

Risk Transfer Feature

posted 10 Feb 2004 in Volume 2 Issue 2

Anatomy of an IMF review

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The International Monetary Fund (IMF) is a specialised agency of the United Nations system set up by treaty in 1945 to help promote the health of the world economy. Headquartered in Washington, D.C., the

IMF is an international organisation of 184 member countries. Simply stated, the IMF is the central institution of the international monetary system – the system of international payments and exchange rates among national currencies that enable business to take place between countries.

The IMF promotes the balanced expansion of world trade, the stability of exchange rates, the avoidance of competitive currency devaluations, and as its name suggests, a fund that can be tapped by members needing temporary financing to address balance of payments problems. IMF operations involve providing surveillance, financial assistance, and technical assistance to its member countries.

The IMF has long been involved in international efforts to combat money laundering, but over the past year it has intensified and extended its activities to combat terrorist financing. As an