Rationale of Estimating the Hidden Economy" *The Economic Journal* 109(456): f348-f359; Tanzi, V. (1999). "Uses and abuses of estimates of the underground economy." *The Economic Journal* 109(456): f338-f347.

not within the scope of this dissertation to calculate the scope of illegal economies, since this research has found problems compiling crime rates from some countries, only for countries such as the UK and the USA, the crimes rates for these countries are published in aggregate form.

#### **5.2.2.13. Risk of Terrorist Financing**

The world network that represents the financial industry and non business designated professions today are the linchpin of the mechanisms that permit the financing of international terrorism. The country or jurisdiction vulnerability to Terrorist Financing risk is discussed for each country in every mutual evaluation report, GAO (USA reports) and Giraldo and Trinkunas (2007). For this study, three risk levels were assigned: high (3), medium (2), and low (1). This variable is used in each country to test the correlation between the Overall compliance with the AML/CFT and the indicator of the risk of Terrorist Financing.

#### **5.2.2.14. Size of the Financial System**

The size of the financial system is presented in this study using different ratios: Bank Deposits/GDP, Financial System Deposit/GDP, Life Insurance/GDP, Non Life Insurance/GDP. The data is gathered from the World Bank (Finance Structure Database). These variables are used in each country to test the correlation between the Overall compliance with the AML/CFT Regime and the size of its financial system.

#### **5.1.2.15. GDP (2005)**

This data is gathered from the World Bank

#### **5.2.2.16. World Income Group<sup>134</sup>**

The classifications of Low Income (1), Low-Medium Income (2), Upper middle Income (3), and High Income (4) are provided by the World Bank.

This classification is used to provide information on the level of implementation of the AML/CFT by world income groups.

#### **5.2.2.17. World Region Group<sup>135</sup>**

The region classifications are provided by the World Bank in: Western Countries, Latino American Countries (LAC), East Asian Pacific Countries (EAP), Middle East (MNA), South African Countries (SNA), and Southern Asian Countries (SSA). This classification is used to provide information on the level of implementation of the AML/CFT by world region groups.

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<sup>134</sup> <http://siteresources.worldbank.org/DATASTATISTICS/Resources/OGHIST.xls> (2005)

World Income Groups within the sample: High Income Countries are: Australia, Bahrain, Belgium, Brunei, Cyprus, Denmark, Gibraltar, Iceland, Ireland, Italy, Norway, Portugal, Slovenia, Spain, Sweden, Switzerland, The United States, The United Kingdom.

Upper Medium Income Countries: Uruguay, Slovakia, Panama, Lithuania, Latvia, Turkey, Hungary, Chile.

Low Medium Income Countries: Albania, Belarus, Colombia, Dominican Republic, Fiji, Jamaica, Paraguay, Peru, Samoa, Slovakia, Syria, Vanuatu, China, Georgia, Sri Lanka.

Low Income Countries: India, Mauritania, Nepal, Sudan.

<sup>135</sup> Western : Australia, Belgium, Cyprus, Island, Ireland, Italia, Norway, Portugal, Slovenia, Spain, Sweden, Switzerland, United Kingdom, Gibraltar, US, Bahrain, Brunei, Denmark.

ECA: Albania, Belarus, Latvia, Lithuania, Hungary, Slovakia, Turkey, Georgia.

<http://siteresources.worldbank.org/DATASTATISTICS/Resources/CLASS.XLS> (2005)

LAC: Jamaica, Panama, Paraguay, Peru, Uruguay, Chile, Colombia, Bolivia, Dominican Republic; EAP: China, Vanuatu, Samoa, Fiji; SSA: Mauritania and Sudan; SAS: Sri Lanka, Nepal, India; MNA: Bahrain and Syria.

### 5.2.2.18 Multilateral Institutions

The considered multilateral organizations are OECD, NON OECD, IMF, WB, APG, MONEYVAL, EAG, MENAFATF, FATF, GAFISUD, CFAFT, and OGBS. If a country belongs to the multilateral organization, it receives the value 1, if not 0. Table 5.6 summarizes the coding of the independent variables used in this study. These variables are from 2004-2006

| Table 5.6 Description of Independent Variables   |   |   |
|--|---|---|
| Variable   | Description   | Source  |
| <p><b>Ratification of International Money Laundering Convention (RATML)</b></p> <p>1.UN Vienna Convention 1988<br/>2.Criminalise ML beyond drugs<br/>3.UN Palermo Convention 2000<br/>4.UN Convention against Corruption 2005<br/>5.Antibribery Convention 1997.OECD</p>   | Sum of (1, 2, 3, 4 and 5). For each variable value 1 if the country or jurisdiction has ratified the Convention, 0 otherwise (2005)                       | INCSR (2006), UN(2006), OECD (2006)             |
| <p><b>Ratification of International Terrorism Convention (RATFT)</b></p> <p>1.Aircraft-Conv-1963<br/>2.Unl Seiz Conv 1970<br/>3. Unl Safety CA Conv 1971<br/>4.CA Conv 1973<br/>5.HT Conv 1979<br/>6.N. Mat Conv 1990<br/>7.Airport Prot Conv 1988<br/>8.FP Prot Conv 1988<br/>9.Marit Nav Conv 1988<br/>10.PE Conv 1991<br/>11.TB Conv 1997<br/>12.InternationalTerrorismFinancing Convention<br/>13. Criminalising Terrorist Financing</p> | Sum of (1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11,12,13) For each variable value 1 if the country or jurisdiction has ratified the Convention, 0 otherwise (2005) | {United Nations, 2006 }, US (2006), Ward (2003) |
| <p><b>Regulatory Quality (RQ)</b></p>  | Index measures the ability of the government to formulate and implement sound policies, regulations that permit the promotion of private sector (2005)    | (Kaufmann, 2006 )<br><br>(Kaufmann, 2006 )      |
| <p><b>Corruption (CO)</b></p>  | Index measures how public power is exercised for private  |   |

|   |  |  |
|---|--|--|
|   | gain, including both petty and grand forms of corruption, and capture of the states by elites and private interests (2005)   |  |
| <b>Failed States ( FS)</b>  | Index measures economic and military and social indicators of instability (2007)   | (Peace 2007 )  |
| <b>Egmont Group (EG)</b>  | Dummy is 1 if country is part of Egmont Group, otherwise 0   | <a href="http://www.egmontgroup.com">http://www.egmontgroup.com</a>  |
| <b>Attractiveness to Money Laundering (ATML)</b>  | Ranking from 0 to 25.7, measuring how attractive country is for Money Laundering   | (Unger 2006 )  |
| <b>Average Size of the Shadow Economy (ASISH)</b>   | % of Shadow economy / GDP 2004   | (Schneider 2004)   |
| <b>Ratio of net exports of financial ( REFS)</b>  | OFC is a country or jurisdiction that provides financial services to non residents on a scale that is incommensurate with the size and the financing of its domestic economy | (Zoromé 2007)  |
| <b>Risk of Terrorist Financing (RITF)</b>   | 3 for high risk, 2 medium risk and 1 high risk   | (US 2006:20-22), Mutual evaluations Reports and and GAO report for International Sanctions   |
| <b>Informal Remittance in GDP (INRE)</b>  | Own calculations based on Spatafora percentages of informal remittances /GDP 2004  | (Freund, Spatafora et al. 2005) and* Source: World Bank staff formal remittances inflows and outflows estimates based on the International Monetary Fund's Balance of Payments Statistics Yearbook 2006. |
| <b>Size of Financial System (SFS)</b><br>Bank Deposits/GDP (SBFS)<br>Financial System Deposit /GDP (SFSD)<br>Life Insurance/GDP (SLI)<br>Non Life Insurance/GDP ( SNLI) | This selection of ratios indicates the size of the financial system for each country.<br>Financial Institutions are the main objective of the AML/CFT Regime                 | Financial Structure Dataset<br><a href="Http://www.worldbank.org">Http://www.worldbank.org</a>   |
| <b>Cross Border Financial</b>   | Sum ( Portfolio Investment   | International Investment Position (2005)IMF  |



|  |   |   |
|--|---|---|
| <b>Assets/GDP (2005). (COBAS)</b><br><br>Portfolio Invest Assets<br>Loan Deposit Bank Assets                           | Assets 2005+ Loans Deposit<br>Bank Assets 2005/GDP 2005   | Bis International Loan (2005) BIS   |
| <b>Cross Border Financial Liabilities. ( COBLI)</b><br>Portfolio Invest Liabilities<br>Loans Deposits Bank Liabilities | Sum (Portfolio Investment<br>2005+Loans Deposit Bank<br>Liabilities 2005)/ GDP 2005   | International Investment Position (2005)IMF<br>Bis International Loan (2005) BIS  |
| <b>GDP</b>   | Gross Product Production<br>Current price US Dollars(2005)  | <a href="http://www.worldbank.org">http://www.worldbank.org</a>   |
| <b>Income (INC)</b>  | Low Income, Lower Middle<br>Income, Upper Middle, and<br>High Income (2005)   | <a href="http://siteresources.worldbank.org/DATASTATISTICS/Resources/OGHIST.xls">http://siteresources.worldbank.org/DATASTATISTICS/Resources/OGHIST.xls</a> (2005)  |
| <b>Region (RG)</b>   | Western, ECA,LAC, EAP,<br>SNA, SSA, MENA  | <a href="http://siteresources.worldbank.org/DATASTATISTICS/Resources/CLASS.XLS">http://siteresources.worldbank.org/DATASTATISTICS/Resources/CLASS.XLS</a> (2005)  |
| <b>Multilateral Institutions. (MI)</b>   | Dummy, the country became<br>part of the institution is 1,<br>otherwise, 0<br>OECD, NON OECD, IMF,<br>WB, APG, MONEYVAL,<br>EAG,MENAFATF, FATF,<br>GAFISUD, CFAFT, OGBS | <a href="http://www.imf.org">http://www.imf.org</a> <a href="http://www.worldbank.org">http://www.worldbank.org</a><br><br><a href="http://www.fatf-gafi.com">http://www.fatf-gafi.com</a> , <a href="http://www.cftaf.org">http://www.cftaf.org</a><br><br><a href="http://www.apgml.org">http://www.apgml.org</a> , <a href="http://www.coe.int/T/E/Legal_affairs/Legal_co-operation/Combating_economic_crime/Money_laundering/">http://www.coe.int/T/E/Legal affairs/Legal co-operation/Combating economic crime/Money laundering/</a> |

### **5.3. The Quantitative and Qualitative Analytical Methodology**

As explained at the beginning of this chapter, this research establishes two types of research: the exploratory research and the testing of theories and hypotheses. The following points describe the goal of these two types of research and the methods selected.

#### **5.3.1 Exploratory Research**

The goal of the exploratory research is to answer the following questions:

- 1) What level of Overall compliance has the cooperative AML/CFT Regime achieved in countries?
- 2) How efficient has the implementation of the AML/CFT been?

A mixed methods approach is applied to conduct the exploratory research. The quantitative and qualitative methods utilized are described in the following sections. The analysis and interpretation combines the two forms of data to seek convergence between the results. During the phase of the interpretation of the main findings and results, the manner in which the qualitative findings helped to elaborate on or extend the quantitative results will be discussed. The analysis and interpretation of results will combine the quantitative and qualitative data to seek convergence between the results.

##### **5.3.1.1. Quantitative Methods**

Two types of statistical analysis will be used during the exploratory research, frequencies, and bivariate correlations. The SPSS statistical computer program is used to obtain descriptive statistics and bivariate correlations.

###### 1) Descriptive Statistics

In order to quantify the overall jurisdiction compliance with the AML/CFT Regime, descriptive statistics were calculated to establish the frequencies of Overall compliance for the 40 Recommendations and 9 Special Recommendations from a cross-section of 46 countries. Furthermore, the profile of Overall compliance is described by world region groups and world income groups. These frequencies permit a response to other related questions, such as which subgroup of Recommendations are less compliant within countries by world income group and world region groups.

The goal of the exploratory research is to confirm the four statements below:

- There is no universal implementation of international Convention on ML and FT.

- There are no adequate preventive policies to fight against ML/FT in all world income groups.
- Jurisdictions fail to provide resources to supervise anti-Money Laundering programs and institutions.
- Jurisdictions fail to enhance international cooperation with national sectors and across borders.

## 2) Bivariate Correlations

This statistical analysis permits us to obtain information about the relationship between two variables and the direction of that relationship. Correlation suggests that two variables have variation; in other words, when the value of one variable changes, the other will also change in a predictable manner. When the correlation is calculated between two variables (in a representative sample), it is possible that there could be no relationship, a positive relationship, or a negative relationship. In this dissertation, we will observe variables that increase or decrease together (positive relationship) or a variable that increases when the other decreases (negative relationship). It is also possible to observe a zero correlation, or non-linear relationship.

### **5.3.1.2 Qualitative Methods**

The qualitative analysis will be used to complete the quantitative analysis of the dependent variables. The qualitative analysis of the dependent variable is conducted through two steps:

#### 1) The analysis of factors underlying rating of compliance for each FATF Recommendations on ML and Special Recommendations FT.

The analysis of factors underlying rating is conducted through the analysis of public documents as mutual evaluation reports. Some information is protected and unavailable to public or private access. Some materials are incomplete, and sometimes documents are not accurate.

#### 2) The analysis of the emailing results and interview remarks.

E-mail discussions with IOs official provide information and represent data that are thoughtful, in that participants have given attention to compiling. No bias is predicted. This information has been very helpful to complete the exploratory research.

### **5.3.2 Testing Theories and Hypotheses Stated in the Theoretical Chapters**

This part of the methodology chapter outlines the tests of the theories developed in chapters 2, 3, and 4 to respond to the follow question: Which legal, economic and political factors are the determinants of compliance with the Regime? As it has been mentioned, the existing literature provides only theoretical insights into determinants of compliance with the AML/CFT Regime. This study provides an original contribution *by demonstrating empirically that several governance variables represent key determinants in AML/CFT compliance*. Secondly, the study provides a sound empirical framework that includes a substantial list of multiple variables for further international research on the topic of AML/CFT compliance. Thirdly, the study recommends further research to create a consistent database of studies on this topic.

Theory testing will be conducted in two steps using both quantitative methods and qualitative methods.

1) The first quantitative step is to test bivariate correlations according to the theories stated in earlier chapters.

2) The second step is to formulate multivariate OLS regression equations to test the four proposed hypotheses. Interviews (qualitative method) were planned to be helpful when formulating the OLS regression. The interviews were conducted in person, and the researcher had control over the line of questioning. No bias is predicted in responses. A list of the interviewees and issues discussed are submitted in appendix 1.

The Stata statistical computer program is used to estimate the OLS regression equation.

#### **5.3.2.1. Main Assumptions**

The main adopted assumption to formulate the multivariate analysis has been stated in chapter 2. It assumes that: “There is a nexus between transnational organized crime and transnational terrorist groups”. So due to this convenience marriage for a short run, it is necessary to evaluate the Overall compliance with the AML/CFT Regime.

This assumption is adopted even though some scholars in international relations consider the nexus to be tenuous. (Further explanations are given in chapter 2.

### **5.3.2.2 Causal Relationships**

Figure 5.1 shows the causal relationships between X and Y according to theoretical explanations given throughout this work. We can summarize the independent variables into three groups:

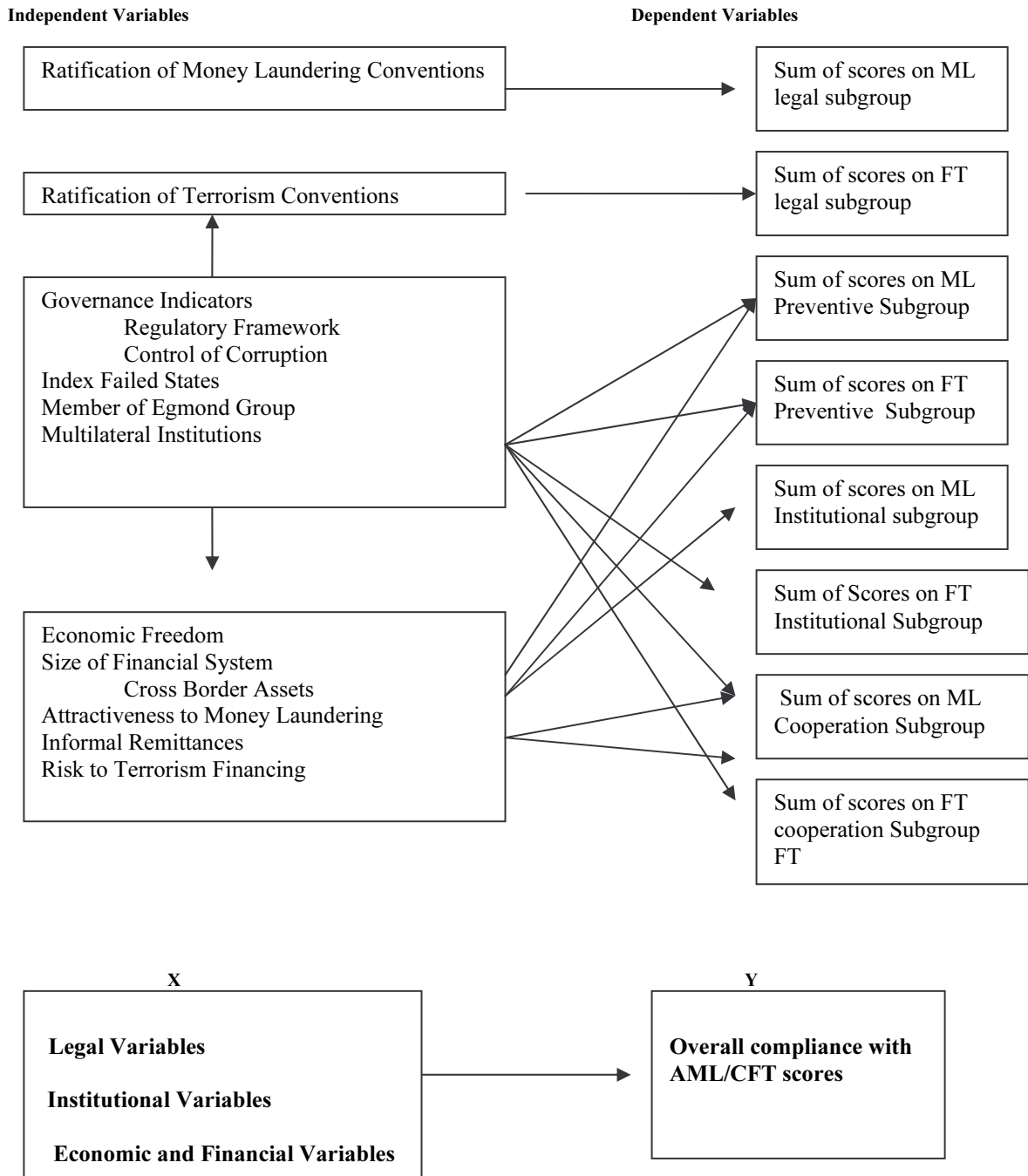
The first group of independent variables is named ‘Legal Variables’. This group is related to the ratifications of Money Laundering UN Convention and UN Terrorist Financing Convention, and also includes the concept of criminalization. Criminalization of Money Laundering and Terrorist Financing is the most important concept contained in the Palermo Convention and the 1999 UN Convention on Terrorist Financing. The causal relationship between this group of legal variables and the dependent variables are developed in depth in chapter IV.

The second group of independent variables is named “Institutional Variables”, and it is related to the existing preconditions of governance in each country, that is, the governance indicators provided by the World Bank, the index of failed states, the existence of conflicts, the participation in the Egmond Group, and the participation in Multilateral Institutions.

The third group of independent variables, named ‘Economic Variables’ is related to the economic freedom of the country, the size of the financial system, a measure of the cash economy (informal remittances/GDP), the average of the shadow economy, the ratio of net financial services, cross border assets/GDP and cross border liabilities/GDP, the country attractiveness to Money Laundering, and the risk of the country for Terrorist Financing.

The following figure specifies the measurement model in reference to theoretical explanations detailed in earlier chapters

Figure 5.1: Causal Relationships between Independent Variables and Dependent Variables



### 5.3.2.3 Bivariate Correlations

In most social science research, the bivariate correlations are the first step for studying the association between two variables. Theoretical models allow us to predict relationships between concepts and variables are our attempts to measure these concepts

During the theoretical framework chapters, some theoretical explanations have been presented which predict casual relationships between the compliance with the AML/CFT Regime and a list of independent variables: (e.g., Index of Attractiveness to Money Laundering, Indicators of the Size of the Financial System, Index of Failed States, Ratio of Informal Remittances, Score of Risk to Terrorist Financing and the vulnerability to Money Laundering and Terrorist Financing, the Index of Economic Freedom, the Index of national governance, conflicts, ratifications of Money Laundering and Terrorist Financing Convention, ratio of net export financial services, ratio of cross border assets, ratio of cross border liabilities, Egmont group, and Multilateral organizations).

Theoretical models allow us to predict relationships between concepts and variables are our attempts to measure these concepts. Therefore, we expect that measured relationships between the variables indicate a relationship in the concepts and in turn support the theory. The aforementioned “theoretical explanations” will be tested using the bivariate correlations method. The following list summarizes the objectives to be demonstrated with this analysis:

- Countries with the highest number of the ratifications on ML and FT variables (RATML and RATFT) are positive correlated with the Overall compliance with the AML/CFT variable (YOCAML).
- Good preconditions of governance are positively correlated with Overall compliance with the AML/CFT variable (YOCAML).
- The country attractiveness to Money Laundering variable (ATML) is positively correlated with Overall compliance with the AML-CFT variable (YOCAML).
- Jurisdictions with the highest level formal banking are positively correlated with Overall compliance with the AML-CFT variable (YOCAML).
- The economies characterized by the highest ratio of informal remittance/GDP (indicator of a cash economy) are negatively correlated with the Overall compliance with the AML/CFT.

- Whether offshore centers, failed states, countries with conflicts and risk of Terrorist Financing are negatively correlated with the overall AML/CFT compliance.

Of the total number of possible bivariate correlations, the selected bivariate correlations were those that test some statements of the theoretical framework. The selected correlations are listed below:

- The bivariate correlation between Ratifications of Money Laundering and Terrorism International Convention (RATML and RATFT) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between “a set of Governance Indicators” (RQ and CO) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the Index of Attractiveness to Money Laundering (ATML) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between some indicators of the Size of the Financial System and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the Index of Failed States (FS ) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the Ratio of Terrorist Financing Risk (RITF) and Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the ratio of Informal Remittance/ GDP 2004. (INRE) The Y Overall compliance with AML/CFT.
- The bivariate correlation between the ratio of net exports of financial Services (REFS) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the ratio of cross border assets/GDP (COBAS), the ratio of cross border liabilities/GDP (COBLI) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the Egmond Group Dummy (EG) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between the Multilateral Organizations variable (MI) and the Overall compliance with the AML/CFT variable (YOCAML).
- The bivariate correlation between Economic Freedom and the Overall compliance with the AML/CFT variable (YOCAML).



- The bivariate correlations will be also tested between the explanatory variables within particular subgroups (Legal, Institutional, and Economic), and the different subgroups and concepts of Y variables (Legal, Preventive, Institutional, International Cooperation) are also tested.

Table 5.7 Correlations between Dependent Variable Subgroups and Independent Variable Subgroups to be tested

| <b>Independent Variables</b>                  | <b>Dependent Variable Subgroups and Concepts</b>                       |
|---|--|
| <b>Legal Explanatory Variables</b>            | <b>Subgroup on Y legal Recommendations</b>                             |
| Ratifications of Money Laundering (RATML)     | Y Legal Recommendations on Money Laundering (YLEML)                    |
| Ratifications of Terrorist Financing ( RATFT) | Y Special Legal Recommendations on Terrorist Financing (YLEFT)         |
| <b>Institutional Explanatory Variables</b>    | <b>Subgroup on Y preventive Recommendations</b>                        |
| Regulatory Framework Quality ( RQ)            | Y Preventive Recommendations on Money Laundering (YPRML)               |
| Control of Corruption (CO)                    | Y Special Preventive Recommendations Terrorist Financing (YPRFT)       |
| Failed States (FS)                            | <b>Subgroup on Y institutional Recommendations</b>                     |
| Egmont Group (EG)                             | Y Institutional Recommendations on Money Laundering (YINML)            |
| Multilateral Organizations (MI)               | Y Special Institutional Recommendations on Terrorist Financing (YINFT) |
| <b>Economic Explanatory Variables</b>         | <b>Subgroup on Y international Recommendations</b>                     |
| Attractiveness to Money Laundering (ATML)     | Y International Recommendations on Money Laundering (YICML)            |
| Average Shadow Economy (ASISH)                | Y Special International Recommendations on Terrorist Financing (YICFT) |
| Ratio of Net Exports of Financial (REFS)      | <b>Y Overall compliance with AML/CFT(YOCAML)</b>                       |
| Risk Terrorist Financing (RITF)               | Y Overall compliance -Legal (YOLE)                                     |
| Informal Remittances/GDP ( INRE)              | Y Overall compliance- Preventive (YOPR)                                |
| Bank Deposits /GDP (SBFS)                     | Y Overall compliance- Institutional (YOIN)                             |
| Financial System Deposits /GDP (SFSD)         | Y Overall compliance -International Cooperation (YOIC)                 |
| Life Insurance/GDP (SLI)                      | <b>Y Overall compliance ML (YOCML)</b>                                 |
| Non Life Insurance/GDP (SNLI)                 | <b>Y Overall compliance FT ( YOCFT)</b>                                |
| Cross Border Assets/GDP (COBAS)               |  |
| Cross Border Liabilities /GDP (COBLI)         |  |
| Income Group IG                               |  |
| Region Group RG                               |  |
| Multilateral Institutions MI                  |  |

Once I establish those bilateral linkages, I start with the multivariate relations to introduce other variables.

#### 5.3.2.4. Multivariate Relationships: The OLS Method and Hypotheses

The second research question, ‘Which are the legal, economic and institutional determinants of the Overall compliance with the AML/CFT?’ requires subsequent steps after the bivariate analysis. This question involves notions of causal connections between multiple X’s and Y simultaneously. Causality in relationships has been playing a central role in this work. The theoretical analysis has provided information to understand how the independent variables (legal, economic, and institutional variables) have influenced the overall jurisdictions’ compliance with the AML/CFT Regime, but not vice versa. The relationships between explanatory variables (legal, institutional, and economic) and Y Overall compliance satisfy three necessary components of causation, an appropriate time order, and the elimination of alternative causes.

The OLS<sup>136</sup> method allows a proper estimation of the determinants of jurisdictions’ compliance with the AML/CFT because the OLS is a robust estimator. This estimator might help the researcher to predict the level of overall compliance with the AML/CFT population values. The OLS helps with the first and the 3rd areas by allowing multiple correlations to be estimated at the same time. This also allows for multiple causes to be tested against one another. Therefore, by using the OLS, the researcher will be able to determine the slopes of the determinant explanatory variables of AML/CFT compliance. A series of tests can also be performed that indicate whether the observed outcomes from a sample are likely to also exist in a population of interest within a predetermined margin of error.

The following list specifies the assumptions of the OLS regression

- Model is linear in parameters.
- The data are a random sample of the population and the errors are statistically independent from one another
- The expected value of the errors is always zero
- The independent variables are not too strongly collinear
- The independent variables are measured precisely

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<sup>136</sup> For a comprehensive treatment of OLS method, it is best to refer to an instructional manual for multivariate statistics or econometrics, see Greene (1997) and Legault (2008). An application of OLS could be found at :Richardson, G. (2006). "Taxation determinants of fiscal corruption: evidence across countries." Journal of Financial Crime **13**(3): 323-338.

- The residuals have constant variance
- The errors are normally distributed

Although the random sample and the measurement assumptions are violated, no better data are available. Therefore, the researcher is left with only two choices. One may abandon the analyses completely or move forward while being cautious in interpreting the results. In this case, the data being used here are the best, and only, data available so we must move forward with the analysis while the results should be interpreted with care. Despite this violation, the estimator will be unbiased.

Prior to presenting the OLS analysis, each of the dependent variables has been subjected to a preliminary evaluation (bivariate correlations) to determine whether an additional analysis is justified. Strong and detailed conclusions cannot be drawn from this bivariate analysis, but they do provide useful baselines to include some of the variables in the model. A fundamental concept using this method is to control some variables in our study. GDP has been included as a control variable because it is highly correlated with the institutional explanatory variables.

The specified regression equation will attempt to find evidence to support the following hypotheses about the determinants of the Overall compliance with the AML/CFT Regime. The hypotheses can be presented as four statements:

*Hypothesis 1 : Ratifications of the international Anti-Money Laundering and Terrorist Financing are not determinants that can explain the jurisdictions' Overall compliance with the AML/CFT Regime.*

*Hypothesis 2 : The National Regulatory Quality Framework and Control of Corruption (preconditions of governance variables) are determinants that explain the jurisdiction's Overall compliance with the AML/CFT Regime.*

*Hypothesis 3 :The overall amount of cross border assets is a determinant that explains the jurisdiction's Overall compliance with the AML/CFT Regime.*

*Hypothesis 4:The ratio of Informal Remittances/GDP is a determinant that explains the jurisdiction's Overall compliance with the AML/CFT Regime.*

To test these hypotheses, the following equation has been estimated. Y is the function of three types of explanatory variables:

$$\boxed{YOCAML = f(\text{legal, institutional, economic})}$$

Legal explanatory variables are:

- Ratification of International Money Laundering Convention: RATML
- Ratification of International Terrorism Convention: RATFT

Institutional explanatory variables are:

- Regulatory Quality Framework: RQ
- Control of Corruption: CO
- Egmond Group (Dummy): EG

Economic and Financial explanatory variables are:

- Cross Border Assets/GDP: COBAS
- Attractiveness to Money Laundering: ATML
- Informal Remittances/GDP: INRE

The regression takes the following general form:

$$\ln YOCAML_i = \beta_1 RATML_i + \beta_2 RATFT_i + \beta_3 RQ_i + \beta_4 CO_i + \beta_5 EG_i + \beta_7 COBAS_i + \beta_8 ATML_i + \beta_9 INRE_i + \varepsilon$$

- Because the dependent variable is highly skewed, in order to correct for the skewness the dependent variable has been transformed to its natural log.
- Where YOCAML scores for each country (the score is the sum of all AML/CFT compliance scores in mutual evaluation reports).
- $i=1, \dots, 46$ .
- In this model, the dependent variable is in its log-transformed state, and the independent variable is in its original metric. In such models where the dependent variable has been log-transformed and the predictors have not, the format for interpretation is that the dependent variable changes by 100\*(beta coefficient) percent for a one unit increase in the independent variable while all other variables in the model are held constant..

- The first matter is whether the explanatory variables collectively have a significant effect on the response variable YOCAML

$$H_0 = \beta_1 = \beta_2 = \beta_3 = \beta_4 = \dots = \beta_7$$

$H_a$ : At least one  $\beta_k \neq 0$

F distribution is used to test the significant effect of explanatory variables

When the P-value is small, we can conclude that at least one explanatory variable is related to YOCAML

- The larger value of  $R^2$ , the better the set of explanatory variables ( $X_1, \dots, X_K$ )
- VIF is the statistic to evaluate collineality, when VIF is  $< 10$ , there is not collineality between explanatory variables.
- for  $P > |t| \alpha$  is significant a 0.1. As the theory predicts a direction of the relationship it is acceptable to use a one-tailed test. This simply means that we can consider the coefficient to be statistically significant at an alpha level of 0.1

#### 5.3.2.5. Why Were Neither the Factors Analysis nor Logit Analysis Used?

Despite the fact this work uses the OLS model to answer the second research question, at the beginning of this research, the possibility of using the 'logit' model to study the qualitative dependent variable was also considered. Four initial scores were converted into a binary variable and a logit regression was run (the results of the Binary study are displayed in Appendix 2, but the problem was that data are no longer logistically distributed because the researcher summed the scores.

Due to the nature of the dependent variable, that is, the y dependent variable being composed by subgroups, the use of factor analysis (principal components analysis) was also taken into account. Principal Components Analysis (factor analysis) was not used because the dependent variables were created based on sound theoretical predictions of the concepts. Using theoretical reasons to sum these variables is not much different than factor analysis because neither are statistical measures, that is, neither method allows for tests of statistical significance. Additionally, because of the well founded theoretical predictions of the concepts an exploratory analysis is neither beneficial nor necessary to the analysis.

## **CHAPTER 6**

### **Main Results and Findings**

## **Chapter 6. Main Results and Findings**

The purpose of this chapter is to discuss the main results and findings obtained through the exploratory research. It also verifies the consistency of some theories and the hypotheses tested. The consolidation of these results and findings are a previous stage which opens chapter 7, in which the questions are answered and a different strategy to combat the financing of terrorism is proposed.

### **6.1 Results of Exploratory Research: The Overall compliance with the AML/CFT Regime within the Sample**

Both the quantitative and qualitative results suggest that some jurisdictions in high income countries and upper middle income countries have had some elements of an AML/CFT Regime in place, and many of them are in the process of broadening and strengthening it. Some lower middle and low income countries are still in the first stage of the process of ratifying international Convention which forms the basis of the AML/CFT Regime. The results of the analysis confirm the same weaknesses highlighted in theoretical studies.

- A failure to ratify and implement international Convention on ML and TF in some countries.
- Inadequate customer identification policies in countries in all income groups.
- A failure to provide resources to supervise anti-Money Laundering programs and institutions.
- A need to enhance mutual legal assistance, information sharing and cooperation with national sectors and across borders.

The results of this dissertation show that there still remain loopholes in financial regulation, inadequate resources, and obstacles designed to restrict the supervisory powers of the relevant administrative or judicial authorities or the means to exercise these powers and obstacles to international cooperation. The following list includes the most relevant weaknesses found:

- Failure to criminalize Money Laundering and Terrorist Financing in some countries.
- Inadequate regulations and supervision of financial institutions and non financial institutions.

- Possibility for individuals or legal entities to operate in some financial institutions without effective authorization or registration
- Absence of measures to prevent criminals from holding controlling positions in financial institutions in some countries
- Still existing anonymous accounts or accounts under obviously fictitious names in some countries
- Lack of effective regulations requiring the identification of beneficial owners. Inadequate commercial law requirements for the registration of business and legal entities. There still remain some systems which allow financial institutions to carry out transactions without knowing the beneficial owner of the assets involved.
- Weak transaction records systems
- Existence of secrecy provisions that complicate administrative or judicial processes in some countries.
- Failure to provide the law enforcement bodies and judicial authorities with the necessary financial, technical and human resources to conduct investigations.
- Some countries have a lack of centralized financial intelligence unit for the collection, analysis and dissemination of information.
- Laws or regulations prohibiting the international exchange of information, or subjecting the exchange of information to restrictive procedures in some countries.
- Refused or unwillingness to provide judicial cooperation or to respond constructively to requests for assistance in some countries.

#### **6.1.1. Profile of the Overall Compliance with FATF Recommendations**

The results from the quantitative analysis (See Table 6.1 and Table 6.3) show that compliance of over 46 jurisdictions with the 40 Recommendations and 9 Special Recommendations (AML/CFT Regime) is very low in the legal, preventive, institutional and international cooperation in AML/CFT subgroups. This indicates that the implementation of the Regime is still too weak to fight against the prevailing trends and emerging threats in Money Laundering and Terrorist Financing in the vast majority of the countries within the sample. The qualitative analysis of the 46 mutual evaluation reports reveals the following findings:



- The higher level of compliance in the wealthier jurisdictions reflect, in many cases, measures they have taken to strengthen their supervisory and regulatory systems in advance of, or as result of the mutual assessment reports. The financial sector makes an important contribution to the economies of many of the higher income jurisdictions, and these jurisdictions have taken steps to protect the integrity of their financial industry.
- The quantitative analysis results show that the overall compliance with FATF Recommendations on Money Laundering on legal aspects is different among income group countries. While the high and upper middle income countries have criminalized Money Laundering, low income countries do not fully comply with the standard and are still in the process of passing draft legislation. Some countries, especially in low and lower middle income groups, are still only focused on drugs related to Money Laundering with legislation.
- In the light of the quantitative results, the AML/CF overall compliance with the FATF legal subgroup of Special Recommendations on TF is very low in all income groups.
- Despite some of the assessed high and upper middle income countries adopting a range of preventive measures, the overall compliance regarding basic preventive measures is extremely low in all groups. Breaking down the findings by Recommendations, the majority of countries were universally non-compliant with R5. The vast majority of the sample is non-compliant with the core goal of the AML/CFT Regime, which means there is not an implemented global system of preventive measures for financial institutions.
- Breaking down the findings by income groups, the majority of countries were universally non-compliant on Recommendations R12 to R16; that is, there are no universal preventive measures to control designated non-financial business and professions.
- Furthermore, the effectiveness of Institutional measures on AML/CFT Regime for developing national supervisory systems remains a concern. With respect to Recommendation 26, relating to the FIU's existence, 40 % of the countries within the sample are not totally compliant with R26, which indicates some major shortcomings in a critical area of the AML/CFT Regime.

The results suggest weaknesses concerning lack of resources in all income groups, a failure to provide adequate feedback to the reporting institutions, and insufficient analysis of suspicious transaction reports. Within all the income groups, ML/FT investigations and prosecutions were limited, even where legal provisions and law enforcement powers were in place.

- The results of the overall compliance analysis of the International Cooperation subgroup of the AML/CFT Recommendations show that upper middle and low income countries generally had only limited legal frameworks for international cooperation

The results of this quantitative analysis are in line with the outcomes of the analysis of INCSR 2006 discussed in chapter 2.

The goal of the following table and figure show the overall compliance scores by the 46 jurisdictions with AML/CFT, before starting the discussion in the following sections.

Table 6.0 The Jurisdictions' Overall Compliance Scores

| Cod | Jurisdictions | Overall Compliance AML/CFT Store | Cod | Jurisdictions  | Overall Compliance AML/CFT Store |
|-----|---------------|----------------------------------|-----|----------------|----------------------------------|
| ALB | ALBANIA       | 59                               | NPL | NEPAL          | 16                               |
| AUS | AUSTRALIA     | 77                               | NOR | NORWAY         | 87                               |
| BHR | BAHRAIN       | 75                               | PAN | PANAMA         | 99                               |
| BLR | BELARUS       | 54                               | PRY | PARAGUAY       | 55                               |
| BEL | BELGIUM       | 109                              | PER | PERU           | 93                               |
| BOL | BOLIVIA       | 38                               | PRT | PORTUGAL       | 93                               |
| BRN | BRUNEI        | 55                               | SAM | SAMOA          | 40                               |
| CHL | CHILE         | 73                               | SVK | SLOVAKIA       | 50                               |
| COL | COLOMBIA      | 80                               | SVN | SLOVENIA       | 100                              |
| CYP | CYPRUS        | 105                              | ESP | SPAIN          | 86                               |
| DNK | DENMARK       | 73                               | LKA | SRI LANKA      | 41                               |
| DOM | DOMINICAN REP | 43                               | SDN | SUDAN          | 22                               |
| FJI | FIJI          | 67                               | SWE | SWEDEN         | 76                               |
| GIB | GIBRALTAR     | 92                               | CHE | SWITZERLAND    | 88                               |
| HUN | HUNGARY       | 112                              | SYR | SYRIA          | 57                               |
| ISL | ICELAND       | 70                               | TUR | TURKEY         | 55                               |
| IND | INDIA         | 53                               | URY | URUGUAY        | 52                               |
| IRL | IRELAND       | 87                               | USA | US             | 103                              |
| ITA | ITALY         | 92                               | VUT | VANUATU        | 49                               |
| JAM | JAMAICA       | 76                               | GRB | UNITED KINGDOM | 109                              |
| LVA | LATVIA        | 79                               | GRC | GREECE         | 49                               |
| LTU | LITHUANIA     | 87                               | CHN | CHINA          | 68                               |
| MRT | MAURITANIA    | 44                               | GEO | GEORGIA        | 57                               |

Figure 6.0 The Jurisdictions' Overall Compliance with the AML/CFT

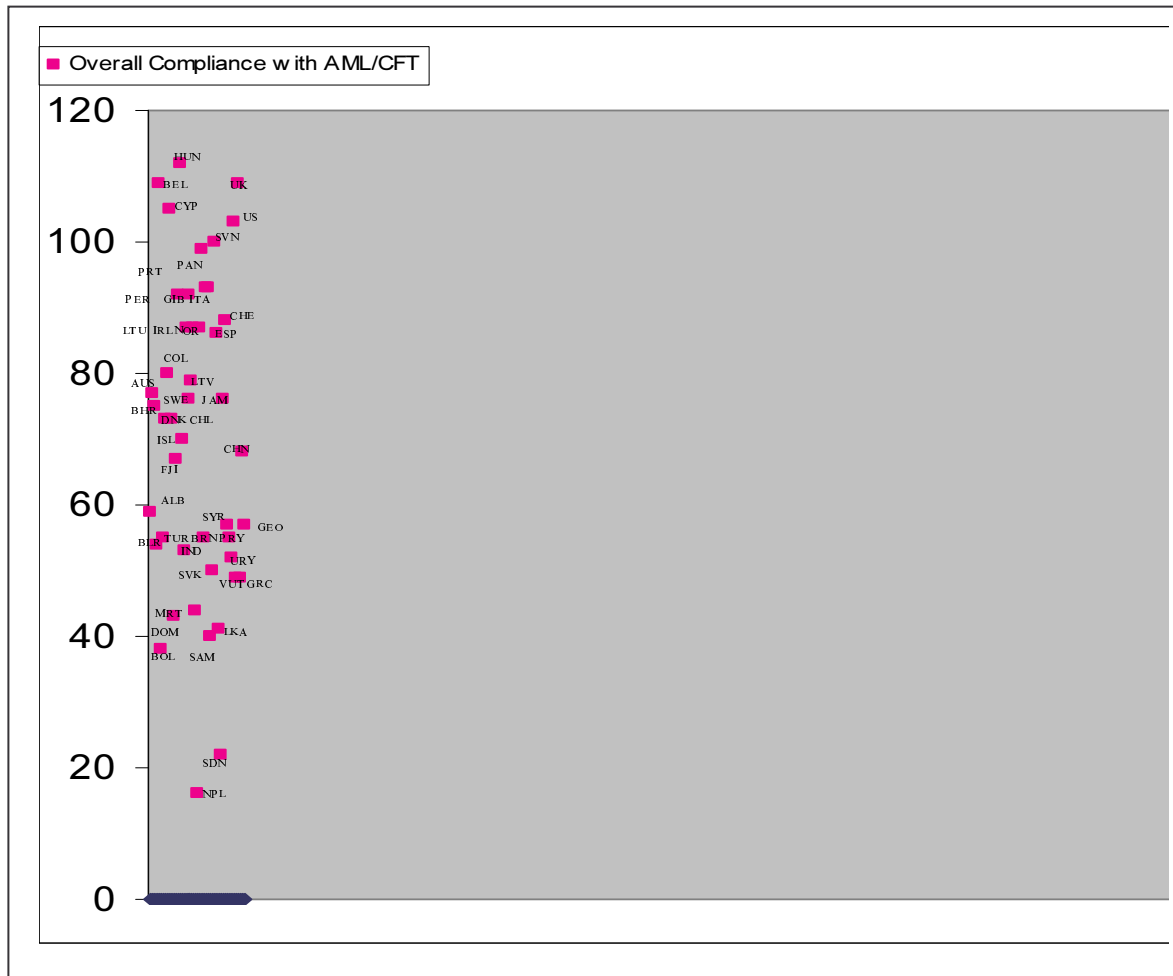


Table 6.1 Profile of the Overall Compliance of 46 Countries with FATF Recommendations

| <b>FATF RECOMMENDATIONS</b>                         | <b>Compliant<br/>In Percent</b> | <b>Largely<br/>Compliant<br/>In Percent</b> | <b>Partially<br/>Compliant<br/>In Percent</b> | <b>Not<br/>Compliant<br/>In Percent</b> | <b>Missing<br/>Values<br/>In percent</b> | <b>Assessed<br/>Countries/<br/>Jurisdic.</b> |
|---|---------------------------------|---|---|---|--|--|
| 1.ML offence  | 6.5                             | 47.8  | 43.5  | 2.2                                     | 0  | 46   |
| 2.ML offence-mental element and corporate liability | 30.4                            | 41.3  | 26.1  | 2.2                                     | 0  | 46   |
| 3.Confiscation and provisional measures             | 15.2                            | 50.0  | 32.6  | 2.2                                     | 0  | 46   |
| 4.Secretcy laws consistent with the Recommendations | 58.7                            | 37.0  | 4.3   | 0                                       | 0  | 46   |
| 5.Customer due diligence                            | 0                               | 13.0  | 71.5  | 15.2                                    | 0  | 46   |
| 6.Politically exponed persons                       | 0                               | 19.6  | 26.1  | 54.3                                    | 0  | 46   |
| 7.Correspondent banking                             | 10.9                            | 21.7  | 17.4  | 50.0                                    | 0  | 46   |
| 8.New technologies & non face-to face business      | 17.4                            | 19.6  | 34.8  | 28.3                                    | 0  | 46   |
| 9.Third parties and introducers                     | 13.0                            | 15.2  | 28.3  | 17.4                                    | 26.1                                     | 46   |
| 10.Record keeping                                   | 32.6                            | 37.0  | 26.1  | 4.3                                     | 0  | 46   |
| 11.Unusual transactions                             | 13.0                            | 28.3  | 37.0  | 21.7                                    | 0  | 46   |
| 12.DNFBP- R.5,6,8-11                                | 0                               | 0   | 52.2  | 47.8                                    | 0  | 46   |
| 13.Suspicious transaction reporting                 | 6.5                             | 30.4  | 54.2  | 10.9                                    | 0  | 46   |
| 14. Protection no tipping-off                       | 56.5                            | 21.7  | 19.6  | 2.2                                     | 0  | 46   |
| 15.Internal controls, compiance& audit              | 6.5                             | 39.1  | 47.8  | 6.5                                     | 0  | 46   |
| 16.DNFBP-R.13-15&21                                 | 0                               | 6.5   | 50.0  | 43.5                                    | 0  | 46   |
| 17.Sanctions  | 0                               | 37.0  | 54.3  | 8.7                                     | 0  | 46   |
| 18.Shell Banks                                      | 26.1                            | 37.0  | 30.4  | 6.5                                     | 0  | 46   |
| 19.Other forms of reporting                         | 58.7                            | 17.4  | 8.7   | 15.2                                    | 0  | 46   |
| 20.Other NFBP&secure transaction techniques         | 43.5                            | 19.6  | 10.9  | 23.9                                    | 2.2                                      | 46   |
| 21.Special attention for higher risk countries      | 15.2                            | 21.7  | 32.6  | 30.4                                    | 0  | 46   |
| 22.Foreign Branches&subsidiaries                    | 8.7                             | 30.4  | 30.4  | 26.1                                    | 4.3                                      | 46   |
| 23.Regulation, supervision and monitoring           | 0                               | 30.4  | 60.9  | 8.7                                     | 0  | 46   |
| 24.DNFBP-regulation,supervision and monitoring      | 0                               | 8.7   | 34.8  | 56.5                                    | 0  | 46   |
| 25.Guidelines& feedback                             | 6.5                             | 21.7  | 39.1  | 32.6                                    | 0  | 46   |
| 26.The FIU  | 6.5                             | 52.2  | 26.1  | 15.2                                    | 0  | 46   |
| 27.Law enforcement authorities                      | 30.4                            | 37.0  | 26.1  | 6.5                                     | 0  | 46   |
| 28.Powers of competent authorities                  | 65.2                            | 21.7  | 13.0  | 0                                       | 0  | 46   |
| 29.Supervisors                                      | 15.2                            | 41.3  | 39.1  | 4.3                                     | 0  | 46   |
| 30.Resources, integrity and training                | 2.2                             | 43.5  | 45.7  | 8.7                                     | 0  | 46   |
| 31.National Co-operation                            | 15.2                            | 43.5  | 34.8  | 6.5                                     | 0  | 46   |
| 32.Statitstics                                      | 0                               | 28.3  | 47.8  | 23.9                                    | 0  | 46   |
| 33.Legal persons beneficial owners                  | 10.9                            | 19.6  | 50.0  | 19.6                                    | 0  | 46   |
| 34.Legal arrangements beneficial owners             | 10.9                            | 13.0  | 21.7  | 13.0                                    | 41.3                                     | 46   |
| 35.Convention                                       | 8.7                             | 45.7  | 45.7  | 0                                       | 0  | 46   |
| 36.Mutual Legal Assistance(MLA)                     | 26.1                            | 52.2  | 19.6  | 2.2                                     | 0  | 46   |
| 37.Dual Criminality                                 | 45.7                            | 34.8  | 15.2  | 4.3                                     | 0  | 46   |
| 38.MLA on confiscation and freezing                 | 21.7                            | 39.1  | 34.8  | 4.3                                     | 0  | 46   |
| 39.Extradition                                      | 45.7                            | 39.1  | 6.5   | 8.7                                     | 0  | 46   |
| 40.Other forms of cooperation                       | 2.2                             | 4.3   | 2.2   | 9.1.3                                   | 0  | 46   |

Source : Author's Calculations using data from Mutual evaluations

### 6.1.2. Profile of the Overall compliance by World Income Group

Figure 6.1 shows how High Income countries (4) have reached the highest scores of the overall compliance, and the variance between the overall compliance by countries within the group is shorter than the differences between compliance in Upper Middle Income Countries (3). The Low Middle Income countries (2) show higher scores than the Low Income countries (1), and the variance between the countries within the group (2) is shorter than the variance between countries scores in group (3). Low Income countries show the lowest overall compliance scores.

Hungary is an outlier within upper middle income countries; its overall compliance is higher than the overall compliance in the high income group, but curiously, the scope of Money Laundering is not fully consistent with the Vienna and Palermo Convention. Hungary was included in the 2001 NCCT list and high pressure was placed on it to implement AML/CFT Recommendations. At present, Hungary has achieved a high overall compliance with the AML/CFT Regime. Also Panama has a high compliance with the AML/CFT. Panama was included in the 2000 NCCT and has improved its institutional measures as well as the preventive measures. Since then and according to the mutual evaluation scores, Panama has not still implemented strong regulations to control DNBP.

In the case of Hungary and Panama, it can be stated that international pressure over these two financial loopholes has resulted in these countries making a significant effort towards applying corrective measures as well as enacting and implementing necessary reforms. These financial centres have become better regulated. It could be concluded that some jurisdictions should not be removed from the NCCT blacklist until they have made adequate progress.

Peru is an outlier within the low middle income countries; its overall compliance is higher than the overall compliance in the majority of upper middle and high income countries due to the fact that some Andean Countries (Peru, Colombia, Ecuador and Bolivia) within the LAC world region group have been obliged to subscribe the Vienna Convention to become beneficiaries of the Special Regime agreed upon by the European Union for countries fighting against drug production in the framework of the Generalized System of Preferences<sup>137</sup> until January, 2006. This argument explains the high score for

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<sup>137</sup> Further explanations of SPG in Granell, F. and Université libre de Bruxelles. Institut d'études européennes (2005). La coopération au développement de la Communauté européenne. Bruxelles, Editions de l'Université de Bruxelles.

Peru and Colombia. Despite Peru’s efforts in the criminalization of drug trafficking, the country should criminalize the financing of terrorism and enhance the implementation of UN resolutions.

Figure 6.1. The Overall Compliance with AML/CFT by World Income Group

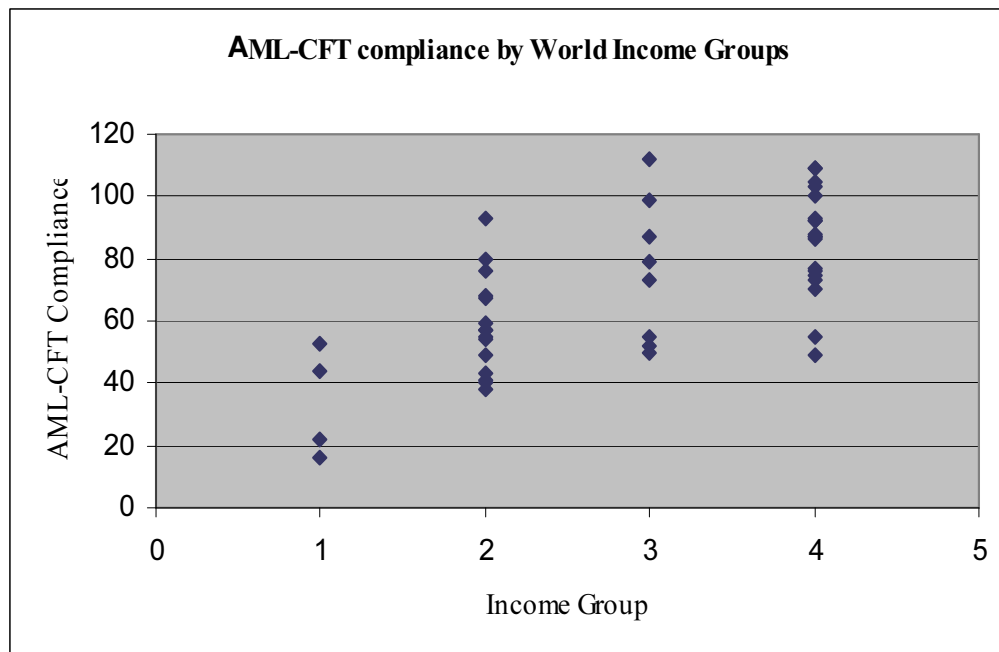


Figure 6.2 shows the low overall compliance with the legal Recommendations in low income and low middle income groups.

It should be pointed out that Greece and Bahrain are the least compliant countries with the legal Recommendations on Money Laundering.

It indicates that some high income countries are developing countries in some aspects, as is the case of the implementation of the international regulations. These results confirm that some loopholes exist within the high income countries group.

Nepal is the least compliant country with the legal Recommendations of the AML/CFT.

Figure 6.2. The Overall Compliance with Legal Recommendations on ML by World Income Group

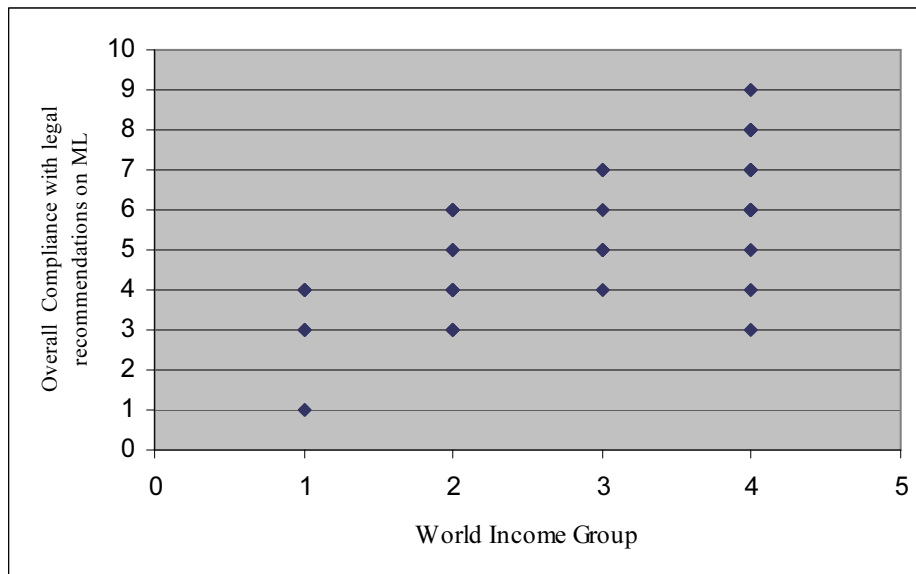


Figure 6.3 shows the low overall compliance with the preventive Recommendations in all income groups.

Brunei is the least compliant within the high income countries.

Sri Lanka is the least compliant within low middle income countries. Peru is the most compliant among low middle income countries.

Nepal is the least compliant in low income groups.

Uruguay is the least compliant country in the upper middle income group. Special pressure should be put on this country as long as it is considered an OFC. This country should enhance its preventive regulatory framework according to international standards and avoid the risk of the abuse of money launderers and terrorist financiers.

Figure 6.3. The Overall Compliance with Preventive Recommendations on ML by World Income Group

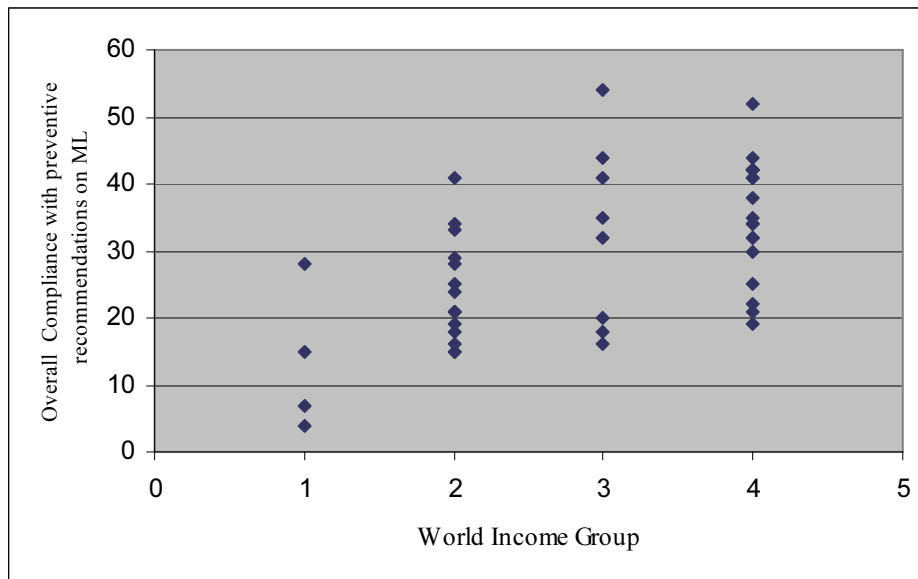


Figure 6.4 shows the low overall compliance with the institutional Recommendations on ML in all the income groups.

Greece is the least compliant country in the high income group.

Turkey is the least compliant country in the upper middle group and Hungary is the highest compliant country in this group.

Peru and Colombia are the most compliant among the low middle income countries, even though the level of compliance is still low. Bolivia and Vanuatu are the least compliant within group 2.

Sudan is the least compliant country with the institutional Recommendations on ML in all world regions.

This demonstrates that countries with a high risk of drug trafficking (Peru, Colombia) and arms trafficking (Sudan) do not have law enforcement and intelligence agencies to fight against Money Laundering and the financing of terrorism. Also, some of these countries (Peru, Colombia, Turkey, and Sudan) are considered vulnerable to terrorist violence.



Figure 6.4. The overall Compliance with Institutional Recommendations on ML by World Income Group

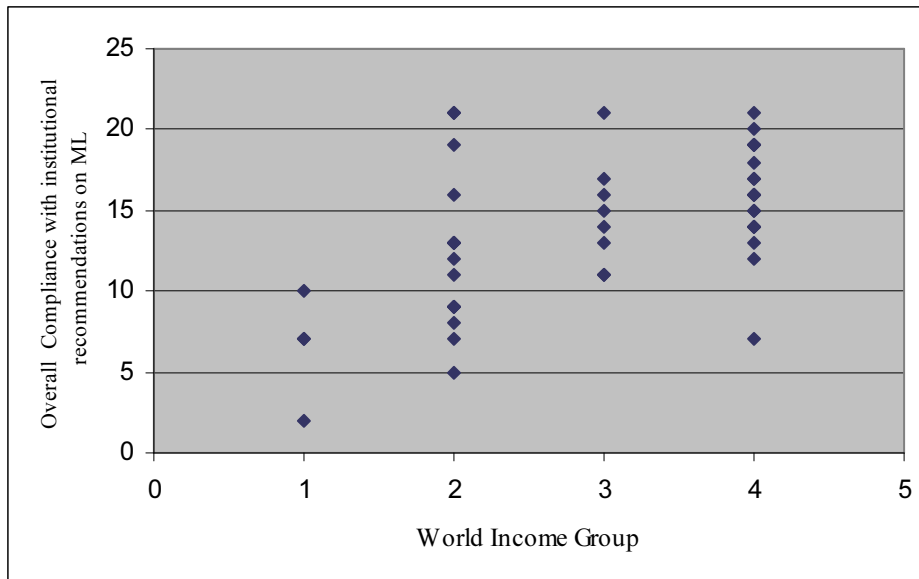


Figure 6.5 shows the low overall compliance with the international cooperation Recommendations on ML in all the income groups.

Nepal and India (low income countries), Samoa (low middle income country) and Brunei (High Income country) are the least compliant with the international cooperation Recommendations on ML.

Figure 6.5 The Overall Compliance with International Cooperation Recommendations on ML by World Income Group

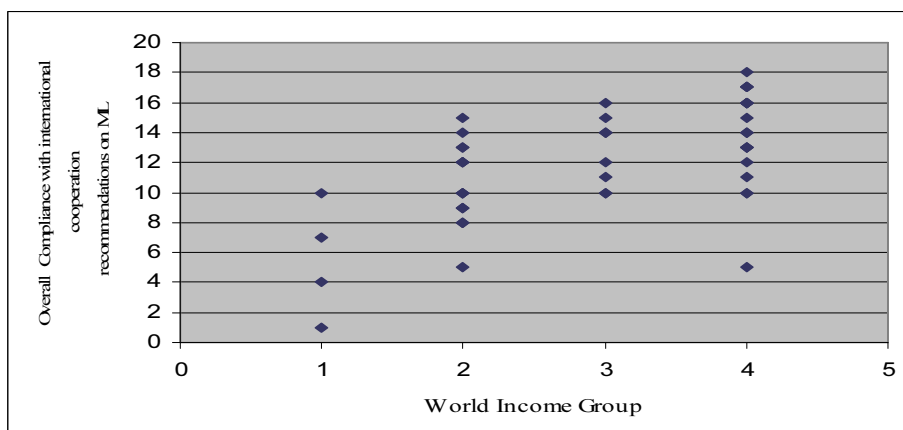


Figure 6.6 shows the low overall compliance with the Special Recommendations on FT among low and low middle income groups, some countries within the upper middle income group, and two countries in the high income group.

Bolivia, Sudan, Dominican Republic, Samoa, Paraguay, Nepal, Mauritania, Sri Lanka, Syria, Slovakia, Vanuatu, Georgia, Greece, India, Iceland, Turkey, and Chile are the countries that are least compliant with the Special Recommendations. Some of them are related to a high risk of terrorism violence.

Figure 6.6. The Overall Compliance with Special Recommendations on FT by World Income Group

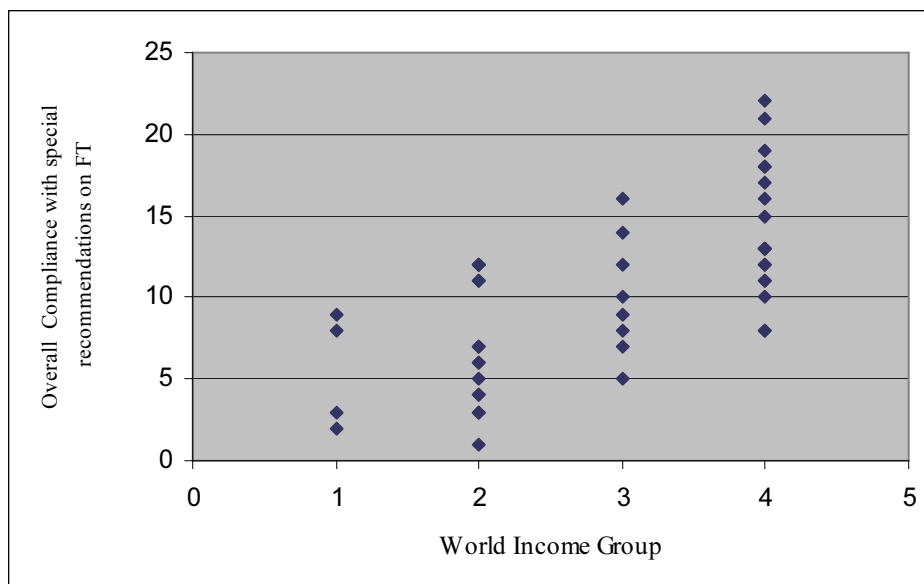


Figure 6.7 shows the low overall compliance with the legal Special Recommendations on FT in low and low middle income groups, some countries within the upper middle income group, and two countries in the high income group.

Colombia, Bolivia, Nepal, Samoa, Paraguay, Fiji, Georgia, China, Bahrain, Mauritania are the least compliant countries with the Special Legal Recommendations. The majority of these countries do not criminalize the financing of terrorism according to International Convention and the AML/CFT Regime.

Bolivia, Mauritania, Nepal, Samoa, Fiji, and The Dominica Republic are not compliant with UN Convention on Terrorist Financing.

Bahrain, Belarus, Bolivia, Colombia, the Dominican Republic, Nepal, Slovakia, Georgia, Sudan, Samoa, and Paraguay do not criminalize the Terrorist Financing offence.

This evidence confirms that the international soft law against Terrorist Financing has not become universal.

Neither Belarus, Bolivia, Brunei, Chile, Colombia, Fiji, Iceland, Nepal, Samoa, Peru, Paraguay, nor China have accomplished the order to freeze and confiscate terrorist funds.

Figure 6.7. The Overall Compliance with Special Legal Recommendations on FT by World Income Group

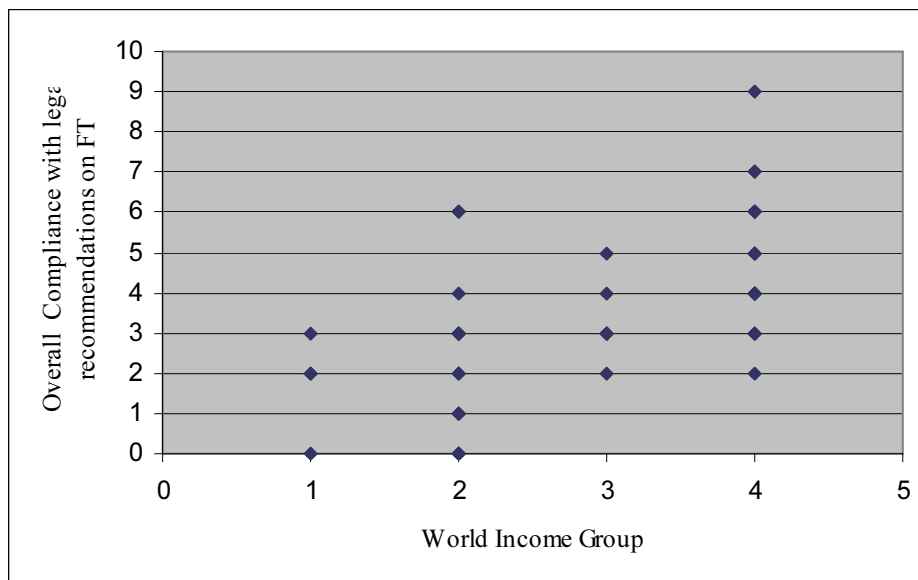


Figure 6.8 shows the low overall compliance with the preventive Special Recommendations on FT in low and low middle income groups.

Bolivia, Iceland, Sri Lanka, Sudan, Syria, Uruguay, and Vanuatu are not compliant with the AML preventive requirements for money/value transfers.

Georgia, Uruguay, Turkey, Syria, Sweden, Sudan, Sri Lanka, Portugal, Norway, Latvia, Italia, Ireland, Brunei, Belarus, Albania, and Australia are not compliant with the wire transfer rules.

Syria, Vanuatu, Albania, Bolivia, Chile, Colombia, Dominican Republic, Iceland, Jamaica, Norway, Paraguay, Sudan, Slovakia, and Samoa are not compliant with SR.VIII Non-profit organisations rules.

These results show that most countries deal ineffectively with the Special Recommendations related to preventive issues.

Figure 6.8. The Overall Compliance with Special Preventive Recommendations on FT by World Income Group

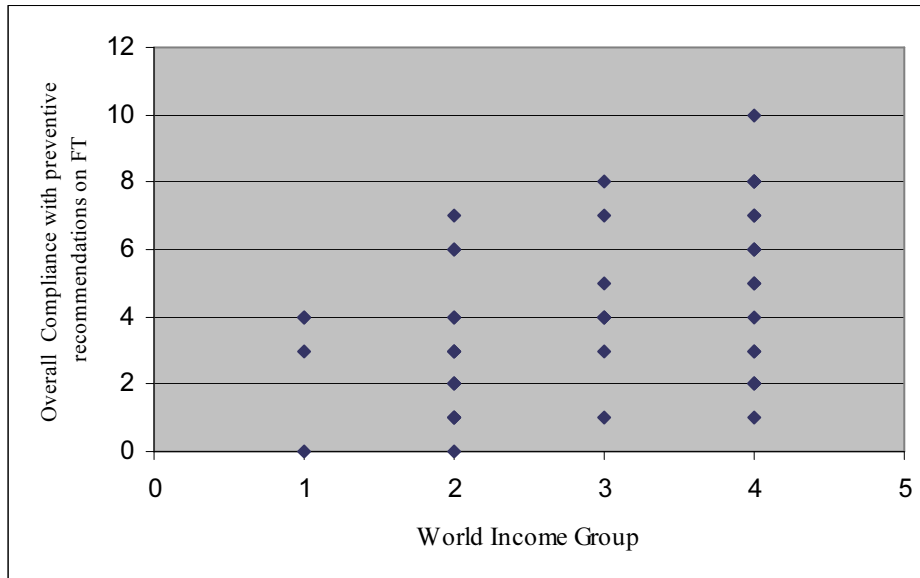


Figure 6.9 shows the low overall compliance with the institutional Special Recommendations on FT in all the world income groups.

Countries unable to report suspicious activity reports on Terrorist Financing have been: Belarus, Bolivia, Chile, Colombia, Dominican Republic, Fiji, Hungary, India, Nepal, Paraguay, Samoa, Slovakia, Slovenia, Sri Lanka, Sudan, Uruguay and Chile

Figure 6.9. The overall compliance with Special Institutional Recommendations on FT by World Income Group

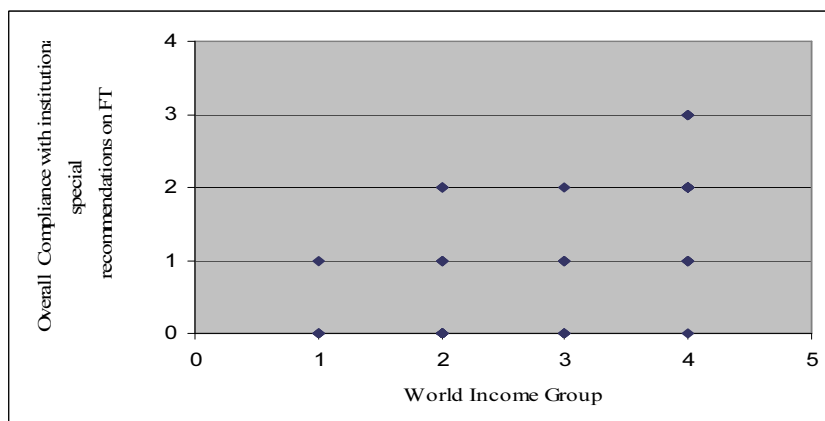
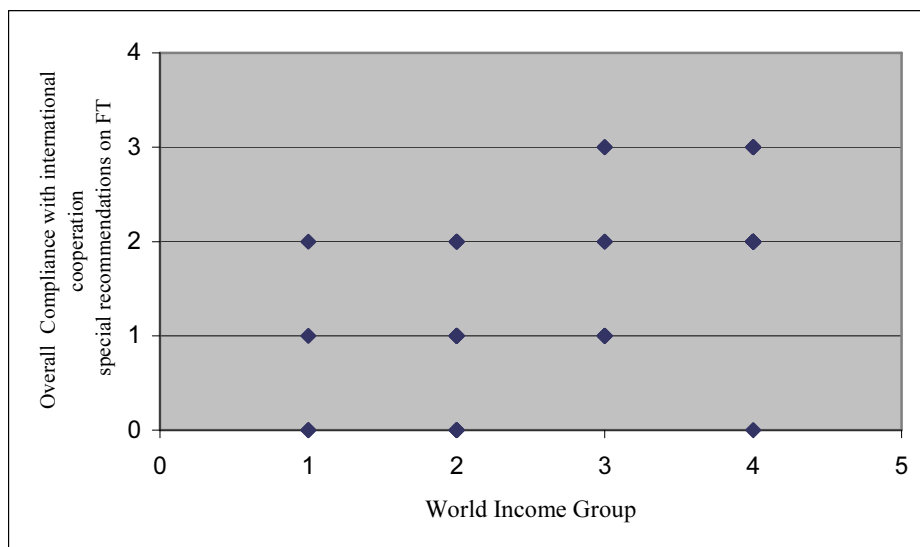


Figure 6.10 shows some jurisdictions in the world (within the sample) that do not provide international cooperation on Terrorist Financing issues. These countries are Dominican Republic, Nepal, Samoa, Sudan, Bolivia, and Brunei. This evidence shows difficulties to enhance mutual legal assistance, information sharing, and cooperation with national sectors and across borders.

Figure 6.10. The Overall Compliance with Special International Cooperation Recommendations on FT by World Income Group



### 6.1.3. Profile of the Overall Compliance by World Region Group

Figure 6.11 shows that Western Countries (1) have reached the highest scores of the overall compliance with the AML/CFT. The variance between the overall compliance within the countries in the first group is shorter than the differences between the overall compliance in the other groups. EAP Countries (4), SSA Countries (5), and SAS (6) countries have the lowest scores of the overall compliance, and some of the countries belonging to this group are characterized as being failed states or jurisdictions with ‘bad governance indicators’. Some of the countries in these regions: EAP(4), SAS(5), SSA(6), and MNA(7) are victims of terrorism networks.<sup>138</sup>

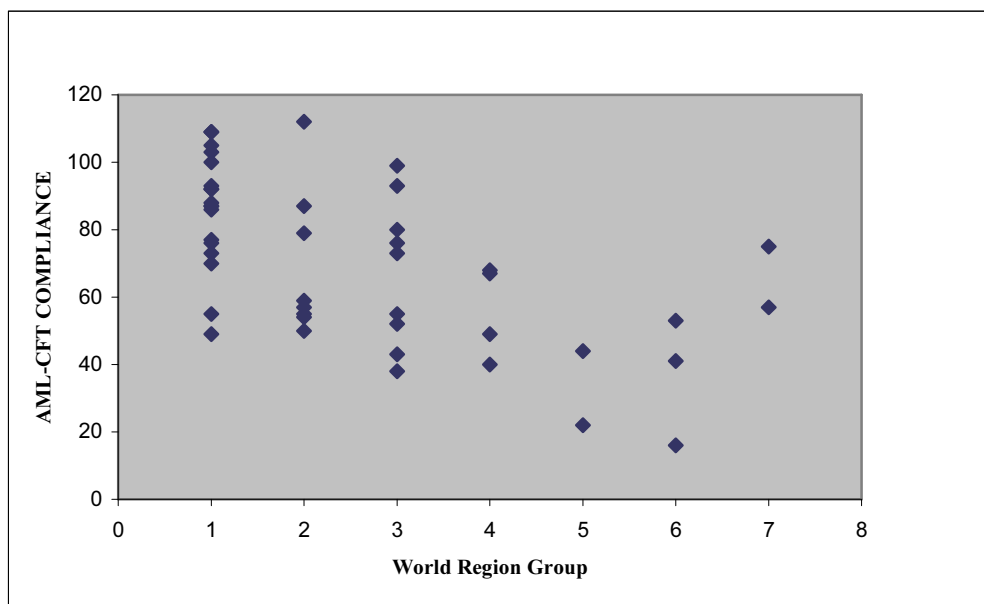
<sup>138</sup> According to the World Markets Research Centre (2003) and the results of the assessment of the risk of terrorism in 186 countries and against those countries’ interest abroad in 2003/3004, regionally, the Middle East and North Africa have the highest ratio of risk of terrorism as well as Pakistan, where domestic terrorism issues continue to be a source of constant problems. The UK faces the greatest risks from terrorism of any European State and is ranked 10<sup>th</sup> overall. Columbia is ranked top out of the 186 countries, and it was assessed that leftist (guerrillas) and right-wing paramilitary groups are extremely active there. Dealing with

In ECA (2) and LAC (3), the variance between the overall compliance scores by countries in the same group is high.

Within the western countries, the least compliant countries are Greece and Brunei.

The countries least compliant with the AML/CFT within ECA are Slovakia and Georgia. The least compliant with the AML/CFT within LAC are Bolivia and The Dominican Republic. The least compliant countries with AML/CFT within the EAP: Vanuatu, Samoa, and China. The least compliant countries with AML/CFT within the SSA are Mauritania and Sudan. The least compliant countries with AML/CFT within the MNA is Syria. The least compliant countries with AML/CFT within the SAS are: Sri Lanka, Nepal, and India. These results show that there are lots of vulnerabilities in some regions such LAC, EAP, SSA, and MNA. Some of the least compliant countries are considered OFCs (Vanuatu, China), some are considered failed states (Sudan), and a majority of those countries are developing countries.

Figure 6.11. The overall compliance with AML/CFT by World Region Group



the threat they pose is a government priority. In this index, countries such as Colombia, India, Sri Lanka, UK, Nepal, Peru, Spain and Georgia are included as high risk description countries. Others such as Italy, Australia, Belgium are described as Medium/High. Brunei, China, Panama, Denmark and Greece are considered as medium risk.

See also: Brau, H. (2004). Terror Islamista en Asia: Nuevo golpe de Al Qaida en Yakarta. *La Vanguardia*. Barcelona: 3-4.

Figure 6.12. show the overall compliance with Special Recommendations on FT by World Region Groups. Despite some Andean countries within the LAC, the world region group have been obliged to subscribe the Vienna Convention to become beneficiary of the Special Regime agreed upon by the European Union for countries fighting against drug production in the framework of the Generalized System of Preferences (Granell 2005, 136).The least compliant countries on FT Recommendations are: LAC, EAP, and the SAS region. These countries are also the most vulnerable to terrorist incidents according to table 6.15 (data provided by MIPT).

Figure 6.12. The Overall Compliance with Special Recommendations by World Region Group

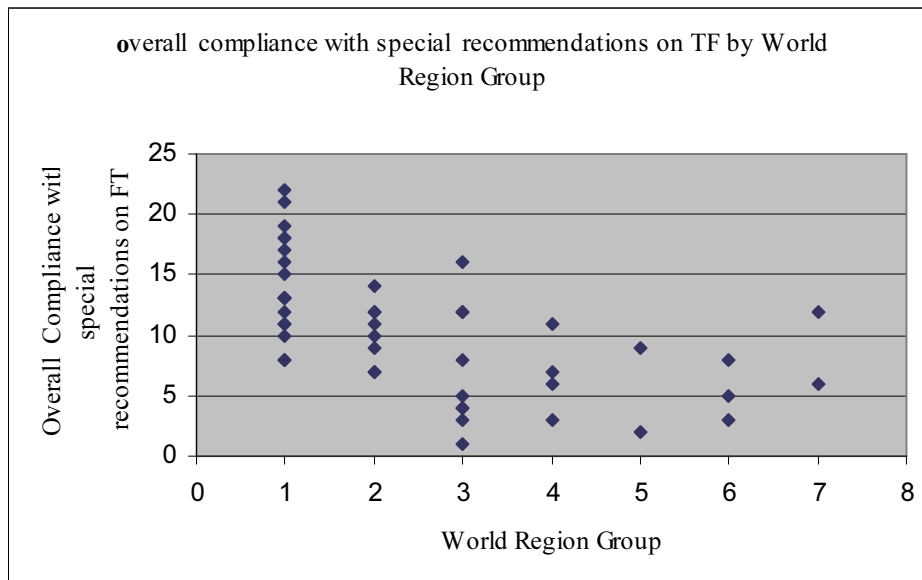


Figure 6.13 shows that within the world regions LAC, SAS, SNA, and EAP, the compliance with Special Recommendations is very low.

Figure 6.13. The Overall Compliance with Special Legal Recommendations  
World Region Group

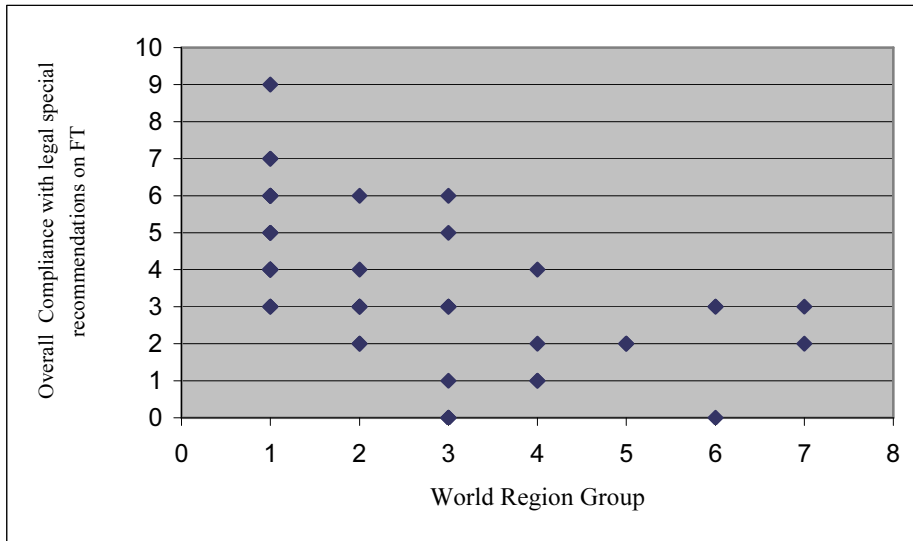


Figure 6.14 shows that among the world regions the West, LAC, SAS, SNA, EAP, and MNA, the compliance with Special Recommendations is very low.

Figure 6.14. The Overall Compliance with Preventive Special Recommendations by  
World Region Group

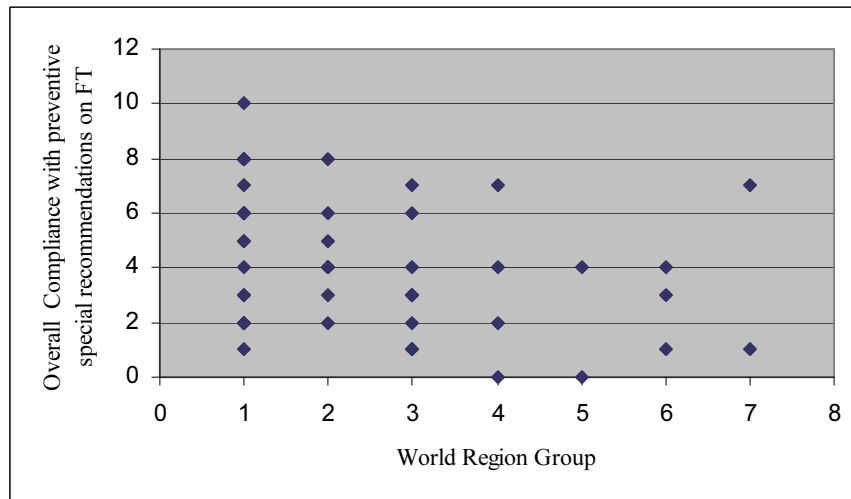


Figure 6.15 shows that the overall compliance with special institutional Recommendations is very low in all groups, in particular: the West, ECA, LAC, EAP, SAS, SNA, and MNA.



Figure 6.15. The overall compliance with Special Institutional Recommendations  
By World Region Group

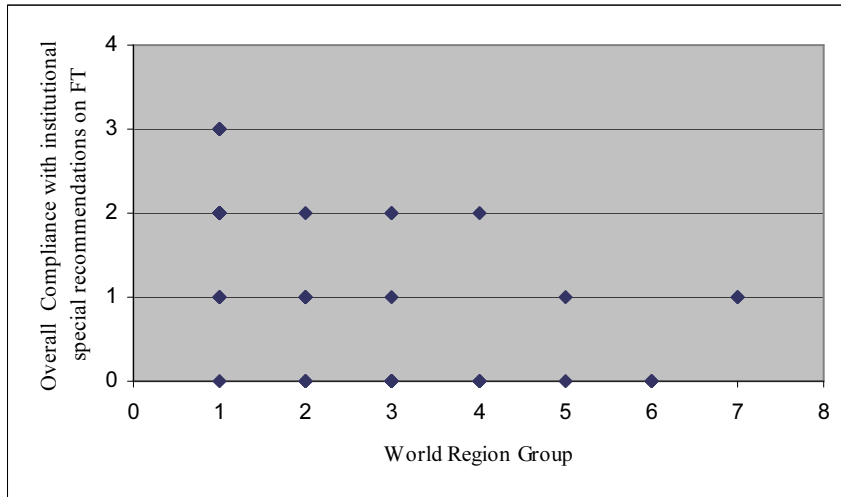
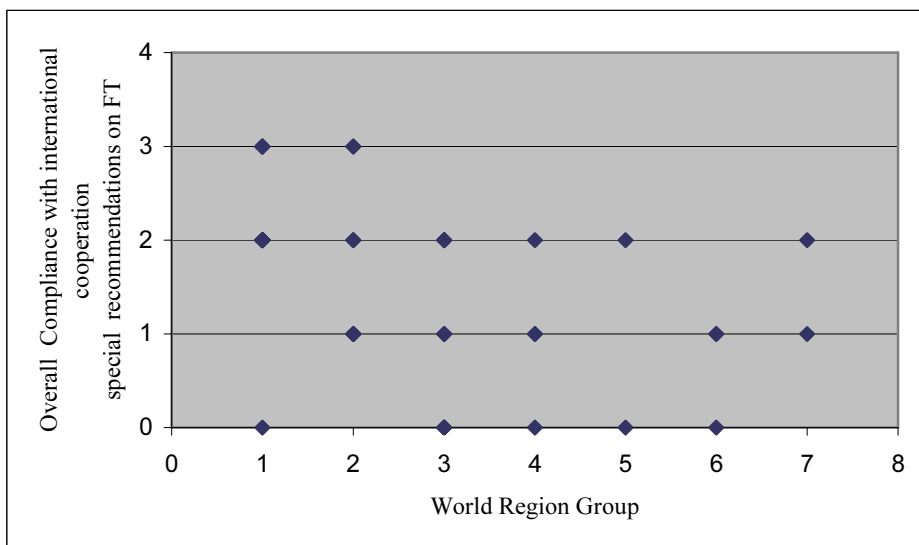


Figure 6.16 shows that the compliance with international cooperation with Special Recommendations is very low in all world region groups.

Figure 6.16. The Overall Compliance with International Cooperation with Special Recommendations on FT  
by World Region Group



In line with the previous results, it should be highlighted that the regions least compliant with the CFT Regime are the regions with a high a number of incident attacks according to table 6.16

In general, the results of this research are in line with some other results obtained by:

- Croissant & Barlow (2007), when comparing the government responses to FT by Southeast Asian Countries. Although they did not use the 49 Recommendation variables to assess the compliance with the AML/CFT, and they only utilized the 16 variables of proposed by INCSR, their results are: Some countries show the strongest degree of compliance (Singapore, Thailand and Indonesia), followed after a considerable gap by Malaysia, the Philippines and Brunei. They insist that laws may be on the books but they are not effectively implemented. The relevant governmental institutions are not well developed, and international law enforcement cooperation is low.
- Piombo (2007), when examining the government responses of East African countries, states that the most common forms of generating incomes do not rely on financial institutions of any kind but involve smuggling and arms trafficking. She concludes that better border, coast surveillance and customs efficiency would improve the AML/CFT effectiveness because terrorists and organized crime are engaged in illegal activities in these areas.
- De Moraes (2007), when examining the Arab government responses, insisted that it is necessary to encourage and assist the passage, implementation and enforcement of stricter anti-Money Laundering legislation (terrorism financing is a predicate offense) because there is a lack of uniformity in AML/CFT compliance in the region. According to her, Morocco, Tunisia, Lybia and Kuwait have been slow to enact legislation and Kuwait has not adequately implemented the laws in accordance with AML/CFT. *“It would seem very easy, therefore, if a terrorist organization wanted to move money out of the region, to transmit funds from on of these jurisdictions, none of which is on FATF’s list of Non-Cooperative Countries.”* (De Moraes 2007:170)
- Lombardi & Sánchez when examining the South American Countries state *“ Tri-Border Area of South America (Argentina, Brazil and Paraguay) is a critical, strategic node in the global war on terrorirsm because it tremains a permissive*

*environment for Islamic extremist networks to generate and transfer immeasurable quantities of revenue for their respective parent terrorist organizations.(...) Scholarly research suggests the existence of “ several fre-trade areas in Latin America with Large Middle Eastern populations that allow Islamic terrorist groups, organized crime mafias, and corrupt officials to thrive in a mutually beneficial, symbiotic relationship”.(Lombardi & Sánchez 2007:245)*

## **6.2. Summary of Factors Underlying the Rating of Compliance<sup>139</sup>**

This section provided a broad discussion of common factors underlying the rating of compliance on ML and FT for subgroups such as legal, preventive, institutional, and international cooperation.

### **6.2.1 Factors Underlying the Rating of Compliance with Legal Recommendations**

The basis of the AML/CFT compliance is to ratify and criminalize the Money Laundering and Terrorist Financing Offences according to the UN Convention on ML and FT. Even where there has been a ratification of international Convention this does not necessarily imply compliance, as there may be a lack of developments in domestic law. In order to know which countries have ratified the UN Convention, the ratification frequencies have been calculated within the sample.

#### **6.2.1.1 Factors Underlying the Rating of Compliance with Legal Recommendations on Money Laundering**

Table 6.2 shows the frequencies of the ratified UN Convention on Money Laundering and Corruption. 41.3% of the sample has not ratified/implemented the Palermo Convention (according to the Mutual evaluations reports and the INCSR 2006). In addition, the ratified frequency of the last UN Convention on Corruption is low (only 17.4%).

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<sup>139</sup> Partially compliant countries are not compliant with the essential criteria of the 2004 methodology. Largely compliant countries are compliant with a broad range of essential criteria of the 2004 methodology. Totally compliant countries are compliant with the essential criteria of the 2004 methodology. Not compliant countries are not compliant with the essential criteria of the 2004 methodology.

Table 6.2 Ratification of UN Money Laundering and Corruption Convention

| Ratify UN Money Laundering   | N  | Frequencies |  | Percentage |              |
|------------------------------|----|-------------|--|------------|--------------|
|                              |    | Ratified    |  | Ratified   | Not Ratified |
| UN Viena Conv 1988           | 46 | 45          |  | 97.8%      | 2.2%         |
| Criminalise ML beyond drugs  | 46 | 44          |  | 95.7%      | 4.3%         |
| Palermo Conv 2000            | 46 | 27          |  | 58.7%      | 41.3%        |
| Conv against corruption 2005 | 46 | 8           |  | 17.4%      | 82.6%        |
| Antibribery Conv OECD 1997   | 46 | 18          |  | 39.1%      | 60.9%        |

Author calculations based on INCSR (2006), OECD (2006), and UN (2006).

In addition to the information presented in Table 6.1, only 6.5% of the countries within the sample have totally criminalised Money Laundering on the basis of the 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substance and the 2000 United Nations Convention on Transnational Organized Crime, according to the essential criteria of FATF methodology (2004).

The factors underlying the low overall compliance in the legal Subgroup of Recommendations are listed as follows:

- In the vast majority of jurisdictions, incrimination of ML is not fully consistent with the Vienna and Palermo Convention (R.1). In some countries, predicate offence categories do not respect the 40 Recommendations (some legislations do not include migration smuggling, participation in criminal activities, racketeering, arms trafficking or Terrorist Financing in the list of predicate offences).
- Only 30.4% of the countries in the sample are compliant with the ML offence-mental element and corporate liability (R.2). In some countries, legislation on corporate criminal liability is missing, and objective factual circumstances as standard of proof are not explicitly provided.
- The current framework hinders the prosecution of ML offences.
- The lack of Money Laundering prosecutions indicates that the Regime is not being effectively implemented. Few Money Laundering cases have been prosecuted in any of the groups of income countries, and it is therefore not possible to evaluate the effectiveness of the Money Laundering legislation.
- The sanction Regime is not being effectively applied. In the cases where it has been applied, sentences appear to be low.

- The overall compliance on R3, that is, confiscation and provisional measures is around 15%. A majority of the countries show a lack of meaningful data and insufficient regular review of confiscation and tracing efforts/accomplishments. Seizure and confiscation provisions are shown not to have been fully implemented. 85% of countries have not enabled their competent authorities to confiscate property laundered or proceeds from Money Laundering and predicate offences. The least compliant countries with the legal Recommendations on ML are: India, Nepal , Mauritania, Sri Lanka, Samoa, Paraguay, Lithuania, Dominican Republic, Bolivia, Belarus, Bahrain, and Albania

#### **6.2.1.2 Factors Underlying the Rating of Compliance with Special Legal Recommendations on Terrorist Financing**

As has been stated in Chapter 4, the international system has not been able to establish a truly universal common definition on terrorism. For this reason, it is very important to show the different attitudes to different Convention on Terrorism through the ratification frequencies of all the instruments against Terrorist Financing. The acceptance and ratification of the instruments should be a necessary step to accept common concepts on terrorism. Table 6.3 shows the lack of common attitudes to the different terrorism Convention among the 46 countries. There are still some countries that have not ratified some Convention on Terrorism, from the first Aircraft Convention to International Convention on Suppressing Terrorist Financing. This confirms some statements of the theoretical framework developed in chapter 4, and it shows that the system has not been able to establish a truly universal law.

Table 6.3. Ratified UN Conventions on terrorism

| <b>Ratify UN Terrorism Convention</b>              | <b>N</b> | <b>Frequencies Ratified</b> | <b>Percentage Ratified</b> | <b>Frequencies Not Ratified</b> | <b>Percentage Not Ratified</b> |
|--|----------|-----------------------------|----------------------------|---------------------------------|--------------------------------|
| <b>Aircraft Conv 1963</b>                          | 46       | 45                          | 97.8%                      | 1                               | 2.2%                           |
| <b>Unl Seiz Conv 1970</b>                          | 46       | 45                          | 97.8%                      | 1                               | 2.2%                           |
| <b>C.A.Conv 1971</b>                               | 46       | 45                          | 97.8%                      | 1                               | 2.2%                           |
| <b>D.A Conv 1973</b>                               | 46       | 43                          | 93.5%                      | 3                               | 6.5%                           |
| <b>HT Conv 1979</b>                                | 46       | 40                          | 87%                        | 6                               | 13%                            |
| <b>N Mat Conv 1980</b>                             | 46       | 34                          | 73.9%                      | 12                              | 26.1%                          |
| <b>Airport Prot Conv1988</b>                       | 46       | 43                          | 93.5%                      | 3                               | 6.5%                           |
| <b>Marit Conv 1988</b>                             | 46       | 39                          | 84.8%                      | 7                               | 15.2%                          |
| <b>P.E Conv 1991</b>                               | 46       | 35                          | 76.1%                      | 11                              | 23.9%                          |
| <b>F.P Prot 1988</b>                               | 46       | 37                          | 80.4%                      | 9                               | 19.6%                          |
| <b>T.B Conv 1997</b>                               | 46       | 39                          | 84.8%                      | 7                               | 15.2%                          |
| <b>Terrorism Financ Convention Criminalized FT</b> | 46       | 40                          | 87.0%                      | 6                               | 13%                            |
|  | 46       | 36                          | 78.3%                      | 10                              | 13.0%                          |

Source: Author's calculations using data from the UN (2006), mutual evaluations reports, and INCSR (2006)

In the light of the results on table 6.3, the following findings can be stated:

- There are no universal application of the UN instruments against terrorism.
- International cooperation needs to harmonize laws and overcome obstacles that have arisen in areas of extradition and mutual legal assistance, which can undermine measures against terrorism.
- There are still legislative loopholes and safe havens which facilitate the spread of terrorism.

Table 6.4. Profile of the Overall Compliance with Nine Special Recommendations on Terrorist Financing

| NINE SPECIAL<br>RECOMMENDATIONS            | Compliant | Largely        | Partially      | Not            | Missing     | Assessed<br>Jurisdicti<br>ons<br>In<br>number |
|--|-----------|----------------|----------------|----------------|-------------|---|
|  | t<br>%    | Compliant<br>% | Compliant<br>% | Compliant<br>% | Values<br>% |   |
| SR.I. Implement UN Instruments             | 8.7       | 23.9           | 52.2           | 15.2           | 0           | 46  |
| SR.II. Criminalise Terrorist<br>Financing  | 8.7       | 32.6           | 37.0           | 21.7           | 0           | 46  |
| SR.III. Freeze /confiscate terror ass      | 2.2       | 19.6           | 50             | 28.3           | 0           | 46  |
| SR.IV. Suspicious transaction<br>report    | 8.7       | 30.4           | 23.9           | 37.0           | 0           | 46  |
| SR.V. International Cooperation            | 13.0      | 45.7           | 26.1           | 15.2           | 0           | 46  |
| SV.V.I. Requirements for money<br>transfer | 15.2      | 32.6           | 34.8           | 15.2           | 2.2         | 46  |
| SR.VII. Wire transfer rules                | 8.7       | 15.2           | 34.8           | 41.3           | 0           | 46  |
| SR.VIII. Non-profit organisations          | 10.9      | 19.6           | 39.1           | 30.4           | 0           | 46  |
| SR.IX. Bearer instruments                  | 6.5       | 8.7            | 34.8           | 37.0           | 13.0        | 46  |

Source: Author's calculations using data from Mutual evaluation Reports

Table 6.4 shows the results of the overall compliance with nine Special Recommendations on Terrorist Financing. Qualitative analysis suggests that the most important weaknesses in complying with the legal subgroup of Special Recommendations are the following:

- Only 8.7% of the sample have totally implemented the 1999 International Convention for the Suppression of the Financing of Terrorism (UNCSFT). In some countries there are no laws or regulations outlining special procedures for achieving full compliance with the UN Security Council Resolution.
- In almost 91% of the sample, the S/Res/1267 (1999) and S/RES/1373 (2001) are not fully implemented – or the legislation is insufficient. Usually the CDD requirements are inadequate and the implementation of STR financing terrorism reporting is not fully effective. In some countries, legislation does not cover certain requirements: the collection of funds for terrorism and the collection or provision of

funds for an individual terrorist. The current process does not allow freezing of terrorist assets without delay. The less compliant countries are Bolivia, Colombia, Dominican Republic, Fiji, Mauritania, Nepal, Samoa, and Sudan.

For some countries, the law does not cover those who finance terrorism and terrorist organisations outside specific terrorist acts. The term “terrorist activities” should be specified and unequivocally defined to be consistent with the UNSTF and Special Recommendation II.

- Only 73% of the sample has criminalised Terrorist Financing according to INCSR (2006). The results of the overall compliance with SR Recommendations show that only 8.7% of countries within the sample have criminalized the TF completely, according to the essential criteria of SR2. The least compliant countries are Bahrain, Belarus, Bolivia, Colombia, Dominican Republic, Nepal, Paraguay, Slovakia, Sudan, and Georgia.
- In some countries, the dissemination of the United Nations Security Council Resolution List of Terrorists and Terrorist Organisations is only done after an internal review undertaken in order to ascertain the integrity of the persons listed. This has resulted in a delayed distribution of financial institutions. In some countries, the process of notifying ministries and the financial sector of entities on UN or EU listing process takes too long and ,as a result, no entity is able to comply with freezing terrorist assets without delay.
- Some countries have not established procedures that give guidance to financial institutions as well as DNFBPs to enforce the resolutions or to address any problems that may arise in the enforcement of the resolutions.
- If Terrorist Financing is not criminalised in a national legislation, this may be evidence of an absence of a formal mechanism for transmission of updates of the lists to the system under supervision, or of any obligation on the part of the supervised entities to carry out the verifications, or any legal basis for penalising non-compliance.
- Only 2.2 % of the countries within the sample are totally compliant with the SR3, that is, to freeze and confiscate terrorist assets. Countries not compliant are



Bahrain, Belarus, Bolivia, Colombia, Dominican Republic, Nepal, Paraguay, Slovakia, Sudan, and Georgia.

- In some countries there are no sanctions and there is a failure to follow freezing requests and the processes for de-listing and unfreezing funds are not publicly known, so it is impossible to determine the global effectiveness of the freezing system.
- In some countries, the authorities are only able to freeze terrorist assets once a criminal organization has been opened, thus slowing down the process.

## **6.2.2. Factors Underlying the Rating of Compliance with Preventive Recommendations**

This section focuses on analyzing the common weaknesses of the compliance with the the core of the AML/CFT, that is , the Preventive Recommendations on ML and FT.

### **6.2.2.1. Factors Underlying the Rating of Compliance with Preventive Recommendations on Money Laundering**

#### R.4 Secrecy laws<sup>140</sup>

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<sup>140</sup> The following list of mutual evaluation reports shows that many countries still face challenges to total eliminate secrecy laws.

The Swiss Mutual Evaluation Report points out:

- 1) des dispositions du droit Suisse imposent dans certains domaine (échange de renseignements entre autorités compétentes au niveau international, supervision par une autorité étrangère de contrôle, des conditions contraignante à la transmission d'informations nominatives.
- 2) Le secret professionnel peut constituer un obstacle à la mise en œuvre sans entrave de la special recommendation entre intermédiaires financiers pour les virements électroniques nationaux-

The Uruguay Mutual Evaluation Report points out :

- 1) Hay dificultades para aplicar eficazmente las disposiciones para levantar el velo de confidencialidad
- 2) Las normas sobre secreto prohíben que las instituciones financieras incluyan números de cuenta de los clientes en los giros telegráficos sin el consentimiento del cliente

The Nepal Mutual Evaluation Report pointed out:

- 1) Financial institution secrecy laws do not appear to inhibit the disclosure to and sharing of requisite information with the competent authorities, despite compliance procedures

The Greece Mutual Evaluation Report points out:

- 1) It has not been clearly shown that bank secrecy has been fully lifted by the AML law. The AML law potentially only lifts bank secrecy for STRs in respect to money laundering.

The Georgia Mutual evaluation Report points out:

- 1) There should be consistent provisions in legislation, ensuring that requests for information by the FMS cannot be challenged because of confidentiality/secrecy. Financial institutions are not specifically authorised to share information for the implementation of Recommendation 7 and SR.VII

The Dominican Republic Mutual Evaluation Report points out:

- 1) Rec. 4 is not fully complied with, since the question of confidential submission of a STR is not clear.

- The vast majority of the jurisdictions have fully observed the ‘secrecy law’ within the sample, and they are consistent with AML Recommendations. 54% of the countries are fully compliant. In some countries, it has not been clearly shown that bank secrecy has been fully lifted by the AML national law.
- In some countries, it is necessary to request to “relieve” the rules of confidentiality at the judicial authority, and this can compromise the system’s efficacy.
- In some countries, financial institutions are not authorised to share information in the implementation of correspondent banking and third parties and introducers.
- Some countries do not inhibit the implementation of the FATF Recommendations, but the varying interpretations within the private sector of the duty of confidentiality as defined in the many statutes and constitutions have led, in practice, to less information sharing than would be optimal.
- This research points out that some countries and jurisdictions (among OFCs, Failed States and others) put at risk the financial system while maintaining the secrecy laws.

#### R.5.Customer due diligence

- The 86.% of the countries are not totally compliant with the core goal of the AML/CFT Regime that is to undertake customer due diligence measures, including identifying and verifying the identity of their customers when establishing business relations, carrying out occasional transactions, there is a suspicion of Money Laundering or Terrorist Financing and the financial institution has doubts about the veracity or adequacy of previously obtained customer identification

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- 2) The institutions of the Stock Market and Insurance Market have no recommendations applied on this matter, and they are not submitting STRs as required.

The Brunei Mutual Evaluation Report:

- 1) The lack of legal protection has made financial institutions hesitant about submitting suspicious transactions reports to the FID.

The Chile Mutual Evaluation Report:

- 1) La necesidad de acudir a instancia judicial para solicitar el relevamiento de las normas de confidencialidad puede comprometer la eficacia del sistema.

The Colombia Mutual Evaluation Report points out:

- 1) Deberían arbitrarse las medidas necesarias para zanjar los obstáculos existentes y posibilitar el intercambio de información entre Instituciones Financieras.

The Bahrain Mutual Evaluation Report points out:

- 1) No on-site inspections have been completed for insurance or capital markets and licensees.

- The least compliant countries with the core of Preventives Recommendations on ML are Albania, Australia, Mauritania, Nepal, Sri Lanka, Turkey, Uruguay.
- There is no requirement in law or regulation in many countries to: identify the beneficial owner, or to determine the natural persons that ultimately own or control the customer are, including those persons who exercise ultimate effective control over a legal person or arrangement.
- In some countries, there is no explicit obligation to obtain information on the purpose and nature of the business relationship in all cases.
- In some low and lower middle countries, there is no legislative text obliging insurance companies, foreign exchange institutions (other than banks) to take measures to identify the real beneficiary.
- Undertaking CDD measures is not required when carrying out occasional transactions that are wire transfers in circumstances covered by the interpretative note SR VII.
- In the majority of countries, there are limited procedures for on-going procedures for on-going due diligence in the guidance. They are only applied for higher-risk scenarios.
- A series of obligations has not yet been effectively been implemented, as when conducting CDD whenever there is a suspicion of Terrorist Financing or whenever there are doubts about the veracity or adequacy of the previous data.

#### R.6. Politically exposed persons

- Any country is totally compliant with R.6. There are not enforceable obligations regarding the identification of PEPs or the issues generally involved. Some European Countries seem to be awaiting a 3rd EU directive.
- Sometimes the law is in compliance with the International standards but there are no instructions clarifying for the benefit of financial institutions the conditions applicable to carrying out due diligence with respect to PEPs for the financial institutions.

#### R.7. Correspondent banking

Only 10.9% of the countries within the sample are totally compliant with the R.7.

For the majority of the countries: There is no legislative, regulatory or other

enforceable requirement in respect to politically corresponding banking relationships.

- There is no requirement to ascertain that the respondent banking AML/CFT controls are adequate and effective regarding payable through accounts, or regarding the obligation to identify/verify the customer and to perform ongoing due diligence.

This signifies that correspondent accounts in unregulated, poorly-managed and corrupt financial institutions have direct access to any country with a weak implementation of R.7 and once there, easy access to the financial system.

#### R.8. New technologies and non face-to face business

Only 17.4% of the countries within the sample are totally compliant with the R.8

For the majority of countries:

- There are no requirement of measures in respect to technological development or non-face-to-face business for financial institutions to have policies in place. There are no requirements to take such measures as needed to prevent the misuse of technological developments in ML/FT, or effective CDD procedures that apply to non face-to-face customers.
- Measures to deter ML/FT threats arising from new technologies must be put in place and regulations for insurance and capital markets licensees on non face-to-face account opening must be developed.

#### R.9. Third parties and introducers

Only 13.0% of countries within the sample are totally compliant with the R.9.

- Financial institutions relying on third parties are not required to immediately obtain the identification data from referees.
- Financial institutions relying on third parties are not required to immediately obtain the identification data from referees; take adequate steps to confirm that copies of identification data and other relevant documentation relating to CDD requirements will be made available from the third party upon request without delay; confirm that the third party is regulated and supervised according to R 23, R 24, and R 29, and has measures in place to comply with, the CDD requirements set out in R.5 and R.10.

#### R.10. Record keeping

32.6% of the countries are totally compliant with the R.10 despite the fact that in some

countries:

- Transaction records must be kept for a least 7 years after the day the account is closed. This provision should not be limited to financial institutions. The cash dealers, securities and insurance entities, foreign exchange dealers, and money remitters should report.
- The provisions for record keeping do not specifically require that all account files and business correspondence be retained.

R.11. Unusual transactions

Only 13% of the countries are compliant with Recommendation R.11

- No specific obligations for financial institutions to monitor unusual and large transactions.

R.12. DNFBP- R.5,6,8-11

No country is fully compliant or largely compliant with the R.12. The main weaknesses found were:

- DNFBPs operating in some countries do not have mandatory CDD, record keeping and other obligations. Same weaknesses to cover CDD with real estate agents, casinos, traders in precious metals, attorneys, notaries and independent legal professional and accountants.
- Most DNFBPs are not legally required to report suspicious transactions to FIUs. There are no adequate measures for DNFBPs to pay special attention to transactions involving certain countries.
- No requirements with regard to PEPs that will apply to any of the DNFBPs.
- For DNFBPs, there is no obligation to have policies in place or take such measures that may be necessary to prevent the misuse of technological developments in ML/FT.
- There are currently no enforceable obligations with regard to introduced business.
- There are no requirements to oblige financial institutions to record sufficient information to permit the reconstruction of individual transactions so as to provide, if necessary, evidence for prosecution of criminal activity.
- There are no explicit requirements in law or regulation to maintain records of account files.

- There are no obligations to pay special attention to compiling, unusual large transactions, or unusual transaction that have no apparent or visible economic or lawful purpose.

R.13. Suspicious transaction reporting

Only 6.5% of the countries are totally compliant with R.13, and the majority of the countries within the sample:

- Have no clear legal requirement to report funds suspected to be linked or related to financing of terrorism.
- Sometimes the obligation to report suspicious reports related to FT does not extend to investment fund and credit card companies.
- More guidance and outreach required to ensure that all financial institutions are reporting suspicious transactions; the large majority of STRs have been filed by a small number of financial institutions.
- The detailed mutual evaluation report of Denmark (IMF 2006;117-119) has presented the number of STRs per 100000 euros in bank assets. The Figure presents some differences on reports by countries, and these differences are due to the underlying level or pattern of predicate crime in the various jurisdictions, differences in the level and patterns of Money Laundering, differences in the parties of financial institutions or differences in the definition of ML and FT.

R.14. Protection no tipping-off

56.7% of the countries within the sample are compliant with R.14. Despite the fact that:

- In some countries, banks had concerns on client confidentiality when filing suspicious transaction reports.
- Safe harbour provisions should cover temporary as well as permanent staff.
- A clear provision of general application sanctioning tipping off by employees of financial institutions.

R.15. Internal controls, compliance and audit

Only 6.5% of the countries within the sample are totally compliant with R.15.

- Apart from banks and credit unions, financial institutions should be required to implement and maintain an adequately resourced and independent audit function
- The country should designate an AML/CFT compliance officer at the management level, and the officer should have an adequately resourced and independent audit

function.

#### R.16. DNFBP-R.13-15&21

No country is totally compliant with R.16 within the sample

The common problems within the sample are:

- Most DNFBPs are not legally required to report suspicious transactions to the national FIU.
- Most DNFBPs are not required to develop internal policies, procedures, internal controls, ongoing employee training, and compliance in respect of AML/CFT.
- No reporting requirements regarding real estate agents, lawyers and accountants; the existing requirements are ineffective and the internal control procedures are not always fully in place.
- More outreach and guidance to those DNFBPs with reporting obligations is required to explain the reporting obligations.

#### R17. Sanctions

No country is totally compliant with R.17. The majority of countries:

- The administrative sanctions system does not clearly extend to CFT. Different authorities can apply sanction or the requirement under AML law is still limited.
- Lack of intermediate sanctions, it which means that formal sanctions are generally not applied to.
- In countries where sanctions are available for legal persons which do not fulfil the AML obligations, it is too early to assess their effectiveness.
- No sanctions are available for senior staff in institutions where violations occur.

#### R18. Shell Banks

Only 26% of the countries are totally compliant with R.18

In the majority of countries:

- There is no explicit prohibition on the establishment of shell banks.
- There is no provision that prohibits some national banks from entering into or requiring operations with shell banks.
- There are no requirements for financial institutions to ensure that their respondent banks do not have a relationship with shell banks.

#### R19. Other forms of reporting

58.7% of the countries are totally compliant with R.19

- In some countries however there is no requirement for financial institutions to report large cash transactions.

R20. Other NFBP and secure transaction techniques

43.5% of the countries are totally compliant with R.20

- Some countries have not yet undertaken a formal risk assessment of vulnerabilities of the businesses and professions vulnerable to Money Laundering or terrorism financing risk.
- Measures should be taken to encourage the uses of non-cash transactions.

R21. Special attention for higher risk countries

Only 15.2% of the countries are totally compliant with R.21. In the majority of the countries:

- There are no instructions, guidance notes or advisories for the financial institutions to pay special attention to transactions involving countries that do not adequately apply the FATF Recommendations.
- No specific requirement to examine, as far as it is possible, the background and purpose of such transactions, and make written findings available for authorities.

The Recommendation 21 is considered the most important measure against non compliant jurisdictions and regarding the low overall level of compliance with this recommendation by 46 jurisdictions, one can state that this Regime has not been effective against 'non-compliance'.

R22. Foreign Branches and subsidiaries

Only 8.7 % of the countries are totally compliant with R.22

- There is no requirement that this principle be observed with respect to their branches and subsidiaries in countries which do not apply or insufficiently apply the FATF Recommendations.
- There is no requirement that financial institutions inform their home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures, because this is prohibited by local (i.e. host country) laws, regulations or other measures.

R23. Regulation, supervision and monitoring

No country is totally compliant with R.23.



- FIUs on-site supervision activities do not cover the full range of tools available. The number of formal compliance inspection audits has been very low across the range of supervised entities.
- The impact assessment method does not sufficiently take into account AML/CFT risks, and therefore there are some concerns about the adequacy of supervision for small firms.
- Consumer credit, financial leasing, guarantees and commitments, brokers, factoring, safe-keeping and administration are not supervised.

R24. DNFBP-regulation, supervision and monitoring

No country is totally compliant with R.24.

- Currently, AML/CFT supervision does not include supervision for real state agents, legal or accountancy professionals, or accountants that are not members of professional bodies.
- In some countries casinos are not compliant with concerns regarding the scope of AML/CFT requirements and the effectiveness of the supervisory Regime.
- In general, most of the DNFBPs are not covered under effective regulatory and supervisory systems for monitoring to ensure compliance with AML/CFT requirements.
- Criminal sanctions, are mostly not extended to most DNFBPs. The lack of administrative sanctions coupled with an absence of criminal prosecutions of DNFBPs suggests that sanctions are generally not applied to breaches of AML/CFT requirements.

R25. Guidelines and feedback

6.5% of the countries are totally compliant with R.25

- Inadequate regard to general detailed CDD guidance, with particular reference to the identification and verification of clients, internal controls and record keeping.
- Training and guidelines are needed for DNFBPs which have never reported before.
- Sometimes the guidelines do not apply to trustee companies.

### **6.2.2.2 Factors Underlying the Rating of Compliance with Special Preventive Recommendations on Terrorist Financing**

#### SR VI Alternative Remittances

Only 15.2% of the countries are totally compliant with the SR.VI

- Measures should be taken to ensure that persons or legal entities, including agents who provide a service for the transmission of ML or value transfer system or network are compliant with SR.VI. All of these countries should ensure that persons or legal entities that carry out this service illegally are subject to administrative civil or criminal sanctions.
- In the majority of the countries there is no a general requirement that all MVT services be licensed or registered.
- No adequate sanctions and effectiveness of supervisors.
- Poor customer identification, such as a lack of beneficial ownership requirements (R.5), PEPs (R.6), and transaction monitoring (R.11 and 21).

Non-compliant are: Bolivia, Iceland, Sri Lanka, Sudan, Syria, Uruguay, and Vanuatu.

#### SR VII Wire Transfers<sup>141</sup>

Only 8.7% of the Countries are totally compliant with SR.VII.

- Sanctioning Regime is not effective or dissuasive.
- Countries take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address, and account number) on funds transfers and related messages that are sent.
- In some countries, there is no requirement by a national regulators to obtain information such as the name and address of the originator for one-off wire transfer if the value of the transfer is low.
- There is no requirement for originators' information to be included in cross-border wire transfers.

The countries that are not compliant with SR.VII are: Albania, Australia, Belarus, Brunei, Iceland, Ireland, Italy, Latvia, Norway, Portugal, Sri Lanka, Sudan, Sweden, Paraguay, Syria, Turkey, Uruguay, Vanuatu and Georgia.

#### SR VIII. Non profit organizations<sup>142</sup>

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<sup>141</sup> The derogation set out in the EU regulation for wire transfers within the EU (classified as domestic transfers) is not in compliance with the FATF requirements under SR.VII. The FATF has decided, following the June 2007 Plenary, to further consider the subject.

Only 10.9% of the countries are totally compliant with SR.VIII.

Countries do not have adequate laws or regulations that relate to entities that can be abused for the financing of terrorism. (to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations). Some common weaknesses are:

- National regulators should review laws and regulations governing non-profit organisations to ensure that they are adequate for preventing the potential abuse by terrorists or terrorist organisations
- In the vast majority of the countries, there are no assessments of the vulnerabilities of the non-profit sector to Terrorist Financing or other abuses.
- There is insufficient monitoring of NGOs to ensure funds are used to achieve charitable objectives.
- There has been no education to NGOs on how to protect themselves from Terrorist Financing and other abuses.
- There is no specific guidance issued to financial institutions in respect of customers that are NGOs.

Non-compliant countries are: Albania, Bolivia, Chile, Colombia, the Dominican Republic, Iceland, Jamaica, Norway, Paraguay, Samoa, Slovakia, and Greece.

#### SR IX. Cash Courier

Only 6.5% of the countries are totally compliant. The 13% of the countries have missing values.

- The vast majority of the countries have no measures in place to detect the physical cross-border transportation of currency and bearer negotiable instruments, including a declarations system or other disclosure obligation.

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<sup>142</sup> It also should be pointed out at this point that there is a lack of information about the dimensions of the global NPO sector. The only attempt to measure the dimension of the NPO in 33 countries has been carried out by Salamon (2004). In the view of his results, it should be remarked that some countries non-compliant are included in the list submitted by Salomon, such as: Colombia, Norway, Slovakia. In these countries, the formal NPO sector represents a significant amount of the total GDP (2.42%, 6.53% and 1.60%) and these countries have not implemented measures to control the NGOs. In other countries such as Australia (6.63%), Belgium (11.05%), Hungary (3.39%), India (1%), Ireland (9.07%), Peru (2.22%) , Spain (5,86%), Sweden (8,40%). This ratio indicates that high amounts of money are moved through the NPO and NGOs and this sector is far from being regulated. Cases of corruption related to the NGOs such as Intervida in Spain, and the Arca de Zoé in France and the use of NGOs by terrorist groups should concern countries about the necessity to regulate them.

- Sometimes when a declaration system is in place for cross border transportation of currency, there is no mechanism to ascertain origin of the currency and its intended use in relation to Money Laundering or terrorist activity.
- There is no mechanism in place to maintain comprehensive statistics and pass the information on the declaration of cross border transportation to the FIU which, in some cases, has yet to be established.

Non-compliant Countries are Bahrain, Belarus, Belgium, Bolivia, Brunei, Gibraltar, Latvia, Paraguay, Sri Lanka, Sweden, Switzerland, Syria, Turkey, Uruguay, Vanuatu and Greece.

### **6.2.3. Factors Underlying Rating of Compliance with Institutional Recommendations**

This section analyzes the weaknesses of countries regarding compliance with Institutional Recommendations on ML and FT.

#### **6.2.3.1. Factors Underlying the Rating of Compliance with Institutional Recommendations on Money Laundering**

##### R.26. The FIU

Only 6.5% of the countries are compliant with R.26.

Belarus, Brunei, India, Nepal, Sri Lanka, Sudan and Greece are the least compliant countries with the core of the institutional Recommendations on ML.

- In some countries the FIU is not in operation.
- In some countries the FIU does not have enough staff to effectively manage the very high volume of STRs and other reports that it receives.
- Some countries do not publish periodic reports including STRs statistics typologies and trends.
- Some countries have not provided guidance and training to the financial sector, law enforcement agencies, and other relevant entities on AML/CFT.
- There is no evidence in some countries that the work of the FIU has resulted in successfully investigation, prosecution, and conviction of ML or FT.

##### R.27. Law enforcement authorities

30.4% of the countries are compliant with R.27

In some countries:

- There is a lack of awareness by law enforcement and prosecution authorities of the value or authority to use specialised investigation techniques in FT investigations.

R.28. Powers of competent authorities

65.2% of the countries are totally compliant with R.28

- Despite the fact that in some countries there is a lack of an effective implementation of broad authorities to compel the production of records, conduct searches and make seizures in Money Laundering and Terrorist Financing investigations.

R.29. Supervisors

15.2% of the countries are totally compliant with the AML/CFT with R.29

- Although countries with FIUs have the power to conduct compliance inspections to assess AML/CFT compliance with the reporting and identification obligations, formal compliance inspections are rarely conducted.
- FIUs powers of enforcement and AML/CFT sanctions exist but are limited to criminal sanctions and are thus rarely applied.

R.30. Resources, integrity and training

Only 2.2% of the countries are compliant with R.30.

- The FIUs should increase resources in order to meet commitments made with the AML/CFT.

R.31. National Co-operation

Only 15.2 % of the countries are compliant with R.31

- Lack of organized AML/CFT interagency cooperation on the supervision of the Recommendations.

R.32. Statistics

No country is totally compliant with R.32

- Some FIUs do not specify the figures on the number of STRs analyzed and disseminated.
- Some countries do not maintain comprehensive statistics on cross-border disclosures concerning suspected ML/FT.

- There are no comprehensive statistics for CFT and ML convictions and prosecution.

R.33. Legal persons beneficial owners

Only 10.9% are compliant with R.33

- Mechanism to provide adequate access in a timelier manner to adequate and accurate information on beneficial ownership and control for the majority of some countries' legal persons could be improved.
- Information on the companies' register pertains only to legal ownership/control (as opposed to beneficial ownership) and it is neither verified nor reliable.
- Despite the fact that in some countries the use of share warrants to the bearer is reportedly rare, there are no specific measures to ensure that they are not misused for Money Laundering.

R.34. Legal Arrangements beneficial owners

*Only 10.9 % of the countries are compliant with R.34. 41.3% of the countries have missing values in this score.*

- Competent authorities have some powers to obtain access to information on the beneficial owner and control of certain legal arrangements; however, the mechanisms in place are not sufficient.
- In some countries, there is no standardisation of beneficial ownership data held, and the nature of information collected will vary with the provision of any relevant guidance.
- In some countries, providers of trust services who are not lawyers or accountants but are members of professional bodies, are not monitored for their AML/CFT obligations, and therefore it is not clear how reliable the information they maintain would be.

**6.2.3.2. Factors Underlying Rating of Compliance with Special Institutional Recommendations on Terrorism Financing**

SR. IV Reporting suspicious transactions related to terrorism

- 60.9% of the countries evaluated should implement the report of suspicious transactions related to terrorism in financial institutions or other businesses or entities subject to anti-Money Laundering obligations, suspect or have reasonable

grounds to suspect that funds are linked or related to, or are to be used for terrorism, terrorist acts or by terrorist organisations, they should be required to promptly report their suspicious to the competent authorities.

- Relevant institutions should be required to report and should be more aware of their obligation to report.
- There are no laws or regulations imposing suspicious transaction reporting obligations to financial institutions, when the transaction is suspected.

#### **6.2.4. Factors Underlying Rating of Compliance with International Cooperation Recommendations on Money Laundering**

This section analyses the weaknesses that undermine the compliance with the International Cooperation on ML and FT.

##### **6.2.4.1 Factors Underlying Rating of Compliance with International Cooperation Recommendations on Money Laundering**

###### R.35. Convention

Only 8.7% of the countries are compliant with the R.35.

- Some countries have not fully implemented the CFT Convention because of insufficient measures to identify beneficial owners of accounts and transactions as required in article 18 of this Convention.

###### R.36. Mutual Legal Assistance (MLA)

26.1% of the countries are totally compliant with R.36.

- But there still remain concerns about the ability of some national authorities to handle mutual legal assistance requests in a timely and effective manner.
- Some countries are unable to ensure timely and effective turnaround of all routine requests.

In practice, this has meant that the authorities' power to cooperate is affected by the absence of clear rules. The lack of clear rules in 'mutual legal assistance' renders the process of international cooperation and the sharing of information less systematic. Nepal is not compliant with the Mutual Legal Assistance and the Countries partially compliant with the MLA are: Vanuatu, Syria, Sudan, Sri Lanka, Samoa, India, Dominican Rep, Chile and Brunei.

### R.37. Dual Criminality

45.7 % of the countries are compliant with dual criminality.

- Some countries refuse MLA requests where dual criminality requirements are not met.
- There are only statistics for extradition requests in high income countries, and it is difficult to assess whether the legislation has been fully implemented.  
Brunei, Dominican Republic, Iceland, India, Nepal, Samoa, Slovakia, and Syria are not compliant or only partially compliant.

### R.38. MLA on confiscation and freezing

Some countries have no measures or procedures that will allow extradition requests and proceedings for ML to be enforced without undue delay.

Brunei and Nepal are not compliant.

Bolivia, Colombia, Dominican Republic, India, Jamaica, Latvia, Norway, Peru, Samoa, Slovakia, Sudan, Syria, Turkey, and Georgia are only partially compliant.

### R.39. Extradition

45% of the countries are totally compliant with R.39.

- Some countries have no measures or procedures that will allow extradition requests and proceedings for ML to be handled without undue delay (Bolivia, India, Nepal, Samoa, Brunei, Gibraltar, and Sudan).

### R.40. Other forms of cooperation

- In some countries apart from FIU there are no legislative gateways or mechanisms that authorise other competent authorities to cooperate and exchange information with its foreign counterparts.
- In some countries, there are no legislative gateways or mechanisms that identify the information that can be requested and establish controls and safeguards to ensure that the information is used in an authorised manner.

## **6.2.4.2 Factors Underlying the Rating of Compliance with International Cooperation Recommendations on Terrorist Financing**

### SR.V. International Cooperation

41.3% of the countries should allow another country, on the basis of a treaty, arrangement or other mechanism for mutual assistance and information exchange and ensure they do not provide safe havens for individuals charged with the financing of terrorism, terrorist



acts or terrorist organisations, and should have procedures in place to extradite such individuals where possible.

- In some countries a Mutual Legal Assistance Order that contains all of the necessary elements with respect to AML/CFT needs to be introduced.
- International cooperation to foreign counterpart is sometimes limited and given on an ad hoc basis.
- There is limited regulatory cooperation with overseas regulators of financial institutions.
- There is no authority for Financial Intelligence Unit to share financial intelligence with other FIUs.

### 6.3. Results of Testing Theory

This section provide the results of the most important bivariate correlations tested

#### 6.3.1. Bivariate Correlations Providing Support for the Posited Hypotheses

The quantitative study results using bivariate correlations provide support for the majority of the posited hypotheses in Chapter V. Looking at the bivariate results in Tables 6.5, the findings are the following:

- The bivariate correlation coefficient between ratifications of Money Laundering Convention variable (RATML) and the overall compliance with the AML/CFT scores variable (YOCAML) is +0.381\*\*, indicating a moderate positive linear relationship in the sample.
- The bivariate correlation coefficient between the ratifications of Terrorism Financing variable (RATFT) and the overall compliance with the AML/CFT scores variables (YOCAML) is +0.350\*, indicating a moderate positive linear relationship in the sample.
- The bivariate correlation coefficients between some of the preconditions of governance such as the regulatory quality indicator (RQ) and the control of the corruption indicator (CO) and the overall compliance with the AML/CFT scores variable (YOCAML) are positive, indicating a positive linear relationship.  
RQ/ YOCAML is +0.668\*\* indicating a strong positive linear relationship within the sample.  
CO/ YOCAML is +0.548\*\* indicating a strong positive linear relationship within the sample.  
Countries with high indicator values for the national regulatory quality framework tend to have a high overall compliance scores with the AML/CFT.  
Countries with high indicator values for the control of corruption tends to have a high overall compliance with the AML/CFT.
- The bivariate correlation coefficient between the country attractiveness to Money Laundering variable (ATML) and the overall compliance with the AML-CFT scores variable (YOCAML) is 0.558\*\*, indicating a strong positive linear relationship in the sample. Countries with the highest index of attractiveness to ML tend to have the highest overall compliance with the AML/CFT Regime.

- The bivariate correlation coefficient between Cross Border Assets/GDP variable (COBAS) and the overall compliance with AML/CFT scores (YOCAML) is 0.358\*, indicating a moderate positive linear relationship in the sample.
- The bivariate correlation coefficient between the ratio of informal remittance/GDP (indicator of a cash economy) and the overall compliance with the AML/CFT scores (YOCAML) is - 0.437\*\*, indicating a moderate negative linear relationship in the sample.
- The bivariate correlation coefficient between the ratio of the net financial service variable (indicator of the offshore center financial services) and the overall compliance with AML/CFT scores (YOCAML) is 0.005, indicating a very weak positive linear relationship in the sample.
- The bivariate correlation coefficient between the index of failed states variable (FS) and the overall compliance with the AML/CFT scores is -0.640\*\*, indicating a strong negative linear relationship in the sample.  
A higher index of failed states indicates a low overall compliance with AML/CFT scores.
- The bivariate correlation coefficient between The Risk of Terrorism Financing variable (RITF) and the overall compliance with the AML/CFT scores (YOCAML) is -0.381\*\*, indicating a moderate positive linear relationship in the sample of 46 countries.
- The bivariate correlation coefficient between the Egmond Group variable (EG) and the overall compliance with the AML/CFT scores (YOCAML) is +0.463\*\*, indicating a moderate positive linear relationship in the sample of 46 countries.
- The bivariate correlation coefficient between Multilateral Institutions variable (MI) and the overall compliance with the AML/CFT scores (YOCAML) is +0.498\*\*, indicating a moderate positive linear relationship in the sample of 46 countries.

Table 6.5a. Correlations between the most important independent variables and dependent variable subgroups

| Variables | YOCML   | YOCFT  | YOCAML  | Ln YOCML | Ln YOCFT | Ln YOCAML | ATML    | RITF   | ASISH   | INRE    | COBAS  | COBLIS | GDP    | REFS    | MI     | RATML  | RATFT |
|-----------|---------|--------|---------|----------|----------|-----------|---------|--------|---------|---------|--------|--------|--------|---------|--------|--------|-------|
| YOCML     | 1       |        |         |          |          |           |         |        |         |         |        |        |        |         |        |        |       |
| YOCFT     | .771**  | 1      |         |          |          |           |         |        |         |         |        |        |        |         |        |        |       |
| YOCAML    | .990**  | .853** | 1       |          |          |           |         |        |         |         |        |        |        |         |        |        |       |
| Ln YOCML  | .962**  | .724** | .947**  | 1        |          |           |         |        |         |         |        |        |        |         |        |        |       |
| Ln YOCFT  | .737**  | .936** | .808**  | .731**   | 1        |           |         |        |         |         |        |        |        |         |        |        |       |
| Ln YOCAML | .964**  | .805** | .968**  | .991**   | .809**   | 1         |         |        |         |         |        |        |        |         |        |        |       |
| ATML      | .536**  | .546** | .558**  | .507**   | .518**   | .530**    | 1       |        |         |         |        |        |        |         |        |        |       |
| RITF      | -.390** | -.283  | -.381** | -.443**  | -.248    | -.424**   | -.411** | 1      |         |         |        |        |        |         |        |        |       |
| ASISH     | -.25    | -.372* | -.285   | -.191    | -.333*   | -.236     | -.215   | -.357* | 1       |         |        |        |        |         |        |        |       |
| INRE      | -.455** | -.295  | -.437** | -.459**  | -.312    | -.449**   | -.395*  | .390*  | .074    | 1       |        |        |        |         |        |        |       |
| COBAS     | .332*   | .386** | .358*   | .311*    | .335*    | .333*     | .458**  | -.211  | -.05    | -.218   | 1      |        |        |         |        |        |       |
| COBLIS    | .155    | .121   | .157    | .161     | .113     | .159      | .343*   | -.17   | .304    | -.106   | .642** | 1      |        |         |        |        |       |
| GDP       | .227    | .375*  | .27     | .202     | .276     | .234      | .148    | -.09   | -.1     | -.144   | -.043  | -.071  | 1      |         |        |        |       |
| REFS      | -.028   | .133   | .005    | -.027    | .137     | .005      | .204    | -.068  | -.022   | -.115   | .646** | -.052  | -.052  | 1       |        |        |       |
| MI        | .451**  | .594** | .498**  | .425**   | .533**   | .465**    | .448**  | -.19   | -.347*  | -.413** | -.015  | -.14   | .499** | -.232   | 1      |        |       |
| RATML     | .380**  | .318*  | .381**  | .405**   | .268     | .404**    | .184    | -.153  | -.3     | -.329*  | -.213  | -.252  | .185   | -.461** | .488** | 1      |       |
| RATFT     | .333*   | .356*  | .350*   | .353*    | .361*    | .370*     | .263    | .001   | -.456** | -.176   | -.259  | -.254  | .147   | -.450** | .542** | .687** | 1     |

Correlations calculated using STATA v9.2.

\*\* p < .01

\* p < .05

n=46

Table 6.5b Correlations Between the Most Important Institutional Independent Variable and Dependent Variable Subgroups

| Variables | YOCML   | YOCFT   | YOCAML  | Ln YOCML | Ln YOCFT | Ln YOCAML | RQ      | CO      | FS      | EG |
|-----------|---------|---------|---------|----------|----------|-----------|---------|---------|---------|----|
| YOCML     | 1       |         |         |          |          |           |         |         |         |    |
| YOCFT     | .771**  | 1       |         |          |          |           |         |         |         |    |
| YOCAML    | .990**  | .853**  | 1       |          |          |           |         |         |         |    |
| Ln YOCML  | .962**  | .724**  | .947**  | 1        |          |           |         |         |         |    |
| Ln YOCFT  | .737**  | .936**  | .808**  | .731**   | 1        |           |         |         |         |    |
| Ln YOCAML | .964**  | .805**  | .968**  | .991**   | .809**   | 1         |         |         |         |    |
| RQ        | .656**  | .608**  | .668**  | .639**   | .610**   | .656**    | 1       |         |         |    |
| CO        | .541**  | .489**  | .548**  | .540**   | .507**   | .550**    | .883**  | 1       |         |    |
| FS        | -.629** | -.574** | -.640** | -.641**  | -.589**  | -.653**   | -.880** | -.913** | 1       |    |
| EG        | .502**  | 0,257   | .463**  | .520**   | 0,237    | .484**    | .527**  | .489**  | -.561** | 1  |

Correlations calculated using STATA v9.2.

n=46

\*\* p.<01 Correlation is significant at the 0.01 level (2-tailed).

\*p.<05 Correlation is significant at the 0.05 level

### **6.3.1.1. Bivariate Correlations between Subgroups of Dependent Variables and concepts**

Table 6.6 shows:

- The bivariate correlation between the Y Sum of FATF Legal Recommendations Scores on ML variable (YLEML) and the Y Sum of FATF Preventive Recommendations Scores on ML variable (YPRML) is + 0.673\*\*, indicating a strong positive linear relationship. This means that the countries with the highest scores with legal Recommendations compliance (ML) have the highest scores on the preventive Recommendations compliance.
- The bivariate correlation between the Y Sum of FATF Legal Recommendations Scores on the ML variable (YLEML) and the Y Sum of FATF Institutional Recommendations Scores on ML variable (YINML) is + 0.763\*\*, indicating a very strong positive linear relationship. This means that countries with the highest scores on legal Recommendations compliance have the best developed national regulatory systems.
- The bivariate correlation between the Y Sum of FATF Legal Recommendations Scores on ML variable (YLEML) and the Y Sum of FATF International Cooperation Recommendations Scores on ML variable (YICML) is + 0.632\*\*, indicating a strong positive linear relationship. This means that the countries with the highest scores on the legal Recommendations compliance have the highest scores on International Cooperation on ML.
- The bivariate correlation between the Y Sum of FATF Legal Recommendations Scores on ML variable (YLEML) and the Y Sum of FATF Legal Special Recommendations Scores on ML variable (YLEFT) is + 0.607\*\*, indicating a strong positive linear relationship. This means that countries with the highest scores on legal Recommendations compliance have the highest scores on Legal Special Recommendations Compliance. It seems that the countries with the best developed and strongest AML Regimes have also more facility to extend the Regime to the Financing of terrorism aspects.
- The bivariate correlation between the Y Sum of FATF International Cooperation Recommendations Scores on ML variable (YICML) and the Y Sum of FATF

International Cooperation Special Recommendations Scores on FT variable (YICFT) is + 0.717\*\*, indicating a very strong positive linear relationship. This means that the countries with the best scores on International Cooperation on ML also have the best scores also on International Cooperation on FT.

- The bivariate correlation between the Y Sum of FATF Institutional Recommendations Scores on ML variable (YINML) and the Y Sum of FATF Institutional Special Recommendations Scores on FT variable (YINFT) is + 0.398\*\*, indicating a moderate positive linear relationship.
- The bivariate correlation between the Y Sum of FATF Legal Special Recommendations Scores on FT variable (YLEFT) and the Y Sum of FATF Preventive Special Recommendations Scores on FT variable (YPRFT) is + 0.302\*, indicating a moderate positive linear relationship.

#### **6.3.1.2. Bivariate correlations between dependent variable and legal Group of Independent Variables**

Table 6.7 shows the following results:

- The bivariate correlation between the ratifications on Money Laundering International Convention variable (RATML) and the ratifications on Terrorism International Convention variable (RATFT) is +0.687\*\*, indicating a strong positive linear relationship. This means that countries with most ratifications on Money Laundering have the most ratifications on Terrorism.
- The bivariate correlation between the ratifications on Money Laundering International Convention variable (RATML) and the Y Sum of the FATF Legal Recommendations Scores on ML variable (YLEML) is + 0.455\*\*, indicating a moderate linear relationship.
- The bivariate correlation between the ratifications on Money Laundering International Convention variable (RATML) and the Y Sum of the FATF Preventive Recommendations Scores on ML variable (YPRML) is +0.214, indicating a weak positive linear relationship. This means that ratifications do not imply a development of a regulatory framework according to the ratified Convention.

- The bivariate correlation between The ratifications on Money Laundering International Convention variable (RATML) and the Y Sum of FATF Institutional Recommendations Scores on ML variable (YINML) is + 0.333\*, indicating a moderate positive linear relationship.
- The bivariate correlation between The ratifications on Money Laundering International Convention variable (RATML) and the Y Sum of FATF International Cooperation Recommendations Scores on ML variable (YICML) is +0.506\*\*, indicating a strong positive linear relationship. This means that the countries with the most Ratifications on international Money Laundering Conventions are the countries with the highest scores for International cooperation on Money Laundering.
- The bivariate correlation between the ratifications on Terrorism Financing International Convention variable (RATFT) and the Y Sum of FATF Special Legal Recommendations scores variable (YLEFT) is +0.382\*\*, indicating a moderate positive linear relationship.
- The bivariate correlation between the ratifications on Terrorism Financing International Convention variable (RATFT) and the Y Sum of FATF Special Legal Recommendations scores variable (YPRFT) is +0.112, indicating a weak positive linear relationship.
- The bivariate correlation between the ratifications on Terrorism Financing International Convention variable (RATFT) and the Y Sum of FATF Special Legal Recommendations scores variable (YINFT) is +0.234, indicating a weak positive linear relationship.
- The bivariate correlation between The ratifications on Terrorism Financing International Convention variable (RATFT) and the Y Sum of FATF Legal Special Recommendations scores variable (YICFT) is +0.449\*\*, indicating a moderate positive linear relationship. It means that countries with the highest scores in Special Legal Recommendations variables have the highest scores in the Special International Cooperation Recommendations.



Table 6.6 Correlations between Y Subgroups and Concepts

| Variables | YLEML  | YPRML  | YINML  | YICML  | YLEFT  | YPRFT | YINFT  | YICFT |
|-----------|--------|--------|--------|--------|--------|-------|--------|-------|
| YLEML     | 1      |        |        |        |        |       |        |       |
| YPRML     | .673** | 1      |        |        |        |       |        |       |
| YINML     | .763** | .759** | 1      |        |        |       |        |       |
| YICML     | .632** | .462** | .648** | 1      |        |       |        |       |
| YLEFT     | .607** | .474** | .523** | .538*  | 1      |       |        |       |
| YPRFT     | .425** | .617** | .607** | .352** | .302*  | 1     |        |       |
| YINFT     | .545** | .428** | .398** | .410** | .659** | .247  | 1      |       |
| YICFT     | .471** | .580** | .614** | .717** | .670** | .376* | .437** | 1     |

Correlations calculated using STATA v9.2.

n=46                   \*\*                   p.<01  
                          \*                   p.<05

Table 6.7. Bivariate Correlations between Subgroups of Y and Legal Group of Independent Variables

| Variables | YLEML  | YPRML  | YINML  | YICML  | YLEFT  | YPRFT | YINFT  | YICFT  | RATML  | RATFT |
|-----------|--------|--------|--------|--------|--------|-------|--------|--------|--------|-------|
| YLEML     | 1      |        |        |        |        |       |        |        |        |       |
| YPRML     | .673** | 1      |        |        |        |       |        |        |        |       |
| YINML     | .763** | .759** | 1      |        |        |       |        |        |        |       |
| YICML     | .635** | .462** | .648** | 1      |        |       |        |        |        |       |
| YLEFT     | .607** | .474** | .523** | .538*  | 1      |       |        |        |        |       |
| YPRFT     | .425** | .617** | .607** | .352** | .302*  | 1     |        |        |        |       |
| YINFT     | .545** | .428** | .398** | .410** | .659** | .247  | 1      |        |        |       |
| YICFT     | .471** | .580** | .614** | .717** | .670** | .376* | .437** | 1      |        |       |
| RATML     | .455** | .214   | .333*  | .506** | .220   | .244  | .186   | .349*  | 1      |       |
| RATFT     | .404** | .200   | .250   | .476** | .382** | .112  | .234   | .449** | .687** | 1     |

Correlations calculated using STATA v9.2.

n=46                   \*\*                   p.<01  
                          \*                   p.<05

Table 6.8 Bivariate Correlations between Institutional Independent Variables and Subgroups of Dependent Variable

| Variables | VoiAcc  | PolStab | GovEffect | RQ      | RulLaw  | CO      | FS      | Conflicts | MI     | RATML  | RATFT  | YLEML  | YPRML  | YINML  | YICML  | YLEFT  | YPRFT | YINFT  | YICFT |  |
|-----------|---------|---------|-----------|---------|---------|---------|---------|-----------|--------|--------|--------|--------|--------|--------|--------|--------|-------|--------|-------|--|
| VoiAcc    | 1       |         |           |         |         |         |         |           |        |        |        |        |        |        |        |        |       |        |       |  |
| PolStab   | .690**  | 1       |           |         |         |         |         |           |        |        |        |        |        |        |        |        |       |        |       |  |
| GovEffect | .213    | .250    | 1         |         |         |         |         |           |        |        |        |        |        |        |        |        |       |        |       |  |
| RQ        | .833**  | .722**  | .304**    | 1       |         |         |         |           |        |        |        |        |        |        |        |        |       |        |       |  |
| RulLaw    | .789**  | .783**  | .315**    | .897**  | 1       |         |         |           |        |        |        |        |        |        |        |        |       |        |       |  |
| CO        | .775**  | .740**  | .0271     | .883**  | .952**  | 1       |         |           |        |        |        |        |        |        |        |        |       |        |       |  |
| FS        | -.859** | -.803** | -.0274    | -.880** | -.902** | -.913** | 1       |           |        |        |        |        |        |        |        |        |       |        |       |  |
| Conflicts | -.256   | -.492** | .022      | -.295** | -.306** | -.0264  | .383**  | 1         |        |        |        |        |        |        |        |        |       |        |       |  |
| MI        | .486**  | .362**  | .198      | .649**  | .592**  | .536**  | -.596** | -.142     | 1      |        |        |        |        |        |        |        |       |        |       |  |
| RATML     | .370**  | 0.243   | 0.254     | .389**  | 0.283   | .335**  | -.454** | -.011     | .488** | 1      |        |        |        |        |        |        |       |        |       |  |
| RATFT     | .422**  | .308**  | 0.158     | .472**  | .384**  | .421**  | -.513** | -.097     | .542** | .687** | 1      |        |        |        |        |        |       |        |       |  |
| YLEML     | .594**  | .444**  | .204      | .626**  | .539    | .575**  | -.612   | -.300     | .415** | .455** | .404** | 1      |        |        |        |        |       |        |       |  |
| YPRML     | .471**  | .298    | .182      | .518**  | .444**  | .404**  | -.484** | -.014     | .284** | .214   | .200   | .673** | 1      |        |        |        |       |        |       |  |
| YINML     | .502**  | .343    | .173      | .610**  | .439**  | .464**  | -.545** | -.312     | .449** | .333*  | .250   | .763** | .759** | 1      |        |        |       |        |       |  |
| YICML     | .469**  | .363    | -.21      | .472**  | .348**  | .423**  | -.494** | -.287     | .541** | .506** | .476** | .635** | .462** | .648** | 1      |        |       |        |       |  |
| YLEFT     | .496**  | .400**  | .179      | .534**  | .507**  | .485**  | -.568** | -.227     | .517** | .220   | .382** | .607** | .474** | .523** | .538*  | 1      |       |        |       |  |
| YPRFT     | .086    | .109    | .173      | .289    | .167    | .118    | -.176   | -.105     | .359   | .244   | .112   | .425** | .617** | .607** | .352** | .302*  | 1     |        |       |  |
| YINFT     | .452**  | .393**  | .091      | .581**  | .563**  | .546**  | -.540   | -.107     | .429** | .186   | .234   | .545** | .428** | .398** | .410** | .659** | .247  | 1      |       |  |
| YICFT     | .500**  | .496**  | .170**    | .573**  | .518**  | .520**  | -.655** | -.415**   | .548** | .349*  | .449** | .471** | .580** | .614** | .717** | .670** | .376* | .437** | 1     |  |

Correlations calculated using STATA v9.2.

n=46

\*\* p<.01

\* p<.05

### 6.3.1.3. Bivariate Correlations Between Dependent Variable and the Institutional Group of Independent Variables

This section shows the following findings on the basis of the above:

The countries with the best indicators of governance, high participation in multilateral institutions, and the best indicators of economic freedom are highly and positively correlated with the overall compliance. Despite the lack of mutual evaluations reports for all the members in each FSRBs, European OECD Countries participating in FATF are the most compliant countries. The APGML countries seem to have difficulty to be compliant with Money Laundering aspects as well as the overall compliance with the AML/CFT.

Gafisud country members show negative correlations with the overall compliance on the FT concept.

- The results in Table 6.9 shows that there is a strong positive correlation between some governance indicators and the overall compliance with AML/CFT, the overall compliance on ML concept as well as with the overall compliance on TF.
- The bivariate correlation coefficient between the failed states (FS) variable and the overall compliance with AML/CFT is  $-0.640^{**}$ , indicating a strong negative correlation linear relationship. The countries considered failed states have the least overall compliance with the AML/CFT.
- The bivariate correlation coefficient between the failed states (FS) variable and the overall compliance with the FT concept is  $-0.574^{**}$ , indicating a strong negative correlation linear relationship. The countries considered failed states tend to have least overall compliance with the AML/CF Regime, and they also have least overall compliance on FT issues.
- The bivariate correlation coefficient between the regulatory quality framework variable (RQ) and the Y sum of FATF Legal Recommendations scores on ML variable (YLEML) is  $+0.626^{**}$ , indicating a strong positive linear relationship in the sample. The countries with the highest values on RQ have higher overall compliance scores on Money Laundering legal Recommendations.

- The bivariate correlation coefficient between the regulatory quality framework variable (RQ) and the Y sum of FATF Preventive Recommendations scores on ML variable (YPRML) is  $+0.518^{**}$ , indicating a strong positive linear relationship in the sample. The countries with the highest values on RQ have developed the best preventive Regimes on ML.
- The bivariate correlation coefficient between the regulatory quality framework variable (RQ) and the Y sum of FATF Institutional Recommendations Scores on ML variable (YINML) is  $+0.610^{**}$ , indicating a strong positive linear relationship in the sample. The countries with the highest values on RQ tend to have the best national regulator authorities.
- The bivariate correlation coefficient between the regulatory quality framework variable (RQ) and the Y sum of FATF International Cooperation Recommendations Scores on ML variable (YICML) is  $+0.472^{**}$ .
- The bivariate correlation between the regulatory quality framework variable (RQ) and the Y Sum of FATF Legal Special Recommendations Scores variable (YLEFT) is  $+0.534^{**}$ , indicating a strong positive linear relationship.
- The bivariate correlation coefficient between the regulatory quality framework variable (RQ) and the Y sum of FATF Preventive Special Recommendations Scores on ML variable (YPRFT) is  $+0.289$ , indicating a moderate positive linear relationship in the sample.
- The bivariate correlation coefficient between the regulatory quality framework variable (RQ) and the Y sum of FATF Institutional Special Recommendations Scores on ML variable (YINFT) is  $+0.581^{**}$ , indicating a strong positive linear relationship in the sample. The countries with the highest values on RQ tend to have the best national regulator authorities on FT.
- The bivariate correlation between the ratifications on Terrorism Financing International Convention variable (RATFT) and the Y Sum of FATF International Cooperation Special Recommendations Scores variable (YICFT) is  $+0.449^{**}$ , indicating a moderate positive linear relationship.

Table 6.9. Correlations between the Institutional Group of Dependent Variables and the Overall Compliance with AML/CFT

| Variables | YOCML   | YOCFT   | YOCAML  | LnYOCML | LnYOCFT | LnYOCAML | VoiAcc  | PolStab | GovEffect | RQ      | Rullaw  | CO      | TI    | FS      | Conflicts | EG     | EcoFree | RATML  | RATFT |
|-----------|---------|---------|---------|---------|---------|----------|---------|---------|-----------|---------|---------|---------|-------|---------|-----------|--------|---------|--------|-------|
| YOCML     | 1       |         |         |         |         |          |         |         |           |         |         |         |       |         |           |        |         |        |       |
| YOCFT     | .771**  | 1       |         |         |         |          |         |         |           |         |         |         |       |         |           |        |         |        |       |
| YOCAML    | .990**  | .853**  | 1       |         |         |          |         |         |           |         |         |         |       |         |           |        |         |        |       |
| LnYOCML   | .962*** | .724**  | .947**  | 1       |         |          |         |         |           |         |         |         |       |         |           |        |         |        |       |
| LnYOCFT   | .737*** | .936**  | .808**  | .731**  | 1       |          |         |         |           |         |         |         |       |         |           |        |         |        |       |
| LnYOCAML  | .964**  | .805**  | .968**  | .991**  | .809**  | 1        |         |         |           |         |         |         |       |         |           |        |         |        |       |
| VoiAcc    | .619**  | .453**  | .605**  | .623**  | .435**  | .606**   | 1       |         |           |         |         |         |       |         |           |        |         |        |       |
| PolStab   | .470**  | .408**  | .474**  | .545**  | .490**  | .546**   | .690**  | 1       |           |         |         |         |       |         |           |        |         |        |       |
| GovEffect | .149    | .194    | .167    | .116    | .154    | .136     | .213    | .25     | 1         |         |         |         |       |         |           |        |         |        |       |
| RQ        | .656**  | .608**  | .668**  | .639**  | .610**  | .656**   | .833**  | .722**  | .304*     | 1       |         |         |       |         |           |        |         |        |       |
| Rullaw    | .545**  | .523**  | .561**  | .545**  | .529**  | .559**   | .789**  | .783**  | .315*     | .897**  | 1       |         |       |         |           |        |         |        |       |
| CO        | .541**  | .489**  | .548**  | .540**  | .507**  | .550**   | .775**  | .740**  | .271      | .883**  | .952**  | 1       |       |         |           |        |         |        |       |
| TI        | .019    | .112    | .036    | .022    | .127    | .03      | .076    | .021    | .138      | .187    | .126    | .126    | 1     |         |           |        |         |        |       |
| FS        | -.629** | -.574** | -.640** | -.641** | -.589** | -.653**  | -.859** | -.803** | -.274     | -.880** | -.902** | -.913** | -.087 | 1       |           |        |         |        |       |
| Conflicts | -.276   | -.252   | -.28    | -.355*  | -.248   | -.346*   | -.256   | -.492** | .022      | -.295*  | -.306*  | -.264   | -.105 | -.383*  | 1         |        |         |        |       |
| EG        | .502**  | .257    | .463**  | .520**  | .237    | .484**   | .623**  | .375*   | -.027     | .527**  | .378*   | .489**  | -.315 | -.561** | -.094     | 1      |         |        |       |
| EcoFree   | .580**  | .549**  | .595**  | .573**  | .487**  | .586**   | .751**  | .627**  | .24       | .870**  | .824**  | .820**  | .072  | -.793** | -.296     | .425** | 1       |        |       |
| RATML     | .380**  | .318*   | .381**  | .405**  | .268    | .404**   | .370*   | .243    | .254      | .389**  | .283    | .335*   | -.069 | -.454** | -.111     | .391** | .395*   | 1      |       |
| RATFT     | .333*   | .356*   | .350*   | .353*   | .361*   | .370*    | .422**  | .308*   | .158      | .472**  | .384**  | .421**  | -.05  | -.513** | -.097     | .288   | .464**  | .687** | 1     |

Correlations calculated using STATA v9.2.

n=46

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p<.01

\*

p<.05

Table 6.10. Correlations between Multilateral Institutions and the overall compliance with AML/CFT

| Variables | YOCML  | YOCFT  | YOCAML | LnYOCML | LnYOCFT | LnYOCAML | MI     | G8     | G20    | IMF     | WB     | OECD   | FAFT   | EC     | MONEY | APGML  | GAFISUD | CFATF | EAG   | MENAF  | GCC    | OGBS  | RATML  |  |
|-----------|--------|--------|--------|---------|---------|----------|--------|--------|--------|---------|--------|--------|--------|--------|-------|--------|---------|-------|-------|--------|--------|-------|--------|--|
| YOCML     | 1      |        |        |         |         |          |        |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| YOCFT     | .771** | 1      |        |         |         |          |        |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| YOCAML    | .990** | .853** | 1      |         |         |          |        |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| LnYOCML   | .962** | .724** | .947** | 1       |         |          |        |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| LnYOCFT   | .737** | .936** | .808** | .731**  | 1       |          |        |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| LnYOCAML  | .964** | .805** | .968** | .991**  | .809**  | 1        |        |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| MI        | .451** | .594** | .498** | .425**  | .533**  | .465**   | 1      |        |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| G8        | .283   | .459** | .334*  | .241    | .319*   | .278     | .612** | 1      |        |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| G20       | .096   | .282   | .144   | .113    | .242    | .147     | .573** | .623** | 1      |         |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| IMF       | -.08   | -.016  | -.073  | -.094   | -.016   | -.087    | .466** | .056   | .09    | 1       |        |        |        |        |       |        |         |       |       |        |        |       |        |  |
| WB        | -.08   | -.016  | -.073  | -.094   | -.016   | -.087    | .466** | .056   | .09    | 1.000** | 1      |        |        |        |       |        |         |       |       |        |        |       |        |  |
| OECD      | .405** | .439** | .428** | .380**  | .417**  | .402**   | .692** | .345*  | .303*  | .163    | .163   | 1      |        |        |       |        |         |       |       |        |        |       |        |  |
| FAFT      | .308*  | .435** | .348*  | .316*   | .406**  | .347*    | .672** | .380** | .480** | .148    | .148   | .812** | 1      |        |       |        |         |       |       |        |        |       |        |  |
| EC        | .495** | .470** | .507** | .428**  | .427**  | .445**   | .540** | .208   | -.017  | .141    | .141   | .472** | .245   | 1      |       |        |         |       |       |        |        |       |        |  |
| MONEYVAL  | .219   | .109   | .204   | .194    | .155    | .191     | .073   | -.121  | -.194  | .098    | .098   | .098   | -.319* | .444** | 1     |        |         |       |       |        |        |       |        |  |
| APGML     | -.312* | -.165  | -.291* | -.339*  | -.163   | -.321*   | -.056  | .111   | .125   | -.183   | -.183  | -.114  | -.074  | -.303* | -.211 | 1      |         |       |       |        |        |       |        |  |
| GAFISUD   | -.028  | -.349* | -.106  | .007    | -.400** | -.068    | -.265  | -.102  | -.164  | .083    | .083   | -.297* | -.269  | -.256  | -.178 | -.178  | 1       |       |       |        |        |       |        |  |
| CFATF     | .023   | .02    | .02    | -.036   | -.006   | .026     | -.115  | -.07   | -.112  | .056    | .056   | -.202  | -.184  | -.175  | -.121 | -.121  | -.102   | 1     |       |        |        |       |        |  |
| EAG       | -.123  | .039   | -.088  | -.08    | .081    | -.046    | .014   | -.056  | .206   | .045    | .045   | -.163  | .079   | -.141  | -.098 | -.098  | -.083   | -.056 | 1     |        |        |       |        |  |
| MENAFATF  | -.13   | -.056  | -.117  | -.088   | .003    | -.075    | -.049  | -.07   | -.112  | .056    | .056   | -.202  | -.184  | -.175  | -.121 | -.121  | -.102   | -.07  | -.056 | 1      |        |       |        |  |
| GCC       | .027   | .076   | .034   | .046    | .089    | .053     | .122   | -.039  | -.063  | .032    | .032   | -.114  | -.104  | -.099  | -.068 | -.068  | -.058   | -.032 | -.032 | .564** | 1      |       |        |  |
| OGBS      | .171   | .254   | .198   | .162    | .231    | .185     | -.03   | -.092  | -.148  | -.268   | -.268  | -.267  | -.243  | -.079  | .024  | .024   | -.135   | .191  | -.074 | .191   | .427** | 1     |        |  |
| RATML     | .380** | .318*  | .381** | .405**  | .268    | .404**   | .488** | .074   | .164   | .384**  | .384** | .487** | .353*  | .257   | .02   | -.306* | .255    | -.026 | .1    | -.126  | -.015  | -.193 | 1      |  |
| RATFT     | .333*  | .356*  | .350*  | .353*   | .361*   | .370*    | .542** | .163   | .172   | .653**  | .653** | .405** | .326*  | .372*  | .219  | -.371* | .096    | -.161 | .053  | -.161  | -.018  | -.222 | .687** |  |

Correlations calculated using STATA v9.2.

n=46

\*\* p<.01

\* p<.05

Table 6.11. Correlations between Jurisdictions' financial system size and the overall compliance with AML/CFT

| Variables                           | YOCML  | YOCFT   | YOCAML  | LnYOCML | LnYOCFT | LnYOCAML | SBFS    | SFSD    | NIM     | SLI    | SNLI   | COBAS  | COBLI  | GDP   | REFS    | OGBS  | RATML  | RATML |  |
|-------------------------------------|--------|---------|---------|---------|---------|----------|---------|---------|---------|--------|--------|--------|--------|-------|---------|-------|--------|-------|--|
| YOCML                               | 1      |         |         |         |         |          |         |         |         |        |        |        |        |       |         |       |        |       |  |
| YOCFT                               | .771** | 1       |         |         |         |          |         |         |         |        |        |        |        |       |         |       |        |       |  |
| YOCAML                              | .990** | .853**  | 1       |         |         |          |         |         |         |        |        |        |        |       |         |       |        |       |  |
| LnYOCML                             | .962** | .724**  | .947**  | 1       |         |          |         |         |         |        |        |        |        |       |         |       |        |       |  |
| LnYOCFT                             | .737** | .936**  | .808**  | .731**  | 1       |          |         |         |         |        |        |        |        |       |         |       |        |       |  |
| LnYOCAML                            | .964** | .805**  | .968**  | .991**  | .809**  | 1        |         |         |         |        |        |        |        |       |         |       |        |       |  |
| Bank                                |        |         |         |         |         |          |         |         |         |        |        |        |        |       |         |       |        |       |  |
| Deposits/GDP (SBFS)                 | .420*  | .615**  | .486**  | .388*   | .546**  | .449**   | 1       |         |         |        |        |        |        |       |         |       |        |       |  |
| Financial System Deposit/GDP (SFSD) | .407*  | .588**  | .469**  | .374*   | .510**  | .431*    | .996**  | 1       |         |        |        |        |        |       |         |       |        |       |  |
| Net Interest_Margin (NIM)           | -.416* | -.435** | -.434** | -.375*  | -.451** | -.406*   | -.622** | -.602** | 1       |        |        |        |        |       |         |       |        |       |  |
| Life Insurance/GDP (SLI)            | .493** | .633**  | .547**  | .452*   | .562**  | .497**   | .641**  | .627**  | -.539** | 1      |        |        |        |       |         |       |        |       |  |
| NonLife_Insurance/GDP (SNLI)        | .578** | .654**  | .621**  | .524**  | .565**  | .560**   | .698**  | .697**  | -.387   | .747** | 1      |        |        |       |         |       |        |       |  |
| COBAS                               | .332*  | .386**  | .358*   | .311*   | .335*   | .333*    | .550**  | .550**  | -.389*  | .706** | .587** | 1      |        |       |         |       |        |       |  |
| COBLI                               | .155   | .121    | .157    | .161    | .113    | .159     | .215    | .211    | -.370*  | .032   | .173   | .642** | 1      |       |         |       |        |       |  |
| GDP                                 | .227   | .375*   | .27     | .202    | .276    | .234     | .116    | .106    | -.112   | .213   | .391*  | -.043  | -.071  | 1     |         |       |        |       |  |
| REFS                                | -.028  | .133    | .005    | -.027   | .137    | .005     | .263    | .261    | -.159   | -.035  | -.12   | .646** | .526** | -.052 | 1       |       |        |       |  |
| OGBS                                | .171   | .254    | .198    | .162    | .231    | .185     | .389*   | .371*   | -.202   | -.111  | -.089  | .543** | .361*  | -.099 | .381*   | 1     |        |       |  |
| RATML                               | .380** | .318*   | .381**  | .405**  | .268    | .404**   | .102    | .103    | -.069   | .086   | .22    | -.213  | -.252  | .185  | -.461** | -.193 | 1      |       |  |
| RATML                               | .333*  | .356*   | .350*   | .353*   | .361*   | .370*    | .271    | .265    | -.369*  | .218   | .197   | -.259  | -.254  | .147  | -.450** | -.222 | .687** | 1     |  |

Correlations calculated using STATA v9.2.

n=46

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p.<.01

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p.<.05

| Variables                         | YOCAML  | Ln YOCAML | Vienna Conv | Crimi ML bey drugs | Palermo Conv | Corruption conv | Antiribbery Conv n 1997 | UN FT Conv tion | Criminalize d FT | RATML   | RATTF   | RQ      | CO      | FS      | Economic F | ATML    | RITF  | INRE | COBAS  | COBLI   | GDP | REFS  | OGBS |
|-----------------------------------|---------|-----------|-------------|--------------------|--------------|-----------------|-------------------------|-----------------|------------------|---------|---------|---------|---------|---------|------------|---------|-------|------|--------|---------|-----|-------|------|
| YOCAML                            | 1       |           |             |                    |              |                 |                         |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Ln YOCAML                         | .968**  | 1         |             |                    |              |                 |                         |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Vienna Convention                 | -.136   |           | 1           |                    |              |                 |                         |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Criminalise ML beyond drugs       | .375*   |           | -.032       | 1                  |              |                 |                         |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Palermo_Convention                | .121    |           | .178        | .254               | 1            |                 |                         |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Corruption Convention             | .008    |           | .068        | -.183              | .152         | 1               |                         |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Antiribbery_Convention_199        | .444**  |           | .12         | .171               | -.051        | -.133           | 1                       |                 |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| UN Financing Terrorism Convention | .174    |           | .208        | .385**             | .234         | .199            | .178                    | .311*           |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| Criminalized Financing Terrorism  | .450**  |           | -.079       | .146               | -.014        | -.036           | .315*                   | .265            |                  |         |         |         |         |         |            |         |       |      |        |         |     |       |      |
| RATML                             | .381**  |           | .353*       | .384**             | .685**       | .411**          | .528**                  | .478**          | .172             | 1       |         |         |         |         |            |         |       |      |        |         |     |       |      |
| RATTF                             | .350*   |           | .511**      | .261               | .409**       | .177            | .428**                  | .711**          | .451**           | .687**  | 1       |         |         |         |            |         |       |      |        |         |     |       |      |
| RQ                                | .668**  |           | (a)         | .205               | .059         | -.25            | .711**                  | .294*           | .541**           | .389**  | .472**  | 1       |         |         |            |         |       |      |        |         |     |       |      |
| CO                                | .548**  |           | (a)         | .191               | -.006        | -.26            | .699**                  | .353*           | .489**           | .335*   | .421**  | .883**  | 1       |         |            |         |       |      |        |         |     |       |      |
| FS                                | -.640** |           | (a)         | -.308*             | -.037        | .196            | -.748**                 | -.308*          | -.542**          | -.454** | -.513** | -.880** | -.913** | 1       |            |         |       |      |        |         |     |       |      |
| Economic_F                        | .595**  |           | (a)         | .231               | .14          | -.179           | .553**                  | .324*           | .454**           | .395*   | .464**  | .870**  | .820**  | -.793** | 1          |         |       |      |        |         |     |       |      |
| ATML                              | .558**  |           | -.135       | .164               | -.141        | -.141           | .566**                  | .23             | .412**           | .184    | .263    | .761**  | .821**  | -.815** | .690**     | 1       |       |      |        |         |     |       |      |
| RITF                              | -.381** |           | .065        | -.383**            | .071         | .056            | -.251                   | .169            | -.24             | -.153   | .001    | -.426** | -.380*  | -.520** | -.406**    | -.411** | 1     |      |        |         |     |       |      |
| INRE                              | -.437** |           | (a)         | -.083              | .005         | -.124           | -.437**                 | -.217           | -.234            | -.329*  | -.176   | -.499** | -.533** | .520**  | -.347*     | -.395*  | .390* | 1    |        |         |     |       |      |
| COBAS                             | .358*   |           | -.729**     | .109               | -.194        | -.134           | .088                    | -.154           | .136             | -.213   | -.259   | .415**  | .450**  | -.440** | .531**     | -.458** | -.211 | -.22 | 1      |         |     |       |      |
| COBLI                             | .157    |           | .159        | .615**             | .089         | -.1             | .084                    | -.134           | .187             | -.252   | -.254   | .279    | .394**  | -.305*  | .372*      | .343*   | -.17  | -.11 | .642** | 1       |     |       |      |
| GDP                               | .27     |           | .234        | .043               | .104         | -.103           | .271                    | .033            | .137             | .185    | .147    | .221    | .113    | -.201   | .289       | .148    | -.09  | -.14 | -.043  | -.07    | 1   |       |      |
| REFS                              | .005    |           | .005        | -.824**            | (a)          | -.323           | -.058                   | -.321           | .117             | -.461** | -.450** | .073    | -.003   | -.066   | -.1        | .204    | -.068 | -.12 | .646** | -.526** | -.1 | 1     |      |
| OGBS                              | .198    |           | .185        | -.427**            | .074         | .009            | -.024                   | -.072           | .015             | -.193   | -.222   | .03     | -.023   | .052    | .167       | .07     | -.152 | -.08 | .543** | .361*   | -.1 | .381* |      |

Correlations calculated using STATA v9.2.

n=46  
 \*\* p<.01  
 \* p<.05

Table 6.12. Correlations between Ratifications on International Conventions on Money Laundering and Terrorism and some Explanatory Variables.



According to table 6.10 within countries in the sample: There is a positive correlation between the overall compliance with AML/CFT (YOCAML) and OECD members, FATF members and European Union Members.

There is a moderate positive correlation between the overall compliance with AML/CFT (YOCAML) and APGML members.

There is a positive correlation between the overall compliance on ML with AML/CFT (YOCML) and OECD members, FATF members and European Union Members.

There is a negative correlation between the overall compliance on ML with AML/CFT (YOCML) and APGML members.

There is a positive correlation between the overall compliance on FT with AML/CFT (YOCFT) and OECD members, FATF members and European Union Members.

There is a negative correlation between the overall compliance with AML/CFT on FT (YOCFT) and GAFISUD members.

There are no correlations established with other FSRBs, which may be due to the reduced number of countries represented within the sample.

#### **6.3.1.4. Bivariate Correlations between Dependent Variable and Economic and Financial Group of Explanatory Variables**

According to table 6.11, the bivariate correlation results show that:

- There is positive linear relationship between some indicators of the jurisdictions' financial system size (formal banking) and the jurisdictions' overall compliance with AML/CFT. The correlation between Bank Deposits /GDP and YOCAML is 0.486\*\* , and there is also a positive correlation between Financial System Deposits/GDP and YOCAML (0.469\*\*)
- The bivariate correlation coefficient between Life Insurance/GDP and YOCAML is +0.547\*\*, indicating an strong positive relationship between these variables. The economies reporting the highest formal volume of Life Insurance have the highest overall compliance with the AML/CFT.
- The bivariate correlation coefficient between Non Life Insurance/GDP and YOCAML is +0.621\*\*, indicating a strong positive relationship between these variables. The economies reporting the highest formal volume of Life Insurance have the highest overall compliance with the AML/CFT.

- In particular, the research failed to find an effect for Ratio of net exports of financial services (REFS) on the overall compliance with AML/CFT.
- In particular, the research shows that there is a moderate negative relationship between YOCAML, YOCFT, YOCML and the net margin interest. The economies reporting the highest net margin interest are the ones showing the lesser overall compliance with the AML/CFT

Table 6.12 shows the following results:

- The bivariate correlation coefficient between the ratification of the Vienna Convention variable (States party of UN Vienna Convention) and Ratio of net exports of financial services (REFS) is  $-0.824^{**}$ , indicating a very strong negative correlation. That is, countries with the highest ratios of REFS have not ratified the UN Vienna Convention.
- The bivariate correlation coefficient between the RATML and Ratio of net exports of financial services (REFS) is  $-0.461^{**}$ , indicating a moderate negative correlation.
- On the other hand, the bivariate correlation coefficient between the ratification of Vienna Convention variable (States party of UN Vienna Convention) and OGBS is  $-0.427^{**}$ , indicating a moderate negative correlation.
- The bivariate correlation coefficient between the ratification of Vienna Convention variable (States party of UN Vienna Convention) and Cross Border Asses /GDP 2004 (COBAS) is  $-0.729^{**}$ , indicating a very strong negative correlation. That is, countries with highest ratios of COBAS have not ratified the UN Vienna Convention.
- The bivariate correlation coefficient between the ratification of the UN Vienna Convention and Cross Border Liabilities /GDP 2004 (COBLI) is  $-.615^{**}$ , indicating a strong negative correlation. That is, countries with the highest ratios of COBLI have not ratified the UN Vienna Convention.
- The bivariate correlation coefficient between the YOCAML and GDP is  $+0.27$ , indicating a positive low correlation.
- The bivariate correlation coefficient between the YOCML and GDP is  $.375$ , indicating a positive moderate correlation.

- The bivariate correlation coefficient between the YOCFT and GDP is .27, indicating a positive low correlation.

Table 6.13. Correlations between other Economic Explanatory Variables and the Overall Compliance with AML/CFT (YOCAML)

| Variables                            | YOCML   | YOCFT  | YOCAML  | LnYOCML | LnYOCFT | LnYOCAML | RITF    | ASHE    | FORE    | INRE    | GDP   | RATML   | RATFT   |
|--------------------------------------|---------|--------|---------|---------|---------|----------|---------|---------|---------|---------|-------|---------|---------|
| YOCML                                | 1       | .771** | .990**  | .962**  | .737**  | .964**   | -.390** | -.25    | -.484** | -.455** | .227  | .380**  | .333*   |
| YOCFT                                | .771**  | 1      | .853**  | .724**  | .936**  | .805**   | -.283   | -.372*  | -.358*  | -.295   | .375* | .318*   | .356*   |
| YOCAML                               | .990**  | .853** | 1       | .947**  | .808**  | .968**   | -.381** | -.285   | -.480** | -.437** | .27   | .381**  | .350*   |
| LnYOCML                              | .962**  | .724** | .947**  | 1       | .731**  | .991**   | -.443** | -.191   | -.507** | -.459** | .202  | .405**  | .353*   |
| LnYOCFT                              | .737**  | .936** | .808**  | .731**  | 1       | .809**   | -.248   | -.333*  | -.374*  | -.312   | .276  | .268    | .361*   |
| LnYOCAML                             | .964**  | .805** | .968**  | .991**  | .809**  | 1        | -.424** | -.236   | -.509** | -.449** | .234  | .404**  | .370*   |
| Risk to Terrorism Financing (RITF)   | -.390** | -.283  | -.381** | -.443** | -.248   | -.424**  | 1       | -.357*  | .271    | .390*   | -.09  | -.153   | .001    |
| Average of the Shadow Economy (ASHE) | -.25    | -.372* | -.285   | -.191   | -.333*  | -.236    | -.357*  | 1       | .151    | .074    | -.1   | -.3     | -.456** |
| Formal Remittances/GDP (FORE)        | -.484** | -.358* | -.480** | -.507** | -.374*  | -.509**  | .271    | .151    | 1       | .756**  | -.161 | -.517** | -.463** |
| Informal Remittances (INRE)          | -.455** | -.295  | -.437** | -.459** | -.312   | -.449**  | .390*   | .074    | .756**  | 1       | -.144 | -.329*  | -.176   |
| GDP                                  | .227    | .375*  | .27     | .202    | .276    | .234     | -.09    | -.1     | -.161   | -.144   | 1     | .185    | .147    |
| RATML                                | .380**  | .318*  | .381**  | .405**  | .268    | .404**   | -.153   | -.3     | -.517** | -.329*  | .185  | 1       | .687**  |
| RATFT                                | .333*   | .356*  | .350*   | .353*   | .361*   | .370*    | .001    | -.456** | -.463** | -.176   | .147  | .687**  | 1       |

Correlations calculated using STATA v9.2.

n=46 \*\* p<.01

\* p<.05

- The bivariate correlation between the average of the shadow economies and the YOCAML with AML/CFT variable is - 0.285.
- The bivariate correlation between the average of the shadow economies and the YOCFT compliance with AML/CFT variable is - .372\*, indicating a negative moderate to strong linear relationship between variables.
- The bivariate correlation coefficient between the formal remittance in GDP and YOCAML is -.480\*\*, indicating a negative moderate to strong linear relationship between variables. The economies with higher formal remittances are the least compliant countries with the CFT.

### 6.3.2. Multivariate Regression Results

$$\text{LnYOCAML}_i = \beta_1 \text{RATML}_i + \beta_2 \text{RATFT}_i + \beta_3 \text{RQ}_i + \beta_4 \text{CO}_i + \beta_5 \text{EG}_i + \beta_7 \text{COBAS}_i + \beta_8 \text{ATML}_i + \beta_9 \text{INRE}_i + \varepsilon$$

Where compliance with the AML/CFT regime scores for country as a linear combination of: Ratification of International Conventions on Money Laundering (RATML); Ratification of International Conventions on Terrorism (RATFT); Regulatory Quality Framework (RQ); Control of Corruption (CO); Egmond Group (EG); Cross Border Assets/GDP COBAS; Attractiveness to Money Laundering (ATML); and Informal Remittances/GDP (INRE).

Table 6.14 shows the results for the bivariate correlations between variables in the model.

Table 6.14 Bivariate Correlations/ Variables OLS regression.

| Variables | YOCAML  | LnYOCAML | RQ      | CO      | EG     | ATML   | INRE   | COBAS | RATML  | RATFT |
|-----------|---------|----------|---------|---------|--------|--------|--------|-------|--------|-------|
| YOCAML    | 1       |          |         |         |        |        |        |       |        |       |
| LnYOCAML  | .968**  | 1        |         |         |        |        |        |       |        |       |
| RQ        | .668**  | .656**   | 1       |         |        |        |        |       |        |       |
| CO        | .548**  | .550**   | .883**  | 1       |        |        |        |       |        |       |
| EG        | .463**  | .484**   | .527**  | .489**  | 1      |        |        |       |        |       |
| ATML      | .558**  | .530**   | .761**  | .821**  | .369*  | 1      |        |       |        |       |
| INRE      | -.437** | -.449**  | -.499** | -.533** | -.318* | -.395* | 1      |       |        |       |
| COBAS     | .358*   | .333*    | .415**  | .450**  | .263   | .458** | -.218  | 1     |        |       |
| RATML     | .381**  | .404**   | .389**  | .335*   | .391** | .184   | -.329* | -.213 | 1      |       |
| RATFT     | .350*   | .370*    | .472**  | .421**  | .288   | .263   | -.176  | -.259 | .687** | 1     |

Correlations calculated using STATA v9.2.

n=46  
 \*\* p.<01  
 \* p.<05

| Table 6.15 OLS Regression              |             |   |          |       |       |
|--|-------------|---|----------|-------|-------|
| Variables                              | Coefficient |   | SE       | t     | P     |
| Ratifications INTML                    | .036749     |   | .081978  | .45   | .657  |
| Ratifications INTCFT                   | .033188     |   | .026778  | 1.24  | .225  |
| Regulatory Quality                     | .290818     | * | .114786  | 2.47  | .020  |
| Corruption                             | -.228567    | * | .115952  | -1.97 | .058  |
| Egmont Group                           | -.007968    |   | .137914  | .58   | .568  |
| Cross Border Assets/gdp                | .000005     |   | .000040  | .13   | .897  |
| Attractiveness to ML                   | .021511     |   | .014393  | 1.49  | .146  |
| Informal Remittances/gdp               | -2.138308   |   | 1.490285 | -1.43 | .162  |
| -CONS                                  | 3.424813    | * | .256116  | 13.37 | <.001 |
| F=5. P=.003                            |             |   |          |       |       |
| * =.1 Avg VIF=3.11 R <sup>2</sup> =.60 |             |   |          |       |       |

There were no VIF's over 10 and that the average is under 4. Technically, though the VIF's over 4 might indicate a problem. The VIF shows a value under 4, which suggests no collineality between explanatory variables.

White's general test statistic:  $\chi^2(37)$  P-value = .4236 . The results of the White test show that the errors are not over dispersed or heteroskedastic.

This extremely small P-value ( $P < .003$ ) provides strong evidence against  $H_0$ , and it suggests that at least one explanatory variable is related to compliance, controlling for the other explanatory variables as GDP. Significantly better predictions of the determinants have been obtained by using the multiple regression than by applying the lineal probability method or the use of the main component analysis methodology.

$R^2$  = the *R-square* value in the estimated model is .6. it is an indicator of how well the model fits the data (e.g., an *R-square* close to 1.0 indicates that we have accounted for almost all of the variability with the variables specified in the model).

In this model, the dependent variable is in its log-transformed state and the independent variable is in its original metric. In such models, where the dependent variable has been log-transformed and the predictors have not, the format for interpretation is that

the dependent variable changes by  $100 \times (\text{beta coefficient})$  percent for a one unit increase in the independent variable, while all other variables in the model are held constant.

The results of this regression support the hypothesis that “institutional indicators” are determinants of compliance with the AML/CFT. Findings are consistent with previous studies, such as the IMF study, in which it was found that some preconditions of governance have a positive correlation with “the compliance of some regulatory standards” as the IAIS, IOSCO, and BCP standards. In our case, the data shows a clear positive relationship between regulatory quality framework on one hand and the sum of compliance with the AML/CFT Regime on the other hand.

Going further, the research suggests that the general tendency to be compliant with regulatory standards depends on preconditions of governance. The results suggest that the overall compliance with AML/CFT tend to increase when the national preconditions of governance such as the “Regulatory Quality Framework” and the control of corruption are good.

The best predictor of a jurisdiction’s compliance with the AML/CFT is the RQ variable followed by the control of corruption variable. In this particular model, we would say that an increase by one unit in the regulatory quality framework would result in an increase of + 29% percent change in the average of the compliance while controlling the control of corruption variable.

An increase in corruption signifies that the control of corruption indicator decreases and it becomes negative. Then, if the control of corruption indicator decreases by one unit, this would result in a decrease of - 22% percent change in the average of the overall compliance (YOCAML), while controlling the variable of regulatory framework quality (RQ). It should be taken into account that there is also a high correlation between income and these governance indicators.

This dissertation has developed a greater understanding of how weak regulatory quality framework and corruption damages the effectiveness of AML/CFT systems. In chapter 7, appropriate strategies to deal with this issue are developed.

Evidence was found to support that ratifications of International Money Laundering and Terrorism Convention are not sufficient for an overall jurisdiction compliance with AML/CFT. RATML and RATFT are not determinants of the overall compliance with AML/CFT (YOCAML).

Although the cross border assets variable (COBAS) is positively correlated with the overall compliance with AML/CFT (YOCAML), the OLS method failed to find an effect of Cross Border Assets on the overall compliance with AML/CFT. The total amount of cross border assets/ GDP variable is not a determinant of compliance.

Even though the country attractiveness to Money Laundering variable (ATML) is positively correlated with the overall compliance with AML/CF (YOCAML), the OLS method failed to find an effect of ATML on the overall compliance with AML/CFT. The country attractiveness to Money Laundering variable is not a determinant of compliance.

In the case of the Egmond Group variable (EG), the OLS method also failed to find an effect of the jurisdiction participation in the Egmond Group on the overall jurisdiction compliance with the AML/CFT. Nevertheless, the EG is positively correlated with YOCAML.

No evidence was found to support the theory that the Offshore Centers are negatively correlated with the overall compliance with the AML/CFT. The ratio of the net financial services (the measure of the offshore centre financial services) has a very weak correlation with the overall compliance (AML/CFT). Nevertheless, some evidence was found to suggest that REFS is very strongly negatively correlated with the ratification of the Palermo Convention and moderately negatively correlated with the RATML explanatory variable.

There is an outcome that deserves greater examination. There is evidence that vulnerability to Financing of Terrorism, high informal remittances flows and failed states countries put the AML/CFT efficiency at risk, because the correlations between these variables and the overall compliance with AML/CFT is negative. Nevertheless, no effects on the overall compliance were found using the OLS method.

The results of this research coincide with the results of the comparative analysis provided by:

Croissant and Barlow (2007) after assessing Southeast Asian countries, stating: “ *Rather, our analysis shows that considerable differences in scope, pace, and success of compliance and implementation between countries are related to several factors: their preferences and calculations of rational political actors; the institutional capacity of political systems to produce changes; administrative and law enforcement capacities, especially in those*



*countries that are the major theatres of terrorism financing; and characteristics of the financial systems” (Croissant & Barlow 2007:229)*

Piombo (2007) after assessing East African Countries, stating: *“The traditional concern of democracy and development, such as transparency, good government, and the rule of law, are still important in the war against terror and terrorism financing.” (Piombo 2007:202)*

## **6.4 Other Findings**

This section highlights the lack of financial data reported by jurisdictions as well as the lack of peer evaluations in some World Regions.

### **6.4.1. Lack of the Financial Data Reported**

The results of the descriptive frequencies (Table 6.16) show that this study was unable to evaluate the size of the financial system for 46 countries within the sample. Special difficulties are found with some indicators: Financial System/GDP, Bank Deposit/GDP, Life Insurance/GDP and Non Life Insurance/GDP, and also the ratio of Net Financial Services. The majority of the data reported are from financial institutions of formal economies: banks, insurance companies, savings and loans, foreign exchange offices, securities brokerages, credit card companies. The high percentages of missing values for each indicator of the financial system size imply that it is very difficult to evaluate the global effectiveness of the preventive Recommendations for financial institutions applied to the banking, insurance and securities sectors, as well as other financial sectors that are vulnerable to Money Laundering and the financing of terrorism.

It should be pointed out that the AML/CFT Regime is only applicable to the Formal part of economies since no monitoring takes places of informal and cash economies. Table 6.16 shows that for some indicators of the size of the financial system, more than 25% of the countries within the sample have missing values. The missing data can be due to poor monitoring as well as large informal sectors of cash economies.

There is also no consistent data concerning the volume of cash flows for DNBFP within the total sample. Only a few high income countries have monitored some of the sectors included in this category (casinos, accountants, notaries, gem dealers, etc...).

Table 6.16. Descriptive Frequencies of the Jurisdictions Financial Size Variables

| Size of Financial System Variables   | N  | Missing Values | Missing Values |
|--------------------------------------|----|----------------|----------------|
|                                      |    | Frequency      | Percentatge    |
| Bank Deposits/GDP                    | 46 | 12             | 26.1%          |
| Financial System Deposits/GDP        | 46 | 12             | 26.1%          |
| Life Insurance Premium/GDP           | 46 | 17             | 37%            |
| Non Life Insurance Premium/GDP       | 46 | 17             | 37%            |
| Portfolio Investment Asset           | 46 | 4              | 8.7%           |
| Loans and Diposit Assets             | 46 | 0              | 0%             |
| Portfolio Investment Liabilities     | 46 | 3              | 6.5%           |
| Loans and Diposit Liabilities        | 46 | 0              | 0%             |
| Cross Border Assets                  | 46 | 0              | 0%             |
| Cross Border Liabilities             | 46 | 0              | 0%             |
| Ratio Net Financial Services Exports | 46 | 9              | 19,6%          |

Author's calculations based on data from WB (2005), IMF (2007), Portfolio Survey, and BIS

No correlation between some sizes of financial system variables such as (Deposit\_Money\_Bank\_Assets /Deposits, Liquid Liabilities/GDP, Deposit Money BankAssets/GDP, Private Bond Market Capitalization, Public Bond Market Capitalization, Stock Market Capitalization/GDP , and the Y overall compliance with AML/CFT was analyzed due to the high missing values among these variables.

#### 6.4.1. Lack of published Mutual evaluations reports in some regions

Table 6.17 shows a lack of complete published mutual evaluation reports in several FSRBs (CFATF, EAG, ESAAMLG, GIABA, MENAFATF, GCC and OGBS). The expected global overall compliance with the AML/CFT is likely to be lower than the calculated overall compliance for this sample, as the sample included 30% of FATF Countries, and the best regulated formal jurisdictions.

Table 6.17. Mutual evaluations reports published by FSRBs in (2004-2006)  
according to 2004 Methodology

| <b>Institution</b> | <b>N</b> | <b>Frequencies</b> |
|--------------------|----------|--------------------|
| <b>G8</b>          | 46       | 3                  |
| <b>G20</b>         | 46       | 7                  |
| <b>IMF</b>         | 46       | 44                 |
| <b>WB</b>          | 46       | 44                 |
| <b>OECD</b>        | 46       | 17                 |
| <b>FATF</b>        | 46       | 15                 |
| <b>EC</b>          | 46       | 14                 |
| <b>MONEYVAL</b>    | 46       | 8                  |
| <b>APGML</b>       | 46       | 8                  |
| <b>GAFISUD</b>     | 46       | 6                  |
| <b>CFATF</b>       | 46       | 3                  |
| <b>EAG</b>         | 46       | 2                  |
| <b>ESAAMLG</b>     | 46       | 0                  |
| <b>GIABA</b>       | 46       | 0                  |
| <b>MENAFATF</b>    | 46       | 3                  |
| <b>GCC</b>         | 46       | 1                  |
| <b>OGBS</b>        | 46       | 5                  |

No completed and published peer evaluations were done in some FSRBs such as ESAAMLG and GIABA.

### **7.5. The insufficient AML/CFT efficiency**

In respect to the first goal of the AML/CFT Regime, which is to reduce predicate crimes, it is very difficult to assess this because the AML/CFT Regime has always been responding to moving targets, from tracking down drug-traffickers, then to organized crime and tax frauds and ultimately to Terrorist Financing offences. Even if the effectiveness of the AML/CFT Regime was measured according to its meaning in relation to drugs and organized crime, efficiency in convictions and confiscations cannot easily be proven because the data is available only for the most developed financial centers.

Another measure of effectiveness could be to find out what the effect of AML/CFT is in terms of deterring transnational terrorism<sup>143</sup>.

The existing database on incidents can be used to answer this question. According to table 6.18, the number of incidents has been decreasing but the combating of Terrorism strategy has been unable to deter the attacks in some region groups. Terrorists are conducting continued terrorists attacks around the world as the statistics of MIPT show, and the terrorist attacks seem to be concentrated in some regions (SNA, LAC, MNA). Also, they are changing their financing trends as pointed out during this research. The terrorist networks have been adopting news forms of raising, moving, and storing money to avoid the AML/CFT Regime.

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<sup>143</sup> *"The lack of statistics linked to financial warfare is an issue sufficiently discussed in this dissertation but one should also revise the data on terrorist attacks reported by some government. Krueger states that "[American] Congress should establish a statistical bureau in the department to ensure that scientific standards are respected in all reports [war on terrorism], thereby elevating the status of data-gathering and statistics there. The bureau would promote consistency, statistical rigor, and transparency. When appropriate, it could seek input from the scientific community. And, while respecting classified sources, it could also insist that sufficient information be released to independent analysts for verification. This has also been admitted by the secretary of defense Donald Rumsfeld 'Today, we lack metrics to know if we are winning or losing the global war on terror. Are we capturing, killing, or deterring and dissuading more terrorists every day than the madrassas [Islamic schools] and the radical clerics are recruiting, training, and deploying against us?'. The statement was a stinging acknowledgment that the government lacks both classified and unclassified data to make critical policy decisions. It is also a reminder that only accurate information, presented without political spin, can help the public and decision-makers know where the United States stands in the war on terrorism and how best to fight it". See Krueger, A. et al.(2004). "Misunderestimating Terrorism - The State Department's Big Mistake " Foreign Affairs 83(5): 8-16 and Also, according to Crawford (2005), the U.S congressional research service questions the effectiveness of the Bush administration's measuring stick for determining success in countering terrorism. He points out that this report says measures such as the number of terrorist incidents per year o the number of terrorists killed and captured are inadequate. This report urges the use of broader social indicators, such as the ability of terrorists to recruit other terrorists. See Crawford, D. (2005). U.S. measure of terrorism is challenged. The Wall Street Journal: 1,27.*

Table 6.18. Attack incidents by world regions (1999-2006)<sup>144</sup>

| Regions                           | Incidents<br>1999 | Incidents<br>2000 | Incidents<br>2001 | Incidents<br>2002 | Incidents<br>2003 | Incidents<br>2004 | Incidents<br>2005 | Incidents<br>2006 |
|-----------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| <b>Africa</b>                     | 21                | 9                 | 8                 | 8                 | 15                | 7                 | 10                | 19                |
| <b>East and Central Asia</b>      |                   | 2                 | 6                 | 4                 | 2                 | 2                 | 3                 |                   |
| <b>Eastern Europa</b>             | 8                 | 1                 | 5                 | 13                | 4                 | 12                | 8                 | 1                 |
| <b>LAC</b>                        | 7                 | 15                | 16                | 20                | 24                | 12                | 15                | 4                 |
| <b>Middle East/Persian Gulf</b>   | 20                | 29                | 118               | 173               | 142               | 288               | 202               | 147               |
| <b>North America</b>              |                   |                   | 3                 | 1                 |                   |                   | 1                 |                   |
| <b>South Asia</b>                 | 2                 |                   | 8                 | 41                | 44                | 43                | 43                | 47                |
| <b>Southeast Asia and Oceania</b> | 8                 | 12                | 17                | 14                | 6                 | 5                 | 8                 | 8                 |
| <b>Western Europe</b>             | 59                | 38                | 24                | 24                | 38                | 26                | 20                | 15                |
| <b>Total</b>                      | 125               | 106               | 205               | 298               | 271               | 395               | 310               | 241               |

| Regions                           | Fatalities<br>1999 | Fatalities<br>2000 | Fatalities<br>2001 | Fatalities<br>2002 | Fatalities<br>2003 | Fatalities<br>2004 | Fatalities<br>2005 | Fatalities<br>2006 |
|-----------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Africa</b>                     | 51                 | 15                 | 10                 | 89                 | 42                 | 39                 | 79                 | 39                 |
| <b>East and Central Asia</b>      |                    | 4                  | 0                  | 2                  | 20                 | 5                  | 1                  |                    |
| <b>Eastern Europa</b>             | 0                  | 0                  | 10                 | 163                | 0                  | 6                  | 1                  | 0                  |
| <b>LAC</b>                        | 3                  | 3                  | 2                  | 19                 | 8                  | 3                  | 1                  | 6                  |
| <b>Middle East/Persian Gulf</b>   | 6                  | 20                 | 129                | 375                | 327                | 403                | 415                | 168                |
| <b>North America</b>              |                    |                    | 2982               | 3                  |                    |                    | 0                  |                    |
| <b>South Asia</b>                 | 1                  |                    | 43                 | 102                | 30                 | 72                 | 53                 | 81                 |
| <b>Southeast Asia and Oceania</b> | 3                  | 3                  | 7                  | 217                | 42                 | 12                 | 0                  | 0                  |
| <b>Western Europe</b>             | 1                  | 2                  | 1                  | 0                  | 0                  | 192                | 0                  | 0                  |
| <b>Total</b>                      | 65                 | 47                 | 3184               | 570                | 469                | 732                | 550                | 294                |

Source:MIPT

Evaluating the effectiveness of the second goal, which is to protect the integrity of the financial system by achieving transparency and accountability of the financial system and

<sup>144</sup> This statistic only considered International Terrorism according to MIPT definition.

International incidents are those in which terrorists go abroad to strike the targets, select domestic targets associated with a foreign state, or create an international incident by attacking airline passengers, personnel, or equipment. The Terrorism Knowledge Base incident dataset contains both domestic and international incidents for the years 1998 to the present. Only international attacks incidents are selected. The London attacks (2004) are not considered international terrorism, because the terrorist were home-grown.

according to the results of this study, the AML/CFT has not reached sufficient transparency. The transparency of the Financial System Size remains a constraint. The need to build consistent databases is one of the most important issues identified during this work. The main constraints are listed below:

- Poor submission of data on financial system size within the sample.
- Weak coverage of non financial services.
- Weak coverage of insurance services.
- Some jurisdictions (OFC's) do not compile an International Investment Position or Balance of Payments.
- Some jurisdictions (OFC's), especially those that are not IMF members, either do not compile a Balance of Payments or compile a partial balance, excluding the offshore sector.
- Difficulties in stock valuations, which may require interpolations involving flow data.
- Data Quality is not uniform and collection varies across countries.
- Substantial underreporting by some major jurisdictions, where participants choose not to cover all sectors for confidential or practical reasons.
- Almost every International Organization covered in this dissertation has a database either operative or under development but with a lot of weaknesses and overlaps which have been identified by scholars and practitioners.
- Difficulties to analyze data on Money Laundering from different countries because every country reports particular criminal behaviours, policies, implementation, recording and reporting that make any kind of meaningful aggregation difficult.
- There is no consolidated database of global terrorist arrests and global terrorist prosecutions.

On the other hand, it should be remarked that the IMF reports on overall compliance with Integrity Standards found that weaknesses in the implementation of many of the BCP, IAIS AND IOSCO principles were evident across a range of jurisdictions, despite the most marked concerns related to assessments of developing and emerging markets.

It should be pointed out that regulators of banking, insurance and securities have a lack of authority to investigate, limited access to time-sensitive data needed for surveillance purposes, insufficient resources for inspection, surveillance and investigation, and often a limited enforcement mandate. The reports also underline that there is a clear need for more efficient methods to disseminate information to the public and to improve the quality of the information being released. This signifies that the implementation of complementary standards of AML/CFT Regime is still weak to create positive effects on Money Laundering and terrorism financing control.

For measuring the effectiveness of the third goal, which is to strengthen the legal, financial, and regulatory infrastructure capacity of countries, a good indicator has been the official data on implementation of the legislations and regulations, such as the data provided by the mutual evaluation reports of the FATF, despite their implementation being difficult to assess objectively. The results of this research show that the implementation of the AML/CFT has not been totally efficient. In the light of the results presented in chapter 6, it can be pointed out that:

- The AML/CFT has not effectively monitored the financial system to prevent future acts of terrorism. According to the quantitative and qualitative results: there still remains loopholes in financial regulation, inadequate resources, obstacles designed to restrict the supervisory powers of the relevant administrative or judicial authorities or the means to exercise these powers and obstacles to international cooperation. Some of these weaknesses could be characteristic of NCCT jurisdictions. The FATF's members should determine to revise the list of NCCTs and what type of sanctions should be applied in some jurisdictions.
- The AML/CFT has not effectively provided information to law enforcement authorities, intelligence agencies, and military personnel to assist them in identifying and locating individuals, organizations, and states which are responsible for supporting and carrying out acts of terror. The vast majority of the countries assessed have a lack of data to support credible estimates on Money Laundering and Terrorist Financing. The number of suspicious activity reports seems to be the best available statistic regarding suspicious transactions<sup>145</sup> and the amount involved

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<sup>145</sup> A Bermuda Official answered to the researcher's questionnaire that *"while institutions have clearly identified on a few occasions specific clients as having the same or similar names as those on published lists of terrorist suspects, on further inquiry they have managed to*

in the transactions for each country. To compare the statistics of suspicious activity reports of all countries was attempted, but the first analysis confirms that the nature of each country's report is very different from others due to the nature of every national FIU<sup>146</sup>. So it is very difficult to formulate a projection based on the information submitted by FIUs. This research confirms again that the problem of measuring the magnitude and the geographic scope of Money Laundering and Terrorist Financing continues to persist.

- The offered data on sums seized intercepting Money Laundering and Terrorist Financing investigations or prosecutions do not appear to support valid estimates of the amount of total laundered funds.
- The statistics of the AML/CFT do not provide information and insights into how terrorist financiers are moving money for their purposes. It is very difficult to use the information provided by statistics to uncover terrorist support networks and to deprive the terrorists of funds<sup>147</sup>.
- In general and in too many countries, the governments have concentrated on identifying cash deposits as a priority, and have failed to improve a total program against Money Laundering that takes into account all of the traditional and modern

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*establish satisfactorily that the individuals concerned are not those included within lists of suspects. I believe, therefore, that very few SARs that have been made in Bermuda will have related to terrorist-links. And certainly there is no indication, to my knowledge, suggesting the identification of any terrorist funds or assistance in or through Bermuda institutions."*

<sup>146</sup> A FATF official answered to this researcher's questionnaire via email that she was afraid that they did not keep such statistics or compilations about total terrorist frozen funds. Other legal advisor of CTIF-CFI answered "At present there is no central source of information that captures statistical data on the application of AML/CFT regimes from several jurisdictions. Those data are kept by each jurisdiction separately on the basis of their own criteria and parameters. This enables them i.a. to comply with the need to assess effectiveness of their system for purposes of evaluation against the FATF 40+9 Recommendations." According with a OSCE official "The Kyrgyz FIU or FIS as it is called has only been operational for two years. Most of this time has been spent on training staff and establishing a working relation with the banking system in order to review suspicious transactions. The banks are reporting to the FIS, but whether the FIS has the technology to actually deal with vast amounts of data is still debatable".

A Europol Official answered to this research's questionnaire via email that "regarding the question concerning the cumulative set of data in the manner you would need (expect). I am of the opinion that you are looking for the data that no single authority is in a possession of and you would most likely need to combine data gathered from various sources according to subject, competent body etc..".

<sup>147</sup> According to an FSA official that has managed to get some data for my questionnaire: "Unfortunately, I have nothing readily available that goes back before 2002. As regards the freezing of terrorist assets, I understand that it is the practice of the Bank of England (which is responsible for the UK sanctions regime) only to publish the aggregate amount that has been frozen. At end-2006 the figure stood at US\$921,393". But no public data exist on the part of Bank of England. In any case, international organizations that produce official reports on this subject are the following: EUROPOL, Security Council Committee established pursuant to paragraph 6 of resolution 1267, Security Council Committee established pursuant to resolution 1373 and UNODC annual report on drugs and crime, which do not provide any consistent public statistic to evaluate the capacity of the AML/CFT to freeze terrorist funds.



resources used today to convert illicit proceeds from Money Laundering and Terrorist Financing. Traffickers and Terrorists are all too familiar with traditional customer identification procedures used by banks, and they have adopted new mechanisms of laundering and new strategies. There are still havens for Money Laundering and Terrorist Financing and this dissertation demonstrates this. The least regulated non-bank financial institutions can provide businesses to them, because their activities are less supervised and regulated. The following are included in this: *bureaux de change*, cheque cashers, money transmission services, securities and commodities brokers, life insurance companies, and underground banking systems.

- Following September 11, an estimated 112\$ million in terrorist funds were frozen by the international community, a figure that has decreased significantly in the following years according to statistics reported in mutual evaluation reports. The decline in frozen funds has been assessed by some as an indicator of the failure to combat the financing of Terrorism.

# **CHAPTER 7**

## **Conclusions**

## **Chapter 7. Conclusions**

This research provides evidence that the implementation of the Anti Money Laundering and the Combating of the Financing of Terrorism (AML/CFT) Regime is not as efficient as it should be. Although International Organizations have fully understood terrorist networks and tried a strategy to combat them, international cooperation on financial issues is not yet strong enough. Through a methodology that is both quantitative and qualitative, this research has showed the cooperative AML/CFT Regime's poor level of compliance among the 46 countries for which there is available data. The research has also identified the explanatory determinants of the overall compliance by jurisdictions. Based on the main conclusions of the previous chapters, this chapter proposes a better strategy to fight against terrorism financing and opens directions for future research.

### **7.1. The Overall Compliance Achieved among the 46 Countries with the Cooperative AML/CFT Regime Has Been Insufficient.**

The question of AML/CFT efficiency has emerged repeatedly all over the world and the need to understand the determinants of the overall compliance with AML/CFT Regime is all the more urgent, because of the continuous terrorist attacks. As explained when regarding the general theoretical framework, in chapter 4, the effectiveness of the AML/CFT Regime can only be tested in relation to its third goal, that is, the implementation of standards to strengthen the legal, financial, and regulatory infrastructure capacity of countries. To do so, this study started out by examining the level of compliance of AML/CFT standards.

The evidence indicates that the overall compliance with the AML/CFT Regime varies quite substantially across income groups during 2004-2006. Quantitative analysis results show that the 46 jurisdictions' compliance with the 40 Recommendations and 9 Special Recommendations (AML/CFT Regime) is very low in the legal, preventive, institutional and international cooperation areas. This indicates that the implementation of the Regime is still too weak to fight against the prevailing trends and emerging threats in Money Laundering and Terrorist Financing in the vast majority of the countries within the sample.

The higher level of compliance in the wealthier jurisdictions reflects, in many cases, the various measures taken to strengthen these jurisdictions' supervisory and regulatory systems prior to, or as a result of the mutual assessment reports. This is probably due to the financial sector making an important contribution to the economies of these high income jurisdictions, and these jurisdictions have taken steps to protect the integrity of their financial industry.

The most important weaknesses of the AML/CFT implementation are thus the following four:

1) *Failure to ratify and implement international Convention on Money Laundering (ML) and the financing of terrorism (FT) in some countries.* The quantitative analysis indicates that:

- The overall compliance with FATF Recommendations on Money Laundering on legal aspects is different between world income groups. While the upper- middle and high-income countries have criminalized Money Laundering, low- income countries do not fully comply with the standard, and they are still in the process of passing draft legislation. Some countries, especially in low and low- middle-income groups, are still with legislation only focused on drugs related Money Laundering.
- The overall compliance with the FATF legal subgroup of Special Recommendations on FT is very low in all income groups.

The qualitative analysis shows that:

- The international legislative Regime against terrorism is characterized by diversity and fragmentation in the way it shows the ratifications of international Convention on Terrorism. Despite the existing anti-terrorist Convention before 2001, they are not universal. Technical standards developed for the fighting against Money Laundering and Terrorist Financing have not been adopted by a great number of States. International anti-terrorism laws only exist on paper in many countries. The most important weakness for the AML/CFT lies in the inability of the international community to find a definition of terrorism, something that has constrained the system. This situation permits the existence of safe havens for terrorist networks.
- Furthermore the names of terrorists groups are different within the lists published by the United Nations, European Union, The United States and The United Kingdom. There are no international agreement as to what constitutes terrorism and

Terrorist Financing. (e.g., IRA is a terrorist group for UK, but not for US. Hezbollah is a terrorist for US but not for EU, etc)

- In some countries, the list of predicate offences does not respect the 40 Recommendations. There are only a limited number of predicate crimes for Money Laundering and it means that incrimination of ML is not fully consistent with Vienna and Palermo Convention.
  - When Money Laundering is prevalent in a country, it generates more crime and corruption and the effects of countries attractiveness for Money Laundering purposes has been broadly discussed in theoretical chapters.
  - Insufficient, weak and selective enforcement of AML/CFT provisions. The confiscation Regime is not clear and effective enough. Ineffective penalties, including difficult confiscation provisions are some of the reasons why the freeze strategy has not been more successful.
  - The lack of Money Laundering prosecutions indicates that the Regime is not being effectively implemented.
  - In the majority of countries no sanctions Regime exist for ML offences committed by natural persons acting as a front or on behalf of trustee.
  - The lack of harmonization of corporate law can create a “domino effect” on other laws and regulations, such as the criminal, administrative and banking laws. The greatest obstacles to international co-operation for the prevention of Money Laundering are found in the area of “identification of the real beneficial owner”. The main obstacle is a lack of regulation requiring full information regarding the real beneficial owner of a public or private limited company, especially when a legal entity is a shareholder or director, or the issuance of bearer shares is permitted.
- 2) *There are inadequate customer identification policies in countries in all income groups.* The quantitative analysis indicates that:
- Despite some of the assessed upper-middle and high-income countries adopting a range of preventive measures, the overall compliance regarding basic preventive measures is extremely low in all groups. Breaking down the findings by Recommendations, the majority of countries were universally non-compliant with

the core goal of the AML/CFT Regime, which means there is not an implemented global system of preventive measures for financial institutions.

- Breaking down the findings by income groups, the majority of countries were universally non-compliant in implementing universal preventive measures to control designated non-financial businesses and professions.

The qualitative analysis shows that:

- In addition to the preventive weaknesses of the AML/CFT broadly discussed in chapter 6, it can be argued that the low level of overall compliance in this area is due to the fact that the customer due diligence approach to fight against Money Laundering and Terrorist Financing is not a simple task and can contradict the culture of banking which is that of gaining clients. The compliance officer or risk manager in charge of “customer due diligence” tends to be in conflict with the incentives provided to customer service units dedicated to personal, private or offshore banking.
- Generally, national corporate law can affect the opacity/transparency of the financial system.
- Preventive measures have only been in formal economies.

In the fight against terrorism, the results of the quantitative analysis show that most countries deal ineffectively with the Special Recommendation related to preventive issues:

- Wire transfers are still not adequately recorded
- The non-profit sector requires greater control
- Greater effort needs to be placed on detecting couriers
- Lack of control of the use of bearer instruments

3) Countries fail to provide resources to supervise anti-Money Laundering programs and institutions. The quantitative analysis indicates that:

- The effectiveness of institutional measures on AML/CFT Regime developing national supervisory systems remains a concern. 40 % of the countries within the sample are not totally compliant in relation to the Financial Intelligence Unit existence, this indicates some major shortcomings in a critical area of AML/CFT Regime.

The results suggest weaknesses concerning lack of resources in all income groups, failure to provide adequate feedback to the reporting institutions, and insufficient analysis of suspicious transaction reports. Within all the income groups ML/FT investigations and prosecutions were limited, even where legal provisions and law enforcement powers were in place.

The qualitative analysis shows that:

- The absence of a strong political commitment at the level of policy makers and legislators is a significant hindrance to the development and implementation of a robust AML/CFT framework. In some countries, the dedications of officials at the technical level of supervisory and law enforcement authorities is hampered by a lack of political commitment in governments and parliaments to pass legislation and assigning necessary resources. The ratifications of the International Convention are not sufficient to implement a robust AML/CFT Regime
  - Corruption and weak governance undermine the effectiveness of the AML/CFT Regime. In environments where the regulatory quality framework is weak and corruption is prevalent, legislators are less likely to enact strong and effective AML/CFT laws and key institutions (courts, law enforcement and supervisory agencies). Accordingly, legislators may be hindered from carrying out their official duties in an effective manner. Development of an AML/CFT Regime also requires the establishment of an effective anti-corruption framework.
  - The high start-up and ongoing costs challenge the implementation of the AML/CFT Regime. Law Enforcement officers also need to police, customs agents need to stop smuggling, financial regulators need to strength their regulations, and politicians need to be aware of their country terrorism risk and to provide a reasonable degree of security for the citizens before whom they are ultimately responsible. In the long run, investment on these resources is likely to pave the way for the fight against Terrorist Financing.
- 4) Countries fail to enhance mutual legal assistance, information sharing and cooperation with national sectors and across borders.The quantitative analysis indicates that:

- The results of the overall compliance analysis of the international cooperation subgroup of the AML/CFT Recommendations show that low and upper-middle-income countries generally had only limited legal frameworks for international cooperation.

The qualitative analysis shows that:

- In practice, this has meant that the authorities' power to cooperate is affected by the absence of clear rules. The lack of clear rules in "mutual legal assistance" renders the process of international cooperation and the sharing information less systematic. Some weaknesses must be overcome in order to enhance international cooperation. The following list suggests improvements:
  - To make the system of legal instruments truly universal.
  - To promote international mutual legal assistance
  - To address possible differences in the treatment of information exchange among jurisdictions
    - Finding ways to share information while protecting legitimate rights to privacy and taking account of supervisors' confidentiality obligations.
    - Sharing information among supervisors of different sectors (e.g., between banking and securities regulators).
    - Sharing information for regulatory, compliance, and law-enforcement purposes.
    - Solving the complexity of multiple gateways for information exchange
  - To harmonize laws, and overcoming obstacles that arise in areas of extradition, mutual legal assistance and corporate law which can undermine the fight against terrorism.

## **7.2 The Institutional Factors that Determine the Level of Compliance with the AML/CFT**

This research shows that there are some common determinants in the overall compliance with the AML/CFT Regime. This dissertation has attempted to identify some of these determinants by estimating an OLS regression.



The base regression model results show that the 'Regulatory Framework Quality' variable (RQ) has the most significant impact on AML/CFT compliance. The second most influential explanatory variable is represented by corruption (CO). Both variables have registered a significant relationship with AML/CFT. The results of this regression are consistent with previous studies on compliance with international regulation standards and support the hypothesis that 'some governance indicators' are key determinants.

In this particular research, compliance tends to increase when the national preconditions of governance such as the 'Regulatory Quality Framework' and 'the Control of Corruption' are good. The best predictor of jurisdiction's compliance with AML/CFT is RQ variable followed by the control of corruption variable. In this particular model we would say that an increase by one unit in regulatory quality framework would result in an increase of + 29% percent in the average of the compliance while controlling the control of corruption variable. An increase in corruption signifies that the control of the corruption indicator decreases and becomes negative; then, if the control of the corruption indicator decreases by one unit this would result in a decrease of - 22% percent in the average of the overall compliance (YOCAML) while controlling the variable of regulatory framework quality (RQ). It should be taken into account that there is also a high correlation between income and these governance indicators.

This research have failed to find evidence that the following variables are determinants of overall compliance with AML/CFT (YOCAML): Ratifications of International Convention on Money Laundering and Terrorist Financing (RATML and RATFT), Cross Border Assets /GDP (COBAS) , Country Attractiveness for Money Laundering (ATML) , Informal Remittances/GDP (INRE) and Participation in Egmond Group (EG)

However, this research has found:

- Evidence to suggest that the ratio of the net financial services (REFS) is very strongly negatively correlated with the ratification of the Palermo Convention as well as being moderately negatively correlated with the RATML explanatory variable.
- There is also evidence that vulnerability to Financing of Terrorism, high informal remittance flows and failed states put the AML/CFT efficiency at risk. The correlations between these variables and the overall compliance with AML/CFT are negative.

The results of the study may allow policy makers and International Organizations to gain a better insight into how preconditions of governance represent the major factors in AML/CFT compliance, and encourage them to redesign and implement appropriate measures to control and reduce its damaging effects. This could lead to more effective country/jurisdiction compliance with AML/CFT, particularly in terms of the quality of governance.

The study is subject to several limitations. Firstly, the sample size of 46 jurisdictions for the study is quite small. However this is a common problem of cross-country Terrorist Financing research. Secondly, the overall compliance with AML/CFT was measured in this dissertation reusing the results of the mutual evaluations reports. This raises concerns about reliability since there can be subjective measurement errors. Notwithstanding these limitations, the present study has provided an original contribution to the literature on exploring the impact of various determinants regarding overall compliance with AML/CFT in empirical terms.

### **7.3. What Would Be the Most Effective Strategy to Tackle the Financing of Terrorism?**

On the basis of the results of this research, a double step strategy is needed to overcome the failings and discrepancies between countries in building a more coordinated global strategy against the financing of terrorism.

In the first step, the states should recognize that they have failed to pay attention to the adequate criminalization of Terrorist Financing, to establish a clear approach towards informal transfer systems, to establish consistent freezing of assets and the approach towards international legal cooperation. This strategy must:

- Achieve a common definition of terrorism and a strict definition of the financing of terrorism
- Convince all stakeholders that action is required at the global level
- Ensure true commitment and resolute political will in CFT
- Take into account the increasing global nexus between crime and terror and its negative effect.

- Be conscious that terrorists continue to use failed states and jurisdictions which progress slowly the implementation of the AML/CFT Regime.
- Create a global index of country vulnerability to Terrorist Financing to improve the capacity of international community to monitor and control key safe havens used by terrorist financiers.

To do so, it can be used the following measures to put pressure:

- There still remain loopholes in the area of financial regulation. Stronger measures should be put again in place according to the FATF in order to put an end to the detrimental rules and practices evidenced by this dissertation. More counter-measures such as the use sanctions and /or blacklists uncooperative jurisdictions should be started up again when FATF members and non-members fail to cooperate in combating the financing of terrorism. Some norms should be designed to protect economies against money of unlawful origin, specific requirements should be made for financial institutions in FATF members to pay special attention to or to report on financial transactions conducted with individuals or legal entities having their account at financial institutions established in a “non-cooperative jurisdiction”; conditioning, restricting, targeting or even prohibiting financial transactions with non-cooperative jurisdictions.
- Improve the implementation of the complementary standards of AML/CFT such as BCP, IAIS and IOSCO because they pave the way for the customer due diligence. Also, establish a non-compliance policy response in the case of a jurisdiction with low rates of integrity standards compliance.
- Revitalise the awareness-raising campaigns of CTC, given the significant role of Counterterrorism Committee to combat the financing of terrorism
- Extend AML/CFT to fight corruption, incorporating new Recommendations focused on the control of corrupted practices in accordance with 2003 UN Convention
- Develop complementary policies and strategies in areas exploited by terrorist groups since certain areas are insufficiently covered by the AML/CFT Regimes such as trade, corporate law, oil smuggling, maritime businesses and humanitarian aid and border controls.

As second step would be to redesign the strategy taking into account not only previous weaknesses but also a recognition that one size model does not fit all, especially when there are cash economies and failed states involved. The following points must be taken into account when building up the new strategy:

- The design and prioritization of policy is an important point and it is also problematic because the goals of avoidance of risk and related casualties are very difficult to measure. It is necessary to reject the traditional cost benefit analysis since a policy of combating Terrorist Financing consists in managing uncertainty and imprecise threats.
- At this point the risk-based approach to CFT must be redefined and implemented differently, because a high number of Recommendations from international bodies have created a maze of requirements that overlap efforts and undermines efficiency. A high level Interagency is needed to lead the national efforts on combating of the financing of terrorism.
- The policy makers should design a strategy to manage and map different levels of analysis (EU, National and Cross Borders); then they should think about determining the main information requirements of CFT stakeholders.
- This change of strategy would compel the international organization to provide clear policy guidance to the Private sector. There is a question of how much information law enforcement agencies should give to regulated financial sector in order to maximise the efficiency of data collection, and thus contribute to keeping financial institutions informed of the new patterns, indicators and typologies relevant to fighting against Terrorist Financing. The complexity of Terrorist Financing requires a coordination of public and private sectors, and law enforcement and intelligence agencies need to advice financial institutions and DNBP on what kind of data they need.
- It should made compulsory to communicate the data requested by IOs to cover the lack of information concerning many questions as stated in chapter 3 and chapter 6.
- Enhancement of public cooperation is also necessary. In the case of prosecutions, one of the largest challenges law enforcement faces is in compiling evidence around a terrorism case. There is a large amount of information that will never be seen in a court room, because it cannot be verified. There is a conflict between

collecting evidence for courts (law enforcement) and collecting information to inform government (intelligence agencies). This conflict must be solved by a better construction of a CFT strategy.

- Information Exchange is another fundamental component of CFT. There still remain legal barriers when two or more jurisdictions are involved and when gathering information in one country is a criminal offence if data privacy and bank secrecy laws remain in place. This poses many restrictions on which institutions can disclose data in their possession. (e.g.,SWIFT). The current legal framework is not designed to deal efficient with the CFT, because financial institutions must comply with five institutions, regulators, law enforcement agencies, internal management and employee conscience, and society. There is still exist formal channels not disclosing information and resulting inefficient and ineffective practices.
- Peer evaluation (mutual evaluation report) should be revised, making it comparable in the long run without preventing methodological improvements.

All these points should be taken into account to genuinely deter Terrorist Financing. Nevertheless, the key that would make it all feasible is to overcome weak governance. That is the real disease of the efficiency of international regulatory standards. Following from this, the main efforts should probably be made in relation to transition economies. Although failed states, which are at the bottom of the compliance analysis, would seem to be a better option at first sight, transitional economies appear to be more willing to try to protect the integrity of the financial system they are building right now. Moreover, transitional economies are the most vulnerable to financial system abuse. It is very important to prevent their becoming failed states.

#### **7.4. Future Research**

Throughout this dissertation, the researcher has attempted to clarify the level of the overall compliance with the AML/CFT Regime and the factors that determine levels of compliance. However, among these efforts, there are some issues of significance, which could not be dealt with in a comprehensive manner due to the restraint of time and the objective focus of the study. Regarding these issues, further research is definitely merited.

Firstly, it is recommended to re-examine the existing databases and to design a consolidated database, including more than just attack frequencies by countries. The country's vulnerability to Terrorist Financing, the overall compliance of each country with the AML/CFT, the evolution of prosecutions, and confiscations data per country need to be included in the database. I have been encouraged by the Center of Studies of Terrorism and Responses to terrorism (USA) to combine the data base on financial transactions with their data base on terrorist events so that can look more specifically at how weak policies on financial transactions regulations cause the risk of terrorist violence.

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Methodology for assessing compliance:

[http://www.fatf-gafi.org/pdf/Meth-2004\\_en.pdf](http://www.fatf-gafi.org/pdf/Meth-2004_en.pdf)

Mutual Evaluation Reports of Jurisdictions are found at:

<http://www.ogbs.net/members.htm>

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International Conventions and Model Laws:

[http://www.incb.org/e/conv/1988,](http://www.incb.org/e/conv/1988)

<http://www.unodc.org/unodc/en/money-laundering/index.html>

[http://www.unodc.org/unodc/treaty\\_adherence.html](http://www.unodc.org/unodc/treaty_adherence.html)

<http://www.un.org/law/cod/finterr.htm>

<http://www.undcp.org/adhoc/palermo/convmain.html>

<http://www.imolin.org>

Integrity Standards:

<http://www.bis.org/index.htm>

[http://www.baselgovernance.org/fileadmin/docs/pdfs/Industry\\_standards/Wolfsberg\\_RBA\\_paper.pdf](http://www.baselgovernance.org/fileadmin/docs/pdfs/Industry_standards/Wolfsberg_RBA_paper.pdf)

<http://www.iaisweb.org/>

<http://www.iosco.org/>

Intelligence Units

<http://www.egmontgroup.org/>

<http://www.interpol.int/Public/FinancialCrime/MoneyLaundering/default.asp>

## **Statistics**

<http://www.state.gov/s/ct/>

<http://siteresources.worldbank.org/DATASTATISTICS/Resources/OGHIST.xls> (2005)

<http://siteresources.worldbank.org/DATASTATISTICS/Resources/CLASS.XLS> (2005)

<http://www.imf.org>

# **Appendix 1**

## Appendix 1

### A. Interviews

The following table list the interviewees, date of the interview, position of the interviewee, place of the interview and scope of the interview.

| Interviews                | Date              | Position                 | Institution                    | Place               | Scope of the Interview  |
|---------------------------|-------------------|--------------------------|--------------------------------|---------------------|---|
| Mr.Gilbert Guillaume      | Sep 05            | Former President of ICJ  | Ex-ICJ                         | Paris/Milano        | International Economic and Legal Conditions permitting flows into Terrorist Hands                           |
| Prof.Ernesto Savona       | Oct 04            | Director/Think Tank/Prof | TransCrime                     | Milano              | Characteristics of Data Flows on Money Laundering and Terrorist Financing.                                  |
| Coronel Bettini           | Mar 05            | Coronel                  | Guardia di Finanza             | Milano              | Flow of Information between Law Enforcement Bodies  |
| Mr.Alejandro Sánchez      | 05-06             | Official                 | Ministry of Defense            | Madrid              | Nature of Terrorist Financing: Mechanisms and Dilemmas  |
| Mr.Lluís Cervera          | Mar 07            | Director AML             | La Caixa. Bank                 | Barcelona           | Problems of Implementation of Preventive Measures in Financial Institutions.                                |
| Prof.Friedrich Kratochwil | Mar 06            | Professor                | European Univ. Institute       | Florence            | Theoretical Problems of international cooperation on FT and the compliance with non-binding recommendations |
| Mr.Nadym Kyriakos         | April 07- July 07 | Coordinator              | Legal Department (IMF)         | Washington          | Responsible Bodies for CFT Data from Mutual Evaluation Reports.   |
| Mr.Erik Kiefel            | April 07- July 07 | Project Manager          | Federal Reserve Bank. US       | Washington          | Customer Due Diligence in Banking /Offshore/Informal Remittance Transfers Control                           |
| Prof. Peter Reuter        | May 07            | Think Tank and Professor | University of Maryland         | Maryland            | Explanatory Variables of compliance   |
| David Nelson              | Jun 07            | Director                 | US Terrorism Department        | Maryland            | Frozen Funds from Terrorists  |
| Mikael Eriksson           | March 06          | Project Leader           | Upssala Univ/IUE               | Florence            | Smart Sanctions Conflicts   |
| Patryk Pawlak             | March 06- July 07 | Researcher               | IUE/Georgetown Foreign Service | Florence/Washington | Borders Control and the Financing of Terrorism  |

**The researcher has also assisted to the Penal Process against Shinning Path celebrated in Lima (Peru). September 15<sup>th</sup> ,.2006**

## B. E-MAILING

This section includes, the email type that was sent to 100 officer in different international organizations, as well some information regarding the officials whose answers were taken into account in the research.

Dear Mr:

My name is Concepcion Verdugo and I am a researcher in a joint programme of the Università Bocconi (Milano) and University of Barcelona. Currently, I am a visiting researcher at the START - National Consortium for the Study of Terrorism and Responses to Terrorism at the University of Maryland.

The main goal of my PhD dissertation is the analysis of the effectiveness of the International Organization in the context of the fight against terrorism financing. I try to explain the capacity of the international AML-CFT regime to report Suspicious Activity Reports, to freeze terrorists' funds and to arrest suspects.

Given your extensive knowledge and experience in this area, I have been wondering whether you would be able to help me out with the following issues:

- 1) Suggest sources where I could find a collective data (covering several countries/per year) on: suspicious activity report, total amount remittances ( informal). frozen funds and arrests made.( from 1999-to 2005)
- 2) Recommend any colleagues of yours who could either provide me this information (in case you cannot do so).

Thank you in advance for your time and assistance with my request. Of course, any further suggestions/comments of yours with regard to my research will be more than welcome.

I am looking forward to hearing from you.

Kind regards,

Concepcion Verdugo  
PhD Università Bocconi  
Milano.Italy

-----  
Until September 2007  
Visiting Researcher  
University of Maryland  
National Consortium for the Study of Terrorism and Responses to Terrorism .+1 2023413641  
3300 Symons Hall.College Park MD 20742

## INTERVIEWEES

| <b>International Organization</b> | <b>Email Interviewee</b>  | <b>Date</b> | <b>Position</b>   |
|-----------------------------------|---------------------------|-------------|---|
| <b>UNODC</b>                      | Dolgor Solongo            | May 07      | Preventing the Financing of Terrorism                                     |
|                                   | Brigitte Strobel-Shaw     | May 07      | Coordination between International, Regional and Subregional              |
| <b>OSCE</b>                       | Kimberley Bulkley         |             | Economic and Environmental Officer  |
|                                   |                           |             |   |
| <b>UNICRI</b>                     | Francesco Marelli         | May 07      | United Nations Interregional Crime and Justice Research Institute Officer |
|                                   |                           |             |   |
| <b>EUROPOL</b>                    | Vladimir.jizdny           | May 07      | Europol Officer   |
| <b>FATF</b>                       | Valerie.schilling         | May 07      | FATF Officer  |
| <b>FEDERAL RESERVE BANK</b>       | Erik Kiefel               | May 07      | Project Leader. Division of Reserve Bank Operations and Payment Systems   |
| <b>BANK OF SPAIN</b>              | Enrique Ibañes            | Mar 07      | Head of Operations  |
| <b>IMF</b>                        | Mr Nadim Kyriacos         | May 07      | Senior Legal Counselor. Legal Department IMF. Financial Integrity System. |
|                                   | Ahmed Zorome              | May 07      | MCM R4.IMF  |
| <b>COE</b>                        | Rafael Benitez            | May 07      | Coordinator , Council of Europe Anti-Terrorism                            |
| <b>COE</b>                        | Kirsten Mandrup           | May 07      | Administrator, Moneyval . Directorate of Monitoring                       |
| <b>COE</b>                        | Livia Stoica              | May 07      | Programme Adviser Moneyval  |
| <b>CYPRUS GOVERNMENT</b>          | Eva Rossidou-Papakyriacou | May 07      | FIU Cyprus  |
| <b>UK GOVERNMENT</b>              | Richard Chalmers          | May 07      | Financial Service Authority (FSA) Think Thank                             |
| <b>BERMUDA GOVERNMENT</b>         | Mr.Sutherland             | May 07      | Executive Officer BMA   |
| <b>BELGIUM GOVERNMENT</b>         | Ludhovic D' Hoore         | May 07      | Legal Advisor CTIF-CFI  |
| <b>BAHAMAS GOVERNMENT</b>         | Edward R. Smith,          | May 07      | Deputy Director .FIU Bahamas  |



## **Appendix 2**

## Appendix 2

### A. LOGISTIC REGRESSION

```
log: C:\Documents and Settings\Desktop\Concha Dissertation\Sta
> ta\20070717 Concha Output.smcl
log type: smcl
opened on: 17 Jul 2007, 13:21:18
```

```
. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"
```

```
. regress BIN_Y_SUM_Legal_ML X_SUM_INTCML X_SUM_INTCFT
```

| Source   | SS         | df | MS         | Number of obs = |
|----------|------------|----|------------|-----------------|
| 46       |            |    |            | F( 2, 43) =     |
| 4.91     |            |    |            | Prob > F =      |
| Model    | 2.03723729 | 2  | 1.01861865 | R-squared =     |
| 0.0120   |            |    |            | Adj R-squared = |
| Residual | 8.91928445 | 43 | .20742522  | Root MSE =      |
| 0.1859   |            |    |            |                 |
| 0.1481   |            |    |            |                 |
| Total    | 10.9565217 | 45 | .243478261 |                 |
| .45544   |            |    |            |                 |

| BIN_Y~gal_ML | Coef.     | Std. Err. | t     | P> t  | [95% Conf. Interval] |
|--------------|-----------|-----------|-------|-------|----------------------|
| X_SUM_INTCML | .0979348  | .105025   | 0.93  | 0.356 | -.1138684            |
| .3097379     |           |           |       |       |                      |
| X_SUM_INTCFT | .0520928  | .0340038  | 1.53  | 0.133 | -.0164824            |
| .1206679     |           |           |       |       |                      |
| _cons        | -.5010231 | .2937357  | -1.71 | 0.095 | -1.093398            |
| .0913513     |           |           |       |       |                      |

```
. whitetst
```

```
White's general test statistic : 24.32136 Chi-sq( 5) P-value = 1.9e-04
```

```
. vif
```

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| X_SUM_INTCFT | 1.90 | 0.527461 |
| X_SUM_INTCML | 1.90 | 0.527461 |
| Mean VIF     | 1.90 |          |

```

.
. logistic BIN_Y_SUM_Legal_ML X_SUM_INTCML X_SUM_INTCFT

Logistic regression                               Number of obs =
46                                                LR chi2(2) =
14.06                                           Prob > chi2 =
0.0009                                          Pseudo R2 =
Log likelihood = -23.75955
0.2283

```

```

-----
-----
BIN_Y~gal_ML | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
X_SUM_INTCML |   1.579331   .8405607    0.86   0.391    .5564697
4.482338
X_SUM_INTCFT |   2.476691   1.164532    1.93   0.054    .9854619
6.224492
-----
-----

```

```

. regress BIN_Y_SUM_Legal_FT X_SUM_INTCML X_SUM_INTCFT

```

```

Source |      SS      df      MS                Number of obs =
46
-----+-----
0.47
Model |   .188916284      2   .094458142                F( 2, 43) =
0.6295
Residual |   8.68064893     43   .201875557                Prob > F =
0.0213
-----+-----
0.0242
Total |   8.86956522     45   .197101449                R-squared =
.44931
Root MSE =

```

```

-----
-----
BIN_Y~gal_FT |      Coef.   Std. Err.      t    P>|t|    [95% Conf.
Interval]
-----+-----
X_SUM_INTCML |   .0676703   .1036105    0.65   0.517    -.1412803
.2766208
X_SUM_INTCFT |  -.0324467   .0335458   -0.97   0.339    -.1000982
.0352049
   _cons |   .419468   .2897796    1.45   0.155    -.1649282
1.003864
-----
-----

```

```

.
. whitetst

```

White's general test statistic : 1.101705 Chi-sq( 5) P-value = .954

```
.
. vif
```

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| X_SUM_INTCFT | 1.90 | 0.527461 |
| X_SUM_INTCML | 1.90 | 0.527461 |
| Mean VIF     | 1.90 |          |

```
.
. logistic BIN_Y_SUM_Legal_FT X_SUM_INTCML X_SUM_INTCFT
```

```
Logistic regression           Number of obs =
46                             LR chi2(2)      =
0.95                           Prob > chi2    =
0.6209                         Pseudo R2     =
Log likelihood = -25.925818
0.0180
```

| BIN_Y~gal_FT | Odds Ratio | Std. Err. | z     | P> z  | [95% Conf. Interval] |
|--------------|------------|-----------|-------|-------|----------------------|
| X_SUM_INTCML | 1.428624   | .7614978  | 0.67  | 0.503 | .5025774             |
|              | 4.060999   |           |       |       |                      |
| X_SUM_INTCFT | .8497496   | .1419689  | -0.97 | 0.330 | .6124625             |
|              | 1.178969   |           |       |       |                      |

```
.
. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Voice_and_
> Accountability Political_Stability Government_Effectiveness
Regulatory_Quality
> Rule_of_Law Control_of_corruption FAILED_STATES EGMOND_G Economic_F
Risk_to_
> Terrorism_Financing Informal_Remittances_in__GDP_20
CROSS_BORDER_FINANCIAL_A
> SSETS_IN
```

| Source   | SS         | df | MS         | Number of obs = |
|----------|------------|----|------------|-----------------|
| 36       |            |    |            |                 |
| Model    | 3.14359052 | 14 | .22454218  | F( 14, 21) =    |
| 0.3718   |            |    |            | Prob > F =      |
| Residual | 4.0786317  | 21 | .194220557 | R-squared =     |
| 0.4353   |            |    |            | Adj R-squared = |
| 0.0588   |            |    |            |                 |

Total | 7.22222222 35 .206349206 Root MSE = .4407

```

-----
-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      t    P>|t|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |  -.0088456   .1542242    -0.06   0.955   - .3295723
.3118811
X_SUM_INTCFT |   .0021073   .0516306     0.04   0.968   - .1052645
.109479
Voice_and~y |  -.7259897   .3275608    -2.22   0.038   -1.40719  -
.0447897
Political~y |  -.3027512   .2275881    -1.33   0.198   - .7760465
.1705441
Government~s |   .4721787   .554861     0.85   0.404   - .681718
1.626075
Regulatory~y |   .4381709   .4292253     1.02   0.319   - .4544519
1.330794
  Rule_of_Law |  -.3310355   .4392918    -0.75   0.459   -1.244593
.5825217
Control_of~n |   .0028008   .3566684     0.01   0.994   - .7389317
.7445333
FAILED_STA~S |  -.013725    .0113546    -1.21   0.240   - .0373382
.0098881
  EGMOND_G |   .1297976   .3172734     0.41   0.687   - .5300086
.7896038
  Economic_F |   .0033449   .0219084     0.15   0.880   - .042216
.0489058
Risk_to_Te~g |  -.4945237   .3577292    -1.38   0.181   -1.238462
.2494149
Informal_~20 |   4.632952   3.018941     1.53   0.140   -1.64528
10.91118
CROSS_BORD~N |   .0000358   .0000647     0.55   0.586   - .0000988
.0001704
  _cons |   2.216893   1.724371     1.29   0.213   -1.369133
5.802918
-----
-----

```

. whitetst

White's general test statistic : 36 Chi-sq(35) P-value = .4215

. vif

```

-----
-----
Variable |      VIF      1/VIF
-----+-----
Government~s |   60.24   0.016600
  Rule_of_Law |   36.13   0.027677
Regulatory~y |   27.14   0.036846
Control_of~n |   26.70   0.037455
Voice_and~y |   15.57   0.064209
FAILED_STA~S |   15.18   0.065867
  Economic_F |    8.32   0.120247
-----
-----

```

```

Political_~y |      8.27    0.120875
Risk_to_Te~g |      5.42    0.184585
  EGMOND_G |      3.50    0.285841
X_SUM_INTCML |      3.09    0.323748
X_SUM_INTCFT |      3.07    0.325787
Informal_~20 |      1.92    0.522077
CROSS_BORD~N |      1.73    0.578628
-----+-----
      Mean VIF |      15.45

```

```

.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Voice_and
> _Accountability Political_Stability Government_Effectivenes
Regulatory_Qualit
> y Rule_of_Law Control_of_corruption FAILED_STATES EGMOND_G Economic_F
Risk_to
> _Terrorism_Financing Informal_Remittances_in___GDP_20
CROSS_BORDER_FINANCIAL_
> ASSETS_IN

```

```

Logistic regression                                Number of obs   =
36                                                    LR chi2(14)     =
24.82                                                Prob > chi2     =
0.0364                                              Pseudo R2      =
Log likelihood = -8.8587479
0.5835

```

```

-----+-----
-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML | 16.87864    43.42174      1.10  0.272    .1090306
2612.921
X_SUM_INTCFT | .3801878    .3313133     -1.11  0.267    .0689004
2.097851
Voice_and_~y | 9.89e-06    .0000678     -1.68  0.093    1.43e-11
6.830925
Political_~y | .0331813    .089579      -1.26  0.207    .0001671
6.589727
Government~s | .5693297    4.249794     -0.08  0.940    2.52e-07
1285895
Regulatory~y | 891.6465    6369.778      0.95  0.342    .0007402
1.07e+09
  Rule_of_Law | .2064671    .9700782     -0.34  0.737    .0000207
2061.535
Control_of~n | 14.95366    56.52874      0.72  0.474    .009057
24689.42
FAILED_STA~S | .8201638    .1824385     -0.89  0.373    .5303445
1.268362
  EGMOND_G | 26.75986    86.29936      1.02  0.308    .0481279
14878.91
  Economic_F | 1.299954    .4317215      0.79  0.430    .678015
2.492392

```

```

Risk_to_Te~g | .0010426 .0052332 -1.37 0.171 5.57e-08
19.52768
Informal_~20 | 2.67e+34 1.38e+36 1.54 0.124 3.41e-10
2.09e+78
CROSS_BORD~N | 1.006957 .0108392 0.64 0.520 .9859349
1.028427

```

-----  
Note: 1 failure and 4 successes completely determined.

```

.
. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Political_
> Stability Government_Effectivenes Regulatory_Quality Rule_of_Law
Control_of_c
> orruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN

```

```

Source | SS df MS Number of obs =
-----+-----
45
1.37 F( 9, 35) =
Model | 2.29690187 9 .255211319 Prob > F =
0.2372
Residual | 6.50309813 35 .185802804 R-squared =
0.2610
-----+-----
0.0710 Adj R-squared =
Total | 8.8 44 .2 Root MSE =
.43105

```

```

-----
-----
BIN_Y_S~p_FT | Coef. Std. Err. t P>|t| [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML | .1197798 .1092473 1.10 0.280 -.102004
.3415636
X_SUM_INTCFT | -.0281628 .0372447 -0.76 0.455 -.1037735
.0474479
Political_~y | -.0252105 .111997 -0.23 0.823 -.2525766
.2021555
Government~s | .0080795 .0102238 0.79 0.435 -.012676
.0288349
Regulatory~y | .3048605 .1908415 1.60 0.119 -.0825683
.6922893
Rule_of_Law | -.2190804 .2914969 -0.75 0.457 -.8108505
.3726898
Control_of~n | .1063042 .2305367 0.46 0.648 -.3617103
.5743187
EGMOND_G | -.287502 .2099058 -1.37 0.180 -.7136334
.1386294
CROSS_BORD~N | .0000762 .0000497 1.53 0.134 -.0000247
.000177
_cons | .7216672 .3668094 1.97 0.057 -.0229954
1.46633

```

```
.
. whitetst
```

```
White's general test statistic :          45  Chi-sq(44)  P-value =  .4298
```

```
.
. vif
```

| Variable     | VIF   | 1/VIF    |
|--------------|-------|----------|
| Rule_of_Law  | 20.37 | 0.049086 |
| Control_of~n | 13.99 | 0.071492 |
| Regulatory~y | 6.96  | 0.143692 |
| Political_~y | 2.72  | 0.368205 |
| EGMOND_G     | 2.19  | 0.456166 |
| X_SUM_INTCML | 2.00  | 0.498972 |
| X_SUM_INTCFT | 1.88  | 0.533218 |
| CROSS_BORD~N | 1.41  | 0.710571 |
| Government~s | 1.27  | 0.789927 |
| Mean VIF     | 5.86  |          |

```
.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Political
> _Stability Government_Effectiveness Regulatory_Quality Rule_of_Law
Control_of_
> corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN
```

```
Logistic regression          Number of obs   =
45                             LR chi2(9)    =
20.68                          Prob > chi2   =
0.0141                         Pseudo R2   =
Log likelihood = -15.754563
0.3963
```

| BIN_Y_S~p_FT | Odds Ratio | Std. Err. | z     | P> z  | [95% Conf. Interval] |
|--------------|------------|-----------|-------|-------|----------------------|
| X_SUM_INTCML | 1.920621   | 1.450754  | 0.86  | 0.388 | .4369998             |
| X_SUM_INTCFT | .8552887   | .1853161  | -0.72 | 0.471 | .5593481             |
| Political_~y | .8394917   | .5797389  | -0.25 | 0.800 | .2168657             |
| Government~s | 5.14933    | 13.65971  | 0.62  | 0.537 | .0284285             |
| Regulatory~y | 4.843247   | 9.873003  | 0.77  | 0.439 | .0891158             |
| Rule_of_Law  | .0154293   | .0381509  | -1.69 | 0.092 | .0001212             |



```

Control_of~n | 2.076366 3.335973 0.45 0.649 .0890697
48.40366

EGMOND_G | .063754 .1050443 -1.67 0.095 .0025236
1.61061
CROSS_BORD~N | 1.007062 .0042596 1.66 0.096 .9987481
1.015446

```

-----  
Note: 1 failure and 4 successes completely determined.

```

. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory
> _Quality Rule_of_Law Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_AS
> SETS_IN

```

```

Source | SS df MS Number of obs =
-----+----- F( 7, 37) =
1.73 Model | 2.17379917 7 .310542738 Prob > F =
0.1311 Residual | 6.62620083 37 .179086509 R-squared =
0.2470 ----- Adj R-squared =
0.1046 Total | 8.8 44 .2 Root MSE =
.42319

```

```

-----
BIN_Y_S~p_FT | Coef. Std. Err. t P>|t| [95% Conf.
Interval]
-----+-----
X_SUM_INTCML | .1432703 .1033492 1.39 0.174 -.0661351
.3526757
X_SUM_INTCFT | -.0305318 .0364402 -0.84 0.407 -.1043668
.0433031
Regulatory~y | .3229938 .1859686 1.74 0.091 -.0538144
.6998021
Rule_of_Law | -.2317892 .265271 -0.87 0.388 -.7692793
.3057008
Control_of~n | .105858 .2246868 0.47 0.640 -.3494008
.5611167
EGMOND_G | -.3372894 .1960191 -1.72 0.094 -.7344619
.0598831
CROSS_BORD~N | .0000804 .0000482 1.67 0.104 -.0000172
.0001781
_cons | .6958058 .3569155 1.95 0.059 -.0273736
1.418985

```

-----  
. whitetst

White's general test statistic : 32.51958 Chi-sq(34) P-value = .5402

```
.
. vif
```

| Variable     | VIF   | 1/VIF    |
|--------------|-------|----------|
| Rule_of_Law  | 17.50 | 0.057129 |
| Control_of~n | 13.78 | 0.072543 |
| Regulatory~y | 6.86  | 0.145851 |
| EGMOND_G     | 1.98  | 0.504179 |
| X_SUM_INTCFT | 1.86  | 0.536884 |
| X_SUM_INTCML | 1.86  | 0.537395 |
| CROSS_BORD~N | 1.37  | 0.727816 |
| Mean VIF     | 6.46  |          |

```
.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulator
> y_Quality Rule_of_Law Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_A
> SSETS_IN
```

```
Logistic regression                               Number of obs   =
45                                                  LR chi2(7)       =
19.98                                             Prob > chi2      =
0.0056                                           Pseudo R2        =
Log likelihood = -16.10798
0.3827
```

|              | Odds Ratio | Std. Err. | z     | P> z  | [95% Conf. Interval] |
|--------------|------------|-----------|-------|-------|----------------------|
| X_SUM_INTCML | 2.565162   | 1.73299   | 1.39  | 0.163 | .6824236             |
| X_SUM_INTCFT | .8160575   | .172873   | -0.96 | 0.337 | .5387694             |
| Regulatory~y | 14.32038   | 19.44059  | 1.96  | 0.050 | 1.00094              |
| Rule_of_Law  | .0170176   | .0396749  | -1.75 | 0.081 | .0001764             |
| Control_of~n | 2.952195   | 4.533791  | 0.70  | 0.481 | .1455206             |
| EGMOND_G     | .0391503   | .0599489  | -2.12 | 0.034 | .0019469             |
| CROSS_BORD~N | 1.007529   | .0042644  | 1.77  | 0.076 | .9992058             |

Note: 0 failures and 4 successes completely determined.

```
. logit BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory_Qu
> ality Rule_of_Law Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_ASSET
> S_IN
```

```
Iteration 0: log likelihood = -26.096183
Iteration 1: log likelihood = -20.197908
Iteration 2: log likelihood = -18.806145
Iteration 3: log likelihood = -17.590253
Iteration 4: log likelihood = -16.636473
Iteration 5: log likelihood = -16.208602
Iteration 6: log likelihood = -16.114047
Iteration 7: log likelihood = -16.108006
Iteration 8: log likelihood = -16.10798
Iteration 9: log likelihood = -16.10798
```

```
Logistic regression                               Number of obs   =
45                                                LR chi2(7)     =
19.98                                           Prob > chi2    =
0.0056                                         Pseudo R2     =
Log likelihood = -16.10798
0.3827
```

```
-----
```

| BIN_Y_S~p_FT | Coef.     | Std. Err. | z     | P> z  | [95% Conf. Interval] |
|--------------|-----------|-----------|-------|-------|----------------------|
| X_SUM_INTCML | .9420215  | .675587   | 1.39  | 0.163 | -.3821046            |
| 2.266148     |           |           |       |       |                      |
| X_SUM_INTCFT | -.2032704 | .2118392  | -0.96 | 0.337 | -.6184676            |
| .2119268     |           |           |       |       |                      |
| Regulatory~y | 2.661683  | 1.357547  | 1.96  | 0.050 | .0009394             |
| 5.322427     |           |           |       |       |                      |
| Rule_of_Law  | -4.073509 | 2.331408  | -1.75 | 0.081 | -8.642984            |
| .495966      |           |           |       |       |                      |
| Control_of~n | 1.082549  | 1.535736  | 0.70  | 0.481 | -1.927438            |
| 4.092536     |           |           |       |       |                      |
| EGMOND_G     | -3.240347 | 1.531248  | -2.12 | 0.034 | -6.241538            |
| .2391554     |           |           |       |       |                      |
| CROSS_BORD~N | .007501   | .0042325  | 1.77  | 0.076 | -.0007945            |
| .0157966     |           |           |       |       |                      |
| _cons        | .0225684  | 1.972045  | 0.01  | 0.991 | -3.842569            |
| 3.887706     |           |           |       |       |                      |

```
-----
```

Note: 0 failures and 4 successes completely determined.

```
. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory
> _Quality Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_ASSETS_IN
```

```
Source | SS df MS Number of obs =
45
```

```

-----+-----
1.91
      Model | 2.03706726      6 .339511211
0.1047
      Residual | 6.76293274     38 .177971914
0.2315
-----+-----
0.1101
      Total |           8.8    44      .2
.42187
-----

```

F( 6, 38) =  
Prob > F =  
R-squared =  
Adj R-squared =  
Root MSE =

```

-----
-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      t    P>|t|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |   .1449315   .1030097     1.41   0.168   -.0636007
.3534637
X_SUM_INTCFT |  -.0283316   .0362398    -0.78   0.439   -.1016953
.0450321
Regulatory~y |   .2380502   .1580424     1.51   0.140   -.0818899
.5579902
Control_of~n |  -.0534008   .1309837    -0.41   0.686   -.3185634
.2117619
      EGMOND_G |  -.259199    .1739167    -1.49   0.144   -.6112749
.0928768
CROSS_BORD~N |   .0000703   .0000466     1.51   0.140   -.0000241
.0001647
      _cons |   .630619    .3479437     1.81   0.078   -.0737563
1.334994
-----

```

```

.
. whitetst

```

White's general test statistic : 28.05968 Chi-sq(26) P-value = .3555

```

.
. vif

```

```

-----+-----
Variable |      VIF      1/VIF
-----+-----
Regulatory~y |      4.98     0.200692
Control_of~n |      4.71     0.212132
X_SUM_INTCML |      1.86     0.537577
X_SUM_INTCFT |      1.85     0.539460
      EGMOND_G |      1.57     0.636485
CROSS_BORD~N |      1.29     0.772453
-----+-----
Mean VIF |      2.71

```

```

.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulator
> y_Quality_Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_ASSETS_IN

```

```

Logistic regression
45
16.28
0.0123
Log likelihood = -17.957519
0.3119
Number of obs =
LR chi2(6) =
Prob > chi2 =
Pseudo R2 =

```

```

-----
-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |   2.686243   1.822623     1.46   0.145    .7105633
10.15519
X_SUM_INTCFT |   .8209075   .1731971    -0.94   0.350    .5428822
1.241317
Regulatory~y |   3.697484   3.87575     1.25   0.212    .4738774
28.85006
Control_of~n |   .2889397   .3551562    -1.01   0.312    .0259738
3.214246
    EGMOND_G |   .1380952   .164719     -1.66   0.097    .0133313
1.430493
CROSS_BORD~N |   1.004687   .0030281     1.55   0.121    .9987698
1.01064
-----
-----

```

Note: 0 failures and 2 successes completely determined.

```

.
. logit BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory_Qu
> ality Control_of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN

```

```

Iteration 0: log likelihood = -26.096183
Iteration 1: log likelihood = -20.538463
Iteration 2: log likelihood = -19.450708
Iteration 3: log likelihood = -18.722768
Iteration 4: log likelihood = -18.181611
Iteration 5: log likelihood = -17.975366
Iteration 6: log likelihood = -17.95769
Iteration 7: log likelihood = -17.957519
Iteration 8: log likelihood = -17.957519

```

```

Logistic regression
45
16.28
0.0123
Log likelihood = -17.957519
0.3119
Number of obs =
LR chi2(6) =
Prob > chi2 =
Pseudo R2 =

```

```

-----
-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----

```

```

-----+-----
-----
X_SUM_INTCML | .9881436 .6785027 1.46 0.145 -.3416973
2.317984
X_SUM_INTCFT | -.1973448 .2109825 -0.94 0.350 -.6108629
.2161732
Regulatory~y | 1.307653 1.048213 1.25 0.212 -.7468067
3.362112
Control_of~n | -1.241537 1.229171 -1.01 0.312 -3.650667
1.167593
EGMOND_G | -1.979812 1.192793 -1.66 0.097 -4.317643
.3580191
CROSS_BORD~N | .0046763 .003014 1.55 0.121 -.001231
.0105836
_cons | -.1878498 1.922917 -0.10 0.922 -3.956698
3.580999
-----+-----

```

Note: 0 failures and 2 successes completely determined.

```
. regress BIN_Y_SUM_International_Coop_FT Control_of_corruption
```

```

Source | SS df MS Number of obs =
-----+-----
45
4.38 Model | .813092083 1 .813092083 F( 1, 43) =
0.0424 Residual | 7.98690792 43 .185742045 Prob > F =
0.0924 Total | 8.8 44 .2 R-squared =
0.0713 Adj R-squared =
.43098 Root MSE =
-----+-----

```

```

-----+-----
-----
BIN_Y_S~p_FT | Coef. Std. Err. t P>|t| [95% Conf.
Interval]
-----+-----
Control_of~n | .1289478 .061631 2.09 0.042 .0046571
.2532386
_cons | .6806045 .0690126 9.86 0.000 .5414274
.8197817
-----+-----

```

```
. whitetst
```

White's general test statistic : 8.758994 Chi-sq( 2) P-value = .0125

```
. vif
```

```

Variable | VIF 1/VIF
-----+-----
Control_of~n | 1.00 1.000000

```

```
-----+-----
Mean VIF |          1.00
```

```
.
. logistic BIN_Y_SUM_International_Coop_FT Regulatory_Quality
```

```
Logistic regression          Number of obs =
45                             LR chi2(1)    =
6.00                           Prob > chi2   =
0.0143                         Pseudo R2   =
Log likelihood = -23.098088
0.1149
```

```
-----+-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
Regulatory~y |   2.641496   1.125786     2.28   0.023    1.145708
6.09012
```

```
.
. logit BIN_Y_SUM_International_Coop_FT Regulatory_Quality
```

```
Iteration 0:  log likelihood = -26.096183
Iteration 1:  log likelihood = -23.184773
Iteration 2:  log likelihood = -23.098302
Iteration 3:  log likelihood = -23.098088
```

```
Logistic regression          Number of obs =
45                             LR chi2(1)    =
6.00                           Prob > chi2   =
0.0143                         Pseudo R2   =
Log likelihood = -23.098088
0.1149
```

```
-----+-----
BIN_Y_S~p_FT |          Coef.   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
Regulatory~y |   .9713455   .4261927     2.28   0.023    .1360232
1.806668
      _cons |   .6946168   .3709903     1.87   0.061   -.0325107
1.421744
```

```
.
.
.
```

. \*

```
-----  
> _____  
.  
. regress Ln_Y_SUM_Total X_SUM_INTCML X_SUM_INTCFT Regulatory_Quality  
Control  
> _of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN  
Atractiveness_to_mon  
> ey_launderin Informal_Remittances_in__GDP_20  
Risk_to_Terrorism_Financing
```

| Source      | SS         | df | MS         | Number of obs = |
|-------------|------------|----|------------|-----------------|
| 38          |            |    |            |                 |
| -----+----- |            |    |            | F( 9, 28) =     |
| 4.92        |            |    |            |                 |
| Model       | 3.786635   | 9  | .420737222 | Prob > F =      |
| 0.0005      |            |    |            |                 |
| Residual    | 2.39321439 | 28 | .085471942 | R-squared =     |
| 0.6127      |            |    |            |                 |
| -----+----- |            |    |            | Adj R-squared = |
| 0.4883      |            |    |            |                 |
| Total       | 6.17984938 | 37 | .167022956 | Root MSE =      |
| .29236      |            |    |            |                 |

| Ln_Y_SUM_T~1<br>Interval] | Coef.     | Std. Err. | t     | P> t  | [95% Conf. |
|---------------------------|-----------|-----------|-------|-------|------------|
| -----+-----               |           |           |       |       |            |
| -----                     |           |           |       |       |            |
| X_SUM_INTCML              | .0249988  | .083184   | 0.30  | 0.766 | -.145396   |
| .1953935                  |           |           |       |       |            |
| X_SUM_INTCFT              | .0401445  | .0278948  | 1.44  | 0.161 | -.0169953  |
| .0972844                  |           |           |       |       |            |
| Regulatory~y              | .2693015  | .120467   | 2.24  | 0.034 | .022536    |
| .516067                   |           |           |       |       |            |
| Control_of~n              | -.2148092 | .1172201  | -1.83 | 0.078 | -.4549237  |
| .0253053                  |           |           |       |       |            |
| EGMOND_G                  | .0772879  | .1383066  | 0.56  | 0.581 | -.2060203  |
| .3605961                  |           |           |       |       |            |
| CROSS_BORD~N              | 4.46e-06  | .0000398  | 0.11  | 0.912 | -.0000771  |
| .000086                   |           |           |       |       |            |
| Atractiven~n              | .0185317  | .0147906  | 1.25  | 0.221 | -.0117655  |
| .0488289                  |           |           |       |       |            |
| Informal_~20              | -1.885075 | 1.519431  | -1.24 | 0.225 | -4.997488  |
| 1.227337                  |           |           |       |       |            |
| Risk_to_Te~g              | -.11284   | .1227081  | -0.92 | 0.366 | -.3641962  |
| .1385162                  |           |           |       |       |            |



```

      _cons |    3.654844    .3584971    10.19    0.000    2.920496
4.389192
-----

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. whitetst

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```

White's general test statistic :          38  Chi-sq(37)  P-value =  .4236

```

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. vif

```

| Variable      | VIF  | 1/VIF    |
|---------------|------|----------|
| Control_of~n  | 7.03 | 0.142190 |
| Regulatory~y  | 5.43 | 0.184233 |
| Attractiven~n | 4.12 | 0.242854 |
| X_SUM_INTCFT  | 2.22 | 0.451302 |
| X_SUM_INTCML  | 2.18 | 0.459729 |
| EGMOND_G      | 1.65 | 0.606406 |
| Informal_~20  | 1.57 | 0.635441 |
| CROSS_BORD~N  | 1.51 | 0.662011 |
| Risk_to_Te~g  | 1.46 | 0.682611 |
| Mean VIF      | 3.02 |          |

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>
>
> log: C:\Documents and Settings\Concha\Desktop\Concha Output.smcl
log type: smcl
opened on: 12 Jul 2007, 20:46:50

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. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"

```

```

. regress BIN_Y_SUM_Legal_ML X_SUM_INTCML X_SUM_INTCFT

```

| Source | SS       | df | MS         | Number of obs = |
|--------|----------|----|------------|-----------------|
| 42     |          |    |            |                 |
| 4.48   |          |    |            | F( 2, 39) =     |
| 0.0177 | Model    | 2  | .945367588 | Prob > F =      |
| 0.1868 | Residual | 39 | .21098237  | R-squared =     |
| 0.1451 |          |    |            | Adj R-squared = |
| .45933 | Total    | 41 | .246806039 | Root MSE =      |

| BIN_Y~gal_ML | Coef.     | Std. Err. | t     | P> t  | [95% Conf. Interval]  |
|--------------|-----------|-----------|-------|-------|-----------------------|
| X_SUM_INTCML | .0883696  | .1092282  | 0.81  | 0.423 | -.1325652<br>.3093045 |
| X_SUM_INTCFT | .0527797  | .0351319  | 1.50  | 0.141 | -.0182813<br>.1238406 |
| _cons        | -.4665234 | .2999279  | -1.56 | 0.128 | -1.073185<br>.140138  |

. whitest

White's general test statistic : 22.93505 Chi-sq( 5) P-value = 3.5e-04

. vif

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| X_SUM_INTCFT | 1.95 | 0.513994 |
| X_SUM_INTCML | 1.95 | 0.513994 |
| Mean VIF     | 1.95 |          |

. logistic BIN\_Y\_SUM\_Legal\_ML X\_SUM\_INTCML X\_SUM\_INTCFT

|                             |                 |        |
|-----------------------------|-----------------|--------|
| Logistic regression         | Number of obs = | 42     |
| 12.45                       | LR chi2(2) =    | 12.45  |
| 0.0020                      | Prob > chi2 =   | 0.0020 |
| Log likelihood = -22.119103 | Pseudo R2 =     | 0.2197 |

| BIN_Y~gal_ML | Odds Ratio | Std. Err. | z    | P> z  | [95% Conf. Interval] |
|--------------|------------|-----------|------|-------|----------------------|
| X_SUM_INTCML | 1.511788   | .8149248  | 0.77 | 0.443 | .5255972<br>4.34839  |
| X_SUM_INTCFT | 2.292278   | 1.073529  | 1.77 | 0.077 | .9154383<br>5.739918 |

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```
. regress BIN_Y_SUM_Legal_FT X_SUM_INTCML X_SUM_INTCFT
```

| Source   | SS         | df | MS         | Number of obs | = |
|----------|------------|----|------------|---------------|---|
| 42       |            |    |            | F( 2, 39)     | = |
| 0.61     |            |    |            | Prob > F      | = |
| Model    | .247820776 | 2  | .123910388 | R-squared     | = |
| 0.5464   |            |    |            | Adj R-squared | = |
| Residual | 7.87122684 | 39 | .201826329 | Root MSE      | = |
| 0.0305   |            |    |            |               |   |
| 0.0192   |            |    |            |               |   |
| Total    | 8.11904762 | 41 | .198025552 |               |   |
| .44925   |            |    |            |               |   |

| BIN_Y~gal_FT | Coef.     | Std. Err. | t     | P> t  | [95% Conf. Interval]  |
|--------------|-----------|-----------|-------|-------|-----------------------|
| X_SUM_INTCML | .0730665  | .1068318  | 0.68  | 0.498 | -.1430212<br>.2891542 |
| X_SUM_INTCFT | -.0378611 | .0343611  | -1.10 | 0.277 | -.107363<br>.0316408  |
| _cons        | .4612968  | .2933477  | 1.57  | 0.124 | -.1320549<br>1.054648 |

```
. whitetst
```

```
White's general test statistic : 1.743542 Chi-sq( 5) P-value = .8834
```

```
. vif
```

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| X_SUM_INTCFT | 1.95 | 0.513994 |
| X_SUM_INTCML | 1.95 | 0.513994 |
| Mean VIF     | 1.95 |          |

```
. logistic BIN_Y_SUM_Legal_FT X_SUM_INTCML X_SUM_INTCFT
```

| Logistic regression         | Number of obs | = |
|-----------------------------|---------------|---|
| 42                          | LR chi2(2)    | = |
| 1.24                        | Prob > chi2   | = |
| 0.5375                      | Pseudo R2     | = |
| Log likelihood = -23.530848 |               |   |
| 0.0257                      |               |   |

```

-----
-----
BIN_Y~gal_FT | Odds Ratio   Std. Err.      z    P>|z|      [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |    1.47974    .8245609     0.70   0.482     .4964407
4.41066
X_SUM_INTCFT |    .8269765    .1432692    -1.10   0.273     .5888804
1.16134
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```

. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Voice_and_
> Accountability Political_Stability Government_Effectiveness
Regulatory_Quality
> Rule_of_Law Control_of_corruption FAILED_STATES EGMOND_G Economic_F
Risk_to_
> Terrorism_Financing Informal_Remittances_in___GDP_20
CROSS_BORDER_FINANCIAL_A
> SSETS_IN

```

```

Source |      SS      df      MS              Number of obs =
36
-----+-----
1.16
Model |  3.14359052    14    .22454218          F( 14,   21) =
0.3718
Residual |  4.0786317    21    .194220557        Prob > F      =
0.4353
-----+-----
0.0588
Total |  7.22222222    35    .206349206        R-squared     =
.4407
Root MSE =

```

```

-----
-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      t    P>|t|      [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |   -.0088456   .1542242    -0.06   0.955    -.3295723
.3118811
X_SUM_INTCFT |    .0021073   .0516306     0.04   0.968    -.1052645
.109479
Voice_and~y |   -.7259897   .3275608    -2.22   0.038    -1.40719   -
.0447897
Political~y |   -.3027512   .2275881    -1.33   0.198    -.7760465
.1705441

```

```

Government~s | .4721787 .554861 0.85 0.404 -.681718
1.626075
Regulatory~y | .4381709 .4292253 1.02 0.319 -.4544519
1.330794
Rule_of_Law | -.3310355 .4392918 -0.75 0.459 -1.244593
.5825217
Control_of~n | .0028008 .3566684 0.01 0.994 -.7389317
.7445333
FAILED_STA~S | -.013725 .0113546 -1.21 0.240 -.0373382
.0098881
EGMOND_G | .1297976 .3172734 0.41 0.687 -.5300086
.7896038
Economic_F | .0033449 .0219084 0.15 0.880 -.042216
.0489058
Risk_to_Te~g | -.4945237 .3577292 -1.38 0.181 -1.238462
.2494149
Informal_~20 | 4.632952 3.018941 1.53 0.140 -1.64528
10.91118
CROSS_BORD~N | .0000358 .0000647 0.55 0.586 -.0000988
.0001704
_cons | 2.216893 1.724371 1.29 0.213 -1.369133
5.802918

```

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. whitetst

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```

White's general test statistic :          36  Chi-sq(35)  P-value = .4215

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. vif

```

| Variable     | VIF   | 1/VIF    |
|--------------|-------|----------|
| Government~s | 60.24 | 0.016600 |
| Rule_of_Law  | 36.13 | 0.027677 |
| Regulatory~y | 27.14 | 0.036846 |
| Control_of~n | 26.70 | 0.037455 |
| Voice_and~y  | 15.57 | 0.064209 |
| FAILED_STA~S | 15.18 | 0.065867 |
| Economic_F   | 8.32  | 0.120247 |
| Political~y  | 8.27  | 0.120875 |
| Risk_to_Te~g | 5.42  | 0.184585 |
| EGMOND_G     | 3.50  | 0.285841 |
| X_SUM_INTCML | 3.09  | 0.323748 |
| X_SUM_INTCFT | 3.07  | 0.325787 |
| Informal_~20 | 1.92  | 0.522077 |
| CROSS_BORD~N | 1.73  | 0.578628 |
| Mean VIF     | 15.45 |          |

```

.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Voice_and
> _Accountability Political_Stability Government_Effectivenes
Regulatory_Qualit
> y Rule_of_Law Control_of_corruption FAILED_STATES EGMOND_G Economic_F
Risk_to

```

```
> _Terrorism_Financing Informal_Remittances_in___GDP_20
CROSS_BORDER_FINANCIAL_
> ASSETS_IN
```

```
Logistic regression      Number of obs   =
36                       LR chi2(14)      =
24.82                   Prob > chi2       =
0.0364                  Pseudo R2        =
Log likelihood = -8.8587479
0.5835
```

```
-----
```

| -----        |            |           |       |       |                      |
|--------------|------------|-----------|-------|-------|----------------------|
| BIN_Y_S~p_FT | Odds Ratio | Std. Err. | z     | P> z  | [95% Conf. Interval] |
| -----+-----  |            |           |       |       |                      |
| X_SUM_INTCML | 16.87864   | 43.42174  | 1.10  | 0.272 | .1090306             |
| 2612.921     |            |           |       |       |                      |
| X_SUM_INTCFT | .3801878   | .3313133  | -1.11 | 0.267 | .0689004             |
| 2.097851     |            |           |       |       |                      |
| Voice_and_~y | 9.89e-06   | .0000678  | -1.68 | 0.093 | 1.43e-11             |
| 6.830925     |            |           |       |       |                      |
| Political_~y | .0331813   | .089579   | -1.26 | 0.207 | .0001671             |
| 6.589727     |            |           |       |       |                      |
| Government~s | .5693297   | 4.249794  | -0.08 | 0.940 | 2.52e-07             |
| 1285895      |            |           |       |       |                      |
| Regulatory~y | 891.6465   | 6369.778  | 0.95  | 0.342 | .0007402             |
| 1.07e+09     |            |           |       |       |                      |
| Rule_of_Law  | .2064671   | .9700782  | -0.34 | 0.737 | .0000207             |
| 2061.535     |            |           |       |       |                      |
| Control_of~n | 14.95366   | 56.52874  | 0.72  | 0.474 | .009057              |
| 24689.42     |            |           |       |       |                      |
| FAILED_STA~S | .8201638   | .1824385  | -0.89 | 0.373 | .5303445             |
| 1.268362     |            |           |       |       |                      |
| EGMOND_G     | 26.75986   | 86.29936  | 1.02  | 0.308 | .0481279             |
| 14878.91     |            |           |       |       |                      |
| Economic_F   | 1.299954   | .4317215  | 0.79  | 0.430 | .678015              |
| 2.492392     |            |           |       |       |                      |
| Risk_to_Te~g | .0010426   | .0052332  | -1.37 | 0.171 | 5.57e-08             |
| 19.52768     |            |           |       |       |                      |
| Informal_~20 | 2.67e+34   | 1.38e+36  | 1.54  | 0.124 | 3.41e-10             |
| 2.09e+78     |            |           |       |       |                      |
| CROSS_BORD~N | 1.006957   | .0108392  | 0.64  | 0.520 | .9859349             |
| 1.028427     |            |           |       |       |                      |

```
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```

```
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Note: 1 failure and 4 successes completely determined.
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```

. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Political_
> Stability Government_Effectiveness Regulatory_Quality Rule_of_Law
Control_of_c
> orruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN

```

| Source   | SS         | df | MS         | Number of obs = |
|----------|------------|----|------------|-----------------|
| 41       |            |    |            |                 |
| -----    |            |    |            | F( 9, 31) =     |
| 1.12     |            |    |            |                 |
| Model    | 1.96892783 | 9  | .218769759 | Prob > F =      |
| 0.3813   |            |    |            |                 |
| Residual | 6.07985266 | 31 | .196124279 | R-squared =     |
| 0.2446   |            |    |            |                 |
| -----    |            |    |            | Adj R-squared = |
| 0.0253   |            |    |            |                 |
| Total    | 8.04878049 | 40 | .201219512 | Root MSE =      |
| .44286   |            |    |            |                 |

|              | Coef.     | Std. Err. | t     | P> t  | [95% Conf. Interval] |
|--------------|-----------|-----------|-------|-------|----------------------|
| BIN_Y_S~p_FT |           |           |       |       |                      |
| -----        |           |           |       |       |                      |
| X_SUM_INTCML | .0910781  | .1231919  | 0.74  | 0.465 | -.1601735            |
| .3423296     |           |           |       |       |                      |
| X_SUM_INTCFT | -.0282748 | .0392463  | -0.72 | 0.477 | -.1083182            |
| .0517687     |           |           |       |       |                      |
| Political~y  | -.0334804 | .1185002  | -0.28 | 0.779 | -.2751632            |
| .2082023     |           |           |       |       |                      |
| Government~s | .4131789  | .4182714  | 0.99  | 0.331 | -.4398913            |
| 1.266249     |           |           |       |       |                      |
| Regulatory~y | .065533   | .3053973  | 0.21  | 0.831 | -.557329             |
| .6883949     |           |           |       |       |                      |
| Rule_of_Law  | -.3427428 | .3206686  | -1.07 | 0.293 | -.9967509            |
| .3112652     |           |           |       |       |                      |
| Control_of~n | .03118    | .2691788  | 0.12  | 0.909 | -.5178138            |
| .5801738     |           |           |       |       |                      |
| EGMOND_G     | -.2406615 | .2307967  | -1.04 | 0.305 | -.7113745            |
| .2300516     |           |           |       |       |                      |
| CROSS_BORD~N | .0000804  | .0000515  | 1.56  | 0.128 | -.0000245            |
| .0001854     |           |           |       |       |                      |
| _cons        | .766673   | .3796284  | 2.02  | 0.052 | -.0075841            |
| 1.54093      |           |           |       |       |                      |

```

. whitetst

```

White's general test statistic : 41 Chi-sq(40) P-value = .4265

```

. vif

```

| Variable     | VIF   | 1/VIF    |
|--------------|-------|----------|
| Government~s | 37.54 | 0.026638 |

```

Rule_of_Law |      21.26    0.047034
Control_of~n |      16.40    0.060987
Regulatory~y |      15.50    0.064522
Political_~y |       2.80    0.356532
X_SUM_INTCML |       2.31    0.433590
  EGMOND_G |       2.31    0.433787
X_SUM_INTCFT |       1.92    0.521326
CROSS_BORD~N |       1.38    0.725243
-----+-----
      Mean VIF |      11.27

```

```

.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Political
> _Stability Government_Effectiveness Regulatory_Quality Rule_of_Law
Control_of_
> corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN

```

```

Logistic regression              Number of obs   =
41                               LR chi2(9)     =
17.22                            Prob > chi2    =
0.0454                           Pseudo R2     =
Log likelihood = -15.234419
0.3611

```

```

-----+-----
-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |  2.024031    1.5341        0.93   0.352    .4581999
8.940861
X_SUM_INTCFT |  .8375116    .1830746     -0.81   0.417    .545662
1.285458
Political_~y |  .8506812    .5854706     -0.23   0.814    .220769
3.277899
Government~s |  3.790048    10.39637      0.49   0.627    .0175283
819.5023
Regulatory~y |  5.252488    10.74316      0.81   0.417    .0953594
289.3122
  Rule_of_Law |  .0161331    .0397063     -1.68   0.094    .0001296
2.007595
Control_of~n |  2.697516    4.381264      0.61   0.541    .1118036
65.08373
  EGMOND_G |  .0718409    .1158513     -1.63   0.102    .0030459
1.694443
CROSS_BORD~N |  1.006268    .003879       1.62   0.105    .9986943
1.0139
-----+-----
-----

```

Note: 0 failures and 3 successes completely determined.

```

.
. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory

```



```
> _Quality Rule_of_Law Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_AS
> SETS_IN
```

| Source      | SS         | df | MS         | Number of obs = |
|-------------|------------|----|------------|-----------------|
| 41          |            |    |            |                 |
| -----+----- |            |    |            | F( 7, 33) =     |
| 1.33        |            |    |            |                 |
| Model       | 1.7679699  | 7  | .252567129 | Prob > F =      |
| 0.2689      |            |    |            |                 |
| Residual    | 6.28081059 | 33 | .190327594 | R-squared =     |
| 0.2197      |            |    |            |                 |
| -----+----- |            |    |            | Adj R-squared = |
| 0.0541      |            |    |            |                 |
| Total       | 8.04878049 | 40 | .201219512 | Root MSE =      |
| .43627      |            |    |            |                 |

| BIN_Y_S~p_FT<br>Interval] | Coef.     | Std. Err. | t     | P> t  | [95% Conf. |
|---------------------------|-----------|-----------|-------|-------|------------|
| -----+-----               |           |           |       |       |            |
| -----                     |           |           |       |       |            |
| X_SUM_INTCML              | .1367325  | .1129232  | 1.21  | 0.235 | -.0930115  |
| .3664765                  |           |           |       |       |            |
| X_SUM_INTCFT              | -.0343841 | .0381935  | -0.90 | 0.375 | -.1120893  |
| .0433211                  |           |           |       |       |            |
| Regulatory~y              | .2971553  | .1929654  | 1.54  | 0.133 | -.0954358  |
| .6897463                  |           |           |       |       |            |
| Rule_of_Law               | -.2665514 | .2774973  | -0.96 | 0.344 | -.8311239  |
| .2980211                  |           |           |       |       |            |
| Control_of~n              | .1504227  | .2384169  | 0.63  | 0.532 | -.3346401  |
| .6354855                  |           |           |       |       |            |
| EGMOND_G                  | -.3033528 | .2164166  | -1.40 | 0.170 | -.7436556  |
| .13695                    |           |           |       |       |            |
| CROSS_BORD~N              | .0000819  | .0000502  | 1.63  | 0.112 | -.0000203  |
| .0001841                  |           |           |       |       |            |
| _cons                     | .7330517  | .3709457  | 1.98  | 0.057 | -.0216431  |
| 1.487746                  |           |           |       |       |            |

```
. whitetst
White's general test statistic : 33.03268 Chi-sq(34) P-value = .5149
```

```
. vif
```

| Variable     | VIF   | 1/VIF    |
|--------------|-------|----------|
| -----+-----  |       |          |
| Rule_of_Law  | 16.41 | 0.060951 |
| Control_of~n | 13.26 | 0.075442 |
| Regulatory~y | 6.38  | 0.156838 |
| EGMOND_G     | 2.09  | 0.478768 |
| X_SUM_INTCML | 2.00  | 0.500781 |
| X_SUM_INTCFT | 1.87  | 0.534195 |
| CROSS_BORD~N | 1.35  | 0.739424 |

```

-----+-----
      Mean VIF |          6.19

.
. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulator
> y_Quality Rule_of_Law Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_A
> SSETS_IN

```

```

Logistic regression                                Number of obs   =
41                                                  LR chi2(7)      =
16.96                                              Prob > chi2     =
0.0176                                           Pseudo R2      =
Log likelihood = -15.362887
0.3557

```

```

-----+-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
X_SUM_INTCML |   2.382486   1.653531     1.25   0.211    .6113164
9.285273
X_SUM_INTCFT |   .8125655   .173017     -0.97   0.330    .5353215
1.233395
Regulatory~y |  11.71485   15.64535     1.84   0.065    .8549575
160.5198
  Rule_of_Law |   .0177729   .0400148    -1.79   0.073    .0002154
1.46621
Control_of~n |   3.705077   5.589186     0.87   0.385    .1926379
71.26113
    EGMOND_G |   .0579606   .0883552    -1.87   0.062    .0029212
1.150022
CROSS_BORD~N |   1.006455   .0037658     1.72   0.086    .9991009
1.013863

```

Note: 0 failures and 3 successes completely determined.

```

.
. logit BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory_Qu
> ality Rule_of_Law Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_ASSET
> S_IN

```

```

Iteration 0:   log likelihood = -23.843685
Iteration 1:   log likelihood = -19.027599
Iteration 2:   log likelihood = -17.718456
Iteration 3:   log likelihood = -16.547479
Iteration 4:   log likelihood = -15.722445
Iteration 5:   log likelihood = -15.418527
Iteration 6:   log likelihood = -15.365284
Iteration 7:   log likelihood = -15.362893
Iteration 8:   log likelihood = -15.362887

```

```

Logistic regression
41
16.96
0.0176
Log likelihood = -15.362887
0.3557

Number of obs =
LR chi2(7) =
Prob > chi2 =
Pseudo R2 =

```

```

-----
-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCLM |   .8681445   .6940358     1.25   0.211   -.4921406
2.22843
X_SUM_INTCLF |  -.2075588   .2129268    -0.97   0.330   -.6248877
.2097702
Regulatory~y |   2.460857   1.335515     1.84   0.065   -.1567035
5.078417
  Rule_of_Law |  -4.030079   2.251449    -1.79   0.073   -8.442838
.3826807
Control_of~n |   1.309704   1.508521     0.87   0.385   -1.646943
4.266351
  EGMOND_G |  -2.847992   1.524402    -1.87   0.062   -5.835766
.139781
CROSS_BORDER~N | .0064339   .0037416     1.72   0.086   -.0008995
.0137674
  _cons |   .202583   1.968386     0.10   0.918   -3.655382
4.060548
-----
-----

```

Note: 0 failures and 3 successes completely determined.

```

.
.
.
.
.
.
.
.
.
.
. regress BIN_Y_SUM_International_Coop_FT X_SUM_INTCLM X_SUM_INTCLF
Regulatory
> _Quality Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_ASSETS_IN

```

```

Source |      SS      df      MS              Number of obs =
-----+-----
1.40
Model |  1.5923611     6  .265393516          F(  6,   34) =
0.2440
Residual |  6.45641939   34  .189894688          Prob > F      =
0.1978
R-squared =

```

```

-----+-----
0.0563
Total | 8.04878049 40 .201219512
.43577

```

```

Adj R-squared =
Root MSE =

```

```

-----+-----
BIN_Y_S~p_FT |      Coef.   Std. Err.    t    P>|t|    [95% Conf.
Interval]
-----+-----
X_SUM_INTCML |   .1379869   .1127872    1.22   0.230   -.0912242
.367198
X_SUM_INTCFT |  -.0314969   .0380317   -0.83   0.413   -.1087866
.0457928
Regulatory~y |   .2034487     .1663     1.22   0.230   -.1345136
.541411
Control_of~n |  -.0361731   .1380683   -0.26   0.795   -.3167617
.2444155
EGMOND_G |  -.2118912   .1941233   -1.09   0.283   -.6063972
.1826148
CROSS_BORD~N |   .0000698   .0000485    1.44   0.160   -.0000289
.0001684
_cons |   .6548744   .3614953    1.81   0.079   -.0797725
1.389521

```

```

. whitetst

```

```

White's general test statistic : 26.36443 Chi-sq(26) P-value = .4432

```

```

. vif

```

```

-----+-----
Variable |      VIF      1/VIF
-----+-----
Regulatory~y |      4.75     0.210686
Control_of~n |      4.46     0.224446
X_SUM_INTCML |      2.00     0.500848
X_SUM_INTCFT |      1.86     0.537524
EGMOND_G |      1.68     0.593693
CROSS_BORD~N |      1.27     0.789367
-----+-----
Mean VIF |      2.67

```

```

. logistic BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulator
> y_Quality Control_of_corruption EGMOND_G
CROSS_BORDER_FINANCIAL_ASSETS_IN

```

```

Logistic regression
41
13.06
0.0421
Number of obs =
LR chi2(6) =
Prob > chi2 =

```

Log likelihood = -17.312753  
0.2739

Pseudo R2 =

```
-----
-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |   2.446525   1.699259     1.29   0.198   .6271028
9.544658
X_SUM_INTCFT |   .8258128   .1733408    -0.91   0.362   .5472826
1.246096
Regulatory~y |   2.957685   2.990783     1.07   0.284   .4075915
21.46243
Control_of~n |   .3753143    .43506     -0.85   0.398   .0386983
3.639972
    EGMOND_G |   .1915788   .2356644    -1.34   0.179   .0171898
2.135134
CROSS_BORD~N |   1.004069   .0028271     1.44   0.149   .9985435
1.009626
-----
-----
```

Note: 0 failures and 2 successes completely determined.

```
.
. logit BIN_Y_SUM_International_Coop_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory_Qu
> ality Control_of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN
```

```
Iteration 0:  log likelihood = -23.843685
Iteration 1:  log likelihood = -19.470283
Iteration 2:  log likelihood = -18.52772
Iteration 3:  log likelihood = -17.905063
Iteration 4:  log likelihood = -17.470369
Iteration 5:  log likelihood = -17.322979
Iteration 6:  log likelihood = -17.312816
Iteration 7:  log likelihood = -17.312753
Iteration 8:  log likelihood = -17.312753
```

Logistic regression  
41

Number of obs =

13.06

LR chi2(6) =

0.0421

Prob > chi2 =

Log likelihood = -17.312753  
0.2739

Pseudo R2 =

```
-----
-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |   .8946685   .6945603     1.29   0.198   -.4666448
2.255982
X_SUM_INTCFT |  -.1913871   .2099033    -0.91   0.362   -.60279
.2200157
-----
```

```

Regulatory~y | 1.084407 1.01119 1.07 0.284 -.8974899
3.066304
Control_of~n | -.9799916 1.159188 -0.85 0.398 -3.251959
1.291976
EGMOND_G | -1.652456 1.230117 -1.34 0.179 -4.063441
.7585292
CROSS_BORD~N | .0040611 .0028157 1.44 0.149 -.0014575
.0095797
_cons | -.0658505 1.905834 -0.03 0.972 -3.801217
3.669516

```

-----  
Note: 0 failures and 2 successes completely determined.

.  
.  
end of do-file

. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"

. regress BIN\_Y\_SUM\_International\_Coop\_FT Control\_of\_corruption

| Source      | SS         | df | MS         | Number of obs = |
|-------------|------------|----|------------|-----------------|
| 41          |            |    |            |                 |
| -----+----- |            |    |            | F( 1, 39) =     |
| 3.57        |            |    |            |                 |
| Model       | .675577525 | 1  | .675577525 | Prob > F =      |
| 0.0662      |            |    |            |                 |
| Residual    | 7.37320296 | 39 | .189056486 | R-squared =     |
| 0.0839      |            |    |            |                 |
| -----+----- |            |    |            | Adj R-squared = |
| 0.0604      |            |    |            |                 |
| Total       | 8.04878049 | 40 | .201219512 | Root MSE =      |
| .43481      |            |    |            |                 |

```

-----
BIN_Y_S~p_FT | Coef. Std. Err. t P>|t| [95% Conf.
Interval]
-----+-----
Control_of~n | .1233762 .0652664 1.89 0.066 -.0086375
.2553898
_cons | .6795848 .0732899 9.27 0.000 .531342
.8278275

```

. whitetst

White's general test statistic : 7.494494 Chi-sq( 2) P-value = .0236

. vif

| Variable    | VIF | 1/VIF |
|-------------|-----|-------|
| -----+----- |     |       |

```
Control_of~n |      1.00    1.000000
-----+-----
      Mean VIF |      1.00
```

```
.
. logistic BIN_Y_SUM_International_Coop_FT Regulatory_Quality
```

```
Logistic regression                Number of obs =
41                                  LR chi2(1)    =
4.70                                Prob > chi2   =
0.0302                              Pseudo R2   =
Log likelihood = -21.495551
0.0985
```

```
-----+-----
BIN_Y_S~p_FT | Odds Ratio   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
Regulatory~y |   2.416165    1.041522     2.05   0.041    1.038017
5.624047
```

```
.
. logit BIN_Y_SUM_International_Coop_FT Regulatory_Quality
```

```
Iteration 0:  log likelihood = -23.843685
Iteration 1:  log likelihood = -21.552165
Iteration 2:  log likelihood = -21.495628
Iteration 3:  log likelihood = -21.495551
```

```
Logistic regression                Number of obs =
41                                  LR chi2(1)    =
4.70                                Prob > chi2   =
0.0302                              Pseudo R2   =
Log likelihood = -21.495551
0.0985
```

```
-----+-----
BIN_Y_S~p_FT |      Coef.   Std. Err.      z    P>|z|    [95% Conf.
Interval]
-----+-----
Regulatory~y |   .8821818   .4310639     2.05   0.041    .037312
1.727051
      _cons |   .6952922   .3870368     1.80   0.072   -.0632859
1.45387
```

```
.
.
```

end of do-file

## B. OLS REGRESSION

```
. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"  
  
. regress Ln_Y_SUM_Total X_SUM_INTCML X_SUM_INTCFT Regulatory_Quality  
Control  
> _of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN  
Atractiveness_to_mon  
> ey_launderin Informal_Remittances_in___GDP_20  
Risk_to_Terrorism_Financing
```

| Source      | SS         | df | MS         | Number of obs = |
|-------------|------------|----|------------|-----------------|
| 34          |            |    |            |                 |
| -----+----- |            |    |            | F( 9, 24) =     |
| 3.72        |            |    |            |                 |
| Model       | 1.96908969 | 9  | .218787744 | Prob > F =      |
| 0.0048      |            |    |            |                 |
| Residual    | 1.41155646 | 24 | .058814852 | R-squared =     |
| 0.5825      |            |    |            |                 |
| -----+----- |            |    |            | Adj R-squared = |
| 0.4259      |            |    |            |                 |
| Total       | 3.38064615 | 33 | .102443823 | Root MSE =      |
| .24252      |            |    |            |                 |

| Ln_Y_SUM_T~l<br>Interval] | Coef.     | Std. Err. | t     | P> t  | [95% Conf. |
|---------------------------|-----------|-----------|-------|-------|------------|
| -----+-----               |           |           |       |       |            |
| -----                     |           |           |       |       |            |
| X_SUM_INTCML              | .012301   | .076001   | 0.16  | 0.873 | -.1445574  |
| .1691595                  |           |           |       |       |            |
| X_SUM_INTCFT              | .0153274  | .025721   | 0.60  | 0.557 | -.0377582  |
| .0684129                  |           |           |       |       |            |
| Regulatory~y              | .3312129  | .1243634  | 2.66  | 0.014 | .0745393   |
| .5878864                  |           |           |       |       |            |
| Control_of~n              | -.2590095 | .0998097  | -2.60 | 0.016 | -.4650065  |
| .0530124                  |           |           |       |       |            |
| EGMOND_G                  | -.0032824 | .1224564  | -0.03 | 0.979 | -.2560199  |
| .2494551                  |           |           |       |       |            |
| CROSS_BORD~N              | 5.49e-06  | .0000333  | 0.16  | 0.871 | -.0000633  |
| .0000742                  |           |           |       |       |            |
| Atractiven~n              | .0258511  | .0124703  | 2.07  | 0.049 | .0001136   |
| .0515887                  |           |           |       |       |            |
| Informal_~20              | -1.169094 | 1.421895  | -0.82 | 0.419 | -4.103741  |
| 1.765553                  |           |           |       |       |            |
| Risk_to_Te~g              | .0651107  | .1156745  | 0.56  | 0.579 | -.1736298  |
| .3038512                  |           |           |       |       |            |
| _cons                     | 3.543287  | .3121308  | 11.35 | 0.000 | 2.899081   |
| 4.187494                  |           |           |       |       |            |

```
. whitetst
```



White's general test statistic : 34 Chi-sq(33) P-value = .4192

.  
. vif

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| Control_of~n | 6.20 | 0.161356 |
| Regulatory~y | 5.98 | 0.167108 |
| Atractiven~n | 3.96 | 0.252306 |
| X_SUM_INTCFT | 2.20 | 0.454126 |
| X_SUM_INTCML | 2.07 | 0.483519 |
| Risk_to_Te~g | 1.58 | 0.633255 |
| CROSS_BORD~N | 1.49 | 0.672744 |
| Informal_~20 | 1.47 | 0.682282 |
| EGMOND_G     | 1.42 | 0.705572 |
| Mean VIF     | 2.93 |          |

.  
.  
.  
end of do-file

. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"

```
. regress Ln_Y_SUM_Total X_SUM_INTCML X_SUM_INTCFT Regulatory_Quality
Control
> _of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN
Atractiveness_to_mon
> ey_launderin Informal_Remittances_in__GDP_20
```

| Source   | SS         | df | MS         | Number of obs = |
|----------|------------|----|------------|-----------------|
| 34       |            |    |            | F( 8, 25) =     |
| 4.26     |            |    |            | Prob > F =      |
| Model    | 1.95045525 | 8  | .243806906 | R-squared =     |
| 0.0025   |            |    |            | Adj R-squared = |
| Residual | 1.4301909  | 25 | .057207636 | Root MSE =      |
| 0.5769   |            |    |            |                 |
| Total    | 3.38064615 | 33 | .102443823 |                 |
| 0.4416   |            |    |            |                 |
| .23918   |            |    |            |                 |

| Ln_Y_SUM_T~1<br>Interval] | Coef.     | Std. Err. | t     | P> t  | [95% Conf. |
|---------------------------|-----------|-----------|-------|-------|------------|
| X_SUM_INTCML              | .0122609  | .0749554  | 0.16  | 0.871 | -.1421126  |
| .1666345                  |           |           |       |       |            |
| X_SUM_INTCFT              | .0212267  | .0231657  | 0.92  | 0.368 | -.0264838  |
| .0689373                  |           |           |       |       |            |
| Regulatory~y              | .3062452  | .1145855  | 2.67  | 0.013 | .0702519   |
| .5422384                  |           |           |       |       |            |
| Control_of~n              | -.2474283 | .0963223  | -2.57 | 0.017 | -.4458077  |
| .0490488                  |           |           |       |       |            |

```

      EGMOND_G | -.0073609      .12056      -0.06      0.952      -.2556589
      .240937
CROSS_BORD~N | 5.36e-06      .0000329      0.16      0.872      -.0000623
      .000073
Atractiven~n | .0245316      .0120795      2.03      0.053      -.0003466
      .0494098
Informal_~20 | -1.0414      1.384369      -0.75      0.459      -3.892562
      1.809762
      _cons | 3.636831      .2605752      13.96      0.000      3.100167
      4.173496
-----

```

-----

```

.
. whitetst

```

```

White's general test statistic :          34  Chi-sq(33)  P-value =  .4192

```

```

.
. vif

```

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| Control_of~n | 5.93 | 0.168517 |
| Regulatory~y | 5.22 | 0.191465 |
| Atractiven~n | 3.82 | 0.261549 |
| X_SUM_INTCML | 2.07 | 0.483520 |
| X_SUM_INTCFT | 1.84 | 0.544541 |
| CROSS_BORD~N | 1.49 | 0.672777 |
| Informal_~20 | 1.43 | 0.700103 |
| EGMOND_G     | 1.41 | 0.708051 |
| Mean VIF     | 2.90 |          |

```

.
end of do-file

```

```

. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"

```

```

. regress Ln_Y_SUM_Total_FT X_SUM_INTCML X_SUM_INTCFT
Regulatory_Quality Con
> trol_of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN
Informal_Remitta
> nces_in___GDP_20

```

| Source | SS         | df | MS         | Number of obs = |
|--------|------------|----|------------|-----------------|
| 38     |            |    |            |                 |
| 4.02   |            |    |            | F( 7, 30) =     |
| 0.0032 | 7.73394176 | 7  | 1.10484882 | Prob > F =      |
| 0.4842 | 8.2389327  | 30 | .27463109  | R-squared =     |
| 0.3638 |            |    |            | Adj R-squared = |
| .52405 | 15.9728745 | 37 | .43169931  | Root MSE =      |

```

-----
-----
Ln_Y_SUM_T~T |      Coef.   Std. Err.      t    P>|t|    [95% Conf.
Interval]
-----+-----
-----
X_SUM_INTCML |   .0654145   .1461928     0.45   0.658    -.233151
.3639801
X_SUM_INTCFT |   .0747796   .0478507     1.56   0.129    -.0229446
.1725038
Regulatory~y |   .489904    .210867     2.32   0.027    .0592561
.9205519
Control_of~n |  -.1403197   .1750898    -0.80   0.429    -.4979009
.2172614
    EGMOND_G |  -.3365855   .243296     -1.38   0.177    -.8334622
.1602912
CROSS_BORD~N |   .0000517   .0000667     0.77   0.445    -.0000846
.0001879
Informal_~20 |  -.9294838   2.668655    -0.35   0.730    -6.379605
4.520637
    _cons |   1.021243   .4497578     2.27   0.031    .1027146
1.939771
-----
-----

```

```

.
.
. whitetst

```

White's general test statistic : 34.17797 Chi-sq(34) P-value = .4592

```

.
. vif

```

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| Regulatory~y | 5.21 | 0.191864 |
| Control_of~n | 4.92 | 0.203210 |
| X_SUM_INTCML | 2.20 | 0.453805 |
| X_SUM_INTCFT | 2.01 | 0.496656 |
| EGMOND_G     | 1.68 | 0.593618 |
| Informal_~20 | 1.52 | 0.658019 |
| CROSS_BORD~N | 1.33 | 0.753537 |
| Mean VIF     | 2.70 |          |

```

.
end of do-file

```

```

. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"

```

```

. regress Ln_Y_SUM_Total_ML X_SUM_INTCML X_SUM_INTCFT
Regulatory_Quality Cont
> rol_of_corruption EGMOND_G CROSS_BORDER_FINANCIAL_ASSETS_IN
Atractiveness_to_
> money_launderin

```

```

Source |      SS      df      MS      Number of obs =
37

```

```

-----+-----
3.65
      Model | 1.54006123      7 .220008747
0.0061
      Residual | 1.74798554     29 .060275363
0.4684
-----+-----
0.3401
      Total | 3.28804677     36 .091334632
.24551
-----

```

F( 7, 29) =  
Prob > F =  
R-squared =  
Adj R-squared =  
Root MSE =

```

-----
-----
Ln_Y_SUM_T~L |      Coef.   Std. Err.      t    P>|t|    [95% Conf.
Interval]
-----+-----
X_SUM_INTCML | .0445018    .0696982     0.64   0.528   -.0980469
.1870506
X_SUM_INTCFT | .0119595    .0231783     0.52   0.610   -.0354455
.0593646
Regulatory~y | .2161603    .1123391     1.92   0.064   -.0135989
.4459194
Control_of~n | -.1638764    .092759     -1.77   0.088   -.3535898
.025837
      EGMOND_G | .0991592    .1192519     0.83   0.412   -.1447383
.3430566
CROSS_BORD~N | 8.70e-06    .0000295     0.30   0.770   -.0000516
.000069
Atractiven~n | .0195333    .0122509     1.59   0.122   -.0055225
.0445892
      _cons | 3.424035    .2532417    13.52   0.000   2.906098
3.941972
-----

```

```

.
. whitetst

```

White's general test statistic : 34.36738 Chi-sq(34) P-value = .4502

```

.
. vif

```

```

      Variable |      VIF      1/VIF
-----+-----
Control_of~n |      5.25     0.190367
Regulatory~y |      4.80     0.208520
Atractiven~n |      3.77     0.265189
X_SUM_INTCML |      1.84     0.543947
X_SUM_INTCFT |      1.77     0.565409
      EGMOND_G |      1.48     0.675963
CROSS_BORD~N |      1.42     0.705626
-----+-----
      Mean VIF |      2.90

```

```

.
end of do-file

```

```
. do "C:\DOCUME~1\LOCALS~1\Temp\STD00000000.tmp"
```

```
. regress Ln_Y_SUM_Total Regulatory_Quality Control_of_corruption
EGMOND_G CR
> OSS_BORDER_FINANCIAL_ASSETS_IN Atractiveness_to_money_launderin
Informal_Remi
> ttances_in__GDP_20
```

| Source      | SS         | df | MS         | Number of obs = |
|-------------|------------|----|------------|-----------------|
| 34          |            |    |            |                 |
| -----+----- |            |    |            | F( 6, 27) =     |
| 5.65        |            |    |            | Prob > F =      |
| Model       | 1.88173402 | 6  | .313622336 | R-squared =     |
| 0.0007      |            |    |            | Adj R-squared = |
| Residual    | 1.49891213 | 27 | .055515264 | Root MSE =      |
| 0.5566      |            |    |            |                 |
| -----+----- |            |    |            |                 |
| 0.4581      |            |    |            |                 |
| Total       | 3.38064615 | 33 | .102443823 |                 |
| .23562      |            |    |            |                 |

| Ln_Y_SUM_T~l<br>Interval] | Coef.     | Std. Err. | t     | P> t  | [95% Conf. |
|---------------------------|-----------|-----------|-------|-------|------------|
| -----+-----               |           |           |       |       |            |
| -----                     |           |           |       |       |            |
| Regulatory~y              | .3509839  | .1029724  | 3.41  | 0.002 | .1397019   |
| .5622659                  |           |           |       |       |            |
| Control_of~n              | -.2569339 | .0934793  | -2.75 | 0.011 | -.4487376  |
| .0651302                  |           |           |       |       |            |
| EGMOND_G                  | .0282341  | .1104158  | 0.26  | 0.800 | -.1983204  |
| .2547886                  |           |           |       |       |            |
| CROSS_BORD~N              | 4.36e-06  | .0000316  | 0.14  | 0.891 | -.0000604  |
| .0000691                  |           |           |       |       |            |
| Atractiven~n              | .0241294  | .0118837  | 2.03  | 0.052 | -.0002539  |
| .0485128                  |           |           |       |       |            |
| Informal_~20              | -1.078136 | 1.306783  | -0.83 | 0.417 | -3.759434  |
| 1.603162                  |           |           |       |       |            |
| _cons                     | 3.878064  | .1100794  | 35.23 | 0.000 | 3.6522     |
| 4.103929                  |           |           |       |       |            |

```
. whitetst
```

```
White's general test statistic : 21.12075 Chi-sq(26) P-value = .7357
```

```
. vif
```

| Variable     | VIF  | 1/VIF    |
|--------------|------|----------|
| -----+-----  |      |          |
| Control_of~n | 5.76 | 0.173630 |
| Regulatory~y | 4.35 | 0.230073 |
| Atractiven~n | 3.81 | 0.262244 |
| CROSS_BORD~N | 1.41 | 0.707337 |
| Informal_~20 | 1.31 | 0.762460 |

|          |  |      |          |
|----------|--|------|----------|
| EGMOND_G |  | 1.22 | 0.819157 |
| -----    |  |      |          |
| Mean VIF |  | 2.98 |          |

```
. corr Control_of_corruption Economic_F Corruption Transpa_Int
(obs=32)
```

|              |  | Contro~n | Econom~F | Corrup~n | Transp~t |
|--------------|--|----------|----------|----------|----------|
| -----        |  |          |          |          |          |
| Control_of~n |  | 1.0000   |          |          |          |
| Economic_F   |  | 0.7856   | 1.0000   |          |          |
| Corruption   |  | 0.9442   | 0.7888   | 1.0000   |          |
| Transpa_Int  |  | 0.0887   | 0.0723   | 0.0191   | 1.0000   |

### **Appendix 3. Methodology for assessing compliance**

[See PDF, FATF](#)

## **Appendix 4.**

### **Sintesi e Conclusioni**



## SINTESI

### **1. Obiettivo della tesi**

L'obiettivo di questa dissertazione è approfondire il ruolo delle organizzazioni internazionali nell'ambito della lotta al finanziamento del terrorismo, oltre che a formulare e vagliare le strategie alternative per contrastarlo. Questo studio è rivolto ad un elemento estremamente importante del sistema finanziario internazionale: la cooperazione economica e politica all'interno del quadro di raccomandazioni, emesse dagli organismi internazionali competenti, contro il riciclaggio del denaro ed il finanziamento del terrorismo internazionale -*Anti-Money Laundering and the Combating the Financing of Terrorism regime* (AML/CFT)-. Esso costituisce un problema di dimensioni globali che ha un impatto in molte aree; il riciclaggio del denaro, i conflitti, la corruzione e l'integrità del sistema finanziario internazionale.

Il problema generale posto dagli attacchi dei gruppi terroristi ed il loro finanziamento continua ad avere conseguenze negative per le organizzazioni internazionali e per i singoli individui. Precedenti studi teorici hanno già fornito ampia dimostrazione di quanto problematica sia l'applicazione efficace del quadro normativo non vincolante AML/CFT, quando si debba far leva sui singoli stati per l'attuazione delle regole a protezione del sistema finanziario internazionale, ed il rispetto di alcuni criteri standard internazionali.

Questo studio esamina empiricamente il livello di adeguamento complessivo con il quadro di regole AML/CFT, e la metodologia proposta ha, a nostro parere, permesso di mettere alla prova le poco numerose (seppure generalmente accettate come valide) teorie sull'adeguamento al quadro AML/CFT. L'ambito del presente lavoro è tale che qualsiasi risultato significativo sarebbe certamente molto prezioso per chi si trovi a dover prendere decisioni politiche. Per le proprie caratteristiche, il campione scelto risulta essere piuttosto unico e ci pare possa fornire informazioni rilevanti tanto da migliorare le conoscenze in questo settore. Il metodo scelto per l'analisi, inoltre, non è stato ancora utilizzato in modo diffuso nelle indagini sull'efficienza delle regolamentazioni internazionali; se ne desume che i risultati del presente studio forniranno certamente elementi metodologici nuovi ed utili. I risultati suggeriscono che combattere il finanziamento del terrorismo richiede un

sistema globale di cooperazione che consideri aspetti economici e politici dovuti alla situazione presente, piuttosto frammentata.

## **2. Rilevanza della materia oggetto di studio e suo ambito.**

Sembra utile a questo punto approfondire il motivo per il quale il presente lavoro è stato scritto; esso è stato redatto in un momento storico nel quale il terrorismo è considerato dalla comunità internazionale come una delle maggiori minacce alla sicurezza mondiale. Le Nazioni Unite e la Nato sono giunte alla conclusione condivisibile che le minacce alla sicurezza odierne, quali il terrorismo, hanno origine da elementi esterni allo stato nazione e che esse si rivolgano non solo ad esso ma anche direttamente ai singoli individui. L'accento sull'individuo viene posto anche da quanto statuisce la Commissione sulla Sicurezza Umana; secondo essa difendere la sicurezza umana significa assicurare un'insieme di sistemi politici, economici, sociali, ambientali, culturali e militari tali che quando combinati forniscono agli individui le basi per la sopravvivenza, il sostentamento e la dignità. Nel contempo anche le organizzazioni internazionali sono particolarmente preoccupate per l'efficacia dei criteri standard internazionali per la lotta contro il finanziamento del terrorismo. Questo quadro complessivo rende la materia della presente ricerca più rilevante e lo sforzo d'analisi ancor più necessario.

L'ambito della ricerca sarà quindi il seguente: si indagherà su *i fattori che influiscono e limitano la capacità dei sistemi multilaterali, regionali e nazionali di dare attuazione al quadro di norme non vincolanti AML/CFT, e di proporre una nuova strategia per migliorare il quadro attuale*, poiché non esiste, ad oggi uno studio esaustivo che affronti il tema del livello di adeguamento degli stati al quadro AML/CFT seguendo un metodo empirico e rigoroso.

Un altro tema affrontato con ancora minor frequenza con analisi empiriche è stato quello del livello di adeguamento dei singoli stati al quadro normativo AML/CFT, e praticamente niente è stato scritto fino ad oggi sull'analisi incrociata dell'adeguamento degli stati al quadro. Fino ad oggi, in effetti, nessuno ha fatto il tentativo di analizzare empiricamente l'attuazione di questo quadro internazionale al livello dei singoli stati, da parte delle autorità nazionali. *La valutazione empirica delle disposizioni internazionali al livello degli stati è stata assolutamente trascurata.*

L'analisi delle cause determinanti è stata sottoposta ad indagini teoriche, ma non al livello internazionale e certamente non nel contesto di una prospettiva empirica e comparativa. Più concretamente ci si riferisce qui agli studi di Reuter e Truman (2004) che sono la base del presente lavoro, in particolare laddove questi autori dichiarano che ***il quadro AML/CFT non può che portare un contributo modesto al controllo del terrorismo, della corruzione o degli stati dalla conduzione fallimentare, e che gli sforzi per controllare prevenire il flusso di fondi a sostegno del terrorismo è ostacolato dalle gravi divergenze di volontà politica, legislazione, regole e strumenti tra le varie giurisdizioni.***

“Mentre la maggior parte delle attività di riciclaggio del denaro possono essere ricondotte in qualche modo alle motivazioni del profitto, nel finanziamento del terrorismo la logica del profitto (se si astrae dalla minimizzazione dei costi) è largamente sostituita da motivazioni non economiche, in particolare da motivazioni di tipo politico. Questo potrebbe ancora maggiormente ostacolarne la scoperta...e per adesso non c'è base empirica per affermare l'efficacia del corrente quadro normativo AML in termini di soppressione del riciclaggio del denaro e dei crimini che lo generano”

(Reuter e Truman 2004:192)

Gli autori, inoltre, hanno delineato le difficoltà che insorgono nella lotta alla corruzione non appena essa coinvolge funzionari che abbiano una qualche influenza sul potere giudiziario, e i problemi relativi agli stati le cui debolezze strutturali non permettono al quadro AML/CFT d'essere posto tra le principali priorità. È necessario mettere qui in rilievo che anche il rapporto del Fondo Monetario Internazionale (IMF) dal titolo ***“Deterring the abuse of the financial system: elements of an emerging international integrity standard”*** “ nota quanto pochi siano gli studi che valutino i costi ed i benefici dell'attuazione di un quadro solido di regole per prevenire gli abusi a danno del sistema finanziario internazionale (Johnston, Abbott *et alia*, 2005:7)

La guerra finanziaria è emersa come strumento principale delle operazioni strategiche antiterroriste, quasi immediatamente dopo gli attacchi dell'11 settembre 2001 negli Stati Uniti. Essa si è appoggiata su una serie di strumenti legislativi, regolatori e politici già esistenti; tuttavia la strategia come mezzo per combattere il terrorismo internazionale e la sua attuazione ed integrazione nei diversi sistemi legislativi nazionali non sembra evolvere e continua a richiedere sforzi ingenti da parte delle autorità politiche e finanziarie.

Gli obiettivi principali della cooperazione internazionale nell'ambito della soppressione del finanziamento al terrorismo sono di minare la possibilità di dare sostegno alle campagne terroriste. Per fare questo gli sforzi internazionali sono stati centrati sulla prevenzione e la repressione. Sia l'una che l'altra implicano la stipulazione di strumenti legali finalizzati a privare il finanziamento del terrorismo del quantitativo di fondi necessari per svolgere le proprie attività criminose. Nonostante questo, i tentativi multilaterali e nazionali hanno avuto un successo limitato nel riferire transazioni sospette fatte da individui o gruppi precisi, e nell'impedire loro l'accesso al sistema finanziario internazionale.

Sembra essere chiaro che per avere successo, la guerra contro il finanziamento del terrorismo debba essere accompagnata da una serie di misure collegate; la raccolta mirata di informazioni da parte dei servizi di *intelligence*, il congelamento dei beni sospetti, le azioni volte a far rispettare le leggi nazionali vigenti fino agli sforzi diplomatici e ad un esame più scrupoloso delle regolamentazioni già esistenti e della loro estensione verso il settore finanziario, all'aumento della capacità dei vari governi e settori finanziari nazionali attraverso l'azione dei ministeri delle finanze ed ad altri programmi di assistenza tecnica per i diversi settori coinvolti.

Le azioni nazionali pure e semplici non sono sufficienti a combattere il finanziamento del terrorismo internazionale; in questo contesto dunque la cooperazione interstatale è assolutamente necessaria e ha implicazioni per il controllo del rispetto delle leggi al livello delle singole nazioni e per le azioni da intraprendere in tal senso.

La lotta al terrorismo si esplica in una molteplicità di aspetti diversi, e gli sforzi della comunità globale di limitare il flusso di fondi alle organizzazioni terroriste è una delle pietre angolari in questo processo. Rendendo più ridotto il margine per il fluire dei sostegni finanziari, la comunità internazionale spera di indebolire i numerosi gruppi terroristici attivi in tutto il mondo.

Fino ad oggi gli ostacoli eretti di fronte al flusso transnazionale dei finanziamenti si articolavano su due livelli.

- in primo luogo controllare le sorgenti che davano forza ai movimenti ed alle reti terroriste.
- in secondo luogo risalire lungo le tracce lasciate dai fondi.

Malgrado gli sforzi menzionati più sopra, l'identificazione del denaro legato al terrorismo ha presentato due problemi rilevanti;

- Il primo problema è dovuto al fatto che il denaro illegale generato dal crimine internazionale è spesso denaro contante, trasportato direttamente sul luogo del complotto tramite le reti di trasferimento informale del denaro.
- Il secondo ostacolo è rappresentato dal fatto che l'uso della moneta legale, introdotta nel sistema finanziario attraverso società "offshore" (OFC) da parte di reti terroriste è quasi impossibile da rintracciare.

***Questi due problemi spiegano la mancanza di dati sul finanziamento del terrorismo, e mostrano inoltre una delle cause del basso quantitativo di fondi congelati nel corso degli anni passati.*** L'ammontare complessivo di tali fondi, in tutto il mondo, dall'11 settembre 2001 può essere illustrato dettagliatamente come segue:

“Negli anni che seguono settembre 2001 sono stati congelati 112 miliardi di dollari USA legati al terrorismo, in 165 stati (nel quadro di risoluzioni del Consiglio di Sicurezza delle Nazioni Unite)” (Campion 2002:10) come citato in (Mc Cann 2006:221).

Il FMI (IMF) stima che ogni anno vengano riciclati tra i 500 ed i 1050 miliardi di dollari USA attraverso il sistema finanziario globale, cioè circa il 2-5% del Prodotto Lordo Mondiale (GDP) (IMF 2001:10). John Walker è stato il primo studioso a cercare di stimare il riciclaggio del denaro, ed un primo risultato gli suggerì la ragguardevole cifra di 285 miliardi di dollari (Walter, 1999). ***A questo punto è possibile osservare chiaramente quanto sia basso il numero dei fondi congelati nel quadro della lotta al terrorismo in tutto il mondo, in confronto alla stima dell'ammontare dei fondi riciclati.*** La questione più importante che emerge a questo punto è posta da Anne Richard in “Combattere il finanziamento del terrorismo: cooperazione transatlantica ed istituzioni internazionali” ed essa è la seguente: ***la questione del finanziamento del terrorismo dovrebbe o meno essere posta al centro della lotta al terrorismo stesso***, se gli attacchi terroristici stessi possono essere tolti di mezzo in modo poco dispendioso (Richard, 2005)? L'autrice ha commentato che gli attacchi terroristici di Parigi nel 1995 erano costati circa 100\$, e gli attacchi

dell'agosto del 1998 alle ambasciate statunitensi in africa orientale erano costate approssimativamente 10.000\$, mentre le bombe a Bali nell'ottobre del 2002 erano costati circa due volte quella cifra. I dirottatori dell'11 settembre 2001 avranno speso dai 400.000\$ ai 500.000\$ in due anni per pianificare ed eseguire i loro attacchi.

Mentre è vero che *ogni singolo incidente di matrice terrorista può avere luogo senza grandi spese, molto più denaro è necessario per la creazione ed il mantenimento su periodi di mesi ed anni di cellule terroriste o reti, che pianifichino attacchi ambiziosi e attirino reclute, organizzino campi di addestramento e trovino e difendano luoghi nei quali trovare rifugio. I terroristi internazionali si affidano al sistema finanziario internazionale per svolgere le proprie operazioni* (Koh, 2006; Bell, 2003 e Gillespie, 2002).

Questo studio si propone di dimostrare quanto sia di cruciale importanza contrastare non solo il finanziamento del terrorismo ma anche la corruzione ed il crimine organizzato tradizionale, visto il legame esistente tra di essi. Tutte queste attività sono condotte per raccogliere profitti dal crimine: vendita di stupefacenti, tratta di essere umani, ecc. I fondi connessi con la corruzione ed il terrorismo spesso non sono di origine illegale. Laddove una società utilizzi i propri fondi d'origine legale per corrompere un funzionario locale o persino un capo di stato, nessun atto criminale è stato commesso finché la corruzione non ha veramente luogo. Se un'associazione caritatevole sostiene degli individui nel loro ordine del giorno politico, questo non è reato finché i fondi del sostegno non vengono utilizzati per costruire congegni esplosivi oppure organizzare rapimenti.

Il nesso qui brevemente descritto pone una sfida davvero unica alle istituzioni che vigilano sul rispetto delle leggi, agli organismi regolatori, alle istituzioni finanziarie private ed agli intermediari quali gli avvocati, i notai, i contabili o consiglieri d'investimento. Alcuni esperti addirittura sostengono che i movimenti di tali capitali non si configuri affatto come riciclaggio di denaro nella accezione tradizionale del termine. Ciononostante è bene sottolineare che la maggioranza delle opere in materia illustrano il ruolo del riciclaggio del denaro nel finanziamento del terrorismo (Koh 2006:27) specialmente laddove si nasconda coscientemente la fonte illegale di alcuni fondi o beni. *Quindi molti degli strumenti ideati*

***per rispondere al problema del riciclaggio del denaro nella sua accezione tradizionale sono utili nel seguire le tracce del denaro del terrorismo.***

Il riciclaggio del denaro, la corruzione ed il finanziamento del terrorismo sono tutti fenomeni di natura globale, e non possono essere contrastati da misure sporadiche e limitate ad alcuni paesi. Inoltre, le dinamiche del diritto internazionale cogente, nei suoi aspetti cooperative, sono troppo complesse per poter realmente fornire soluzioni in tempi brevi. Purtroppo a volte I governi ed i meccanismi preposti al rispetto delle leggi non restano al passo con il mutare delle strategie criminali e tendono a reagire piuttosto che prevenire. I risultati dell'analisi quantitativa svolta in questo studio dimostreranno che ben 86% dei 46 stati del campione non hanno ancora un quadro di norme volto a recepire il cuore delle raccomandazioni AML/CFT. Questo significa che il sistema non è stato capace di applicare l'approccio della "dovuta cura" da parte del cliente (anche detta della "*due diligence*") e non è stato capace di riferire agli organismi di vigilanza finanziaria preposti, in merito a transazioni sospette. Se le transazioni in denaro non sono regolate e controllate a livello internazionale, i gruppi criminali e terroristi sposteranno semplicemente le loro attività negli stati che non hanno predisposto sistemi di tutela finanziaria efficace, ed i problemi che ci sono familiari riappariranno semplicemente altrove.

Lo scenario che fa da sfondo a questo lavoro si può tratteggiare con tre temi principali:

- il problema di sopprimere il finanziamento del terrorismo è parte dello sforzo globale di combattere il terrorismo nato con l'11.09.01, poiché presuppone un abuso del sistema finanziario.
- c'è una mancanza di teorie che spieghino l'efficacia del quadro normativo non vincolante AML/CFT e non è stata fatta nessuna analisi empirica sul grado di adeguamento complessivo ad esso, da parte degli stati.
- non ci sono né dati precisi né trasparenza in merito ai flussi di fondi legali ed illegali che giungono tra le mani dei terroristi.

### 3. Domande alla base della ricerca e premessa logica di questo lavoro

La domanda principale di questa dissertazione è: quanto efficace è stata la ricezione del quadro AML/CFT in stati e giurisdizioni? A questa domanda si risponderà attraverso le seguenti domande chiave della ricerca:

- *Che livello di adeguamento complessivo da parte degli stati firmatari ha raggiunto il quadro AML/CFT basato sulla cooperazione?*
- *Quali fattori economici e politici sono determinanti per tale livello complessivo di ricezione ed adeguamento al quadro AML/CFT?*
- *Quali sono le strategie alternative per combattere il finanziamento del terrorismo?*

Per rispondere a tutte queste domande, è necessario in primo luogo stabilire un quadro teorico, entro il quale si cercherà di comprendere come:

- le organizzazioni internazionali hanno inteso le reti del terrorismo internazionale.
- le organizzazioni internazionali hanno risposto alla sfida del finanziamento del terrorismo, e quali siano stati i fallimenti e le limitazioni di questa guerra finanziaria.
- valutare al meglio l'efficacia del quadro AML/CFT .

### 4. Quadro teorico

Il quadro teorico si basa sui tre grandi gruppi menzionati più sopra, e l'obiettivo di esso è di stabilire quali siano le supposizioni principali e le ipotesi che saranno sottoposte a verifica con metodi quantitativi e qualitativi.

a) *Natura, meccanismi e dilemmi legati alla definizione delle finanze del terrorismo.*

Il punto di partenza di questa ricerca è la volontà di capire *se le reti del terrorismo siano state pienamente* comprese. Se così non fosse il quadro normativo al quale ci si riferisce



non potrebbe in alcun modo rispondere adeguatamente ad esse. Questo capitolo conclude evidenziando come le organizzazioni internazionali conoscano molto bene i metodi dei terroristi per quanto concerne il modo in cui ottengono e spostano fondi per sostenere le proprie azioni da attività legali ad attività criminali usando sia il sistema finanziario formale che quello informale, e ciò malgrado la mancanza di dati empirici. I servizi di *intelligence* sono ovunque costretti ad estrapolare dall'informazione corrente quello che possono per riempire le lacune nelle nostre conoscenze. Le organizzazioni internazionali hanno imparato molto dall'11 di settembre 2001 su alcuni gruppi terroristi transnazionali quali Al Qaeda. I detenuti hanno confermato le linee di base del finanziamento di Al Qaeda tramite il trasferimento di fondi ed i metodi utilizzati a tal fine. Tuttavia le prove dimostrano:

[ad es. Nel caso del gruppo terrorista Al Qaeda] Al Qaeda si adatta velocemente ed in modo efficace, creando nuove difficoltà nella comprensione dei propri sistemi di sostegno finanziario. Le sfide per i servizi segreti e di informazione rimangono tali e sono anche destinate a durare, benché i fatti siano più chiari oggi che mai in precedenza. Mentre si diffonde, o piuttosto diventa poco distinguibile da altri movimenti gihadisti globali più ampi, il concetto stesso del finanziamento di Al Qaeda potrebbe dover essere riconsiderato. Al posto del modello della singola organizzazione Al Qaeda che cerca di attirare fondi che saranno poi smistati verso un afonte centrale, potremmo trovarci a contendere con un numero indistinto di gruppi dagli gruppi di affiliati poco inquadrati, ognuno con il proprio metodo autonomo di attirare fondi su sua propria iniziativa.

(Monografia sul terrorismo finanziario, *Terrorist Financing Staff Monograph*, Capitolo 2, page 29).

Nell'articolo *Financing of Terrorism: Sources, Methods and Channels* (Raphaeli 2003:80) notava in una citazione che un giudice istruttore francese di primo piano, incaricato di investigare su atti di terrorismo ha osservato che le cellule terroriste proliferano allo stesso modo disordinato di alcune cellule cancerose. Conformemente a questo, la comunità internazionale sa come i gruppi hanno cambiato le proprie modalità di finanziamento in conseguenza degli sforzi globali di regolamentazione per controllare le attività terroriste proprio attraverso i loro aspetti illegali, quali ad esempio nel campo del commercio, della immigrazione, e della mancanza di controlli doganali efficaci. Dopo aver comprato i

gruppi terroristi ed il crimine organizzato, si possono desumere i punti seguenti; sebbene spesso considerati come due minacce distinte con effetti profondamente diversi, il terrorismo transnazionale ed il crimine transnazionale sono entrambe attività illecite perpetrate in larga parte da attori non statuali attraverso o oltre i confini politici del singolo stato. La maggior parte dei crimini transnazionali hanno motivazioni economiche e comprendono una qualche forma di traffico, pirateria o finanziamento illegale, inclusi i flussi transfrontalieri di armi, sostanze stupefacenti messe al bando (quali eroina e cocaina), persone (immigrati, lavoratori del sesso, bambini, organi), ed altri vari beni oltre ai rifiuti tossici. Questi flussi transfrontalieri mettono alla prova la capacità degli stati e degli attori internazionali di valutare e gestire le attività economiche sull'intero pianeta.

Le ipotesi più importanti prese in considerazione nel presente lavoro sono:

- Il crimine organizzato ed i gruppi terroristici si possono incontrare nella pratica, come nel caso del traffico di armi, del narcotraffico, e nel modo in cui i terroristi usano le attività criminose transfrontaliere per trovare fondi per i propri attentati.
- Al-Qaeda ed altri gruppi terroristi si stanno modificando in base alle nuove misure prese contro di essi ed hanno concentrato tutte le proprie attività in aree che mancano ancora di tali controlli più efficaci. Questo include senza limitarsi ad essi, la cosiddetta lista di stati deboli o a gestione fallimentare. Il mercato nero delle armi può fornire agli stati "canaglia" e ad altri attori, quali i terroristi, le armi necessarie per lanciare attacchi mortali contro combattenti militari o civili senza distinzione.

I punti che rendono più specialmente vulnerabili al riciclaggio di denaro secondo INCSR(2006) sono i seguenti:

- Fallimento nel condannare come crimine grave il riciclaggio di denaro e/o limitazione del reato a casi limitati.
- Regole di segreto bancario rigide che impediscono le indagini richieste dal rispetto della legge, o che vietano o limitano i resoconti dovuti dalle istituzioni finanziarie bancarie e non bancarie, rispetto a transazioni sospette o inusuali o ancora legate a grandi somme di denaro.

- Mancanza o inadeguatezza dei requisiti di conoscenza del cliente per aprire conti bancari o espletare transazioni finanziarie, incluso il permesso di utilizzare conti anonimi, numerati, o intestati a prestanome.
- Nessuna richiesta per svelare l'identità del reale beneficiario di un conto o di una transazione.
- L'uso di titoli al portatore.
- Il riciclaggio del denaro attraverso il commercio è un canale importante per l'attività criminosa e sarebbe molto vulnerabile al finanziamento del terrorismo che comprendesse la movimentazione di valuta attraverso il sistema (ad es. assegni, trasferimenti elettronici) e/o corrieri per la consegna del contante. Tutte queste transazioni coprono le tracce del denaro che gli investigatori devono seguire e complicano la messa in atto dei divieti. Esiste una mancanza di dati di analisi sul commercio come manca anche la condivisione internazionale di tali dati. La maggior parte delle unità investigative finanziarie non riceve alcun rapporto su attività sospette nel commercio. La più parte delle organizzazioni doganali, di vigilanza legale e finanziaria, di indagine finanziaria, preposte alla tassazione o di supervisione bancaria riflettono nel proprio agire la loro comprensione limitata delle nuove tecniche di riciclaggio del denaro ed esprimono le proprie preoccupazioni in merito ai limitati controlli sulle esportazioni e la mancanza di modernizzazione delle dogane e della sicurezza delle frontiere.
- Appare chiaro che la prevenzione dell'uso distorto fatti di beni e veicoli commerciali o aziendali per scopi di riciclaggio o finanziamento occulto potrebbero essere molto ridotti se l'informazione riferita al vero proprietario, la conoscenza della fonte patrimoniale, e degli scopi di una fondazione o di una fossero già messi chiaramente a disposizione in ogni struttura.
- L'aiuto umanitario e le spedizioni marittime sembrano essere settori molto vulnerabili al riciclaggio del denaro ed al finanziamento del terrorismo.
- Non esiste alcuna valutazione pubblica o stima del rischio che uno stato porta di essere vulnerabile al finanziamento del terrorismo. Un'analisi dei rischi deve essere

fatta per determinare dove sono maggiori i rischi per il riciclaggio del denaro e per il finanziare il terrorismo. Gli stati hanno bisogno di identificare questi stati più vulnerabili per contrastare le problematiche in modo adeguato. Le istituzioni avranno bisogno di identificare i clienti, i prodotti ed i servizi ad alto rischio, inclusi i canali di consegna delle merci e la loro localizzazione geografica. Queste valutazioni non sono statiche.

In questo capitolo molti nessi causali importanti sono stati stabiliti tra alcune variabili esplicative (il grado di attrazione di uno stato per il riciclaggio del denaro, la taglia del sistema finanziario, “rimesse informali” e *cash-economies*, vulnerabilità al finanziamento del terrorismo e vulnerabilità degli stati più deboli) e la variabile dipendente (la ricezione complessiva da parte delle giurisdizioni con il quadro di raccomandazioni AML/CFT).

Nel presente studio, le correlazioni bivariate tra la ricezione complessiva da parte delle giurisdizioni e tutte le variabili enumerate più sotto saranno messe alla prova:

- La correlazione tra l'indice dell'interesse di uno stato in termini di riciclaggio del denaro sporco e la ricezione complessiva da parte delle giurisdizioni del quadro AML/CFT.  
La correlazione tra indicatori della taglia del sistema finanziario e la ricezione complessiva da parte delle giurisdizioni del quadro AML/CFT.
- La correlazione tra la lista degli stati più deboli/indebitati e la ricezione complessiva da parte delle giurisdizioni del quadro AML/CFT.
- La correlazione tra il punteggio di rischio di finanziamento al terrorismo e la ricezione complessiva da parte delle giurisdizioni con il quadro AML/CFT.
- La correlazione tra adeguamento al quadro AML/CFT e la percentuale di “rimesse informali” per prodotto interno lordo 2004.

*b) Il rischio degli abusi legati al sistema finanziario e la necessità di un quadro AML/CFT efficace.*

Dopo l'undici settembre molte discussioni sul lato negativo o oscuro della globalizzazione dei mercati finanziari si fermano sul punto della sua capacità di rendere agevole il

trasferimento di beni che sostengano il terrorismo internazionale ed il crimine organizzato transnazionale. Il presente lavoro descrive anche le condizioni economiche e legali che hanno permesso ad ingenti flussi di capitali di cadere tra le mani delle reti terroristiche transnazionali. Si pone inoltre l'accento sul modo in cui il terrorismo transnazionale è diventato un fattore della disorganizzazione internazionale. In questo capitolo si esplora sia come il sistema globale finanziario possa essere ingannato dal crimine organizzato, dalle reti terroristiche dalla corruzione, sia come ciò abbia creato il bisogno di sviluppare un ambito di cooperazione per fare da deterrente contro questi abusi.

Questo capitolo esamina i meccanismi che hanno permesso le frodi ed il modo in cui questi abusi avvengono sia in centri finanziari *offshore* che *onshore*. Più nel particolare, questa sezione della ricerca si concentra su due analisi. In primo luogo si dimostra come le principali caratteristiche della globalizzazione finanziaria che hanno semplificato l'accesso alle risorse finanziarie da parte dei gruppi terroristi transnazionali dagli anni '70 ad oggi. In secondo luogo, evidenzia il ruolo svolto dai centri finanziari *offshore* e *onshore*, e di quanto siano vulnerabili i paesi in via di sviluppo a violazioni di tale sorta. Le sfide tradizionali restano le medesime anche di fronte alla globalizzazione dei mercati finanziari: permane la mancanza di trasparenza sui dati finanziari, malgrado la forte spinta della comunità internazionale al riguardo negli ultimi anni, per l'identificazione, lo sviluppo ed il monitoraggio dei criteri-standard in materia di regolamentazione del settore bancario, assicurativo e borsistico. Non è possibile se c'è abuso del sistema finanziario o meno, se non esistono nemmeno dei dati per compiere verifiche in merito alle violazioni. Sarà allora impossibile delineare un quadro normativo efficace a protezione dell'integrità del sistema finanziario, specialmente se la misura di tale sistema non è nemmeno nota!

Questa ricerca studierà la correlazione tra la ricezione complessiva da parte delle giurisdizioni del quadro AML/CFT e delle valutazioni transfrontaliere COBAS),, tenendo presente le precedenti ricerche che individuano nelle attività finanziarie transfrontaliere un meccanismo potenzialmente invitante per il riciclaggio di fondi ed il finanziamento del terrorismo.

La correlazione tra la ricezione complessiva da parte delle giurisdizioni del quadro AML/CFT sarà anche calcolata, come anche le responsabilità transfrontaliere in base alle giurisdizioni (COBLIS).

L'uso della definizione menzionata poco fa della società "offshore" (OFC) permetterà al ricercatore di stabilire la correlazione tra la percentuale di servizi netti all'esportazione e l'adeguamento generale da parte delle giurisdizioni del quadro AML/CFT secondo gli stati e specialmente le OFC. Questa correlazione dimostrerà come alcuni stati che fungono da intermediari finanziari abbiano recepito il quadro AML/CFT, e se e come ci siano ancora scappatoie nella lista di stati del campione che non si sono impegnati ad applicare le raccomandazioni FATF sulla cooperazione internazionale per la lotta al riciclaggio del denaro e del finanziamento del terrorismo. Sono state compiute considerazioni circa la valutazione da dare alla correlazione tra indice di corruzione in uno stato con l'adeguamento al quadro normativo non vincolante AML/CFT. Questo capitolo si propone di riassumere come le organizzazioni internazionali abbiano risposto alle violazioni dell'integrità del sistema finanziario.

Il quadro basato sulla cooperazione AML/CFT, giunto ad altri criteri per la supervisione delle istituzioni finanziarie è emerso per scoraggiare le violazioni globali del sistema finanziario da parte di attori esterni. Questo quadro vuol rendere più arduo e costoso per i gruppi terroristici e le formazioni criminali transnazionali di spostare denaro attraverso il pianeta, una volta erette barriere più efficaci per prevenirlo.

Gli obiettivi del quadro AML/CFT sono riassunti come segue:

- Ridurre il crimine finanziario, il riciclo del denaro ed il finanziamento del terrorismo.
- Proteggere l'integrità del sistema finanziario internazionale, raggiungendo gli obiettivi di trasparenza ed affidabilità.
- Rinforzare la capacità delle infrastrutture legali, finanziarie e regolatrici degli stati a livello mondiale per garantire più solidità al sistema finanziario internazionale di

fronte alle violazioni di attori transnazionali quali i gruppi terroristi ed i loro sostenitori.

c) Si può sostenere che il quadro AML/CFT è un deterrente efficace contro le violazioni al sistema finanziario da parte del crimine organizzato transnazionale e dai flussi di finanziamento al terrorismo?

Il modo per determinare se il quadro AML/CFT agisca o meno da deterrente è tramite una misura di efficacia, che tuttavia non può essere misurata dalla capacità di tale insieme di accordi di evitare attacchi internazionali o dal volume di dati scambiati internazionalmente. Si è sostenuto all'interno di questo ambito teorico che ***il solo modo per misurarne l'efficacia è attraverso la messa in atto delle regolamentazioni internazionali all'interno del quadro legislativo nazionale.***

La costruzione di un quadro AML solido come bene pubblico globale è una sfida a causa delle differenze tra istituzioni, prospettive e priorità tra nazioni e all'interno di esse. Obiettivo di questo capitolo è fornire un riepilogo delle principali istituzioni e dei principali criteri coinvolti nella lotta al finanziamento del terrorismo. Si rivedranno quindi una serie significativa di sforzi internazionali, regionali e nazionali compiuti prima e dopo l'undici settembre 2001 per limitare ogni sfruttamento da parte dei terroristi del sistema finanziario internazionale.

I meccanismi legali esistenti contro il finanziamento del terrorismo, incluso il quadro della lotta contro il finanziamento del terrorismo, inclusa ad esempio la normativa anti-riciclaggio del denaro, le clausole obbligatorie comprese nelle risoluzioni del Consiglio di Sicurezza dell'ONU, la regolamentazione adottata dall'Unione Europea e da qualche organizzazione sovra-regionale, assieme alle convenzioni internazionali e le raccomandazioni ad hoc adottate da organi internazionali specializzati (quali la *Financial Action Task Force*) sono stati gli strumenti più rilevanti a disposizione delle autorità nazionali per combattere contro il finanziamento del terrorismo.

Una tale revisione ci ha permesso di riassumere e valutare i principali benefici e le debolezze del quadro AML/CFT per giudicarne l'efficacia o la sua applicabilità nel momento in cui giunge il flusso di finanziamento del terrorismo. Si vuole affermare qui

che le principali debolezze e limitazioni dell'attuazione del quadro AML/CFT sono le seguenti:

- Il fallimento del processo di ratifica ed attuazione delle convenzioni internazionali sul riciclaggio e sul finanziamento del terrorismo.
- Politiche di identificazione del cliente inadeguate in tutti gli stati e per tutte le classi di reddito.
- Il fallimento della fornitura di risorse per sovrintendere ai programmi ed alle istituzioni anti-riciclaggio.
- Un bisogno di incrementare la mutua assistenza legale, la condivisione delle informazioni e la cooperazione all'interno dei vari settori dello stesso stato e attraverso le frontiere.

Queste affermazioni verranno affrontate con un metodo misto, nel capitolo 6.

In questo capitolo molti nessi causali importanti sono stati stabiliti tra alcune variabili esplicative (ratifica delle convenzioni internazionali sul riciclaggio del denaro e contro il finanziamento del terrorismo, la criminalizzazione del riciclaggio del denaro, del terrorismo e del finanziamento ad esso, fattori istituzionali di governabilità quali un quadro di regole per il controllo della corruzione, e la partecipazione al gruppo Egmond) e la variabile dipendente (l'adeguamento globale da parte delle giurisdizioni al quadro normativo AML/CFT). Nel presente lavoro le correlazioni bivariate tra l'adeguamento della giurisdizione al quadro normativo AML/CFT e tutte le seguenti variabili sarà messo alla prova:

- La correlazione tra le ratifiche delle convenzioni internazionali sul riciclaggio, sul finanziamento del terrorismo e la criminalizzazione del riciclaggio, e la ricezione complessiva da parte della giurisdizione del quadro AML/CFT.
- La correlazione tra le ratifiche delle convenzioni internazionali sul finanziamento del terrorismo e la criminalizzazione del riciclaggio, e la ricezione complessiva da parte della giurisdizione del quadro AML/CFT.



- La correlazione tra alcuni “Indicatori di buona governabilità” e la ricezione complessiva da parte della giurisdizione del quadro AML/CFT.
- La correlazione tra la partecipazione alla “*Egmond Group*” e la ricezione complessiva da parte della giurisdizione del quadro AML/CFT.

## **5. La metodologia mista: un approccio quantitativo ed un approccio qualitativo.**

L’efficacia del quadro AML/CFT si misura comparando la ricezione complessiva da parte della giurisdizione con il quadro AML/CFT. Nel capitolo 5 si spiega come lo studio dell’adeguamento globale della giurisdizione con il quadro AML/CFT sarà condotto. L’obiettivo del capitolo 5 è stabilire le variabili ed i metodi che renderanno possibile rispondere alle principali domande poste dalla ricerca.

Questa sezione inoltre illustra la metodologia mista scelta per raccogliere i dati sia quantitativi che qualitativi, il progetto della ricerca, inclusa una descrizione precisa della tipologia di ricerca svolta, le teorie e le ipotesi sul banco di prova, i metodi qualitativi e quantitativi applicati, e le procedure statistiche usate. Si illustra altresì la ragione per la quale si mescolano diversi tipi di dati durante le varie fasi della ricerca. Durante le prime fasi della ricerca l’impressione era che si sarebbe ottenuto il risultato migliore con un’analisi qualitative. Dopo 15 interviste tuttavia, con insigni esponenti accademici, funzionari di banche internazionali, di organismi internazionali, un giudice, un alto ufficiale di polizia e più di 100 corrieri di posta elettronica con domande sull’efficacia del quadro AML/CFT, il progetto si è spostato da pura e semplice analisi qualitativa ad una integrazione dall’approccio metodologico misto. Una lista dettagliata delle persone intervistate si trova nell’appendice 1.

Il primo metodo usato era stato quello dell’analisi quantitativa per condurre una esplorazione preliminare. Questo metodo ha permesso la valutazione comparata dei rapporti di mutua valutazione annuali da fine 2004 al 2006. Tali rapporti sono pubblicati da FATF e dagli organismi regionali di stile finanziario (FSRB), usando la metodologia di FATF 2004. Obiettivo del primo passo è la valutazione del livello di adeguamento complessivo delle 46 giurisdizioni da un punto di vista comparativo. La prospettiva comparativa in base a classi di reddito degli stati e gruppi regionali mondiali hanno reso

possibile avvicinarsi al problema. Per poter usare metodi quantitativi i punteggi qualitative dei rapporti mutui di valutazione sono stati trasformati in dati quantitative, come descritto nel capitolo 5.

La seconda parte dell'analisi è sviluppata in due parti:

- La prima parte mette alla prova empiricamente le teorie più rilevanti evidenziate nell'introduzione, nel capitolo 2 e 3 e tramite le correlazioni bivariate nel capitolo 4.
- La seconda parte consiste nel modellare le cause dell'adeguamento delle 46 giurisdizioni con il quadro AML/CFT tramite una analisi di regressione multivariata (regressione OLS).

È necessario riconoscere le grandi difficoltà che si incontrano analizzando dati trans-culturali e transnazionali, dato che ogni stato ha tratti peculiari nella definizione del comportamento criminale, delle politiche, del modo di adeguarsi agli standard internazionali, del registrare e fare rapporto sulle attività sospette; tutto ciò ha reso difficile l'ottenimento di risultati significativi per questo aggregato.

La **tabella 1** seguente illustra un breve sommario dello schema della ricerca descritta nel presente capitolo.

**Tabella 1 - Schema della ricerca**

| Nome della variabile   | Domanda della ricerca  | Tipologia della ricerca    | Mix metodologico   | Programma Statistico al Computer |
|--|--|----------------------------|--|----------------------------------|
| Variabile dipendente<br><br><i>YOCAML</i><br><i>(Country/Jurisdiction Overall Compliance with AML/CFT score)</i> | 1) Che livello di adeguamento ha raggiunto il quadro AML/CFT nei vari stati?<br><br>2) Quanto efficace è stato l'adeguamento al quadro ? | Ricerca<br><br>Esplorativa | <u>Metodo quantitativo</u><br><br>▪ <i>Statistica descrittiva (frequenze)</i><br><br>▪ <i>Correlazioni bivariate</i><br><br><u>Metodo qualitativo</u><br><br>▪ <i>Analisi dei fattori sottostanti la percentuale di adeguamento per ogni raccomandazione</i> | SPSS                             |

|   |  |   |   |              |
|---|--|---|---|--------------|
|   |  |   | <ul style="list-style-type: none"> <li>▪ <i>Email discussion and Interviews analysis</i></li> </ul>   |              |
| Variabili indipendenti<br><br><i>Legali</i><br><i>Economiche</i><br><i>Instituzionali</i> | 1) Che fattori legali, economici, istituzionali sono determinanti per il livello globale di adeguamento al quadro AML/CFT? | Provare ipotesi enunciate nei capitoli teorici. | <u>Metodo quantitativo</u><br><br><ul style="list-style-type: none"> <li>▪ <i>Correlazioni bivariate</i></li> <li>▪ <i>OLS</i></li> </ul><br><u>Metodo qualitativo</u><br><br><ul style="list-style-type: none"> <li>▪ <i>analisi delle interviste</i></li> </ul> | SPSS e STATA |

## 6. Limiti della presente tesi di dottorato

Si consideri che la ricerca presente è soggetta a diverse limitazioni. In primo luogo la misura del campione, composto da 46 giurisdizioni, è piuttosto piccola. Si tratta tuttavia a nostro parere di un problema diffuso per gli studi transnazionali sul finanziamento del terrorismo. In secondo luogo la ricezione complessiva delle raccomandazioni AML/CFT è stata misurata qui riutilizzando i risultati dei rapporti di mutua valutazione; questo crea qualche preoccupazione in merito alla affidabilità dei dati, visto che si potrebbe essere in presenza di errori di misurazione soggettivi. Un altro limite da rilevare è la mancanza di dati omogenei per valutare le variabili indipendenti per quanto concerne le dimensioni del sistema finanziario in ogni stato. L'utilizzo dei rapporti di mutua valutazione per la variabile indipendente ha portato allo sforzo di raccogliere i rapporti di valutazione pubblicati secondo la metodologia FATF 2004. Nonostante queste limitazioni, si ritiene che questa ricerca abbia fornito un contributo originale agli studi di settore in materia, esplorando l'impatto di varie determinanti nella ricezione complessiva delle indicazioni normative AML/CFT, in termini empirici.

## 7. Conclusioni

Con la presente ricerca si è potuto fornire elementi che dimostrano come l'attuazione del quadro normativo Anti Money Laundering and Combating of the Financing of Terrorism (AML/CFT ovvero quadro normativo di raccomandazioni anti riciclaggio del denaro ed atto a contrastare il finanziamento del terrorismo) sia stata meno efficiente del previsto. Benché le organizzazioni internazionali abbiano potuto tracciare uno schema completo delle reti del terrorismo e siano state adottate una serie di misure strategiche per combatterlo, la cooperazione internazionale nelle questioni finanziarie non è ancora sufficientemente solida. Attraverso l'utilizzo di una metodologia sia quantitativa che qualitativa, si è potuto dimostrare il basso livello di ricezione nei propri ordinamenti delle raccomandazioni fatte ai vari stati nel quadro degli accordi AML/CFT, che pur si vogliono espressione di un ambito cooperativo. I dati sono stati estratti ed analizzati per i 46 paesi per i quali essi sono disponibili; è stato a nostro parere raggiunto anche l'obiettivo di identificare le ragioni che spiegano il grado complessivo di adeguamento alle raccomandazioni da parte delle varie giurisdizioni.

Riferendosi alle conclusioni principali dei capitoli precedenti, questo capitolo si propone di delineare una strategia più efficace per il contrasto del finanziamento al terrorismo ed apre nuove direzioni a future ricerche.

### **7.1 La ricezione complessiva delle raccomandazioni, raggiunta tra le 46 nazioni nel quadro della cooperazione AML/CFT, è stata insufficiente.**

La questione dell'efficienza dell'AML/CFT è stata proposta ripetutamente su scala mondiale e la necessità di comprendere i determinanti della ricezione del quadro AML/CFT è resa ancor più urgente dalla recrudescenza degli attacchi terroristici. Come precedentemente illustrato nel capitolo quarto, trattando del quadro teorico complessivo, l'efficacia del quadro AML/CFT può essere messa alla prova soltanto facendo riferimento al terzo dei suoi obiettivi, ovvero l'attuazione di norme atte a rinforzare il ruolo delle infrastrutture legali, finanziarie e delle istanze regolatrici dei diversi paesi. Con questo proposito, il presente lavoro ha preso le mosse dall'esame del livello di adeguamento al quadro AML/CFT.

I dati esaminati indicano che l'adeguamento complessivo dei vari ordinamenti a tale quadro varia in modo piuttosto sostanziale tra le classi di reddito durante il 2004-2006. I risultati dell'analisi quantitativa dimostrano che il livello dell'adeguamento delle 46 giurisdizioni alle 40 raccomandazioni ed alle 9 raccomandazioni speciali, previste dal quadro AML/CFT, è molto bassa. Questo soprattutto nelle aree della cooperazione legale, preventiva, istituzionale ed internazionale. Ciò indica che la ricezione da parte degli Stati del quadro regolatore è ancora troppo debole per contrastare le tendenze prevalenti e le minacce che emergono dal riciclaggio del denaro e dal finanziamento del terrorismo; questo avviene nella grande maggioranza delle nazioni comprese nel campione.

Il maggiore livello di adeguamento delle giurisdizioni più abbienti alle raccomandazioni riflette, in molti casi, le varie misure adottate per rinforzare gli organismi di supervisione e regolamentazione di tali giurisdizioni prima o in seguito ai mutui rapporti di accertamento. Ciò è probabilmente dovuto al largo contributo del settore finanziario alle economie di tali giurisdizioni appartenenti a classi di reddito maggiore; esse hanno preso le misure necessarie per proteggere l'integrità della propria industria finanziaria.

Le maggiori debolezze dell'implementazione degli accordi AML/CFT sono quindi le quattro che andremo qui ad elencare:

- 1) Insuccesso nella ratificazione e nell'implementazione delle convenzioni internazionali sul riciclaggio del denaro sporco-*Money Laundering*(ML)- e sul finanziamento del terrorismo-*financing of terrorism*(FT)-in alcuni stati.

L'analisi quantitativa indica che:

- La ricezione complessiva delle raccomandazioni FATF sul riciclaggio del denaro sporco dal

punto di vista legale è differente in base alle classi di reddito mondiali. Mentre gli stati dal reddito medio e dal reddito più alto hanno criminalizzato il riciclaggio del denaro sporco, gli stati dal reddito inferiore non aderiscono completamente ai criteri e sono ancora allo stadio della redazione ed adozione di progetti di legge. Alcuni

stati, specialmente nelle classi dal reddito basso o bassissimo, su scala mondiale, hanno un apparato normativo che contempla solamente il riciclaggio di denaro legato al traffico di stupefacenti.

- La ricezione delle raccomandazioni speciali sul FT, contenute nel titolo FATF più marcatamente legale, è molto bassa a livello globale, e ciò per tutti gli stati, indipendentemente dalla classe di reddito.

L'analisi qualitativa indica che:

- Il quadro legislativo internazionale contro il terrorismo è caratterizzato da diversificazione e frammentazione per quanto concerne le ratifiche delle convenzioni internazionali sul terrorismo. Malgrado le convenzioni contro il terrorismo siano già esistenti prima del 2001, esse non sono universali. Gli strumenti tecnici sviluppati per combattere contro il riciclaggio del denaro ed il finanziamento del terrorismo non sono stati adottati da un gran numero di stati. Le leggi internazionali contro il terrorismo esistono solo sulla carta in molti paesi. La maggiore debolezza dell'accordo AML/CFT risiede nell'incapacità della comunità internazionale di accordarsi su una definizione del terrorismo; questo ha certamente limitato la portata del sistema. Questa situazione permette ancora l'esistenza di porti franchi sicuri per i gruppi terroristi ramificati.
- I nomi dei gruppi terroristi, inoltre, non sono i medesimi nelle diverse liste pubblicate dalle Nazioni Unite, l'Unione Europea o dal G-7. Non c'è nessun accordo internazionale preciso su che cosa costituisca atto terroristico o finanziamento del terrorismo (ad esempio l'IRA è un gruppo terroristico per il Regno Unito, ma non per gli USA; il gruppo degli Hezbollah è terrorista per gli USA ma non per l'Unione Europea, ecc.).
- In alcuni stati, la lista dei reati di base non rispetta le 40 raccomandazioni. Esistono solo un numero limitato di reati fondanti per il riciclaggio del denaro e questo significa che le incriminazioni per ML non sono pienamente coerenti con le convenzioni di Vienna e Palermo.

- In uno stato ove prevalga il riciclaggio del denaro, esso genera altri reati e altra corruzione; gli effetti dell'interesse che uno stato può destare in termini di riciclaggio sono già stati ampiamente discussi nei capitoli teorici.
  - Per quanto concerne l'imposizione del rispetto dei provvedimenti dell'AML/CFT, siamo di fronte ad una imposizione insufficiente, debole e selettiva. Il regime delle confische non è abbastanza chiaro ed efficace. Clausole penali inefficaci, tra le quali provvedimenti per le confische difficili da prendere, sono una delle cause dello scarso successo delle strategie di congelamento dei beni.
  - La mancanza di procedimenti per riciclaggio sono indice del fatto che il rispetto del quadro normativo non venga imposto con sufficiente fermezza ed efficacia.
  - Nella maggior parte degli stati non esiste alcun regime di sanzioni per chi infrange le norme contro il riciclaggio (ML) commesso da persone private che agiscono come copertura o per conto di un fiduciario.
  - La mancanza di armonizzazione nel diritto societario può creare un "effetto di domino" su altre leggi o quadri regolatori, come nel settore del diritto penale, amministrativo e bancario. Gli ostacoli maggiori alla cooperazione internazionale per la prevenzione del riciclaggio del denaro si riscontrano nell'area del "identificazione del reale beneficiario". Il principale problema è rappresentato dalla mancanza di regolamenti che obblighino a dare informazioni complete riguardo all'identità del reale beneficiario di una società pubblica o privata a responsabilità limitata, specialmente quando il direttore o l'azionista sono persone giuridiche, o quando viene permessa l'emissione di titoli al portatore.
- 2) Politiche di identificazione inadeguate per il cliente in tutti gli stati e per tutte le classi di reddito.

L'analisi quantitativa indica che:

- Benché alcuni degli stati della classe di reddito medio o alto abbiano adottato un'ampia gamma di misure preventive, l'adeguamento complessivo alle norme preventive più elementari è estremamente basso in tutti gli stati. Facendo un resoconto analitico dei risultati a fronte delle raccomandazioni, la maggioranza

degli stati sono stati universalmente non conformi all'obiettivo centrale del quadro AML/CFT; questo implica che non esiste ad oggi un sistema globale di attuazione di misure preventive per istituzioni finanziarie.

- Analizzando i risultati per classi di reddito, la maggioranza degli stati sono stati universalmente non conformi nell'attuazione di misure globali preventive per controllare alcune categorie specifiche di aziende e professioni non finanziarie.

L'analisi qualitativa evidenzia che:

- Oltre alle debolezze della AML/CFT nella prevenzione, delle quali si è ampiamente dibattuto nel capitolo 6, si sostiene altresì che il basso livello di adeguamento complessivo delle giurisdizioni, nella presente area, sia dovuta al fatto che l'approccio della "dovuta cura" da parte del cliente (anche detta "*due diligence*") nella lotta al riciclaggio del denaro sporco ed al finanziamento del terrorismo non propone un compito semplice, e può essere in contraddizione con la cultura tipica del settore bancario, che si basa sull'attrarre clienti. Il funzionario preposto a far rispettare gli accordi o il manager del rischio incaricato della "dovuta cura del cliente" tende al conflitto con gli incentivi forniti alle unità di servizio al cliente o "*customer service*" che si dedicano al banking privato, personalizzato o offshore, cioè lontano dalle aree più regolamentate.
- In linea generale, il diritto societario di uno stato può avere effetti sulla opacità o sulla trasparenza del sistema finanziario.
- Le misure preventive si ritrovano solo nelle economie formali.

Nella lotta al terrorismo, i risultati dell'analisi quantitativa dimostrano che la maggior parte degli stati non opera in modo efficace riguardo alla raccomandazione speciale per le misure preventive:

- I trasferimenti via cavo non sono ancora adeguatamente registrati.
- Il settore del c.d. *non-profit* necessita di controlli maggiori.
- Devono essere compiuti sforzi più importanti per scoprire i corrieri.
- È troppo ingente la mancanza di controllo sui titoli al portatore.



- 3) Il fallimento nel procurare risorse per la supervisione dei programmi e delle istituzioni anti-riciclaggio.

Dall'analisi quantitativa si desume che:

- L'inefficacia delle misure istituzionali nel quadro AML/CFT come incentivo a sviluppare sistemi di supervisione nazionali rimane preoccupante. Il 40% degli stati nel campione non sono completamente in linea con la creazione dell'unità investigativa finanziaria, o Financial Intelligence Unit (FIU), e questo rivela l'esistenza di difetti di grande portata in un'area d'importanza critica del quadro normativo AML/CFT.

I risultati suggeriscono l'esistenza di debolezze quali la mancanza di risorse negli stati, indipendentemente dalla classe di reddito; il fallimento del meccanismo di trasmissione di resoconti periodici alle istituzioni preposte ed un'analisi insufficiente delle relazioni che riguardano transazioni sospette. All'interno di tutte le classi di reddito, le indagini e le incriminazioni per riciclaggio o finanziamento del terrorismo (ML/FT) sono state limitate, anche laddove erano state emanate disposizioni di legge precise ed erano presenti poteri che ne controllassero il rispetto.

L'analisi qualitativa mostra che:

- L'assenza di un impegno politico forte al livello dell'esecutivo e del giudiziario è un impedimento significativo allo sviluppo ed alla costruzione di un sistema solido per l'AML/CFT. In alcuni stati l'impegno dei funzionari tecnici dell'ambito della supervisione o dell'applicazione del diritto è ostacolato dalla mancanza d'impegno politico in seno ai governi ed ai parlamenti per far passare le leggi adatte al vaglio delle camere e dell'esecutivo, e ad attribuire alla lotta le risorse necessarie. Le ratifiche delle convenzioni internazionali non sono sufficienti per istituire un regime AML/CFT davvero solido.
- La corruzione e la scarsa capacità di governo minano gli effetti del quadro AML/CFT. In ambienti nei quali la qualità del quadro regolatore è debole e prevale

la corruzione, i legislatori saranno meno inclini ad adottare leggi AML/CFT forti ed efficaci, e rinforzare le istituzioni chiave (le corti di giustizia, gli organismi di controllo e sicurezza). Ne consegue che i legislatori potrebbero venire ostacolati nello svolgimento efficace delle proprie funzioni ufficiali. Lo sviluppo di un regime AML/CFT richiede inoltre la messa a punto di un quadro normativo anti-corruzione efficace.

- Gli ingenti costi d'avvio e di gestione ordinaria sono una sfida per l'istituzione del regime AML/CFT. I funzionari incaricati del mantenimento dell'ordine avranno bisogno di più mezzi per operazioni di polizia, gli agenti preposti alle dogane dovranno poter fermare il contrabbando, i regolatori finanziari dovranno poter inasprire le proprie sanzioni, ed i politici dovranno prendere coscienza del rischio del terrorismo cui espongono il proprio paese e fornire un ragionevole grado di sicurezza ai cittadini, di fronte ai quali essi sono, alla fine, responsabili. Nel lungo periodo, un investimento in queste risorse è sicuramente destinato a preparare la strada alla lotta contro il finanziamento del terrorismo.
- 4) Il fallimento del meccanismo della mutua assistenza legale, della condivisione delle informazioni e della cooperazione nell'ambito nazionale e transfrontaliero.

Dall'analisi quantitativa si desume che:

- I risultati dell'analisi dell'adeguamento complessivo al capitolo di raccomandazioni specifiche all'area della cooperazione internazionale, provano che gli stati appartenenti alle classi di reddito basse e medio-alte dispongono generalmente di quadri ed accordi limitati per la cooperazione legale internazionale.

L'analisi qualitativa mostra che:

- In pratica, questo significa che l'assenza di regole chiare danneggia la capacità delle autorità di cooperare. La mancanza di regole e norme chiare per la "mutua assistenza legale" rende meno sistematico il processo della cooperazione internazionale e della condivisione delle informazioni.

Alcune debolezze devono essere superate perché si possa aumentare la cooperazione internazionale. La lista che segue intende proporre una serie di miglioramenti possibili:

- Rendere davvero universale il sistema degli strumenti legali.
- Promuovere maggiormente la mutua assistenza legale.
- Tenere conto delle eventuali differenze nel trattamento dello scambio delle informazioni tra giurisdizioni.
- Ricerca di mezzi sicuri per condividere le informazioni in materia, proteggendo al contempo i legittimi diritti alla privacy e tenendo conto degli obblighi di rispetto della confidenzialità degli organismi supervisor.
- Condivisione delle informazioni tra gli organismi di supervisione dei vari settori (ad esempio tra organi regolatori nel settore bancario e nell'ambito delle *securities*).
- Condivisione delle informazioni a fini regolatori, di adeguamento agli impegni internazionali presi e per disporre di strumenti per obbligare al rispetto della legge.
- Risoluzione dei problemi scaturiti dalla complessità dei molteplici canali per lo scambio delle informazioni.
- Infine sarebbe necessario armonizzare il quadro normativo e superare gli ostacoli che minano la lotta al terrorismo e nascono nelle aree dell'extradizione, della mutua assistenza legale e della regolamentazione delle norme societarie cui sono sottoposte le società multinazionali (c.d. "*corporate laws*").

## **7.2 I fattori istituzionali che determinano il livello di rispetto degli impegni AML/CFT**

Questa ricerca dimostra come si possa risalire ad alcuni determinanti comuni nello dell'adeguamento complessivo alle raccomandazioni espresse dagli accordi AML/CFT. Questo studio ha voluto tentare l'identificazione di alcuni di essi, stimando una regressione OLS.

I risultati di base del modello di regressione mostrano come la variabile "Qualità del quadro regolatore" (o RQ, ovvero "*Regulatory Framework Quality*") abbia l'impatto più

significativo sull'adeguamento complessivo agli accordi AML/CFT. La seconda più significativa tra le variabili esplicative è rappresentata dalla corruzione (CO). Entrambe le variabili sono risultate statisticamente significative per l'AML/CFT. I risultati di questa regressione sono coerenti con i risultati di studi precedenti sull'adeguamento agli standard regolatori internazionali e danno sostegno all'ipotesi secondo la quale i determinanti chiave siano “alcuni indicatori di governabilità (o *governance*)”

Nel caso specifico di questo studio, l'adeguamento agli accordi tende ad aumentare quando le precondizioni nazionali di governabilità, rappresentate dalle variabili RQ (“*Regulatory Framework Quality*”) e CO (o “Controllo della corruzione”) sono buone. La migliore variabile predittiva per l'adeguamento di una giurisdizione agli accordi AML/CFT è la variabile RQ seguita dalla variabile CO. In questo modello particolare diremmo che un incremento di un'unità nella qualità del quadro regolatore RQ si tradurrebbe in un aumento del +29% nella media dell'adeguamento agli accordi, controllando nel frattempo anche la variabile del controllo della corruzione (CO). Un aumento della corruzione significa che l'indicatore del controllo della corruzione decresce e diventa negativo; quindi, se l'indicatore del controllo della corruzione decresce di un'unità questo si tradurrebbe in un decremento del -22% nella media dell'adeguamento complessivo (YOCAML) controllando nel frattempo la variabile della qualità del quadro regolatore (RQ). Sarebbe opportuno tenere presente l'alto grado di correlazione tra la classe di reddito dello stato e questi fattori di *governance*.

Questa ricerca non è riuscita nel proposito di dimostrare che le variabili seguenti siano determinanti per l'adeguamento complessivo alla AML/CFT (YOCAML): Ratifiche delle convenzioni internazionali sul riciclaggio del denaro e sul finanziamento del terrorismo (RATML e RATFT), gli accordi transnazionali GDP (COBAS), la ATML che valuta l'attrattiva dei vari stati per le attività illecite di riciclaggio del denaro sporco, le “rimesse informali”/ GDP (INRE) e la partecipazione alla Egmont Group (EG).

In base alla ricerca qui presentata, tuttavia, si è potuto evidenziare come:

- Esistano dati che comprovano quanto il rapporto dei servizi finanziari netti mostri una forte correlazione negativa con la ratificazione della convenzione di Palermo ed una correlazione moderatamente negativa con la variabile esplicativa RATML.
- Risultati altrettanto provati che la vulnerabilità al finanziamento del terrorismo, flussi importanti di rimesse informali e stati dalla gestione politica fallace o compromessa mettano a rischio l'efficienza del quadro AML/CFT. Le correlazioni tra queste variabili ed il rispetto generale delle norme del quadro AML/CFT sono negative.

I risultati del presente studio potrebbero essere messi a frutto da organizzazioni internazionali ed organi politici decisionali per acquisire una migliore conoscenza di alcuni meccanismi. Ci si vuol riferire soprattutto a quanto le precondizioni di governabilità politica rappresentino i fattori principali dell'adeguamento al quadro di raccomandazioni AML/CFT; i risultati qui esposti potrebbero incoraggiare gli attori economici e politici coinvolti a ridisegnare ed adottare misure appropriate per controllare e ridurre gli effetti dannosi di precondizioni negative. Si giungerebbe così ad un più reale rispetto degli stati e delle giurisdizioni degli impegni presi con la AML/CFT, in particolare in termini di governabilità.

Si consideri che la ricerca presente è soggetta a diverse limitazioni. In primo luogo la misura del campione, composto da 46 giurisdizioni, è piuttosto piccola. Si tratta tuttavia a nostro parere di un problema diffuso per gli studi transnazionali sul finanziamento del terrorismo. In secondo luogo la ricezione complessiva delle raccomandazioni AML/CFT è stata misurata qui riutilizzando i risultati dei rapporti di mutua valutazione; questo crea qualche preoccupazione in merito alla affidabilità dei dati, visto che si potrebbe essere in presenza di errori di misurazione soggettivi. Nonostante queste limitazioni, si ritiene che questa ricerca abbia fornito un contributo originale agli studi di settore in materia, esplorando l'impatto di varie determinanti nella ricezione complessiva delle indicazioni normative AML/CFT, in termini empirici.

### **7. 3 Quale sarebbe la strategia più efficace per combattere il finanziamento del terrorismo?**

In base ai risultati qui precedentemente illustrati, si raccomanda un approccio in due tempi per superare i fallimenti e le divergenze tra stati nella costruzione di una strategia globale più coordinata contro il finanziamento del terrorismo.

Il primo passo prevedrebbe da parte degli stati coinvolti nella lotta il riconoscere d'aver rivolto una parte esigua del proprio impegno all'adeguata e necessaria criminalizzazione del finanziamento del terrorismo, per stabilire un approccio chiaro ai sistemi di trasferimento informali, per stabilire il congelamento reale delle risorse finanziarie e la realizzazione di un'autentica cooperazione legale internazionale. Tale strategia dovrebbe:

- Accordarsi su una comune definizione del terrorismo e su una definizione precisa del finanziamento al terrorismo.
- Convincere tutti gli attori presenti nel processo di lotta a tale finanziamento dell'urgenza e necessità di un approccio globale alle questioni di finanziamento del terrorismo.
- Assicurarsi dell'impegno veritiero e della risolutezza della volontà politica dei partecipanti alla CFT.
- Tenere conto delle connessioni sempre più globali e forti tra crimine finanziario e terrorismo e del loro effetto negativo.
- Essere consci del fatto che i terroristi continueranno ad utilizzare a propri fini gli stati e le giurisdizioni fallaci che procedono a rilento nella ricezione delle misure raccomandate dal regime AML/CFT.
- Creare un indice globale di vulnerabilità degli stati al finanziamento del terrorismo per aumentare la capacità di monitoraggio e controllo della comunità internazionale su alcuni porti franchi sicuri che svolgono un ruolo chiave per i finanziatori del terrorismo.

Per raggiungere questi obiettivi possono essere utilizzati efficacemente gli strumenti di pressione seguenti:

1. Predisporre un numero di sanzioni o porre su lista nera gli stati non cooperativi che rifiutino di adoperarsi per combattere il finanziamento del terrorismo.
2. Sviluppare politiche e strategie complementari in aree spesso sfruttate dalle formazioni d'ispirazione terrorista, perché coperte in modo inadeguato dalla regolamentazione proposta dalla AML/CFT; ci si riferisce ad esempio ai flussi commerciali, al diritto societario, al commercio del petrolio, agli affari marittimi ed all'aiuto umanitario.

Un ulteriore passo potrebbe essere il ridisegnare la strategia con la quale si è cercato di rispondere al terrorismo, tenendo conto non solo di precedenti debolezze ma anche riconoscendo che il modello unidimensionale non funziona per tutti, specialmente ove si parli delle cosiddette *cash economies* o di stati fallimentari. I punti seguenti devono essere presi in considerazione all'atto di costruire una nuova strategia:

- La progettazione e la scelta delle priorità nella politica sono un punto importante ed anche  
Problematico, visto che gli obiettivi della minimizzazione dei rischi e delle relative perdite sono molto difficoltosi a misurarsi. È necessario rifiutare la tradizionale analisi costi-benefici visto che adottare politiche che combattano il finanziamento del terrorismo significa proprio gestire minacce incerte ed imprecise.
- A questo punto l'approccio alla CFT basato sul rischio deve essere ridefinito e messo in atto in modo diverso, poiché l'alto numero di raccomandazioni emesse da parte degli organismi internazionali ha creato una mole ingente di requisiti che sovrappongono gli sforzi e minano l'efficienza complessiva del sistema. Un alto livello di interazione è una necessità vitale per guidare gli sforzi degli stati nel combattere il finanziamento del terrorismo.
- Le istanze politiche decisionali dovrebbero in primo luogo sviluppare una strategia per gestire e rilevare i diversi livelli di analisi (in seno alla UE, nazionale e transfrontaliero) ed in seguito compiere una riflessione sulle principali necessità in

materia di informazione dei partecipanti alla lotta contro il finanziamento del terrorismo.

- Questo cambiamento di strategia renderebbe obbligatorio per l'organizzazione internazionale il fornire una guida chiara per le scelte politiche del settore privato. Si pone a questo stadio la questione della quantità di informazioni che gli organismi che vigilano sull'applicazione delle leggi dovrebbero rendere disponibili al settore finanziario regolare, per massimizzare l'efficienza della raccolta dati, e contribuire in tal modo a mantenere aggiornate le istituzioni finanziarie sulle nuove tendenze, gli indicatori e le tipologie rilevanti al fine della lotta contro il finanziamento del terrorismo. La complessità di quest'ultimo richiede un coordinamento tra settori privati e pubblici; gli organismi preposti al rispetto delle leggi ed alla raccolta delle informazioni devono formare richieste chiare alle istituzioni finanziarie ed al DNBFP sulla tipologia di dati loro necessaria.
- Dovrebbe acquisire carattere obbligatorio la fornitura dei dati richiesti dalle organizzazioni internazionali (International Organizations o IO's) per coprire la mancanza di informazioni riguardante molte questioni, come più dettagliatamente descritto qui nel terzo e sesto capitolo.
- È inoltre impellente la necessità di rinforzare la cooperazione pubblica. Nel caso dei processi d'accusa una delle sfide più complesse per il rispetto della legalità è proprio nella raccolta dei dati necessari alla formulazione dei capi d'accusa nei casi di terrorismo. Esiste una ingente mole di informazioni che non giungerà mai ad una sala d'udienza perché non è possibile verificarne l'attendibilità. C'è un evidente conflitto tra la raccolta di dati probatori per i processi (organismi preposti al rispetto delle leggi o di *Law enforcement*) e la raccolta di dati per informare gli organi di governo (agenzie di informazione legate al ministero dell'interno o *Intelligence Agencies*). Questo conflitto deve essere risolto tramite una migliore costruzione della strategia nella CFT.



- Lo scambio delle informazioni è un'altra fondamentale componente della CFT. Sono tuttora presenti una serie di ostacoli giuridici laddove due o più giurisdizioni si trovino coinvolte in nel processo o dove la raccolta di informazioni in uno stato sia ancora perseguibile come violazione delle leggi a tutela della privacy o del segreto bancario. Questi ostacoli pongono molte restrizioni agli organismi che possono condividere i dati in proprio possesso (ad esempio i dati SWIFT). Il quadro normativo corrente non è concepito per contrastare efficacemente il finanziamento al terrorismo perché le istituzioni finanziarie devono conformarsi a cinque attori diversi; gli organismi regolatori, gli organismi di vigilanza incaricati di far rispettare la normativa (il c.d. *Law enforcement*), quelli di gestione interna, la coscienza dei singoli impiegati e la società nel suo complesso. Siamo a tutt'oggi ancora alla mercè dell'opacità di canali formali che non rivelano le proprie informazioni, sostenendo un'insieme di pratiche inefficienti.
- La valutazione tra pari o *Peer to peer*, nella forma del rapporto di mutua valutazione, dovrebbe essere rivista, per farne uno strumento comparativo di lunga durata che non sia in contrasto con eventuali miglioramenti metodologici.

Tutti i punti sopraelencati dovrebbero essere presi in attenta considerazione per creare deterrenti davvero efficaci contro il finanziamento del terrorismo. La chiave fondamentale, che renderebbe tutto quanto fattibile, è tuttavia il superamento della debolezza delle istanze decisionali, la *weak governance*. Ad essa possiamo con certezza attribuire tutte le disfunzioni ed inefficienze del quadro regolatore internazionale.

Da qui la necessità di rivolgere la maggior parte dei nostri sforzi alle economie in transizione. Benché gli stati che hanno già fallito nella lotta, e che sono in coda all'analisi dell'adeguamento alle raccomandazioni AML/CFT, sembrano dapprima l'opzione migliore, le economie in transizione sarebbero più motivate nella protezione dell'integrità del loro sistema finanziario proprio mentre lo stanno ancora costruendo. Inoltre, tali economie sono le più vulnerabili agli usi distorti del sistema finanziario; è di estrema importanza evitare che vadano a far parte degli stati dal sistema regolatore fallimentare.

#### **7.4 Per le ricerche future**

Nel corso di tutta la presente dissertazione, si è cercato di chiarire il livello dell'adeguamento complessivo alle raccomandazioni espresse dal quadro AML/CFT, ed i fattori che determinano i livelli di tale adeguamento. Tuttavia, malgrado gli sforzi compiuti, alcuni temi molto significativi non sono stati affrontati in modo esaustivo, per mancanza di tempo e per la necessità di limitare l'ambito della ricerca. La ricerca sui temi che si sono qui dovuti trascurare meriterebbe assolutamente d'essere proseguita.

Si raccomanda in primo luogo di riesaminare le banche dati esistenti e di creare una banca dati consolidata, che includa qualcosa di più sostanziale che la mera frequenza degli attacchi agli stati. La vulnerabilità di uno stato al finanziamento del terrorismo, l'adeguamento complessivo alle raccomandazioni AML/CFT di ogni singolo stato, l'evoluzione delle incriminazioni, i dati delle confische stato per stato, devono poter essere incluse in una banca dati. Fortissimi incoraggiamenti sono giunti infine all'autrice di queste pagine dal Centro Studi per il Terrorismo e per le Risposte al terrorismo (sede negli Stati Uniti) perché si confrontasse la banca dati sulle transazioni finanziarie con la banca dati del centro sugli attacchi di matrice terrorista, al fine di comprendere più nello specifico gli effetti che politiche deboli nel settore della regolamentazione delle transazioni finanziarie portino al rischio della violenza terrorista.



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

**Methodology for Assessing Compliance  
with the FATF 40 Recommendations and  
the FATF 9 Special Recommendations**

**27 February 2004  
(Updated as of February 2007)**

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# **METHODOLOGY FOR ASSESSING COMPLIANCE WITH THE FATF 40 RECOMMENDATIONS AND THE FATF 9 SPECIAL RECOMMENDATIONS**

## **ANTI-MONEY LAUNDERING/COMBATING TERRORIST FINANCING METHODOLOGY 2004 (UPDATED AS OF FEBRUARY 2007)**

### **Introduction**

This document consists of three sections. Following this introduction, the first section consists of an overview of the assessment methodology, its background, how it will be used in evaluations/assessments, and a description of what is necessary for an effective anti-money laundering and combating the financing of terrorism (“AML/CFT”) system. The second section contains guidance and interpretation concerning the Methodology, including on the essential criteria, the additional elements and on compliance. The third section sets out the essential criteria and the additional elements for each of the FATF Recommendations. Finally, there is annex to the Methodology that sets out definitions or meanings for many of the words or phrases that are used in the document.

### **The AML/CFT Assessment Methodology**

#### **Background to Methodology**

1. The Anti-Money Laundering/Combating Terrorist Financing (AML/CFT) Methodology 2004, including the assessment criteria, is designed to guide the assessment of a country’s compliance with the international AML/CFT standards as contained in the FATF Forty Recommendations 2003 (updated as of October 2004) and the FATF Nine Special Recommendations on Terrorist Financing 2001 (updated as of February 2006) (referred to jointly as the FATF Recommendations). The criteria within this Methodology do not expand upon or modify the Forty Recommendations and Nine Recommendations which constitute the international standard. The Methodology is a key tool to assist assessors when they are preparing AML/CFT detailed assessment reports/mutual evaluation reports. It will assist them in identifying the systems and mechanisms developed by countries with diverse legal, regulatory and financial frameworks, in order to implement robust AML/CFT systems. The Methodology is also useful for countries that are reviewing their own systems, including in relation to technical assistance projects.

2. It reflects the principles set out in the FATF Recommendations. It is also informed by the experience of the FATF and the FATF-style regional bodies (FSRBs) from their mutual evaluations, of the International Monetary Fund (the Fund) and the World Bank (the Bank) in the Financial Sector Assessment Program and by the Fund from the Offshore Financial Center assessment program. The FATF, the Fund and the Bank have also reviewed the assessments/mutual evaluations conducted in 2002 and 2003 using the AML/CFT Methodology issued in October 2002, and these reviews have also provided guidance in developing this Methodology.

#### **Evaluations/assessments using the Methodology**

3. The Methodology follows the structure of the FATF Recommendations. However, as the Methodology is a tool to assist assessors in determining whether countries are in compliance with the FATF Recommendations, it is not intended that detailed assessment reports/mutual evaluation reports will rigidly follow the format and structure of the Methodology. Rather the format for these reports will be based on the four fundamental areas noted in paragraph 6 below.

4. The assessments will also need to be based on and refer to relevant underlying information, such as the quantum and type of predicate offences for money laundering; the vulnerability of the country to money laundering or terrorist financing, the methods, techniques and trends used to launder money or fund terrorists; the structure of the financial system and the nature of the sectors dealing with designated non-financial businesses and professions; the nature of the underlying criminal justice system, as well as any changes that have been made to the AML/CFT system in the relevant period. Most importantly, the reports will allow for an assessment of whether the Recommendations have been fully and properly implemented and the AML/CFT system is effective. As in previous FATF evaluation rounds, this could be judged by reference to quantitative data and the results that have been achieved, or could be based upon more qualitative factors.

5. It should be noted that in some countries, AML/CFT issues are matters that are addressed not just at the level of the national government, but also at state/province or local levels. For example, profit generating criminal offences may exist at both federal and state levels. Measures to combat money laundering should be taken at the appropriate level of government, necessary to ensure that the full range of AML/CFT measures applies. When evaluations or assessments are being conducted, appropriate steps should be taken to ensure that AML/CFT measures at the state/provincial level are also adequately addressed.

### **Structure necessary for an effective AML/CFT system**

6. An effective AML/CFT system requires an adequate legal and institutional framework, which should include: (i) laws that create money laundering (ML) and terrorist financing (FT) offences and provide for the freezing, seizing and confiscation of the proceeds of crime and terrorist funding; (ii) laws, regulations or in certain circumstances other enforceable means that impose the required obligations on financial institutions and designated non-financial businesses and professions; (iii) an appropriate institutional or administrative framework, and laws that provide competent authorities with the necessary duties, powers and sanctions; and (iv) laws and other measures that give a country the ability to provide the widest range of international co-operation. It is also essential that the competent authorities ensure that the whole system is effectively implemented. The assessment of individual recommendations, as well as any findings relevant to paragraph 7 below, may lead to broader conclusions on the global effectiveness of a country's AML/CFT system. These conclusions should be mentioned in both the mutual evaluation report/detailed assessment report and in the executive summary as part of the report's overall findings on the AML/CFT system in the country and the effectiveness of that system (see also the MER template in the Handbook for Countries and Assessors).

7. An effective AML/CFT system also requires that certain structural elements, not covered by the AML/CFT assessment criteria, be in place. The lack of such elements, or significant weaknesses or shortcomings in the general framework, may significantly impair the implementation of an effective AML/CFT framework. Although the AML/CFT assessment criteria do not cover these conditions, assessors should consider whether there are apparent major weaknesses or shortcomings and should note these in the mutual evaluation/detailed assessment report. These elements should include in particular:

- a) the respect of principles such as transparency and good governance;
- b) a proper culture of AML/CFT compliance shared and reinforced by government, financial institutions, designated non-financial businesses and professions; industry trade groups, and self-regulatory organisations (SROs);
- c) appropriate measures to prevent and combat corruption, including, where information is available, laws and other relevant measures, the jurisdiction's participation in regional or international anti-corruption initiatives (such as the United Nations Convention against Corruption<sup>1</sup>) and the impact of these measures on the jurisdiction's AML/CFT implementation;

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<sup>1</sup> Other initiatives include the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the Group of States against Corruption (Groupe d'Etats contre la corruption—GRECO), the ADB/OECD Anti-Corruption Initiative for Asia/Pacific, the African Union Convention on Preventing and Combating Corruption, and the Inter-American Convention against Corruption.



- d) a reasonably efficient court system that ensures that judicial decisions are properly enforced;
- e) high ethical and professional requirements for police officers, prosecutors, judges, etc. and measures and mechanisms to ensure these are observed;
- f) a system for ensuring the ethical and professional behaviour on the part of professionals such as accountants and auditors, and lawyers. This may include the existence of codes of conduct and good practices, as well as methods to ensure compliance such as registration, licensing, and supervision or oversight.

**Guidance on the Essential Criteria, the Additional Elements, and the Compliance Ratings, and General Interpretation concerning the AML/CFT Standards and Methodology**

8. The assessment of the adequacy of a country’s AML/CFT framework will not be an exact process, and the vulnerabilities and risks that each country has in relation to ML and FT will be different depending on domestic and international circumstances. ML and FT techniques evolve over time, and therefore AML/CFT policies and best practices will also need to develop and adapt to counter the new threats.

9. The FATF Recommendations provide the international standard for combating money laundering and terrorist financing and the Recommendations and the criteria set out in this Methodology are applicable to all countries. However, assessors should be aware that the legislative, institutional and supervisory framework for AML/CFT may differ from one country to the next. Provided the FATF Recommendations are complied with, it is acceptable that countries implement the international standards in a manner consistent with their national legislative and institutional systems, even though the methods by which compliance is achieved may differ. In this regard, assessors should be aware of each country’s stage of economic development, its range of administrative capacities, and different cultural and legal conditions. Moreover, the report should provide the context for the assessment, and make note of any progress that has been or is being made in implementing the international standards and the criteria in this Methodology.

**Essential Criteria**

10. The essential criteria are those elements that should be present in order to demonstrate full compliance with the mandatory elements of each of the Recommendations. Criteria to be assessed are numbered sequentially for each Recommendation, but the sequence of criteria is not important. In some cases elaboration (indented below the criteria) is provided in order to assist in identifying important aspects of the assessment of the criteria. In addition, examples are provided, for some criteria, of situations in which a particular requirement could apply, or where there may be exceptions to the normally applicable obligations. The examples are not part of the criteria, and are only illustrative, but they may provide guidance as to whether national measures for particular criteria may be appropriate.

**Compliance Ratings**

11. For each Recommendation there are four possible levels of compliance: compliant, largely compliant, partially compliant, and non-compliant. In exceptional circumstances a Recommendation may also be rated as not applicable. These ratings are based only on the essential criteria, and defined as follows:

|                     |   |
|---------------------|---|
| Compliant           | The Recommendation is fully observed with respect to all essential criteria.                        |
| Largely compliant   | There are only minor shortcomings, with a large majority of the essential criteria being fully met. |
| Partially compliant | The country has taken some substantive action and complies with some of the essential criteria.     |

|                |  |
|----------------|--|
| Non-compliant  | There are major shortcomings, with a large majority of the essential criteria not being met.   |
| Not applicable | A requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country e.g. a particular type of financial institution does not exist in that country. |

12. Assessors should review whether the laws and regulations meet the appropriate standard and whether there is adequate capacity and implementation of those laws. Countries should only be regarded as fully complying with criteria if the relevant laws, regulations or other AML/CFT measures are in force and effect at the time of the on-site visit to the country or in the period immediately following the on-site mission, and before the finalisation of the report.

13. Laws that impose preventive AML/CFT requirements upon the banking, insurance, and securities sectors should be implemented and enforced through the supervisory process. In these sectors, the core supervisory principles issued by the Basel Committee, IAIS, and IOSCO should also be adhered to. For certain issues, these supervisory principles will overlap with or be complementary to the requirements set out in this Methodology. Assessors should be aware of, and have regard to any assessments or findings made with respect the Core Principles, or to other principles or standards issued by the supervisory standard-setting bodies. For other types of financial institutions, it will vary from country to country as to whether these laws and obligations are implemented and enforced through a regulatory or supervisory framework, or by other means.

#### **Additional Elements**

14. The additional elements are options that can further strengthen the AML/CFT system and may be desirable. They are derived from non-mandatory elements in the FATF Recommendations or from Best Practice and other guidance issued by the FATF, or by international standard-setters such as the Basel Committee on Banking Supervision. Although they form part of the overall assessment, they are not mandatory, and are not assessed for compliance purposes. To make this absolutely clear, the additional elements are formulated as questions. Assessors may consider and comment on the measures that have been taken or not taken, having regard to the particular circumstances of that country. In a similar way, assessors also have discretion to note other matters which they identify as strengthening or which might strengthen the AML/CFT system.

#### **Effective Implementation**

15. It is essential that all the FATF Recommendations are effectively implemented, and that assessments or evaluations address this issue and reflect it in the rating. The fundamental point, as noted in paragraphs 6 and 7 above, is that reports will not only assess formal compliance with the FATF Recommendations, but will also assess compliance having regard to whether the Recommendations have been implemented effectively. Assessors should regard effectiveness as an essential component in assessing each Recommendation. Effectiveness could have a positive, neutral, or negative influence on the overall rating for each Recommendation. The assessors' findings should be fully set out in the report. Assessors should note that the onus is on the assessed country to demonstrate (whether through statistics or by other factors) that implementation of the Recommendations is effective.

16. When assessing whether particular Recommendations have been effectively implemented, assessors will need to take into account quantitative data and qualitative and other information. As noted in paragraph 9 above, it must be recognised that every country has different AML/CFT laws and systems and that each evaluation will always need to be assessed on its own merits. Judging effectiveness will also require assessors to be aware of the particular circumstances of an assessed country, including the ML and FT vulnerabilities and risks, the legal and institutional AML/CFT framework and the structural elements referred to in paragraphs 6 and 7 above. Consideration should also always be given to certain fundamental factors such as the population of the country, the size of its financial and DNFBP sectors, the amount and type of predicate crime and money laundering activity, and of vulnerability to terrorist financing etc.

Absolute data is not usually determinative by itself, and should normally be considered relative to these other factors.

17. In addition to obtaining information on direct results and on the underlying context, assessors should also consider a range of other sources that may provide other relevant information on effectiveness such as reports by other bodies focused on similar or related issues including:

- country reports made under UNSCR 1373;
- FSAP or OFC reports issued by the IMF or World Bank
- reports on anti-bribery measures prepared by bodies such as the OECD or the GRECO committee of the Council of Europe;
- national studies on AML/CFT measures.

18. Another important element of the process for discussing and checking effectiveness is the on-site visit to the assessed country. The assessment team has the opportunity to obtain more detailed information from the various meetings that are held on-site, including in relation to ML and TF risks and vulnerabilities, and to cross check responses provided by government with the various associations and bodies from the private sector. Assessors should also note that it is permissible to use criteria from one recommendation to assess the effectiveness of implementation of other recommendations. For example, the resources available to an agency tasked to combat money laundering or terrorist financing (c.30.1), would usually also be relevant to the effectiveness of that agency e.g. financial supervisor body (R.23), FIU (R.26) etc.

## General Interpretation and Guidance

19. A full set of definitions from the FATF Recommendations, together with some additional terms that are employed in this Methodology, are at Annex 1. Assessors should be fully familiar with the meaning of all these terms, and in particular those terms that are used throughout the Methodology, such as: *consider*, *country*, *designated non-financial businesses and professions (DNFBP)*, *financial institutions*, *financing of terrorism (FT)*, *legal persons and legal arrangements*. The term *financial institutions* is particularly fundamental to any AML/CFT assessment, and one of the starting points for all assessments will entail assessors developing a thorough understanding of the types of financial institutions that engage in the financial activities referred to in the definition. Assessors should also take note of the following guidance on other points of general interpretation, which is important to ensure consistency of approach.

20. **Risk of money laundering or terrorist financing** - For each Recommendation and each essential criteria where financial institutions should be required to take certain actions, assessors should normally assess compliance on the basis that all financial institutions should have to meet all the specified requirements. However, an important consideration underlying the FATF Recommendations is the degree of risk of money laundering or terrorist financing for particular types of financial institutions or for particular types of customers, products or transactions. A country may therefore take risk into account and may decide to limit the application of certain FATF Recommendations provided that either of the following conditions are met:

(a) When a financial activity referred to in the definition of “financial institution” as defined in the Glossary is carried out on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering or terrorist financing activity occurring.

(b) In other circumstances where there is a proven low risk of money laundering and terrorist financing, a country may decide not to apply some or all of the requirements in one or more Recommendations. However, this should only be done on a strictly limited and justified basis. For the purposes of this Methodology, assessors should be satisfied as to the adequacy of the process to determine low risk and the reasonableness of the conclusions.

21. In Recommendation 5 there are a number of criteria which allow countries to permit their financial institutions to take risk into account when determining the extent of the customer due diligence measures that the institution must take. This should not allow financial institutions to completely avoid doing the required measures, but could allow them to reduce or simplify the measures they have to take for certain criteria. Assessors need to be satisfied that there is an adequate mechanism by which competent authorities assess or review the procedures adopted by financial institutions to determine the degree of risk and how they manage that risk, as well as to review the determinations made by institutions.

22. In Recommendations 5 and 9, reference is made to a financial institution being satisfied as to a matter. This also requires that the institution must be able to justify its assessment to competent authorities, and that assessors need to be satisfied that there is an adequate mechanism by which competent authorities can review the assessments of financial institutions.

23. **Requirements for financial institutions and designated non-financial businesses and professions** - The FATF Recommendations state that financial institutions or designated non-financial businesses and professions “should” or “should be required by law or regulation to” take certain actions. These references require countries or their competent authorities to take measures that will oblige their financial institutions or designated non-financial businesses and professions to comply with each of the relevant Recommendations. In the Methodology, in order to use one consistent phrase, the criteria relevant to financial institutions use the phrase “Financial institutions should be required” (a similar approach is taken for designated non-financial businesses).

24. **Law or regulation or other enforceable means** - The Interpretative Notes also require that “The basic obligations under Recommendations 5, 10 and 13 should be set out in law or regulation”. *Law or regulation* refers to primary and secondary legislation, such as laws, decrees, implementing regulations or other similar requirements, issued or authorised by a legislative body, and which impose mandatory requirements with sanctions for non-compliance. *Other enforceable means* refers to guidelines, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for non-compliance, and which are issued by a competent authority (e.g. a financial supervisory authority) or an SRO. In both cases, the sanctions for non-compliance should be effective, proportionate and dissuasive (see R.17). The Methodology criteria in respect of Recommendations 5, 10 and 13 that are basic obligations are marked with an asterisk (\*). More detailed elements in the criteria in respect of Recommendations 5, 10 and 13, as well as obligations under Recommendations 6-9, 11, 14-15, 18, and 21-22 could be required either by law or regulation or by other enforceable means.

25. **Assessment for designated non-financial businesses and professions** - Under Recommendations 12 and 16 designated non-financial businesses and professions should be required to take certain actions. Assessors should assess compliance on the basis that all the designated categories of non-financial businesses and professions should meet the requirements set out in the Recommendation. However, it is not necessary to require these actions through laws, regulations or other enforceable means that relate exclusively to lawyers, notaries, accountants and the other designated non-financial businesses and professions so long as these businesses or professions are included in laws, regulations or other enforceable means covering the underlying activities. Assessors should note that compliance by designated non-financial businesses and professions with all the necessary AML/CFT measures is to be assessed only under Recommendations 12 & 16, and not under other Recommendations. Failure by a country to extend the AML/CFT obligations to such businesses and professions should not be reflected in the assessment of the other Recommendations. In determining whether laws, regulations or other enforceable means should be used for particular criteria, assessors should take a corresponding approach to that used for financial institutions.

## **THE FORTY RECOMMENDATIONS** **ESSENTIAL CRITERIA AND ADDITIONAL ELEMENTS**

### **A. LEGAL SYSTEMS**

#### *Scope of the Criminal Offence of Money Laundering*

##### **Recommendation 1**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 1 and Special Recommendation II. (Note to assessors: Ensure that the assessments of Criteria 1.3 – 1.6 and Criteria II.2 – II.3 (in SR.II) are consistent.)

##### **Essential criteria**

- 1.1 Money laundering should be criminalised on the basis of the 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Pyschotropic Substances (the Vienna Convention) and the 2000 UN Convention against Transnational Organized Crime (the Palermo Convention) i.e. the physical and material elements of the offence (see Article 3(1)(b)&(c) Vienna Convention and Article 6(1) Palermo Convention).
- 1.2 The offence of ML should extend to any type of property, regardless of its value, that directly or indirectly represents the proceeds of crime.
  - 1.2.1 When proving that property is the proceeds of crime it should not be necessary that a person be convicted of a predicate offence<sup>2</sup>.
- 1.3 The predicate offences for money laundering should cover all serious offences, and countries should seek to extend this to the widest range of predicate offences. At a minimum, predicate offences should include a range of offences in each of the designated categories of offences<sup>3</sup>. Where the designated category is limited to a specific offence, then that offence must be covered.
- 1.4 Where countries apply a threshold approach or a combined approach that includes a threshold approach<sup>4</sup>, predicate offences should at a minimum comprise all offences:
  - a) which fall within the category of serious offences under their national law; or
  - b) which are punishable by a maximum penalty of more than one year's imprisonment; or
  - c) which are punished by a minimum penalty of more than six months imprisonment (for countries that have a minimum threshold for offences in their legal system).

Examples of categories of serious offences include: “indictable offences” (as opposed to summary offences), “felonies” (as opposed to misdemeanours); “crimes” (as opposed to délits).

- 1.5 Predicate offences for money laundering should extend to conduct that occurred in another country, which constitutes an offence in that country, and which would have constituted a predicate offence had it occurred domestically.

<sup>2</sup> This criterion applies at any stage of the proceedings, including when a decision is being made whether to initiate proceedings.

<sup>3</sup> Note to assessors: R.1 does not require countries to create a separate offence of “participation in an organised criminal group and racketeering”. In order to cover this category of “designated offence” (c.1.3), it is sufficient if a country meets either of the two options set out in the Palermo Convention i.e. either a separate offence or an offence based on conspiracy.

<sup>4</sup> Countries determine the underlying predicate offences for money laundering by reference to (a) all offences, or (b) to a threshold linked either to a category of serious offences or to the penalty of imprisonment applicable to the predicate offence (threshold approach), or (c) to a list of predicate offences, or (d) a combination of these approaches.

- 1.6 The offence of money laundering should apply to persons who commit the predicate offence. However, countries may provide that the offence of money laundering does not apply to persons who committed the predicate offence, where this is required by fundamental principles of their domestic law.
- 1.7 There should be appropriate ancillary offences to the offence of money laundering, including conspiracy to commit, attempt, aiding and abetting, facilitating, and counselling the commission, unless this is not permitted by fundamental principles of domestic law.

**Additional elements**

- 1.8 Where the proceeds of crime are derived from conduct that occurred in another country, which is not an offence in that other country but which would have constituted a predicate offence had it occurred domestically, does this constitute a money laundering offence?

## **Recommendation 2**

The essential criteria listed below should be read in conjunction with the text of Recommendation 2.

### **Essential criteria**

- 2.1 The offence of ML should apply at least to natural persons that knowingly engage in ML activity.
- 2.2 The law should permit the intentional element of the offence of ML to be inferred from objective factual circumstances.
- 2.3 Criminal liability for ML should extend to legal persons. Where that is not possible (i.e. due to fundamental principles of domestic law), civil or administrative liability should apply.
- 2.4 Making legal persons subject to criminal liability for ML should not preclude the possibility of parallel criminal, civil or administrative proceedings in countries in which more than one form of liability is available.
- 2.5 Natural and legal persons should be subject to effective, proportionate and dissuasive criminal, civil or administrative sanctions for ML.<sup>5</sup>

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<sup>5</sup> Note to assessors: In assessing whether criminal penalties are effective, proportionate and dissuasive (c.2.5) assessors should consider:

- The level of penalties (imprisonment/fines) for the offence relative to other serious offences in the assessed country;
- The level of penalties (imprisonment/fines) for ML/TF offences relative to ML/TF offences in other countries;
- The penalties actually imposed by the courts for ML/TF offences.

## ***Provisional Measures and Confiscation***

### **Recommendation 3**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 3 and Special Recommendation III. (Note to assessors: Ensure that the assessments of Criteria 3.1 – 3.4, Criterion 3.6 and Criterion III.11 (in SR.III) are consistent.)

#### **Essential criteria**

3.1 Laws should provide for the confiscation of property that has been laundered or which constitutes:

- a) proceeds from;
- b) instrumentalities used in; and
- c) instrumentalities intended for use in

the commission of any ML, FT or other predicate offences, and property of corresponding value.

3.1.1 Criterion 3.1 should equally apply:

- (a) to property that is derived directly or indirectly from proceeds of crime; including income, profits or other benefits from the proceeds of crime; and
- (b) subject to criterion 3.5, to all the property referred to above, regardless of whether it is held or owned by a criminal defendant or by a third party.

All the property referred to in criteria 3.1 and 3.1.1 above is hereafter referred to as “property subject to confiscation”.

- 3.2 Laws and other measures should provide for provisional measures, including the freezing and/or seizing of property, to prevent any dealing, transfer or disposal of property subject to confiscation.
- 3.3 Laws or measures should allow the initial application to freeze or seize property subject to confiscation to be made ex-parte or without prior notice, unless this is inconsistent with fundamental principles of domestic law.
- 3.4 Law enforcement agencies, the FIU or other competent authorities should be given adequate powers to identify and trace property that is, or may become subject to confiscation or is suspected of being the proceeds of crime.
- 3.5 Laws and other measures should provide protection for the rights of bona fide third parties. Such protection should be consistent with the standards provided in the Palermo Convention.
- 3.6 There should be authority to take steps to prevent or void actions, whether contractual or otherwise, where the persons involved knew or should have known that as a result of those actions the authorities would be prejudiced in their ability to recover property subject to confiscation.

#### **Additional elements**

3.7 Do laws provide for the confiscation of:

- a) The property of organisations that are found to be primarily criminal in nature (i.e. organisations whose principal function is to perform or assist in the performance of illegal activities)?
- b) Property subject to confiscation, but without a conviction of any person (*civil forfeiture*), in addition to the system of confiscation triggered by a criminal conviction?
- c) Property subject to confiscation, and which require an offender to demonstrate the lawful origin of the property?



## **B. MEASURES TO BE TAKEN BY FINANCIAL INSTITUTIONS AND NON-FINANCIAL BUSINESSES AND PROFESSIONS TO PREVENT MONEY LAUNDERING AND TERRORIST FINANCING**

### **Recommendation 4**

The essential criteria listed below should be read in conjunction with the text of Recommendation 4.

### **Essential criteria**

- 4.1 Countries should ensure that no financial institution secrecy law will inhibit the implementation of the FATF Recommendations. Areas where this may be of particular concern are the ability of competent authorities to access information they require to properly perform their functions in combating ML or FT; the sharing of information between competent authorities, either domestically or internationally; and the sharing of information between financial institutions where this is required by R.7, R.9 or SR.VII.

## *Customer Due Diligence and Record-keeping*

### **Recommendation 5**

The essential criteria listed below should be read in conjunction with the text of Recommendations 5 and 8, Special Recommendation VII, the Interpretative Notes to Recommendation 5, 12 and 16, and to Recommendation 5. (Note to assessors: Ensure that the assessments of Criteria 5.2 – 5.3 and Criterion VII.1 (in SR.VII) are consistent.)

#### **Essential criteria**

5.1\* Financial institutions should not be permitted to keep anonymous accounts or accounts in fictitious names.

Where numbered accounts exist, financial institutions should be required to maintain them in such a way that full compliance can be achieved with the FATF Recommendations. For example, the financial institution should properly identify the customer in accordance with these criteria, and the customer identification records should be available to the AML/CFT compliance officer, other appropriate staff and competent authorities.

#### *When CDD is required<sup>6</sup>*

5.2\* Financial institutions should be required to undertake customer due diligence (CDD) measures when:

- a) establishing business relations;
- b) carrying out occasional transactions above the applicable designated threshold (USD/€ 15,000). This also includes situations where the transaction is carried out in a single operation or in several operations that appear to be linked;
- c) carrying out occasional transactions that are wire transfers in the circumstances covered by the Interpretative Note to SR VII;
- d) there is a suspicion of money laundering or terrorist financing, regardless of any exemptions or thresholds that are referred to elsewhere under the FATF Recommendations; or
- e) the financial institution has doubts about the veracity or adequacy of previously obtained customer identification data.

#### *Required CDD measures<sup>7</sup>*

5.3\* Financial institutions should be required to identify the customer (whether permanent or occasional, and whether natural or legal persons or legal arrangements) and verify that customer's identity using reliable, independent source documents, data or information (identification data)<sup>8</sup>.

5.4 For customers that are legal persons or legal arrangements, the financial institution should be required to:

- (a)\* verify that any person purporting to act on behalf of the customer is so authorised, and identify and verify the identity of that person; and
- (b) verify the legal status of the legal person or legal arrangement, e.g. by obtaining proof of incorporation or similar evidence of establishment or existence, and obtain information

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<sup>6</sup> Financial institutions do not have to repeatedly perform identification and verification every time that a customer conducts a transaction.

<sup>7</sup> The general rule is that customers should be subject to the full range of CDD measures. However, there are circumstances in which it would be reasonable for a country to allow its financial institutions to apply the extent of the CDD measures on a risk sensitive basis.

<sup>8</sup> Examples of the types of customer information that could be obtained, and the identification data that could be used to verify that information is set out in the paper entitled General Guide to Account Opening and Customer Identification issued by the Basel Committee's Working Group on Cross Border Banking.

concerning the customer's name, the names of trustees (for trusts), legal form, address, directors (for legal persons), and provisions regulating the power to bind the legal person or arrangement.

5.5\* Financial institutions should be required to identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner<sup>9</sup> using relevant information or data obtained from a reliable source such that the financial institution is satisfied that it knows who the beneficial owner is.

5.5.1\* For all customers, the financial institution should determine whether the customer is acting on behalf of another person, and should then take reasonable steps to obtain sufficient identification data to verify the identity of that other person.

5.5.2 For customers that are legal persons or legal arrangements, the financial institution should be required to take reasonable measures to:

- (a) understand the ownership and control structure of the customer;
- (b)\* determine who are the natural persons that ultimately own or control the customer. This includes those persons who exercise ultimate effective control over a legal person or arrangement.

Examples of the types of measures that would be normally needed to satisfactorily perform this function include:

- For companies - identifying the natural persons with a controlling interest and the natural persons who comprise the mind and management of company.
- For trusts - identifying the settlor, the trustee or person exercising effective control over the trust, and the beneficiaries.

Note to assessors: where the customer or the owner of the controlling interest is a public company that is subject to regulatory disclosure requirements i.e. a public company listed on a recognised stock exchange, it is not necessary to seek to identify and verify the identity of the shareholders of that public company.

5.6 Financial institutions should be required to obtain information on the purpose and intended nature of the business relationship.

5.7\* Financial institutions should be required to conduct ongoing due diligence on the business relationship.

5.7.1 Ongoing due diligence should include scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, and where necessary, the source of funds.

5.7.2 Financial institutions should be required to ensure that documents, data or information collected under the CDD process is kept up-to-date and relevant by undertaking reviews of existing records, particularly for higher risk categories of customers or business relationships.

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<sup>9</sup> For life and other investment linked insurance, the beneficiary under the policy must also be identified and verified. See criteria 5.14 concerning the timing of such measures.

## Risk

- 5.8 Financial institutions should be required to perform enhanced due diligence for higher risk categories of customer, business relationship or transaction.

Examples of higher risk categories (which are derived from the Basel CDD Paper) may include<sup>10</sup>

- a) Non-resident customers,
- b) Private banking,
- c) Legal persons or arrangements such as trusts that are personal assets holding vehicles,
- d) Companies that have nominee shareholders or shares in bearer form.

Types of enhanced due diligence measures may include those set out in Recommendation 6.

- 5.9 Where there are low risks, countries may decide that financial institutions can apply reduced or simplified measures. The general rule is that customers must be subject to the full range of CDD measures, including the requirement to identify the beneficial owner. Nevertheless there are circumstances where the risk of money laundering or terrorist financing is lower, where information on the identity of the customer and the beneficial owner of a customer is publicly available, or where adequate checks and controls exist elsewhere in national systems. In such circumstances it could be reasonable for a country to allow its financial institutions to apply simplified or reduced CDD measures when identifying and verifying the identity of the customer and the beneficial owner.

Examples of customers, transactions or products where the risk may be lower<sup>11</sup> could include:

- a) Financial institutions – provided that they are subject to requirements to combat money laundering and terrorist financing consistent with the FATF Recommendations and are supervised for compliance with those requirements.
- b) Public companies that are subject to regulatory disclosure requirements. This refers to companies that are listed on a stock exchange or similar situations.
- c) Government administrations or enterprises.
- d) Life insurance policies where the annual premium is no more than USD/€1000 or a single premium of no more than USD/€2500.
- e) Insurance policies for pension schemes if there is no surrender clause and the policy cannot be used as collateral.
- f) A pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme rules do not permit the assignment of a member's interest under the scheme.
- g) Beneficial owners of pooled accounts held by DNFBP provided that they are subject to requirements to combat money laundering and terrorist financing consistent with the FATF Recommendations and are subject to effective systems for monitoring and ensuring compliance with those requirements.

- 5.10 Where financial institutions are permitted to apply simplified or reduced CDD measures to customers resident in another country, this should be limited to countries that the original country is satisfied are in compliance with and have effectively implemented the FATF Recommendations.

- 5.11 Simplified CDD measures are not acceptable whenever there is suspicion of money laundering or terrorist financing or specific higher risk scenarios apply.

- 5.12 Where financial institutions are permitted to determine the extent of the CDD measures on a risk sensitive basis, this should be consistent with guidelines issued by the competent authorities.

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<sup>10</sup> Other examples of higher risk are included in Recommendations 6 and 7.

<sup>11</sup> Assessors should determine in each case whether the risks are lower having regard to the type of customer, product or transaction, or the location of the customer.

### Timing of verification

- 5.13 Financial institutions should be required to verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers.
- 5.14 Countries may permit financial institutions to complete the verification of the identity of the customer and beneficial owner following the establishment of the business relationship, provided that:
- (a) This occurs as soon as reasonably practicable.
  - (b) This is essential not to interrupt the normal conduct of business.
  - (c) The money laundering risks are effectively managed.

Examples of situations where it may be essential not to interrupt the normal conduct of business are:

- Non face-to-face business.
- Securities transactions. In the securities industry, companies and intermediaries may be required to perform transactions very rapidly, according to the market conditions at the time the customer is contacting them, and the performance of the transaction may be required before verification of identity is completed.
- Life insurance business – in relation to identification and verification of the beneficiary under the policy. This may take place after the business relationship with the policyholder is established, but in all such cases, identification and verification should occur at or before the time of payout or the time when the beneficiary intends to exercise vested rights under the policy.

5.14.1 Where a customer is permitted to utilise the business relationship prior to verification, financial institutions should be required to adopt risk management procedures concerning the conditions under which this may occur. These procedures should include a set of measures such as a limitation of the number, types and/or amount of transactions that can be performed and the monitoring of large or complex transactions being carried out outside of expected norms for that type of relationship.

### Failure to satisfactorily complete CDD

- 5.15 Where the financial institution is unable to comply with Criteria 5.3 to 5.6 above:
- a) it should not be permitted to open the account, commence business relations or perform the transaction;
  - b) it should consider making a suspicious transaction report.
- 5.16 Where the financial institution has already commenced the business relationship e.g. when Criteria 5.2(e), 5.14 or 5.17 apply, and the financial institution is unable to comply with Criteria 5.3 to 5.5 above it should be required to terminate the business relationship and to consider making a suspicious transaction report.

Existing customers

- 5.17 Financial institutions should be required to apply CDD requirements to existing customers<sup>12</sup> on the basis of materiality and risk and to conduct due diligence on such existing relationships at appropriate times.

For financial institutions engaged in banking business (and for other financial institutions where relevant) - examples of when it may otherwise be an appropriate time to do so is when: (a) a transaction of significance takes place, (b) customer documentation standards change substantially, (c) there is a material change in the way that the account is operated, (d) the institution becomes aware that it lacks sufficient information about an existing customer.

- 5.18 Financial institutions should be required to perform CDD measures on existing customers if they are customers to whom Criterion 5.1 applies.

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<sup>12</sup> Existing customers as at the date that the national requirements are brought into force.

## **Recommendation 6**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 6 and its Interpretative Note.

### **Essential criteria**

- 6.1 Financial institutions should be required, in addition to performing the CDD measures required under R.5, to put in place appropriate risk management systems to determine whether a potential customer, a customer or the beneficial owner is a politically exposed person.

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| Examples of measures that could form part of such a risk management system include seeking relevant information from the customer, referring to publicly available information or having access to commercial electronic databases of PEPS. |
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- 6.2 Financial institutions should be required to obtain senior management approval for establishing business relationships with a PEP.

6.2.1 Where a customer has been accepted and the customer or beneficial owner is subsequently found to be, or subsequently becomes a PEP, financial institutions should be required to obtain senior management approval to continue the business relationship.

- 6.3. Financial institutions should be required to take reasonable measures to establish the source of wealth and the source of funds of customers and beneficial owners identified as PEPS.

- 6.4. Where financial institutions are in a business relationship with a PEP, they should be required to conduct enhanced ongoing monitoring on that relationship.

### **Additional elements**

- 6.5 Are the requirements of R.6 extended to PEPS who hold prominent public functions domestically?
- 6.6 Has the 2003 United Nations Convention against Corruption been signed, ratified, and fully implemented?

## **Recommendation 7**

The essential criteria listed below should be read in conjunction with the text of Recommendation 7.

### **Essential criteria**

In relation to cross-border correspondent banking and other similar relationships<sup>13</sup> financial institutions should, in addition to performing any CDD measures that may be required under R.5, be required to take the measures set out in Criteria 7.1-7.5.

- 7.1 Gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action.
- 7.2 Assess the respondent institution's AML/CFT controls, and ascertain that they are adequate and effective.
- 7.3 Obtain approval from senior management before establishing new correspondent relationships.
- 7.4 Document<sup>14</sup> the respective AML/CFT responsibilities of each institution.
- 7.5 Where a correspondent relationship involves the maintenance of "payable-through accounts", financial institutions should be satisfied that:
  - (a) their customer (the respondent financial institution) has performed all the normal CDD obligations set out in R.5 on those of its customers that have direct access to the accounts of the correspondent financial institution; and
  - (b) the respondent financial institution is able to provide relevant customer identification data upon request to the correspondent financial institution.

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<sup>13</sup> Similar relationships to which financial institutions should apply Criteria 7.1-7.5 include for example those established for securities transactions or funds transfers, whether for the cross-border financial institution as principal or for its customers.

<sup>14</sup> It is not necessary that the two financial institutions always have to reduce the respective responsibilities into a written form provided there is a clear understanding as to which institution will perform the required measures.



## **Recommendation 8**

The essential criteria listed below should be read in conjunction with the text of Recommendation 8.

### **Essential criteria**

- 8.1 Financial institutions should be required to have policies in place or take such measures as may be needed to prevent the misuse of technological developments in money laundering or terrorist financing schemes.
- 8.2 Financial institutions should be required to have policies and procedures in place to address any specific risks associated with non-face to face business relationships or transactions. These policies and procedures should apply when establishing customer relationships and when conducting ongoing due diligence.

Examples of non-face to face operations include: business relationships concluded over the Internet or by other means such as through the post; services and transactions over the Internet including trading in securities by retail investors over the Internet or other interactive computer services; use of ATM machines; telephone banking; transmission of instructions or applications via facsimile or similar means and making payments and receiving cash withdrawals as part of electronic point of sale transaction using prepaid or reloadable or account-linked value cards.

- 8.2.1 Measures for managing the risks should include specific and effective CDD procedures that apply to non-face to face customers.

Examples of such procedures include: the certification of documents presented; the requisition of additional documents to complement those which are required for face-to-face customers; develop independent contact with the customer; rely on third party introduction (see criteria 9.1 to 9.5) and require the first payment to be carried out through an account in the customer's name with another bank subject to similar customer due diligence standards.

Financial institutions should refer to the CDD Paper, Section 2.2.6.

For electronic services, financial institutions could refer to the "Risk Management Principles for Electronic Banking" issued by the Basel Committee in July 2003.

## **Recommendation 9**

The essential criteria listed below should be read in conjunction with the text of Recommendation 9 and its Interpretative Note.

Note: This Recommendation does not apply to:

- (a) outsourcing or agency relationships, i.e. where the agent is acting under a contractual arrangement with the financial institution to carry out its CDD functions<sup>15</sup>;
- (b) business relationships, accounts or transactions between financial institutions for their clients. These are addressed by R.5 and R.7.

### **Essential criteria**

If financial institutions are permitted to rely on intermediaries or other third parties to perform some of the elements of the CDD process (Criteria 5.3 to 5.6)<sup>16</sup> or to introduce business, then the following criteria should be met.

- 9.1 Financial institutions relying upon a third party should be required to immediately obtain from the third party the necessary information<sup>17</sup> concerning certain elements of the CDD process (Criteria 5.3 to 5.6).
- 9.2 Financial institutions should be required to take adequate steps to satisfy themselves that copies of identification data and other relevant documentation relating to CDD requirements will be made available from the third party upon request without delay.
- 9.3 Financial institutions should be required to satisfy themselves that the third party is regulated and supervised (in accordance with Recommendation 23, 24 and 29), and has measures in place to comply with, the CDD requirements set out in R.5 and R.10.
- 9.4 In determining in which countries the third party that meets the conditions can be based, competent authorities should take into account information available on whether those countries adequately apply the FATF Recommendations<sup>18</sup>.
- 9.5 The ultimate responsibility for customer identification and verification should remain with the financial institution relying on the third party.

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<sup>15</sup> Where there is a contract to outsource CDD, R.9 does not apply because the outsource or agent is to be regarded as synonymous with the financial institution i.e. the processes and documentation are those of the financial institution itself.

<sup>16</sup> In practice, this reliance on third parties often occurs through introductions made by another member of the same financial services group, or in some jurisdictions from another financial institution or third party. It may also occur in business relationships between insurance companies and insurance brokers/agents, or between mortgage providers and brokers.

<sup>17</sup> It is not necessary to obtain copies of documentation.

<sup>18</sup> Countries could refer to reports, assessments or reviews concerning AML/CFT that are published by the FATF, FSRBs, the IMF or World Bank.

## **Recommendation 10**

The essential criteria listed below should be read in conjunction with the text of Recommendation 10 and its Interpretative Note.

### **Essential criteria**

10.1\* Financial institutions should be required to maintain all necessary records on transactions, both domestic and international, for at least five years following completion of the transaction (or longer if requested by a competent authority in specific cases and upon proper authority). This requirement applies regardless of whether the account or business relationship is ongoing or has been terminated.

10.1.1 Transaction records should be sufficient to permit reconstruction of individual transactions so as to provide, if necessary, evidence for prosecution of criminal activity.

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| Examples of the necessary components of transaction records include: customer's (and beneficiary's) name, address (or other identifying information normally recorded by the intermediary), the nature and date of the transaction, the type and amount of currency involved, and the type and identifying number of any account involved in the transaction. |
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10.2\* Financial institutions should be required to maintain records of the identification data, account files and business correspondence for at least five years following the termination of an account or business relationship (or longer if requested by a competent authority in specific cases upon proper authority).

10.3\* Financial institutions should be required to ensure that all customer and transaction records and information are available on a timely basis to domestic competent authorities upon appropriate authority.

## **Recommendation 11**

The essential criteria listed below should be read in conjunction with the text of Recommendation 11 and its Interpretative Note.

### **Essential criteria**

- 11.1 Financial institutions should be required to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose.

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| Examples of such transactions or patterns of transactions include: significant transactions relative to a relationship, transactions that exceed certain limits, very high account turnover inconsistent with the size of the balance, or transactions which fall out of the regular pattern of the account's activity. |
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- 11.2 Financial institutions should be required to examine as far as possible the background and purpose of such transactions and to set forth their findings in writing.
- 11.3 Financial institutions should be required to keep such findings available for competent authorities and auditors for at least five years.

## **Recommendation 12**

The essential criteria listed below should be read in conjunction with the text of Recommendation 12, the Interpretative Note to R.5, 12 & 16, and the essential criteria and the additional elements for Recommendations 5, 6 and 8-11.

### **Essential criteria**

12.1 DNFBP should be required to comply with the requirements set out in Recommendation 5 (Criteria 5.1 – 5.18) in the following circumstances<sup>19</sup>:

- a) Casinos (including internet casinos<sup>20</sup>) – when their customers engage in financial transactions<sup>21</sup> equal to or above USD/€3,000<sup>22</sup>.

Examples of financial transactions in casinos include: the purchase or cashing in of casino chips or tokens, the opening of accounts, wire transfers and currency exchanges. Financial transactions do not refer to gambling transactions that involve only casino chips or tokens.

- b) Real estate agents – when they are involved in transactions for a client concerning the buying and selling of real estate<sup>23</sup>.

- c) Dealers in precious metals and dealers in precious stones – when they engage in any cash transaction with a customer equal to or above USD/€15,000<sup>28</sup>.

- d) Lawyers, notaries, other independent legal professionals and accountants when they prepare for or carry out transactions for a client in relation to the following activities:

- buying and selling of real estate;
- managing of client money, securities or other assets<sup>24</sup>;
- management of bank, savings or securities accounts<sup>30</sup>;
- organisation of contributions for the creation, operation or management of companies;
- creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

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<sup>19</sup> The designated thresholds applied in these criteria are referred to in the IN of R. 5, 12 and 16.

<sup>20</sup> Countries should establish rules to determine the basis upon which internet casinos are subject to national AML/CFT requirements. This will require the country to determine the basis or set of factors upon which it will decide whether there is a sufficient nexus or connection between the internet casino and the country. Examples of such factors include incorporation or organisation under the laws of the country, or place of effective management within the country. Assessors should examine the basis for the nexus or connection, with respect to R.12, 16 and 24.

<sup>21</sup> Note to assessors: Recommendation 12 (c.12.1) requires casinos (including internet casinos) to implement Recommendation 5, including identifying and verifying the identity of customers, when their customers engage in financial transactions equal to or above USD/€3,000. Conducting customer identification at the entry to a casino could be, but is not necessarily, sufficient. Countries must require casinos to ensure that they are able to link customer due diligence information for a particular customer to the transactions that the customer conducts in the casino.

<sup>22</sup> The designated thresholds of USD/€3,000 and USD/€15,000 include situations where the transaction is carried out in a single operation or in several operations that appear to be linked.

<sup>23</sup> This means that real estate agents should comply with R.5 with respect to both the purchasers and the vendors of the property.

<sup>24</sup> Where the lawyer, notary, other independent legal professional or accountant is conducting financial activity as a business and meets the definition of “financial institution” then that person or firm should comply with the requirements applicable to financial institutions.

e) Trust and Company Service Providers when they prepare for and when they carry out transactions for a client in relation to the following activities:

- acting as a formation agent of legal persons;
- acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
- providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;
- acting as (or arranging for another person to act as) a trustee of an express trust;
- acting as (or arranging for another person to act as) a nominee shareholder for another person.

DNFBP should especially comply with the CDD measures set out in Criteria 5.3 to 5.7 but may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction.

12.2 In the circumstances set out in Criterion 12.1, DNFBP should be required to comply with the criteria set out under Recommendations 6 and 8-11.

## *Reporting of Suspicious Transactions and Compliance*

### **Recommendation 13**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 1, Recommendation 13 and its Interpretative Note, and the text of Special Recommendation IV. (Note to assessors: Ensure that the assessments of Criteria 13.1 – 13.4 and Criteria IV.1 – IV.2 (in SR.IV) are consistent.)

#### **Essential criteria**

- 13.1\* A financial institution should be required by law or regulation to report to the FIU (a suspicious transaction report – STR) when it suspects or has reasonable grounds to suspect<sup>25</sup> that funds are the proceeds of a criminal activity. At a minimum, the obligation to make a STR should apply to funds that are the proceeds of all offences that are required to be included as predicate offences under Recommendation 1. This requirement should be a direct mandatory obligation, and any indirect or implicit obligation to report suspicious transactions, whether by reason of possible prosecution for a ML offence or otherwise (so called “indirect reporting”), is not acceptable.
- 13.2\* The obligation to make a STR also applies to funds where there are reasonable grounds to suspect or they are suspected to be linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations or those who finance terrorism.
- 13.3\* All suspicious transactions, including attempted transactions, should be reported regardless of the amount of the transaction.
- 13.4 The requirement to report suspicious transactions should apply regardless of whether they are thought, among other things, to involve tax matters.

#### **Additional elements**

- 13.5 Are financial institutions required to report to the FIU when they suspect or have reasonable grounds to suspect that funds are the proceeds of all criminal acts that would constitute a predicate offence for money laundering domestically?

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<sup>25</sup> The requirement to report when the individual “suspects” is a subjective test of suspicion i.e. the person actually suspected that a transaction involved a criminal activity. A requirement to report when there are “reasonable grounds to suspect” is an objective test of suspicion and can be satisfied if the circumstances surrounding the transaction would lead a reasonable person to suspect that the transaction involved a criminal activity. This requirement implies that countries may choose either the two alternatives, but need not have both.

## **Recommendation 14**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 14 and its Interpretative Note.

### **Essential criteria**

- 14.1. Financial institutions and their directors, officers and employees (permanent and temporary) should be protected by law from both criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, if they report their suspicions in good faith to the FIU. This protection should be available even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.
- 14.2. Financial institutions and their directors, officers and employees (permanent and temporary) should be prohibited by law from disclosing (“tipping off”) the fact that a STR or related information is being reported or provided to the FIU.

### **Additional elements**

- 14.3 Do laws or regulations or any other measures ensure that the names and personal details of staff of financial institutions that make a STR are kept confidential by the FIU?



## **Recommendation 15**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 15 and its Interpretative Note.

### **Essential criteria**

The type and extent of measures to be taken for each of the requirements set out below should be appropriate having regard to the risk of money laundering and terrorist financing and the size of the business.

- 15.1 Financial institutions should be required to establish and maintain internal procedures, policies and controls to prevent ML and FT, and to communicate these to their employees. These procedures, policies and controls should cover, *inter alia*, CDD, record retention, the detection of unusual and suspicious transactions and the reporting obligation.
  - 15.1.1 Financial institutions should be required to develop appropriate compliance management arrangements e.g. for financial institutions at a minimum the designation of an AML/CFT compliance officer at the management level.
  - 15.1.2 The AML/CFT compliance officer and other appropriate staff should have timely access to customer identification data and other CDD information, transaction records, and other relevant information.
- 15.2 Financial institutions should be required to maintain an adequately resourced and independent audit function to test compliance (including sample testing) with these procedures, policies and controls.
- 15.3 Financial institutions should be required to establish ongoing employee training to ensure that employees are kept informed of new developments, including information on current ML and FT techniques, methods and trends; and that there is a clear explanation of all aspects of AML/CFT laws and obligations, and in particular, requirements concerning CDD and suspicious transaction reporting.
- 15.4. Financial institutions should be required to put in place screening procedures to ensure high standards when hiring employees.

### **Additional elements**

- 15.5 Is the AML/CFT compliance officer able to act independently and to report to senior management above the compliance officer's next reporting level or the board of directors?

## **Recommendation 16**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 16 and its Interpretative Note, Recommendations 13-15 and their Interpretative Notes and their essential criteria / additional elements, and Special Recommendation IV.

### **Essential criteria**

16.1 DNFBP should be required to comply with the requirements set out in Recommendation 13 (Criteria 13.1 – 13.4)<sup>26</sup> in the following circumstances:

- a) Casinos (which includes internet casinos) and real estate agents – in the circumstances set out in R.13.
- b) Dealers in precious metals or stones - when they engage in any cash transaction equal to or above USD/€15,000<sup>27</sup>.
- c) Lawyers, notaries, other independent legal professionals and accountants - when, on behalf of or for a client, they engage in a financial transaction in relation to the following activities:
  - buying and selling of real estate;
  - managing of client money, securities or other assets;
  - management of bank, savings or securities accounts;
  - organisation of contributions for the creation, operation or management of companies;
  - creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

#### **Note on legal professional privilege or legal professional secrecy.**

Lawyers, notaries, other independent legal professionals, and accountants acting as independent legal professionals, are not required to report suspicious transactions if the relevant information was obtained in circumstances where they are subject to legal professional privilege or legal professional secrecy.

It is for each jurisdiction to determine the matters that would fall under legal professional privilege or legal professional secrecy. This would normally cover information lawyers, notaries or other independent legal professionals receive from or obtain through one of their clients: (a) in the course of ascertaining the legal position of their client, or (b) in performing their task of defending or representing that client in, or concerning judicial, administrative, arbitration or mediation proceedings. Where accountants are subject to the same obligations of secrecy or privilege, then they are also not required to report suspicious transactions.

- d) Trust and Company Service Providers - when they prepare for or carry out a transaction on behalf of a client, in relation to the following activities:
  - acting as a formation agent of legal persons;
  - acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;

<sup>26</sup> DNFBP should comply with all the criteria in Recommendation 13 with two exceptions. First, dealers in precious metals and stones must comply with criteria 13.3, but would only be required to report transactions (or attempted transactions) above the cash threshold of USD/€15,000. Second, as detailed in criteria 16.1, countries may allow lawyers, notaries, other independent legal professionals, and accountants acting as independent legal professionals to send their STR to self-regulatory organizations, and they do not always need to send STR to the FIU.

<sup>27</sup> The designated threshold includes situations where the transaction is carried out in a single operation or in several operations that appear to be linked (cases of “smurfing”/“structuring”).

- providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;
- acting as (or arranging for another person to act as) a trustee of an express trust;
- acting as (or arranging for another person to act as) a nominee shareholder for another person.

16.2 Where countries allow lawyers, notaries, other independent legal professionals and accountants to send their STR to their appropriate self-regulatory organisations (SRO), there should be appropriate forms of co-operation between these organisations and the FIU. Each country should determine the details of how the SRO could co-operate with the FIU.

16.3 In the circumstances set out in criterion 16.1, the criteria set out under Recommendations 14, 15 and 21 should apply in relation to DNFBP.

**Additional elements**

16.5 Is the reporting requirement extended to the rest of the professional activities of accountants, including auditing?

16.6 Are DNFBP required to report to the FIU when they suspect or have reasonable grounds to suspect that funds are the proceeds of all criminal acts that would constitute a predicate offence for money laundering domestically?

## *Other Measures to Deter Money Laundering and Terrorist Financing*

### **Recommendation 17**

The essential criteria listed below should be read in conjunction with the text of Recommendation 17, Special Recommendations IV, VI and VII. (Note to assessors: Ensure that Criteria 17.1 – 17.4 and Criterion VI.5 (in SR.VI) and Criterion VII.9 (in SR.VII) are consistent.)

#### **Essential criteria**

- 17.1 Countries should ensure that effective, proportionate and dissuasive criminal, civil or administrative sanctions are available to deal with natural or legal persons covered by the FATF Recommendations that fail to comply with national AML/CFT requirements.
- 17.2 Countries should designate an authority (e.g. supervisors or the FIU) empowered to apply these sanctions. Different authorities may be responsible for applying sanctions depending on the nature of the requirement that was not complied with.
- 17.3 Sanctions should be available in relation not only to the legal persons that are financial institutions or businesses but also to their directors and senior management.
- 17.4 The range of sanctions available should be broad and proportionate to the severity of a situation. They should include the power to impose disciplinary and financial sanctions and the power to withdraw, restrict or suspend the financial institution's license, where applicable.

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| Examples of types of sanctions include: written warnings (separate letter or within an audit report), orders to comply with specific instructions (possibly accompanied with daily fines for non-compliance), ordering regular reports from the institution on the measures it is taking, fines for non-compliance, barring individuals from employment within that sector, replacing or restricting the powers of managers, directors, or controlling owners, imposing conservatorship or a suspension or withdrawal of the license, or criminal penalties where permitted. |
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## **Recommendation 18**

The essential criteria listed below should be read in conjunction with the text of Recommendation 18.

### **Essential criteria**

- 18.1 Countries should not approve the establishment or accept the continued operation of shell banks.
- 18.2 Financial institutions should not be permitted to enter into, or continue, correspondent banking relationships with shell banks.
- 18.3 Financial institutions should be required to satisfy themselves that correspondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

## **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 computerised data base.

### **Additional elements**

- 19.2 Where systems for reporting large currency transactions are in place, are the reports maintained in a computerised 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?

## **Recommendation 20**

The essential criteria listed below should be read in conjunction with the text of Recommendation 20.

### **Essential criteria**

- 20.1 Countries should consider applying Recommendations 5, 6, 8-11, 13-15, 17 and 21 to non-financial businesses and professions (other than DNFBP) that are at risk of being misused for money laundering or terrorist financing.

Examples of businesses or professions that may be at risk include: dealers in high value and luxury goods, pawnshops, gambling, auction houses and investment advisers.

- 20.2 Countries should take measures to encourage the development and use of modern and secure techniques for conducting financial transactions that are less vulnerable to money laundering.

Examples of techniques or measures that may be less vulnerable to money laundering include:

- Reducing reliance on cash;
- Not issuing very large denomination banknotes;
- Secured automated transfer systems.

## **Recommendation 21**

The essential criteria listed below should be read in conjunction with the text of Recommendation 21.

### **Essential criteria**

- 21.1 Financial institutions should be required to give special attention to business relationships and transactions with persons (including legal persons and other financial institutions) from or in countries which do not or insufficiently apply the FATF Recommendations.
- 21.1.1 There should be effective measures in place to ensure that financial institutions are advised of concerns about weaknesses in the AML/CFT systems of other countries.
- 21.2 If those transactions have no apparent economic or visible lawful purpose, the background and purpose of such transactions should, as far as possible, be examined, and written findings should be available to assist competent authorities (e.g. supervisors, law enforcement agencies and the FIU) and auditors.
- 21.3 Where a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate counter-measures.

Examples of possible counter-measures include:

- Stringent requirements for identifying clients and enhancement of advisories, including jurisdiction-specific financial advisories, to financial institutions for identification of the beneficial owners before business relationships are established with individuals or companies from these countries;
- Enhanced relevant reporting mechanisms or systematic reporting of financial transactions on the basis that financial transactions with such countries are more likely to be suspicious;
- In considering requests for approving the establishment in countries applying the countermeasure of subsidiaries or branches or representative offices of financial institutions, taking into account the fact that the relevant financial institution is from a country that does not have adequate AML/CFT systems;
- Warning non-financial sector businesses that transactions with natural or legal persons within that country might run the risk of money laundering.
- Limiting business relationships or financial transactions with the identified country or persons in that country.



## **Recommendation 22**

The essential criteria listed below should be read in conjunction with the text of Recommendation 22.

### **Essential criteria**

- 22.1 Financial institutions should be required to ensure that their foreign branches and subsidiaries observe AML/CFT measures consistent with home country requirements and the FATF Recommendations, to the extent that local (i.e. host country) laws and regulations permit.
  - 22.1.1 Financial institutions should be required to pay particular attention that this principle is observed with respect to their branches and subsidiaries in countries which do not or insufficiently apply the FATF Recommendations.
  - 22.1.2 Where the minimum AML/CFT requirements of the home and host countries differ, branches and subsidiaries in host countries should be required to apply the higher standard, to the extent that local (i.e. host country) laws and regulations permit.
- 22.2 Financial institutions should be required to inform their home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures because this is prohibited by local (i.e. host country) laws, regulations or other measures.

### **Additional elements**

- 22.3 Are financial institutions subject to the Core Principles required to apply consistent CDD measures at the group level, taking into account the activity of the customer with the various branches and majority owned subsidiaries worldwide?

## **Recommendation 23**

The essential criteria listed below should be read in conjunction with the text of Recommendation 23, its Interpretative Note, the text of Special Recommendation VI, and its Interpretative Note.

Note to assessors: Assessors should use criterion 23.1 to assess the overall adequacy of the regulatory and supervisory system, and to note any deficiencies that are not dealt with in other criteria. Assessors may also wish to have regard to matters raised in assessments made with respect to the Core Principles.

### **Essential criteria**

- 23.1 Countries should ensure that financial institutions are subject to adequate AML/CFT regulation and supervision and are effectively implementing the FATF Recommendations.
- 23.2 Countries should ensure that a designated competent authority or authorities has/have responsibility for ensuring that financial institutions adequately comply with the requirements to combat money laundering and terrorist financing.
- 23.3 Supervisors or other competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function, including in the executive or supervisory boards, councils, etc in a financial institution.
  - 23.3.1 Directors and senior management of financial institutions subject to the Core Principles should be evaluated on the basis of “fit and proper” criteria including those relating to expertise and integrity.
- 23.4 For financial institutions that are subject to the Core Principles<sup>28</sup> the regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, should apply in a similar manner for anti-money laundering and terrorist financing purposes, except where specific criteria address the same issue in this Methodology.

Examples of regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, include requirements for: (i) licensing and structure; (ii) risk management processes to identify, measure, monitor and control material risks; (iii) ongoing supervision and (iv) global consolidated supervision where required by the Core Principles.

- 23.5 Natural and legal persons providing a money or value transfer service, or a money or currency changing service should be licensed or registered.
- 23.6 Natural and legal persons providing a money or value transfer service, or a money or currency changing service should be subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing.
- 23.7 Financial institutions (other than those mentioned in Criterion 23.4) should be licensed or registered and appropriately regulated, and subject to supervision or oversight for AML/CFT purposes, having regard to the risk of money laundering or terrorist financing in that sector i.e. if there is a proven low risk then the required measures may be less.

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<sup>28</sup> Note to assessors: refer to the Core Principles for a precise description of the financial institutions that are covered, but broadly speaking it refers to: (1) banking and other deposit-taking business, (2) insurers and insurance intermediaries, and (3) collective investment schemes and market intermediaries.

## **Recommendation 24**

The essential criteria listed below should be read in conjunction with the text of Recommendation 24.

### **Essential criteria**

- 24.1 Countries should ensure that casinos (including Internet casinos) are subject to a comprehensive regulatory and supervisory regime that ensures they are effectively implementing the AML/CFT measures required under the FATF Recommendations.
- 24.1.1 Countries should ensure that a designated competent authority has responsibility for the AML/CFT regulatory and supervisory regime. The competent authority should have adequate powers to perform its functions, including powers to monitor and sanction (countries should ensure that criteria 17.1-17.4 apply to the obligations under R.12 and R.16).
- 24.1.2 Casinos should be licensed by a designated competent authority.
- 24.1.3 A competent authority should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest, holding a management function in, or being an operator of a casino.
- 24.2 Countries should ensure that the other categories of DNFBP are subject to effective systems for monitoring and ensuring compliance with AML/CFT requirements. In determining whether the system for monitoring and ensuring compliance is appropriate, regard may be had to the risk of money laundering or terrorist financing in that sector i.e. if there is a proven low risk then the extent of the required measures may be less.
- 24.2.1 There should be a designated competent authority or SRO responsible for monitoring and ensuring compliance of DNFBPs with AML/CFT requirements. Such an authority or SRO should have:
- a) Adequate powers to perform its functions, including powers to monitor and sanction (countries should ensure that criteria 17.1-17.4 apply to the obligations under R.12 and R.16).
  - b) Sufficient technical and other resources to perform its functions<sup>29</sup>.

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<sup>29</sup> In assessing compliance with this criterion, assessors should have regard to Criteria 30.1 to 30.4 where it is appropriate to do so (i.e. depending on the type of the designated competent authority or SRO, its size, its responsibilities, etc).

## **Recommendation 25**

The essential criteria listed below should be read in conjunction with the text of Recommendation 25 and its Interpretative Note.

### **Essential criteria**

- 25.1 Competent authorities should establish guidelines that will assist financial institutions and DNFBP to implement and comply with their respective AML/CFT requirements. For DNFBP, such guidelines may be established by SROs.

At a minimum, the guidelines should give assistance on issues covered under the relevant FATF Recommendations, including: (i) a description of ML and FT techniques and methods; and (ii) any additional measures that these institutions and DNFBP could take to ensure that their AML/CFT measures are effective.

- 25.2 Competent authorities, and particularly the FIU, should provide financial institutions and DNFBP that are required to report suspicious transactions, with adequate and appropriate feedback having regard to the FATF Best Practice Guidelines on Providing Feedback to Reporting Financial Institutions and Other Persons.

Examples of appropriate feedback mechanisms (drawn from the Best Practices Paper) may include:

(i) general feedback - (a) statistics on the number of disclosures, with appropriate breakdowns, and on the results of the disclosures; (b) information on current techniques, methods and trends (typologies); and (c) sanitised examples of actual money laundering cases.

(ii) specific or case by case feedback - (a) acknowledgement of the receipt of the report; (b) subject to domestic legal principles, if a case is closed or completed, whether because of a concluded prosecution, because the report was found to relate to a legitimate transaction or for other reasons, and if the information is available, then the institution should receive information on that decision or result.

## **C. INSTITUTIONAL AND OTHER MEASURES NECESSARY IN SYSTEMS FOR COMBATING MONEY LAUNDERING AND TERRORIST FINANCING**

### *Competent Authorities, their Powers and Resources*

#### **Recommendation 26**

The essential criteria listed below should be read in conjunction with the text of Recommendation 26 and its Interpretative Note.

#### **Essential criteria**

- 26.1 Countries should establish an FIU that serves as a national centre for receiving (and if permitted, requesting), analysing, and disseminating disclosures of STR and other relevant information concerning suspected ML or FT activities. The FIU can be established either as an independent governmental authority or within an existing authority or authorities.
- 26.2 The FIU or another competent authority should provide financial institutions and other reporting parties with guidance regarding the manner of reporting, including the specification of reporting forms, and the procedures that should be followed when reporting.
- 26.3 The FIU should have access, directly or indirectly, on a timely basis to the financial, administrative and law enforcement information that it requires to properly undertake its functions, including the analysis of STR.
- 26.4 The FIU, either directly or through another competent authority, should be authorised to obtain from reporting parties additional information needed to properly undertake its functions.
- 26.5 The FIU should be authorised to disseminate financial information to domestic authorities for investigation or action when there are grounds to suspect ML or FT.
- 26.6 The FIU should have sufficient operational independence and autonomy to ensure that it is free from undue influence or interference.
- 26.7 Information held by the FIU should be securely protected and disseminated only in accordance with the law.
- 26.8 The FIU should publicly release periodic reports, and such reports should include statistics, typologies and trends as well as information regarding its activities.
- 26.9 Where a country has created an FIU, it should consider applying for membership in the Egmont Group.
- 26.10 Countries should have regard to the Egmont Group Statement of Purpose and its Principles for Information Exchange Between Financial Intelligence Units for Money Laundering Cases (these documents set out important guidance concerning the role and functions of FIUs, and the mechanisms for exchanging information between FIU).

## **Recommendation 27**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 27 and its Interpretative Note.

### **Essential criteria**

- 27.1 There should be designated law enforcement<sup>30</sup> authorities that have responsibility for ensuring that ML and FT offences are properly investigated.
- 27.2 Countries should consider taking measures, whether legislative or otherwise, that allow competent authorities investigating ML cases to postpone or waive the arrest of suspected persons and/or the seizure of the money for the purpose of identifying persons involved in such activities or for evidence gathering.

### **Additional elements**

- 27.3 Are measures in place, whether legislative or otherwise, that provide law enforcement or prosecution authorities with an adequate legal basis for the use of a wide range of special investigative techniques when conducting investigations of ML or FT (e.g. controlled delivery of the proceeds of crime or funds intended for use in terrorism, undercover operations, etc)?
- 27.4 Where special investigative techniques are permitted, are such techniques used when conducting investigations of ML, FT, and underlying predicate offences, and to what extent?
- 27.5 In addition to special investigative techniques, are the following effective mechanisms used?
- (a) Permanent or temporary groups specialised in investigating the proceeds of crime (financial investigators)? An important component of the work of such groups or bodies would be focused on the investigation, seizure, freezing and confiscation of the proceeds of crime.
  - (b) Co-operative investigations with appropriate competent authorities in other countries, including the use of special investigative techniques, provided that adequate safeguards are in place?
- 27.6 Are ML and FT methods, techniques and trends reviewed by law enforcement authorities, the FIU and other competent authorities (as appropriate) on a regular, interagency basis? Are the resulting information, analyses or studies disseminated to law enforcement and FIU staff, as well as staff of other competent authorities?

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<sup>30</sup> In certain countries, this responsibility also rests with prosecution authorities.

## **Recommendation 28**

The essential criteria listed below should be read in conjunction with the text of Recommendation 28.

### **Essential criteria**

28.1 Competent authorities responsible for conducting investigations of ML, FT and other underlying predicate offences should have the powers to be able to:

- a) compel production of,
- b) search persons or premises for, and
- c) seize and obtain

transaction records, identification data obtained through the CDD process, account files and business correspondence, and other records, documents or information, held or maintained by financial institutions and other businesses or persons. Such powers should be exercised through lawful process (for example, subpoenas, summonses, search and seizure warrants, or court orders) and be available for use in investigations and prosecutions of ML, FT, and other underlying predicate offences, or in related actions e.g. actions to freeze and confiscate the proceeds of crime.

28.2 The competent authorities referred to above should have the powers to be able to take witnesses' statements for use in investigations and prosecutions of ML, FT, and other underlying predicate offences, or in related actions.

## **Recommendation 29**

The essential criteria listed below should be read in conjunction with the text of Recommendation 29.

### **Essential criteria**

- 29.1 Supervisors should have adequate powers to monitor and ensure compliance by financial institutions<sup>31</sup>, with requirements to combat money laundering and terrorist financing, consistent with the FATF Recommendations.
- 29.2 Supervisors should have the authority to conduct inspections of financial institutions, including on-site inspections, to ensure compliance. Such inspections should include the review of policies, procedures, books and records, and should extend to sample testing.
- 29.3 Supervisors should have the power to compel production of or to obtain access to all records, documents or information relevant to monitoring compliance. This includes all documents or information related to accounts or other business relationships, or transactions, including any analysis the financial institution has made to detect unusual or suspicious transactions.
  - 29.3.1 The supervisor's power to compel production of or to obtain access for supervisory purposes should not be predicated on the need to require a court order.
- 29.4 The supervisor should have adequate powers of enforcement and sanction against financial institutions, and their directors or senior management for failure to comply with or properly implement requirements to combat money laundering and terrorist financing, consistent with the FATF Recommendations.

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<sup>31</sup> Note to assessors: With respect to foreign branches and subsidiaries, the requirement for financial institutions to ensure that their foreign branches and subsidiaries observe AML/CFT measures is to be assessed only against R.22. However, under R.29, supervisors should have adequate powers to establish that financial institutions require their foreign branches and majority owned subsidiaries to apply R.22 effectively.



### **Recommendation 30**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 30.

#### **Essential criteria**

- 30.1 FIUs, law enforcement and prosecution agencies, supervisors and other competent authorities involved in combating money laundering and terrorist financing should be adequately structured, funded, staffed, and provided with sufficient technical and other resources to fully and effectively perform their functions. Adequate structuring includes the need for sufficient operational independence and autonomy to ensure freedom from undue influence or interference.<sup>32</sup>
- 30.2 Staff of competent authorities should be required to maintain high professional standards, including standards concerning confidentiality, and should be of high integrity and be appropriately skilled.
- 30.3 Staff of competent authorities should be provided with adequate and relevant training for combating ML and FT.

Examples of issues to be covered under adequate and relevant training include: the scope of predicate offences, ML and FT typologies, techniques to investigate and prosecute these offences, techniques for tracing property that is the proceeds of crime or is to be used to finance terrorism, and ensuring that such property is seized, frozen and confiscated, and the techniques to be used by supervisors to ensure that financial institutions are complying with their obligations; the use of information technology and other resources relevant to the execution of their functions. Countries could also provide special training and/or certification for financial investigators for, *inter alia*, investigations of ML, FT, and the predicate offences.

#### **Additional elements**

- 30.4 Are special training or educational programmes provided for judges and courts concerning ML and FT offences, and the seizure, freezing and confiscation of property that is the proceeds of crime or is to be used to finance terrorism?

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<sup>32</sup> If a country's FIU does not comply with the requirement to have sufficient operational independence and autonomy (Criterion 26.6), the country should only be rated down in Recommendation 26.

### **Recommendation 31**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 31.

#### **Essential criteria**

- 31.1 Policy makers, the FIU, law enforcement and supervisors and other competent authorities should have effective mechanisms in place which enable them to co-operate, and where appropriate, co-ordinate domestically with each other concerning the development and implementation of policies and activities to combat money laundering and terrorist financing.

Such mechanisms should normally address:

- (a) operational co-operation and, where appropriate, co-ordination between authorities at the law enforcement/FIU level (including customs authorities where appropriate); and between the FIU, law enforcement and supervisors;
- (b) policy co-operation and, where appropriate, co-ordination across all relevant competent authorities.

#### **Additional elements**

- 31.2 Are mechanisms in place for consultation between competent authorities, the financial sector and other sectors (including DNFBP) that are subject to AML/CFT laws, regulations, guidelines or other measures?

## **Recommendation 32**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 32.

### **Essential criteria**

32.1 Countries should review the effectiveness of their systems for combating money laundering and terrorist financing on a regular basis.

32.2 Competent authorities should maintain comprehensive statistics on matters relevant to the effectiveness and efficiency of systems for combating money laundering and terrorist financing. This should include keeping annual statistics on:

(a) suspicious transaction reports, and other reports where appropriate under domestic law, received and disseminated -

- STR received by the FIU, including a breakdown of the type of financial institution, DNFBP, or other business or person making the STR;
- Breakdown of STR analysed and disseminated;
- Reports filed on: (i) domestic or foreign currency transactions above a certain threshold, (ii) cross border transportation of currency and bearer negotiable instruments, or (iii) international wire transfers.

(b) ML & FT investigations; prosecutions and convictions, and on property frozen; seized and confiscated -

- ML and FT investigations, prosecutions, and convictions;
- The number of cases and the amounts of property frozen, seized, and confiscated relating to (i) ML, (ii) FT, and (iii) criminal proceeds; and
- Number of persons or entities and the amounts of property frozen pursuant to or under U.N. Resolutions relating to terrorist financing.

(c) Mutual legal assistance or other international requests for co-operation -

- All mutual legal assistance and extradition requests (including requests relating to freezing, seizing and confiscation) that are made or received, relating to ML, the predicate offences and FT, including the nature of the request, whether it was granted or refused, and the time required to respond;
- Other formal requests for assistance made or received by the FIU, including whether the request was granted or refused;
- Spontaneous referrals made by the FIU to foreign authorities.

(d) Other action

- On-site examinations conducted by supervisors relating to or including AML/CFT and any sanctions applied.
- Formal requests for assistance made or received by supervisors relating to or including AML/CFT, including whether the request was granted or refused.

### **Additional elements**

32.3 Do competent authorities maintain comprehensive statistics on:

- a) STR resulting in investigation, prosecution, or convictions for ML, FT or an underlying predicate offence?
- b) any criminal sanctions applied to persons convicted of ML and FT offences?
- c) other formal requests for assistance made or received by law enforcement authorities relating to ML or FT, including whether the request was granted or refused?
- d) the number of cases and the amounts of property frozen, seized, and confiscated relating to underlying predicate offences where applicable?

### **Recommendation 33**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 33.

#### **Essential criteria**

33.1 Countries should take measures to prevent the unlawful use of legal persons in relation to money laundering and terrorist financing by ensuring that their commercial, corporate and other laws require adequate transparency concerning the beneficial ownership and control of legal persons.

Examples<sup>33</sup> of mechanisms that countries could use in seeking to ensure that there is adequate transparency may include:

1. A system of central registration (or up front disclosure system) where a national registry records the required ownership and control details for all companies and other legal persons registered in that country. The relevant information could be either publicly available or only available to competent authorities. Changes in ownership and control information would need to be kept up to date.
2. Requiring company service providers to obtain, verify and retain records of the beneficial ownership and control of legal persons.
3. Relying on the investigative and other powers of law enforcement, regulatory, supervisory, or other competent authorities in a jurisdiction to obtain or have access to the information.

These mechanisms are, to a large degree, complementary and countries may find it highly desirable and beneficial to use a combination of them.

To the extent that countries rely on the investigative powers of their competent authorities, these authorities should have sufficiently strong compulsory powers for the purpose of obtaining the relevant information.

Whatever mechanism is used it is essential that: (a) competent authorities are able to obtain or have access in a timely fashion to the beneficial ownership and control information, (b) the information is adequate, accurate and timely (see Criterion 33.2) and (c) competent authorities are able to share such information with other competent authorities domestically or internationally.

33.2 Competent authorities should be able to obtain or have access in a timely fashion to adequate, accurate and current information on the beneficial ownership and control of legal persons.

33.3 Countries that have legal persons able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering, and that the principles set out in criteria 33.1 and 33.2 above apply equally to legal persons that use bearer shares. The measures to be taken may vary from country to country, but each country should be able to demonstrate the adequacy and effectiveness of the measures that are applied.

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<sup>33</sup> Note to assessors: These examples are summaries of mechanisms set out in the OECD Report “Behind the Corporate Veil. Using Corporate Entities for Illicit Purposes” 2001. An explanation of these mechanisms and their suitability is contained in the report itself.

**Additional elements**

33.4 Are measures in place to facilitate access by financial institutions to beneficial ownership and control information, so as to allow them to more easily verify the customer identification data?

## **Recommendation 34**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 34.

### **Essential criteria**

34.1 Countries should take measures to prevent the unlawful use of legal arrangements in relation to money laundering and terrorist financing by ensuring that its commercial, trust and other laws require adequate transparency concerning the beneficial ownership and control of trusts and other legal arrangements.

Examples<sup>34</sup> of mechanisms that countries could use in seeking to ensure that there is adequate transparency may include:

1. A system of central registration (or up front disclosure system) where a national registry records details on trusts (i.e. settlors, trustees, beneficiaries and protectors) and other legal arrangements registered in that country. The relevant information could be either publicly available or only available to competent authorities. Changes in ownership and control information would need to be kept up to date.
2. Requiring trust service providers to obtain, verify and retain records of the details of the trust or other similar legal arrangements.
3. Relying on the investigative and other powers of law enforcement, regulatory, supervisory, or other competent authorities in a jurisdiction to obtain or have access to the information.

These mechanisms are, to a large degree, complementary and countries may find it highly desirable and beneficial to use a combination of them.

To the extent that countries rely on the investigative powers of their competent authorities, these authorities should have sufficiently strong compulsory powers for the purpose of obtaining the relevant information.

Whatever mechanism is used it is essential that: (a) competent authorities are able to obtain or have access in a timely fashion to the beneficial ownership and control information, (b) the information is adequate, accurate and timely (see Criterion 34.2) and (c) competent authorities are able to share such information with other competent authorities domestically or internationally.

34.2 Competent authorities should be able to obtain or have access in a timely fashion to adequate, accurate and current information on the beneficial ownership and control of legal arrangements, and in particular the settlor, the trustee, and the beneficiaries of express trusts.

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<sup>34</sup> Note to assessors: These examples are summaries of mechanisms set out in the OECD Report “Behind the Corporate Veil. Using Corporate Entities for Illicit Purposes” 2001. An explanation of these mechanisms and their suitability is contained in the report itself.

**Additional elements**

34.3 Are measures in place to facilitate access by financial institutions to beneficial ownership and control information, so as to allow them to more easily verify the customer identification data?



## **D. INTERNATIONAL CO-OPERATION**

### **Recommendation 35**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 35 and Special Recommendation I, and the text of the Conventions referred to in Recommendation 35<sup>35</sup> (Note to assessors: Ensure that the assessments of Criterion 35.1 and Criterion I.1 (in SR.I) are consistent.)

### **Essential criteria**

35.1 Countries should sign and ratify, or otherwise become a party to, and fully implement, the Vienna Convention, the Palermo Convention and the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism (the Terrorist Financing Convention).<sup>36</sup>

### **Additional elements**

35.2 Have other relevant international conventions such as the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and the 2002 Inter-American Convention against Terrorism been signed, ratified or fully implemented?

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<sup>35</sup> Assessors should be satisfied that all the articles relevant to ML and FT are fully implemented.

<sup>36</sup> Assessors should be satisfied that the following relevant articles of the Vienna Convention (Articles 3-11, 15, 17 and 19), the Palermo Convention (Articles 5-7, 10-16, 18-20, 24-27, 29-31, & 34), and the Terrorist Financing Convention (Articles 2-18) are fully implemented.

## **Recommendation 36**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 36 and Special Recommendation V. (Note to assessors: Ensure that the assessments of Criteria 36.1 – 36.6 and Criterion V.1 (in SR.V) are consistent.)

### **Essential criteria**

36.1 Countries should be able to provide the widest possible range of mutual legal assistance in AML/CFT investigations, prosecutions and related proceedings<sup>37</sup>. Mutual legal assistance should include assistance of the following nature: (a) the production, search and seizure of information, documents, or evidence (including financial records) from financial institutions, or other natural or legal persons; (b) the taking of evidence or statements from persons; (c) providing originals or copies of relevant documents and records as well as any other information and evidentiary items, (d) effecting service of judicial documents; (e) facilitating the voluntary appearance of persons for the purpose of providing information or testimony to the requesting country and (f) identification, freezing, seizure, or confiscation of assets laundered or intended to be laundered, the proceeds of ML and assets used for or intended to be used for FT, as well as the instrumentalities of such offences, and assets of corresponding value<sup>38</sup>

36.1.1 Countries should be able to provide such assistance in a timely, constructive and effective manner.

36.2 Mutual legal assistance should not be prohibited or made subject to unreasonable, disproportionate or unduly restrictive conditions.

Possible examples of such conditions (for which an assessment as to reasonableness, proportionality or restrictiveness should be made) could include: generally refusing to provide assistance on the grounds that judicial proceedings have not commenced in the requesting country; requiring a conviction before providing assistance; overly strict interpretations of the principles of reciprocity and dual criminality.

36.3 There should be clear and efficient processes for the execution of mutual legal assistance requests in a timely way and without undue delays.

36.4 A request for mutual legal assistance should not be refused on the sole ground that the offence is also considered to involve fiscal matters.

36.5 A request for mutual legal assistance should not be refused on the grounds of laws that impose secrecy or confidentiality requirements on financial institutions or DNFBP, except where the relevant information was obtained in circumstances where legal professional privilege or legal professional secrecy applies<sup>39</sup>.

36.6 The powers of competent authorities required under R.28 should also be available for use in response to requests for mutual legal assistance.

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<sup>37</sup> Note to assessors: Where the money laundering offence or the terrorist financing offence has deficiencies such as not covering all the required predicate offences, or not criminalising the financing of a terrorist organisation or individual terrorist, this may impact on the ability of the assessed country to provide international co-operation if dual criminality is a precondition for extradition or providing mutual legal assistance. This could be a factor affecting the rating.

<sup>38</sup> Elements (a) to (f) are drawn from the Palermo Convention.

<sup>39</sup> See also Criteria 16.2.

36.7 To avoid conflicts of jurisdiction, countries should consider devising and applying mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country.

**Additional elements**

36.8 Are the powers of competent authorities required under R.28 available for use when there is a direct request from foreign judicial or law enforcement authorities to domestic counterparts?

### **Recommendation 37**

The essential criteria listed below should be read in conjunction with the text of Recommendation 37 and Special Recommendation V. (Note to assessors: Ensure that the assessments of Criterion 37.1 and Criterion V.2 (in SR.V) are consistent.)

#### **Essential criteria**

- 37.1 To the greatest extent possible, mutual legal assistance should be rendered in the absence of dual criminality, in particular, for less intrusive and non compulsory measures.
- 37.2 For extradition and those forms of mutual legal assistance where dual criminality is required, the requested state (that is rendering the assistance) should have no legal or practical impediment to rendering assistance where both countries criminalise the conduct underlying the offence. Technical differences between the laws in the requesting and requested states, such as differences in the manner in which each country categorises or denominates the offence should not pose an impediment to the provision of mutual legal assistance.

## **Recommendation 38**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 38 and its Interpretative Note, and the text of Recommendation 3 and Special Recommendation V. (Note to assessors: Ensure that the assessments of Criteria 38.1 – 38.3 and Criterion 36.1 & V.3 are consistent.)

### **Essential criteria**

38.1 There should be appropriate laws and procedures to provide an effective and timely response to mutual legal assistance requests<sup>40</sup> by foreign countries related to the identification, freezing, seizure, or confiscation of:

- (a) laundered property from,
- (b) proceeds from,
- (c) instrumentalities used in, or
- (d) instrumentalities intended for use in,

the commission of any ML, FT or other predicate offences.

38.2 The requirements in Criterion 38.1 should also be met where the request relates to property of corresponding value.

38.3 Countries should have arrangements for co-ordinating seizure and confiscation actions with other countries.

38.4 Countries should consider establishing an asset forfeiture fund into which all or a portion of confiscated property will be deposited and will be used for law enforcement, health, education or other appropriate purposes.

38.5 Countries should consider authorising the sharing of confiscated assets between them when confiscation is directly or indirectly a result of co-ordinated law enforcement actions.

### **Additional elements**

38.6 Are foreign non criminal confiscation orders (as described in criterion 3.7) recognised and enforced?

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<sup>40</sup> Note to assessors: note also R.36, footnote 37.

### **Recommendation 39**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 39.

#### **Essential criteria**

- 39.1 Money laundering should be an extraditable offence<sup>41</sup>. There should be laws and procedures to extradite individuals charged with a money laundering offence.
- 39.2 Countries should either:
- a) extradite their own nationals or,
  - b) where a country does not extradite its own nationals solely on the grounds of nationality, that country should, at the request of the country seeking extradition, submit the case without undue delay to its competent authorities for the purpose of prosecution of the offences set forth in the request. In such cases, the competent authorities should take their decision and conduct their proceedings in the same manner as in the case of any other offence of a serious nature under the domestic law of that country.
- 39.3 In the case referred to in criterion 39.2(b), countries should cooperate with each other, in particular on procedural and evidentiary aspects, to ensure the efficiency of the prosecution.
- 39.4 Consistent with the principles of domestic law, countries should adopt measures or procedures that will allow extradition requests and proceedings relating to ML to be handled without undue delay.

#### **Additional elements**

- 39.5 Are simplified procedures of extradition in place by allowing direct transmission of extradition requests between appropriate ministries? Can persons be extradited based only on warrants of arrests or judgements? Is there a simplified procedure of extradition of consenting persons who waive formal extradition proceedings in place?

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<sup>41</sup> Note to assessors: note also R.36, footnote 37.

## **Recommendation 40**

The essential criteria and additional elements listed below should be read in conjunction with the text of Recommendation 40 and its Interpretative Note, and Special Recommendation V. (Note to assessors: Ensure that the assessments of Criteria 40.1 – 40.9 and Criterion V.5 (in SR.V) are consistent.)

### **Essential criteria**

40.1 Countries should ensure that their competent authorities are able to provide the widest range of international cooperation to their foreign counterparts.

40.1.1 Countries should be able to provide such assistance in a rapid, constructive and effective manner.

40.2 There should be clear and effective gateways, mechanisms or channels that will facilitate and allow for prompt and constructive exchanges of information directly between counterparts<sup>42</sup>.

Examples of gateways, mechanisms or channels used in international cooperation and exchanges of information (other than MLA or extradition) include laws allowing exchanges of information on a reciprocal basis; bilateral or multilateral agreements or arrangements such as Memorandum of Understanding (MOU); and exchanges through appropriate international or regional organisations or bodies such as Interpol or the Egmont Group of FIUs.

40.3. Such exchanges of information should be possible: (a) both spontaneously and upon request, and (b) in relation to both money laundering and the underlying predicate offences.

40.4 Countries should ensure that all their competent authorities are authorised to conduct inquiries on behalf of foreign counterparts.

40.4.1 In particular, countries should ensure that their FIU is authorised to make the following types of inquiries on behalf of foreign counterparts: (a) searching its own databases, including with respect to information related to suspicious transaction reports; (b) searching other databases to which it may have direct or indirect access, including law enforcement databases, public databases, administrative databases and commercially available databases.

40.5 Countries should ensure that their law enforcement authorities are authorised to conduct investigations on behalf of foreign counterparts; other competent authorities should be authorised to conduct investigations on behalf of foreign counterparts, where permitted by domestic law.

40.6 Exchanges of information should not be made subject to disproportionate or unduly restrictive conditions.

40.7 Requests for cooperation should not be refused on the sole ground that the request is also considered to involve fiscal matters.

40.8 Requests for cooperation should not be refused on the grounds of laws that impose secrecy or confidentiality requirements on financial institutions or DNFBP (except where the relevant

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<sup>42</sup> Obstacles to a prompt and constructive exchange of information include failing to respond or take the appropriate measures in a timely way, and unreasonable delays in responding.

information that is sought is held in circumstances where legal professional privilege or legal professional secrecy applies<sup>43</sup>).

40.9 Countries should establish controls and safeguards to ensure that information received by competent authorities is used only in an authorised manner. These controls and safeguards should be consistent with national provisions on privacy and data protection<sup>44</sup>.

**Additional elements**

40.10 Are mechanisms in place to permit a prompt and constructive exchange of information with non-counterparts? Does it take place directly or indirectly<sup>45</sup>?

40.10.1 Does the requesting authority as a matter of practice disclose to the requested authority the purpose of the request and on whose behalf the request is made?

40.11 Can the FIU obtain from other competent authorities or other persons relevant information requested by a foreign counterpart FIU?

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<sup>43</sup> See also criteria 16.2

<sup>44</sup> This implies that, at a minimum, exchanged information must be treated as protected by the same confidentiality provisions as apply to similar information from domestic sources obtained by the receiving competent authority.

<sup>45</sup> The reference to indirect exchange of information with foreign authorities other than counterparts covers the situation where the requested information passes from the foreign authority through one or more domestic or foreign authorities before being received by the requesting authority.



## **NINE SPECIAL RECOMMENDATIONS** **Essential Criteria and Additional Elements**

### **Special Recommendation I**

The essential criteria listed below should be read in conjunction with the text of Special Recommendation I, Recommendation 35, Special Recommendations II, III and V, the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism (Terrorist Financing Convention), and the following United Nations Security Council Resolutions: S/RES/1267(1999), its successor resolutions 1333(2000), S/RES/1363(2001), S/RES/1390(2002), S/RES/1455(2003), and S/RES/1526(2004), and S/RES/1373(2001). (Note to assessors: Ensure that the assessments of Criterion I.1 and Criterion 35.1 (in R.35) are consistent. Also ensure that the assessments of SR.I, SR.II, SR.III and SR.V are consistent.)

### **Essential criteria**

- I.1 Countries should sign and ratify, or otherwise become a party to, and fully implement, the Terrorist Financing Convention<sup>46</sup>.
- I.2 Countries should fully implement the United Nations Security Council Resolutions relating to the prevention and suppression of FT. These comprise S/RES/1267(1999) and its successor resolutions and S/RES/1373(2001). This requires any necessary laws, regulations or other measures to be in place and for these provisions to cover the requirements contained in those resolutions.

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<sup>46</sup> Assessors should be satisfied that all relevant articles of the Terrorist Financing Convention are fully implemented (Articles 2-6 and 17-18 which relate to SR.II; Article 8 which relates to SR.III; and Articles 7 and 9-18 which relate to SR.V.)

## **Special Recommendation II**

The essential criteria listed below should be read in conjunction with the text of Special Recommendation II, Special Recommendation I, Recommendations 1 and 2, and the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism (Terrorist Financing Convention). (Note to assessors: Ensure that the assessments of Criteria II.1 – II.3, Criterion I.1 (in SR.I) and Criteria 1.3 (in R.1) are consistent.)

### **Essential criteria**

II.1 Terrorist financing should be criminalised consistent with Article 2 of the Terrorist Financing Convention, and should have the following characteristics:<sup>47</sup>

(a) Terrorist financing offences should extend to any person who wilfully provides or collects funds by any means, directly or indirectly, with the unlawful intention that they should be used or in the knowledge that they are to be used, in full or in part:

- (i) to carry out a terrorist act(s);
- (ii) by a terrorist organisation; or
- (iii) by an individual terrorist.

(b) Terrorist financing offences should extend to any *funds* as that term is defined in the TF Convention. This includes funds whether from a legitimate or illegitimate source.

The Terrorist Financing Convention defines *funds* as:

“assets of every kind, whether tangible or intangible, movable or immovable, however, acquired, and legal documents or instruments in any form, including electronic or digital, evidencing title to, or interest in, such assets, including, but not limited to, bank credits, travellers cheques, bank cheques, money orders, shares, securities, bonds, drafts, letters of credit.”

(c) Terrorist financing offences should not require that the funds: (i) were actually used to carry out or attempt a terrorist act(s); or (ii) be linked to a specific terrorist act(s).

(d) It should also be an offence to attempt to commit the offence of terrorist financing.

(e) It should also be an offence to engage in any of the types of conduct set out in Article 2(5) of the Terrorist Financing Convention.

II.2 Terrorist financing offences should be predicate offences for money laundering.

II.3 Terrorist financing offences should apply, regardless of whether the person alleged to have committed the offence(s) is in the same country or a different country from the one in which the terrorist(s)/terrorist organisation(s) is located or the terrorist act(s) occurred/will occur

II.4 Countries should ensure that Criteria 2.2 to 2.5 (in R.2) also apply in relation to the offence of FT<sup>48</sup>.

<sup>47</sup> Note to assessors: the criminalisation of terrorist financing solely on the basis of aiding and abetting, attempt, or conspiracy does not comply with SR.II.

<sup>48</sup> Note to assessors: See also Recommendation 2 and footnote 5 on effective, proportionate and dissuasive criminal penalties.

### **Special Recommendation III**

The essential criteria and additional elements listed below should be read in conjunction with the text of Special Recommendation III, its Interpretative Note, its Best Practices Paper, Special Recommendation I, Recommendation 3, the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism (Terrorist Financing Convention), the following United Nations Security Council Resolutions: S/RES/1267(1999), its successor resolutions 1333(2000), S/RES/1363(2001), S/RES/1390(2002), S/RES/1455(2003) and S/RES/1526(2004), S/RES/1373(2001) and S/RES/1452(2002). (Note to assessors: Ensure that the assessments of Criteria III.1 – III.12, Criteria I.1 – I.2 (in SR.I), Criterion VIII.2 (in SR.VIII) and Criteria 3.1 – 3.4 and Criterion 3.6 (in R.3) are consistent.)

#### **Essential criteria**

*Freezing and, where appropriate, seizing under the relevant U.N. Resolutions:*

- III.1 Countries should have effective laws and procedures to freeze terrorist funds or other assets of persons designated by the United Nations Al-Qaida and Taliban Sanctions Committee in accordance with S/RES/1267(1999). Such freezing should take place without delay and without prior notice to the designated persons involved.

S/RES/1267(1999) and its successor resolutions obligate countries to freeze without delay the funds or other assets owned or controlled by Al-Qaida, the Taliban, Usama bin Laden, or persons and entities associated with them as designated by the United Nations Al-Qaida and Taliban Sanctions Committee established pursuant to United Nations Security Council Resolution 1267(1999), including funds derived from funds or other assets owned or controlled, directly or indirectly, by them or by persons acting on their behalf or at their direction, and ensure that neither these nor any other funds or other assets are made available, directly or indirectly, for such persons' benefit, by their nationals or by any person within their territory. The Al-Qaida and Taliban Sanctions Committee is the authority responsible for designating the persons and entities that should have their funds or other assets frozen under S/RES/1267(1999) and its successor resolutions. All countries that are members of the United Nations are obligated by S/RES/1267(1999) and its successor resolutions to freeze the assets of persons and entities so designated by the Al-Qaida and Taliban Sanctions Committee.

- III.2 A country should have effective laws and procedures to freeze terrorist funds or other assets of persons designated in the context of S/RES/1373(2001). Such freezing should take place without delay and without prior notice to the designated persons involved.

S/RES/1373(2001) obligates countries to freeze without delay the funds or other assets of persons who commit, or attempt to commit, terrorist acts or participate in or facilitate the commission of terrorist acts; of entities owned or controlled directly or indirectly by such persons; and of persons and entities acting on behalf of, or at the direction of such persons and entities, including funds or other assets derived or generated from property owned or controlled, directly or indirectly, by such persons and associated persons and entities. Each individual country has the authority to designate the persons and entities that should have their funds or other assets frozen. Additionally, to ensure that effective co-operation is developed among countries, countries should examine and give effect to, if appropriate, the actions initiated under the freezing mechanisms of other countries. When (i) a specific notification or communication is sent and (ii) the country receiving the request is satisfied, according to applicable legal principles, that a requested designation is supported by reasonable grounds, or a reasonable basis, to suspect or believe that the proposed designee is a terrorist, one who finances terrorism or a terrorist organisation, the country receiving

the request must ensure that the funds or other assets of the designated person are frozen without delay.

- III.3 A country should have effective laws and procedures to examine and give effect to, if appropriate, the actions initiated under the freezing mechanisms of other jurisdictions. Such procedures should ensure the prompt determination, according to applicable national legal principles, whether reasonable grounds or a reasonable basis exists to initiate a freezing action and the subsequent freezing of funds or other assets without delay.
- III.4 The freezing actions referred to in Criteria III.1 – III.3 should extend to:
- (a) funds or other assets wholly or jointly<sup>49</sup> owned or controlled, directly or indirectly, by designated persons, terrorists, those who finance terrorism or terrorist organisations; and
  - (b) funds or other assets derived or generated from funds or other assets owned or controlled directly or indirectly by designated persons, terrorists, those who finance terrorism or terrorist organisations.
- III.5 Countries should have effective systems for communicating actions taken under the freezing mechanisms referred to in Criteria III.1 – III.3 to the financial sector<sup>50</sup> immediately upon taking such action.
- III.6 Countries should provide clear guidance to financial institutions and other persons or entities that may be holding targeted funds or other assets concerning their obligations in taking action under freezing mechanisms.
- III.7 Countries should have effective and publicly-known procedures for considering de-listing requests and for unfreezing the funds or other assets of de-listed persons or entities in a timely manner consistent with international obligations.
- III.8 Countries should have effective and publicly-known procedures for unfreezing, in a timely manner, the funds or other assets of persons or entities inadvertently affected by a freezing mechanism upon verification that the person or entity is not a designated person.
- III.9 Countries should have appropriate procedures for authorising access to funds or other assets that were frozen pursuant to S/RES/1267(1999) and that have been determined to be necessary for basic expenses, the payment of certain types of fees, expenses and service charges or for extraordinary expenses. These procedures should be in accordance with S/RES/1452(2002).
- III.10 Countries should have appropriate procedures through which a person or entity whose funds or other assets have been frozen can challenge that measure with a view to having it reviewed by a court.

*Freezing, Seizing and Confiscation in other circumstances*

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<sup>49</sup> *Jointly* refers to those assets held jointly between or among designated persons, terrorists, those who finance terrorism or terrorist organisations on the one hand, and a third party or parties on the other hand.

<sup>50</sup> For examples of possible mechanisms to communicate actions taken or to be taken to the financial sector and/or the general public, see the FATF Best Practices paper entitled “Freezing of Terrorist Assets – International Best Practices”.

- III.11 Countries should ensure that Criteria 3.1 – 3.4 and Criterion 3.6 (in R.3) also apply in relation to the freezing, seizing and confiscation of terrorist-related funds or other assets in contexts other than those described in Criteria III.1 – III.10.

*General provisions*

- III.12 Laws and other measures should provide protection for the rights of bona fide third parties. Such protection should be consistent with the standards provided in Article 8 of the Terrorist Financing Convention, where applicable.
- III.13 Countries should have appropriate measures to monitor effectively the compliance with relevant legislation, rules or regulations governing the obligations under SR III and to impose civil, administrative or criminal sanctions for failure to comply with such legislation, rules or regulations.

**Additional elements**

- III.14 Have the measures set out in the Best Practices Paper for SR.III been implemented?
- III.15 Have the procedures to authorise access to funds or other assets that were frozen pursuant to S/RES/1373(2001) and that have been determined to be necessary for basic expenses, the payment of certain types of fees, expenses and service charges or for extraordinary expenses been implemented? Are these procedures consistent with S/RES/1373(2001) and the spirit of S/RES/1452(2003)?

## **Special Recommendation IV**

The essential criteria and additional elements listed below should be read in conjunction with the text of Special Recommendation IV, and Recommendations 13, 16 and 17. (Note to assessors: Ensure that the assessments of Criteria IV.1 – IV.2, Criteria 13.1 – 13.4 (in R.13), and Criteria 17.1 – 17.4 (in R.17) are consistent.)

### **Essential criteria**

- IV.1 A financial institution should be required by law or regulation to report to the FIU (a suspicious<sup>51</sup> transaction report – STR) when it suspects or has reasonable grounds to suspect that funds are linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations or those who finance terrorism. This requirement should be a direct mandatory obligation, and any indirect or implicit obligation to report suspicious transactions, whether by reason of possible prosecution for a FT offence or otherwise (so called “indirect reporting”), is not acceptable.
- IV.2 Countries should ensure that Criteria 13.3 – 13.4 (in R.13) also apply in relation to the obligations under SR IV.

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<sup>51</sup> Systems based on the reporting of unusual transactions (rather than suspicious transactions) are equally satisfactory.

## **Special Recommendation V**

The essential criteria and additional elements listed below should be read in conjunction with the text of Special Recommendation V, Special Recommendation I, Recommendations 36-40, the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism (Terrorist Financing Convention), and Special Recommendation III.

### **Essential criteria**

- V.1 Countries should ensure that Criteria 36.1 – 36.6 (in R.36) also apply to the obligations under SR.V<sup>52</sup>.
- V.2 Countries should ensure that Criteria 37.1-37.2 (in R.37) also apply to the obligations under SR.V.
- V.3 Countries should ensure that Criteria 38.1 – 38.3 (in R.38) also apply to the obligations under SR.V.
- V.4 Countries should ensure that Criteria 39.1 – 39.4 (in R.39) also apply to extradition proceedings related to terrorist acts and FT.
- V.5 Countries should ensure that Criteria 40.1 – 40.9 (in R.40) also apply to the obligations under SR.V.

### **Additional elements**

- V.6 Do additional elements 36.7 – 36.8 (in R.36) apply in relation to the obligations under SR.V?
- V.7 Do additional elements 38.4 – 38.6 (in R.38) apply in relation to the obligations under SR.V?
- V.8 Does the additional element 39.5 (in R.39) apply extradition proceedings related to terrorist acts or FT?
- V.9 Do additional elements 40.10 – 40.11 (in R.40) apply in relation to the obligations under SR.V?

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<sup>52</sup> Note to assessors: note also R.36, footnote 37.

## **Special Recommendation VI**

The essential criteria and additional elements listed below should be read in conjunction with the text of Special Recommendation VI, its Interpretative Note and its Best Practices Paper, Special Recommendation VII and its Interpretative Note, and Recommendation 17. (Note to assessors: Ensure that the assessments of Criterion VI.5 and Criteria 17.1 – 17.4 (in R.17) are consistent.)

### **Essential criteria**

- VI.1 Countries should designate one or more competent authorities to register and/or licence natural and legal persons that perform money or value transfer services (MVT service operators), maintain a current list of the names and addresses of licensed and/or registered MVT service operators, and be responsible for ensuring compliance with licensing and/or registration requirements<sup>53</sup>.
- VI.2 Countries should ensure that all MVT service operators are subject to the applicable FATF Forty Recommendations (in particular Recommendations 4-11, 13-15 and 21-23) and FATF Nine Special Recommendations (in particular SR.VII)<sup>54</sup>.
- VI.3 Countries should have systems in place for monitoring MVT service operators and ensuring that they comply with the FATF Recommendations.
- VI.4 Countries should require each licensed or registered MVT service operator to maintain a current list of its agents which must be made available to the designated competent authority.
- VI.5 Countries should ensure that Criteria 17.1 – 17.4 (in R.17) also apply in relation to the obligations under SR VI.

### **Additional elements**

- VI.6 Have the measures set out in the Best Practices Paper for SR.VI been implemented?

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<sup>53</sup> SR.VI does not require countries to establish a separate licensing/registration system or designate another competent authority in respect of money remitters which are already licensed/registered as financial institutions within the country, permitted to perform MVT services under the terms of their license/registration, and already subject to the full range of applicable obligations under the FATF Forty Recommendations and Nine Special Recommendations.

<sup>54</sup> Note to assessors: where there are deficiencies in the laws, regulations or other measures that are required to be applied to money value transfer service operators under other relevant Recommendations (such as those on customer due diligence, record keeping, reporting of suspicious transactions, or wire transfers), such deficiencies should also be noted in SR VI, and be taken into account in the assessment of the rating for SRVI.



## **Special Recommendation VII**

The essential criteria listed below should be read in conjunction with the text of SR.VII and its Interpretative Note, Recommendation 5 as it relates to verification of a customer's identity (see Essential Criterion 5.3) and Recommendation 17. (Note to assessors: Ensure that the assessments of Criterion VII.1, VII.9, Criterion 5.3 (in R.5) and Criteria 17.1 – 17.4 (in R.17) are consistent.)

### **Essential criteria**

SR VII applies to cross-border and domestic transfers between financial institutions. However, SR VII is not intended to cover the following types of payments:

a. Any transfer that flows from a transaction carried out using a credit or debit card so long as the credit or debit card number accompanies all transfers flowing from the transaction, such as withdrawals from a bank account through an ATM machine, cash advances from a credit card, or payments for goods and services. However, when credit or debit cards are used as a payment system to effect a money transfer, they are covered by SR VII, and the necessary information should be included in the message.

b. Financial institution-to-financial institution transfers and settlements where both the originator person and the beneficiary person are financial institutions acting on their own behalf.

VII.1 For all wire transfers, of EUR/USD 1 000 or more, ordering financial institutions should be required to obtain and maintain <sup>55</sup> the following information relating to the originator of the wire transfer:

- the name of the originator;
- the originator's account number (or a unique reference number if no account number exists); and
- the originator's address (countries may permit financial institutions to substitute the address with a national identity number, customer identification number, or date and place of birth).

(This set of information is referred to as full originator information.)

For all wire transfers of EUR/USD 1 000 or more, ordering financial institutions should be required to verify the identity of the originator in accordance with Recommendation 5.

VII.2 For cross-border wire transfers of EUR/USD 1 000 or more the ordering financial institution should be required to include full originator information in the message or payment form accompanying the wire transfer.

However, if several individual cross-border wire transfers (of EUR/USD 1 000 or more) from a single originator are bundled in a batch file for transmission to beneficiaries in another country, the ordering financial institution only needs to include the originator's account number or unique identifier on each individual cross-border wire transfer, provided that the batch file (in

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<sup>55</sup> Financial institutions do not have to repeatedly obtain originator information and verify originator identity every time a customer makes a wire transfer. Financial institutions could rely on the information already available if, as part of the customer due diligence process, they have obtained:

- (i) the originator's name;
  - (ii) account number (or unique reference number if no account number exists); and
  - (iii) address (or national identity number, customer identification number, or date and place of birth if the country permits one of these pieces of information to substitute for the address)
- and verified the originator's identity in accordance with Recommendation 5 (see, in particular, criterion 5.3). This does not apply to occasional customers.

which the individual transfers are batched) contains full originator information that is fully traceable within the recipient country.

- VII.3 For domestic wire transfers the ordering financial institution should be required to either: (a) comply with Criterion VII.2 above or (b) include only the originator's account number or a unique identifier, within the message or payment form. The second option should be permitted only if full originator information can be made available to the beneficiary financial institution and to appropriate authorities within three business days of receiving a request, and domestic law enforcement authorities can compel immediate production of it.
- VII.4 Each intermediary and beneficiary financial institution in the payment chain should be required to ensure that all originator information that accompanies a wire transfer is transmitted with the transfer.
- VII.4.1. Where technical limitations prevent the full originator information accompanying a cross-border wire transfer from being transmitted with a related domestic wire transfer (during the necessary time to adapt payment systems), a record must be kept for five years by the receiving intermediary financial institution of all the information received from the ordering financial institution.
- VII.5 Beneficiary financial institutions should be required to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information. The lack of complete originator information may be considered as a factor in assessing whether a wire transfer or related transactions are suspicious and, as appropriate, whether they are thus required to be reported to the financial intelligence unit or other competent authorities. In some cases, the beneficiary financial institution should consider restricting or even terminating its business relationship with financial institutions that fail to meet SR.VII standards.
- VII.6 Countries should have measures in place to effectively monitor the compliance of financial institutions with rules and regulations implementing SR.VII.
- VII.7 Countries should ensure that Criteria 17.1 – 17.4 (in R.17) also apply in relation to the obligations under SR.VII.

#### **Additional elements**

- VII.8 Countries may require that all incoming cross-border wire transfers (including those below EUR/USD 1 000) contain full and accurate originator information.
- VII.9 Countries may require that all outgoing cross-border wire transfers below EUR/USD 1 000 contain full and accurate originator information.

## **Special Recommendation VIII**

The essential criteria and additional elements listed below should be read in conjunction with the text of Special Recommendation VIII, its Interpretative Note and its Best Practices Paper.

### **Essential criteria**

#### *Reviews of the domestic non-profit sector:*

- VIII.1 Countries should: (i) review the adequacy of domestic laws and regulations that relate to non-profit organisations; (ii) use all available sources of information to undertake domestic reviews of or have the capacity to obtain timely information on the activities, size and other relevant features of their non-profit sectors for the purpose of identifying the features and types of non-profit organisations (NPOs) that are at risk of being misused for terrorist financing by virtue of their activities or characteristics; and (iii) conduct periodic reassessments by reviewing new information on the sector's potential vulnerabilities to terrorist activities.

Some examples of possible sources of information that could be used to undertake a domestic review or provide timely information on the activities, size and other relevant features of the domestic non-profit sector are: regulators, statistical institutions, tax authorities, FIUs, donor organisations, self-regulatory organizations or accreditation institutions, or law enforcement and intelligence authorities.

#### *Protecting the NPO sector from terrorist financing through outreach and effective oversight:*

- VIII.2 Countries should undertake outreach to the NPO sector with a view to protecting the sector from terrorist financing abuse. This outreach should include (i) raising awareness in the NPO sector about the risks of terrorist abuse and the available measures to protect against such abuse; and (ii) promoting transparency, accountability, integrity, and public confidence in the administration and management of all NPOs.

An effective outreach program with the NPO sector may include the development of best practices to address terrorist financing risks, regular outreach events with the sector to discuss scope and methods of abuse of NPOs, emerging trends in terrorist financing and new protective measures, and the issuance of advisory papers and other useful resources.

- VIII.3 Countries should be able to demonstrate that the following steps have been taken to promote effective supervision or monitoring of those NPOs which account for: (i) a significant portion of the financial resources under control of the sector; and (ii) a substantial share of the sector's international activities.

VIII.3.1 NPOs should maintain information on: (1) the purpose and objectives of their stated activities; and (2) the identity of person(s) who own, control or direct their activities, including senior officers, board members and trustees. This information should be publicly available either directly from the NPO or through appropriate authorities.

VIII.3.2 Countries should be able to demonstrate that there are appropriate measures in place to sanction violations of oversight measures or rules by NPOs or persons acting on behalf of NPOs. The application of such sanctions should not preclude parallel civil, administrative, or criminal proceedings with respect to NPOs or persons acting on their behalf where appropriate.

Sanctions may include freezing of accounts, removal of trustees, fines, de-certification, de-licensing or de-registration.

VIII.3.3 NPOs should be licensed or registered. This information should be available to competent authorities.<sup>56</sup>

VIII.3.4 NPOs should maintain, for a period of at least five years, and make available to appropriate authorities, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organisation. This also applies to information mentioned in paragraphs (i) and (ii) of the Interpretative Note to Special Recommendation VIII.

*Targeting and attacking terrorist abuse of NPOs through effective information gathering, investigation:*

VIII.4 Countries should implement measures to ensure that they can effectively investigate and gather information on NPOs.

VIII.4.1 Countries should ensure effective domestic co-operation, co-ordination and information sharing to the extent possible among all levels of appropriate authorities or organisations that hold relevant information on NPOs of potential terrorist financing concern.

VIII.4.2 Countries should ensure that full access to information on the administration and management of a particular NPO (including financial and programmatic information) may be obtained during the course of an investigation.

VIII.4.3 Countries should develop and implement mechanisms for the prompt sharing of information among all relevant competent authorities in order to take preventative or investigative action when there is suspicion or reasonable grounds to suspect that a particular NPO is being exploited for terrorist financing purposes or is a front organization for terrorist fundraising. Countries should have investigative expertise and capability to examine those NPOs that are suspected of either being exploited by or actively supporting terrorist activity or terrorist organisations. Countries should also have mechanisms in place that allow for prompt investigative or preventative action against such NPOs.

*Responding to international requests for information about an NPO of concern:*

VIII.5 Countries should identify appropriate points of contact and procedures to respond to international requests for information regarding particular NPOs that are suspected of terrorist financing or other forms of terrorist support.

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<sup>56</sup> Specific licensing or registration requirements for counter terrorist financing purposes are not necessary. For example, in some countries, NPOs are already registered with tax authorities and monitored in the context of qualifying for favourable tax treatment (such as tax credits or tax exemptions).

## **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 outgoing<sup>57</sup> cross-border transportations of currency or bearer negotiable instruments<sup>58</sup>:

(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 threshold should be required to submit a truthful declaration to the designated competent authorities; and
- (ii) The prescribed threshold cannot exceed EUR/USD 15,000<sup>59</sup>

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

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<sup>57</sup> Countries can use one or both systems for incoming and outgoing cross-border transportation of currency or bearer negotiable instruments.

<sup>58</sup> 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.

<sup>59</sup> 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.

(c) Where there is a suspicion of money laundering or terrorist financing.

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 co-operation 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 computerised data base, available to competent authorities for AML/CFT purposes?

## Annex 1

### GLOSSARY OF DEFINITIONS USED IN THE METHODOLOGY

| Terms                                | Definition  |
|--------------------------------------|---|
| <i>Accounts</i>                      | References to “accounts” should be read as including other similar business relationships between financial institutions and their customers.   |
| <i>Agent</i>                         | For the purposes of Special Recommendation VI, an <i>agent</i> is any person who provides money or value transfer service under the direction of or by contract with a legally registered or licensed remitter (for example, licensees, franchisees, concessionaires). (This definition is drawn from the Interpretative Note to SR.VI. It is used in the criteria under SR.VI.)  |
| <i>Appropriate authorities</i>       | The term <i>appropriate authorities</i> refers to competent authorities, self-regulatory bodies, accrediting institutions and other administrative authorities.   |
| <i>Associate NPOs</i>                | The term <i>associate NPOs</i> includes foreign branches of international NPOs  |
| <i>Batch transfer</i>                | A <i>batch transfer</i> is a transfer comprised of a number of individual wire transfers that are being sent to the same financial institutions, but may/may not be ultimately intended for different persons.  |
| <i>Bearer negotiable instruments</i> | <i>Bearer negotiable instruments</i> includes monetary instruments in bearer form such as: travellers cheques; negotiable instruments (including cheques, promissory notes and money orders) that are either in bearer form, endorsed without restriction, made out to a fictitious payee, or otherwise in such form that title thereto passes upon delivery; incomplete instruments (including cheques, promissory notes and money orders) signed, but with the payee’s name omitted.  |
| <i>Bearer shares</i>                 | <i>Bearer shares</i> refers to negotiable instruments that accord ownership in a corporation to the person who possesses the bearer share certificate.  |
| <i>Beneficial owner</i>              | <i>Beneficial owner</i> refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.   |
| <i>Beneficiary</i>                   | <p>For the purposes of Special Recommendation VIII, the term <i>beneficiaries</i> refers to those natural persons, or groups of natural persons who receive charitable, humanitarian or other types of assistance through the services of the NPO.</p> <p>For the purposes of the other FATF Recommendations, the term <i>beneficiary</i> is as follows. All trusts (other than charitable or statutory permitted non-charitable trusts) must have <i>beneficiaries</i>, who may include the settlor, and a maximum time, known as the perpetuity period, normally of 100 years. While trusts must always have some ultimately ascertainable beneficiary, trusts may have no defined existing beneficiaries but only objects of a power until some person becomes entitled as beneficiary to income or capital on the expiry of a defined period, known as the accumulation period. This period is normally co-extensive with the trust perpetuity period which is usually referred to in the trust deed as the trust period.</p> |



| Terms                                    | Definition  |
|--|---|
| <i>Competent authorities</i>             | <i>Competent authorities</i> refers to all administrative and law enforcement authorities concerned with combating money laundering and terrorist financing, including the FIU and supervisors.   |
| <i>Confiscation</i>                      | The term <i>confiscation</i> , which includes forfeiture where applicable, means the permanent deprivation of funds or other assets by order of a competent authority or a court. Confiscation or forfeiture takes place through a judicial or administrative procedure that transfers the ownership of specified funds or other assets to be transferred to the State. In this case, the person(s) or entity(ies) that held an interest in the specified funds or other assets at the time of the confiscation or forfeiture loses all rights, in principle, to the confiscated or forfeited funds or other assets. (Confiscation or forfeiture orders are usually linked to a criminal conviction or a court decision whereby the confiscated or forfeited property is determined to have been derived from or intended for use in a violation of the law.) |
| <i>Consider</i>                          | References in the Recommendations that require a country to <i>consider</i> taking particular measures means that the country should have made a proper consideration or assessment of whether to implement such measures.  |
| <i>Core Principles</i>                   | <i>Core Principles</i> refers to the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, the Objectives and Principles for Securities Regulation issued by the International Organization of Securities Commissions, and the Insurance Supervisory Principles issued by the International Association of Insurance Supervisors.   |
| <i>Correspondent banking</i>             | <i>Correspondent banking</i> is the provision of banking services by one bank (the “correspondent bank”) to another bank (the “respondent bank”). Large international banks typically act as correspondents for thousands of other banks around the world. Respondent banks may be provided with a wide range of services, including cash management (e.g. interest-bearing accounts in a variety of currencies), international wire transfers of funds, cheque clearing, payable-through accounts and foreign exchange services.   |
| <i>Country</i>                           | All references in the FATF Recommendations and in this Methodology to <i>country</i> or <i>countries</i> apply equally to territories or jurisdictions.   |
| <i>Cross-border transfer</i>             | <i>Cross-border transfer</i> means any wire transfer where the originator and beneficiary institutions are located in different jurisdictions. This term also refers to any chain of wire transfers that has at least one cross-border element.   |
| <i>Currency</i>                          | Currency refers to banknotes and coins that are in circulation as a medium of exchange.   |
| <i>Designated categories of offences</i> | <p><i>Designated categories of offences</i> means:</p> <ul style="list-style-type: none"> <li>• participation in an organised criminal group and racketeering;</li> <li>• terrorism, including terrorist financing;</li> <li>• trafficking in human beings and migrant smuggling;</li> <li>• sexual exploitation, including sexual exploitation of children;</li> <li>• illicit trafficking in narcotic drugs and psychotropic substances;</li> <li>• illicit arms trafficking;</li> </ul>  |

| Terms | Definition  |
|-------|---|
|       | <ul style="list-style-type: none"> <li>• illicit trafficking in stolen and other goods;</li> <li>• corruption and bribery;</li> <li>• fraud;</li> <li>• counterfeiting currency;</li> <li>• counterfeiting and piracy of products;</li> <li>• environmental crime;</li> <li>• murder, grievous bodily injury;</li> <li>• kidnapping, illegal restraint and hostage-taking;</li> <li>• robbery or theft;</li> <li>• smuggling;</li> <li>• extortion;</li> <li>• forgery;</li> <li>• piracy; and</li> <li>• insider trading and market manipulation.</li> </ul> <p>When deciding on the range of offences to be covered as predicate offences under each of the categories listed above, each country may decide, in accordance with its domestic law, how it will define those offences and the nature of any particular elements of those offences that make them serious offences.</p> |

| Terms  | Definition  |
|--|---|
| <i>Designated non-financial businesses and professions</i> | <p><i>Designated non-financial businesses and professions</i> means:</p> <ol style="list-style-type: none"> <li>a) Casinos (which also includes internet casinos).</li> <li>b) Real estate agents.</li> <li>c) Dealers in precious metals.</li> <li>d) Dealers in precious stones.</li> <li>e) Lawyers, notaries, other independent legal professionals and accountants – this refers to sole practitioners, partners or employed professionals within professional firms. It is not meant to refer to ‘internal’ professionals that are employees of other types of businesses, nor to professionals working for government agencies, who may already be subject to measures that would combat money laundering.</li> <li>f) Trust and Company Service Providers refers to all persons or businesses that are not covered elsewhere under these Recommendations, and which as a business, provide any of the following services to third parties: <ul style="list-style-type: none"> <li>• acting as a formation agent of legal persons;</li> <li>• acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;</li> <li>• providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;</li> <li>• acting as (or arranging for another person to act as) a trustee of an express trust;</li> <li>• acting as (or arranging for another person to act as) a nominee shareholder for another person.</li> </ul> </li> </ol> |
| <i>Designated person</i>                                   | <p>The term <i>designated persons</i> refers to those persons or entities designated by the Al-Qaida and Taliban Sanctions Committee pursuant to S/RES/1267(1999) or those persons or entities designated and accepted, as appropriate, by jurisdictions pursuant to S/RES/1373(2001).</p>  |
| <i>Designated threshold</i>                                | <p><i>Designated threshold</i> refers to the amount set out in the Interpretative Notes to the Forty Recommendations.</p>   |
| <i>Domestic transfer</i>                                   | <p><i>Domestic transfer</i> means any wire transfer where the originator and beneficiary institutions are located in the same jurisdiction. This term therefore refers to any chain of wire transfers that takes place entirely within the borders of a single jurisdiction, even though the system used to effect the wire transfer may be located in another jurisdiction.</p>  |

| Terms                         | Definition   |
|-------------------------------|--|
| <i>Express trust</i>          | <i>Express trust</i> refers to a trust clearly created by the settlor, usually in the form of a document e.g. a written deed of trust. They are to be contrasted with trusts which come into being through the operation of the law and which do not result from the clear intent or decision of a settlor to create a trust or similar legal arrangements (e.g. constructive trust).  |
| <i>False declaration</i>      | <i>False declaration</i> refers to a misrepresentation of the value of currency or bearer negotiable instruments being transported, or a misrepresentation of other relevant data which is asked for in the declaration or otherwise requested by the authorities. This includes failing to make a declaration as required.  |
| <i>False disclosure</i>       | <i>False disclosure</i> refers to a misrepresentation of the value of currency or bearer negotiable instruments being transported, or a misrepresentation of other relevant data which is asked for in the disclosure or otherwise requested by the authorities. This includes failing to make a disclosure as required.   |
| <i>FATF Recommendations</i>   | <i>The FATF Recommendations</i> refers to the Forty Recommendations and to the Nine Special Recommendations on Terrorist Financing.  |
| <i>Financial institutions</i> | <p><i>Financial institutions</i><sup>60</sup> means any person or entity who conducts as a business one or more of the following activities or operations for or on behalf of a customer:</p> <ol style="list-style-type: none"> <li>1. Acceptance of deposits and other repayable funds from the public.<sup>61</sup></li> <li>2. Lending.<sup>62</sup></li> <li>3. Financial leasing.<sup>63</sup></li> <li>4. The transfer of money or value.<sup>64</sup></li> <li>5. Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money).</li> <li>6. Financial guarantees and commitments.</li> <li>7. Trading in: <ul style="list-style-type: none"> <li>(a) money market instruments (cheques, bills, CDs, derivatives etc.);</li> <li>(b) foreign exchange;</li> <li>(c) exchange, interest rate and index instruments;</li> <li>(d) transferable securities;</li> <li>(e) commodity futures trading.</li> </ul> </li> <li>8. Participation in securities issues and the provision of financial services related to such issues.</li> </ol> |

<sup>60</sup> For the purposes of Special Recommendation VII, it is important to note that the term *financial institution* does not apply to any persons or entities that provide financial institutions solely with message or other support systems for transmitting funds.

<sup>61</sup> This also captures private banking.

<sup>62</sup> This includes inter alia: consumer credit; mortgage credit; factoring, with or without recourse; and finance of commercial transactions (including forfeiting).

<sup>63</sup> This does not extend to financial leasing arrangements in relation to consumer products.

<sup>64</sup> This applies to financial activity in both the formal or informal sector e.g. alternative remittance activity. See the Interpretative Note to Special Recommendation VI. It does not apply to any natural or legal person that provides financial institutions solely with message or other support systems for transmitting funds. See the Interpretative Note to Special Recommendation VII.

| Terms   | Definition   |
|---|--|
|   | <p>9. Individual and collective portfolio management.</p> <p>10. Safekeeping and administration of cash or liquid securities on behalf of other persons.</p> <p>11. Otherwise investing, administering or managing funds or money on behalf of other persons.</p> <p>12. Underwriting and placement of life insurance and other investment related insurance<sup>65</sup>.</p> <p>13. Money and currency changing.</p> <p>When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering activity occurring, a country may decide that the application of anti-money laundering measures is not necessary, either fully or partially.</p> <p>In strictly limited and justified circumstances, and based on a proven low risk of money laundering, a country may decide not to apply some or all of the Forty Recommendations to some of the financial activities stated above.</p> |
| <i>FIU</i>                                    | FIU means financial intelligence unit.   |
| <i>Foreign counterparts</i>                   | This refers to the authorities in another country that exercise similar responsibilities and functions.  |
| <i>Freeze</i>                                 | This means to prohibit the transfer, conversion, disposition or movement of funds or other assets on the basis of, and for the duration of the validity of, an action initiated by a competent authority or a court under a freezing mechanism. The frozen funds or other assets remain the property of the person(s) or entity(ies) that held an interest in the specified funds or other assets at the time of the freezing and may continue to be administered by the financial institution or other arrangements designated by such person(s) or entity(ies) prior to the initiation of an action under a freezing mechanism.  |
| <i>Fundamental principles of domestic law</i> | This refers to the basic legal principles upon which national legal systems are based and which provide a framework within which national laws are made and powers are exercised. These fundamental principles are normally contained or expressed within a national Constitution or similar document, or through decisions of the highest level of court having the power to make binding interpretations or determinations of national law. Although it will vary from country to country, some examples of such fundamental principles include rights of due process, the presumption of innocence, and a person's right to effective protection by the courts.   |
| <i>Funds</i>                                  | Except in the case of Special Recommendation II, <i>funds</i> refers to assets of every kind, whether corporeal or incorporeal, tangible or intangible, movable or immovable and legal documents or instruments evidencing title to, or interest in, such assets.  |
| <i>Funds or other assets</i>                  | The term <i>funds or other assets</i> means financial assets, property of every kind, whether tangible or intangible, movable or immovable, however acquired, and legal documents or instruments in any form, including electronic or digital,   |

<sup>65</sup> This applies both to insurance undertakings and to insurance intermediaries (agents and brokers).

| Terms   | Definition  |
|---|---|
|   | evidencing title to, or interest in, such funds or other assets, including, but not limited to, bank credits, travellers cheques, bank cheques, money orders, shares, securities, bonds, drafts, or letters of credit, and any interest, dividends or other income on or value accruing from or generated by such funds or other assets.  |
| <i>Funds transfer</i>                                       | The terms <i>funds transfer</i> refers to any transaction carried out on behalf of an originator person (both natural and legal) through a financial institution by electronic means with a view to making an amount of money available to a beneficiary person at another financial institution. The originator and the beneficiary may be the same person.  |
| <i>Identification data</i>                                  | Reliable, independent source documents, data or information will be referred to as “identification data”.   |
| <i>Intermediaries</i>                                       | <i>Intermediaries</i> can be financial institutions, DNFBP or other reliable persons or businesses that meet Criteria 9.1 to 9.4.   |
| <i>Investigations, prosecutions and related proceedings</i> | <i>Investigations, prosecutions and related proceedings</i> may be of a criminal, civil enforcement or administrative nature, and includes proceedings in relation to confiscation or provisional measures.   |
| <i>Law or regulation</i>                                    | <i>Law or regulation</i> refers to primary and secondary legislation, such as laws, decrees, implementing regulations or other similar requirements, issued or authorised by a legislative body, and which impose mandatory requirements with sanctions for non-compliance. The sanctions for non-compliance should be effective, proportionate and dissuasive.   |
| <i>Legal arrangements</i>                                   | <i>Legal arrangements</i> refers to express trusts or other similar legal arrangements. Examples of other similar arrangements (for AML/CFT purposes) include fiducie, treuhand and fideicomiso.  |
| <i>Legal persons</i>  | <i>Legal persons</i> refers to bodies corporate, foundations, anstalt, partnerships, or associations, or any similar bodies that can establish a permanent customer relationship with a financial institution or otherwise own property.  |
| <i>Licensing</i>  | For the purposes of Special Recommendation VI only, <i>licensing</i> means a requirement to obtain permission from a designated competent authority in order to operate a money/value transfer service legally.   |
| <i>Money laundering (ML) offence</i>                        | References in this Methodology (except in R.1) to a <i>money laundering (ML) offence</i> refer not only to the primary offence or offences, but also to ancillary offences.   |
| <i>Money or value transfer service</i>                      | <p><i>Money or value transfer service</i> refers to a financial service that accepts cash, cheques, other monetary instruments or other stores of value in one location and pays a corresponding sum in cash or other form to a beneficiary in another location by means of a communication, message, transfer or through a clearing network to which the money/value transfer service belongs. Transactions performed by such services can involve one or more intermediaries and a third party final payment.</p> <p>A money or value transfer service may be provided by persons (natural or legal) formally through the regulated financial system or informally through non-bank financial institutions or other business entities or any other mechanism either</p> |

| Terms                                       | Definition   |
|---|--|
|   | through the regulated financial system (for example, use of bank accounts) or through a network or mechanism that operates outside the regulated system. In some jurisdictions, informal systems are frequently referred to as <i>alternative remittance services</i> or <i>underground (or parallel) banking systems</i> . Often these systems have ties to particular geographic regions and are therefore described using a variety of specific terms. Some examples of these terms include <i>hawala</i> , <i>hundi</i> , <i>fei-chien</i> , and the <i>black market peso exchange</i> . (This definition is drawn from the Interpretative Note to SR.VI. It is used in the criteria under SR.VI.) |
| <i>Non-profit organisations</i>             | The term <i>non-profit organisation</i> or <i>NPO</i> refers to a legal entity or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of “good works”.  |
| <i>Originator</i>                           | The <i>originator</i> is the account holder, or where there is no account, the person (natural or legal) that places the order with the financial institution to perform the wire transfer.  |
| <i>Other enforceable means</i>              | Other enforceable means refers to guidelines, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for non-compliance, and which are issued by a competent authority (e.g. a financial supervisory authority) or an SRO. The sanctions for non-compliance should be effective, proportionate and dissuasive.   |
| <i>Palermo Convention</i>                   | The 2000 UN Convention against Transnational Organized Crime.  |
| <i>Payable-through accounts</i>             | <i>Payable-through accounts</i> refers to correspondent accounts that are used directly by third parties to transact business on their own behalf.   |
| <i>Physical cross-border transportation</i> | <i>Physical cross-border transportation</i> refers to any in-bound or out-bound physical transportation of currency or bearer negotiable instruments from one country to another country. The term includes the following modes of transportation: (1) physical transportation by a natural person, or in that person’s accompanying luggage or vehicle; (2) shipment of currency through containerised cargo or (3) the mailing of currency or bearer negotiable instruments by a natural or legal person.  |
| <i>Politically Exposed Persons” (PEPs)</i>  | <i>PEPs</i> are individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.   |
| <i>Proceeds</i>                             | <i>Proceeds</i> refers to any property derived from or obtained, directly or indirectly, through the commission of an offence.   |
| <i>Property</i>                             | <i>Property</i> means assets of every kind, whether corporeal or incorporeal, moveable or immovable, tangible or intangible, and legal documents or instruments evidencing title to, or interest in such assets.   |

| <b>Terms</b>  | <b>Definition</b>  |
|---|--|
| <i>Registration</i>                                       | For the purposes of Special Recommendation VI, <i>registration</i> means a requirement to register with or declare to a designated competent authority the existence of a money/value transfer service in order for the business to operate legally.   |
| <i>Related to terrorist financing or money laundering</i> | When used to describe currency or bearer negotiable instruments, the term <i>Related to terrorist financing or money laundering</i> refers to currency or bearer negotiable instruments that are: (i) the proceeds of, or used in, or intended or allocated for use in, the financing of terrorism, terrorist acts or terrorist organisations; or (ii) laundered, proceeds from money laundering or predicate offences, or instrumentalities used in or intended for use in the commission of these offences.  |
| <i>Risk</i>   | All references to <i>risk</i> in this Methodology refer to the risk of money laundering and/or terrorist financing.  |
| <i>Satisfied</i>  | Where reference is made to a financial institution being <i>satisfied</i> as to a matter, that institution must be able to justify its assessment to competent authorities.  |
| <i>Seize</i>  | The term <i>seize</i> means to prohibit the transfer, conversion, disposition or movement of funds or other assets on the basis of an action initiated by a competent authority or a court under a freezing mechanism. However, unlike a freezing action, a seizure is effected by a mechanism that allows the competent authority or court to take control of specified funds or other assets. The seized funds or other assets remain the property of the person(s) or entity(ies) that held an interest in the specified funds or other assets at the time of the seizure, although the competent authority or court will often take over possession, administration or management of the seized funds or other assets. |
| <i>Self-regulatory organisation (SRO)</i>                 | A <i>SRO</i> is a body that represents a profession (e.g. lawyers, notaries, other independent legal professionals or accountants), and which is made up of member professionals, has a role in regulating the persons that are qualified to enter and who practise in the profession, and also performs certain supervisory or monitoring type functions. For example, it would be normal for this body to enforce rules to ensure that high ethical and moral standards are maintained by those practising the profession.   |
| <i>Settlor</i>  | <i>Settlers</i> are persons or companies who transfer ownership of their assets to trustees by means of a trust deed. Where the trustees have some discretion as to the investment and distribution of the trusts assets, the deed may be accompanied by a non-legally binding letter setting out what the settlor wishes to be done with the assets.  |
| <i>Shell bank</i>   | <i>Shell bank</i> means a bank that has no physical presence in the country in which it is incorporated and licensed, and which is unaffiliated with a regulated financial services group that is subject to effective consolidated supervision.<br><br><i>Physical presence</i> means meaningful mind and management located within a country. The existence simply of a local agent or low level staff does not constitute physical presence.  |
| <i>Should</i>   | For the purposes of assessing compliance with the FATF Recommendations, the word <i>should</i> has the same meaning as <i>must</i> .   |



| Terms                      | Definition   |
|----------------------------|--|
| <i>S/RES/1267(1999)</i>    | The term <i>S/RES/1267(1999)</i> refers to <i>S/RES/1267(1999)</i> and its successor resolutions. When issued, <i>S/RES/1267(1999)</i> had a time limit of one year. A series of resolutions have been issued by the United Nations Security Council (UNSC) to extend and further refine provisions of <i>S/RES/1267(1999)</i> . By successor resolutions are meant those resolutions that extend and are directly related to the original resolution <i>S/RES/1267(1999)</i> . As of February 2004, these resolutions included <i>S/RES/1333(2000)</i> , <i>S/RES/1363(2001)</i> , <i>S/RES/1390(2002)</i> , <i>S/RES/1455(2003)</i> and <i>S/RES/1526(2004)</i> .  |
| <i>STR</i>                 | <i>STR</i> refers to suspicious transaction reports.   |
| <i>Subsidiaries</i>        | <i>Subsidiaries</i> refers to majority owned subsidiaries.   |
| <i>Supervisors</i>         | <i>Supervisors</i> refers to the designated competent authorities responsible for ensuring compliance by financial institutions with requirements to combat money laundering and terrorist financing.  |
| <i>Terrorist</i>           | For purposes of SRIII, the term <i>terrorist</i> is as defined in the Interpretative Note of SRIII.<br><br>Otherwise, it refers to any natural person who: (i) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and wilfully; (ii) participates as an accomplice in terrorist acts; (iii) organises or directs others to commit terrorist acts; or (iv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist act or with the knowledge of the intention of the group to commit a terrorist act.   |
| <i>Terrorist act</i>       | A <i>terrorist act</i> includes:<br><br>(i) An act which constitutes an offence within the scope of, and as defined in one of the following treaties: Convention for the Suppression of Unlawful Seizure of Aircraft (1970), Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1971), Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents (1973), International Convention against the Taking of Hostages (1979), Convention on the Physical Protection of Nuclear Material (1980), Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1988), Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation (1988), Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf (1988), and the International Convention for the Suppression of Terrorist Bombings (1997); and<br><br>(ii) any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a Government or an international organisation to do or to abstain from doing any act. |
| <i>Terrorist financing</i> | <i>Terrorist financing (FT)</i> includes the financing of terrorist acts, and of terrorists  |

| <b>Terms</b>                          | <b>Definition</b>   |
|---------------------------------------|---|
| <i>(FT)</i>                           | and terrorist organisations.  |
| <i>Terrorist Financing Convention</i> | The 1999 United Nations International Convention for the Suppression of the Financing of Terrorism  |
| <i>Terrorist financing offence</i>    | References in this Methodology (except in SR II) to a <i>terrorist financing (FT) offence</i> refer not only to the primary offence or offences, but also to ancillary offences.  |
| <i>Terrorist organisation</i>         | For purposes of SR III, the term <i>terrorist organisation</i> is as defined in the Interpretative Note of SR III.<br><br>Otherwise, it refers to any group of terrorists that: (i) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and wilfully; (ii) participates as an accomplice in terrorist acts; (iii) organises or directs others to commit terrorist acts; or (iv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist act or with the knowledge of the intention of the group to commit a terrorist act. |
| <i>Third parties</i>                  | <i>For the purposes of R.9 only, third parties</i> means financial institutions or DNFBP that are supervised and that meet Criteria 9.1 to 9.4  |
| <i>Those who finance terrorism</i>    | For the purposes of SR III only, the phrase <i>those who finance terrorism</i> refers to any person, group, undertaking or other entity that provides or collects, by any means, directly or indirectly, funds or other assets that may be used, in full or in part, to facilitate the commission of terrorist acts, or to any persons or entities acting on behalf of, or at the direction of such persons, groups, undertakings or other entities. This includes those who provide or collect funds or other assets with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out terrorist acts.                                   |
| <i>Transactions</i>                   | In the insurance sector, the word <i>transactions</i> should be understood to refer to the insurance product itself, the premium payment and the benefits. For specific requirements with regard to record keeping of transactions in the insurance sector, see the IAIS Guidance Notes of January 2002.  |
| <i>Trustee</i>                        | <i>Trustees</i> , who may be paid professionals or companies or unpaid persons, hold the assets in a trust fund separate from their own assets. They invest and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes. There may also be a protector, who may have power to veto the trustees' proposals or remove them, and/or a custodian trustee, who holds the assets to the order of the managing trustees.  |
| <i>Unique identifier</i>              | For the purposes of Special Recommendation VII, a <i>unique identifier</i> refers to any unique combination of letters, numbers or symbols that refers to a specific originator.  |
| <i>Vienna Convention</i>              | The 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances  |
| <i>Wire transfer</i>                  | For the purposes of Special Recommendations VII, the terms <i>wire transfer</i> refers to any transaction carried out on behalf of an originator person (both natural and   |

| Terms                | Definition   |
|----------------------|--|
|                      | legal) through a financial institution by electronic means with a view to making an amount of money available to a beneficiary person at another financial institution. The originator and the beneficiary may be the same person.   |
| <i>Without delay</i> | For the purposes of Special Recommendation III, the phrase <i>without delay</i> has the following specific meaning. For the purposes of S/RES/1267(1999), it means, ideally, within a matter of hours of a designation by the Al-Qaida and Taliban Sanctions Committee. For the purposes of S/RES/1373(2001), the phrase <i>without delay</i> means upon having reasonable grounds, or a reasonable basis, to suspect or believe that a person or entity is a terrorist, one who finances terrorism or a terrorist organisation. The phrase <i>without delay</i> should be interpreted in the context of the need to prevent the flight or dissipation of terrorist-linked funds or other assets, and the need for global, concerted action to interdict and disrupt their flow swiftly. |

## **Annex 2**

### **Endorsement of the AML/CFT Methodology 2004**

This Methodology was agreed by the FATF Plenary at its meeting in February 2004, and approved by the Executive Boards of the IMF and the World Bank in March 2004. The following bodies have also endorsed the Methodology: the Asia/Pacific Group on Money Laundering (APG), the Caribbean Financial Action Task Force (CFATF), the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL), the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), the Eurasian Group (EAG), the Financial Action Task Force on Money Laundering in South America (GAFISUD), the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA), the Middle East and North Africa Financial Action Task Force (MENAFATF) and the Offshore Group of Banking Supervisors (OGBS).

## Annex 3

### Information on updates made to the 2004 Methodology

The tables below identify the amendments made to the Methodology since its adoption in February 2004. Editorial amendments (as opposed to substantive amendments) are intended to ensure that the Methodology accurately reflects the Recommendations and have no impact on the substance of the requirements. Technical amendments refer to amendments made to reflect the changes made to the standards themselves (including amendments made to Interpretative Notes), to correct some minor mistakes when transposing the Recommendations or to avoid a duplication of assessment of individual Recommendations in the evaluation process.

#### 1. Editorial amendments

| Date          | Section of the Methodology subject to amendments   |
|---------------|--|
| February 2005 | <ul style="list-style-type: none"> <li>▪ Introduction</li> <li>▪ R.5 – C.5.15</li> </ul> |

#### 2. Technical amendments

| Date          | Type of amendments   | Sections subject to amendments  |
|---------------|--|---|
| February 2005 | <p>Introduction of a new set of criteria in relation to SRIX and its Interpretative Note adopted</p> <p>Update of Annex 2</p>  | <ul style="list-style-type: none"> <li>▪ R.19 – all references to cross-border transportation of currency and bearer negotiable instruments deleted (C.19.1 &amp; C.19.3 deleted, C. 19.2 – new C.19.1- &amp; additional elements unchanged)</li> <li>▪ SRIX – a complete set of criteria is introduced</li> <li>▪ Glossary: adoption of new definitions for (1) <i>bearer negotiable instrument</i>; (2) <i>false declaration</i>; (3) <i>false disclosure</i>; (4) <i>physical cross-border transportation</i> and (5) <i>related to terrorist financing or money laundering</i></li> <li>▪ Annex 2 set out that APG, CFATF, MONEYVAL, ESSAMLG, GAFISUD and OGBS have endorsed the 2004 Methodology.</li> </ul>   |
| October 2005  | <p>Amendment to the treatment of sanctions for DNFBPs to avoid multiple-counting of the same issue</p> <p>Align the Methodology with changes made to the Interpretative Note on SR VII</p> | <ul style="list-style-type: none"> <li>▪ C.12.3 deleted</li> <li>▪ C.16.4 deleted</li> <li>▪ 17.2 reference to <i>“the self-regulatory organisations referred to in Recommendation 24”</i> deleted</li> <li>▪ 24.2.1 a) reference to <i>“criteria 17.1-17.4 that apply to the obligations under R. 12 and R. 16”</i> added</li> <li>▪ note to assessors deleted</li> <li>▪ Chapeau to essential criteria amended – reference to <i>withdrawals from a bank account through an ATM machine, cash advances from a credit card, or payments for goods and services</i> added.</li> <li>▪ C.VII.1&amp; C.VII.2: EUR/USD 1 000 or more threshold introduced</li> <li>▪ C.VII.2: provisions in relation to batch transfers amended – previous provisions deleted</li> <li>▪ C.VII.3: reference to <i>transactions using a credit or debit card</i> deleted</li> <li>▪ C.VII.4 – previous provisions on routine batch transfers deleted – new criterion introduced provision related to the</li> </ul> |

| Date          | Type of amendments  | Sections subject to amendments   |
|---------------|---|--|
|               |   | <ul style="list-style-type: none"> <li>obligation to maintain originator information (previous C.VII.5)</li> <li>▪ C.VII.5 – new criterion introduced provision on effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information</li> <li>▪ two additional elements introduced provisions on incoming &amp; outgoing cross-border wire transfers</li> <li>▪ Glossary – adoption of definition of <i>unique identifier</i></li> </ul>   |
| June 2006     | <p>Introduction – additional elements on corruption</p> <p>Align the Methodology with changes made to the Interpretative Note on SR VII</p> <p>Align the Methodology with the new Interpretative Note on SRVIII</p> | <ul style="list-style-type: none"> <li>▪ Paragraph 7c) – elements on anti-corruption initiatives added</li> <li>▪ Chapeau: reference to Criterion 5.2 deleted</li> <li>▪ C. VII.1 – the verification element amended</li> <li>▪ Footnote of C. VII.1 amended</li> <li>▪ A complete set of essential and additional criteria adopted. C.VIII.1 to C.VIII.4 of Methodology (version February 2004) deleted.</li> <li>▪ Glossary: adoption of new definitions for (1) <i>appropriate authorities</i>; (2) <i>associate NPOs</i>; (3) <i>beneficiary</i>; (4) <i>non-profit organisation</i>.</li> </ul> |
| February 2007 | <p>Introduction – additional elements on effectiveness</p> <p>Insert notes for assessors on interpretation of the FATF Recommendations</p> <p>Insertion of Annex 3</p>  | <ul style="list-style-type: none"> <li>▪ Paragraph 6 – elements on global effectiveness added</li> <li>▪ New paragraphs 15 to 18 – elements on the measure of effectiveness of implementation of individual recommendations added</li> <li>▪ Rec. 1, Rec. 2, SRII, Rec. 12, Rec. 36, 38, 39 &amp; SRV and SRVI</li> <li>▪ Information on updates made to the 2004 Methodology added</li> </ul>   |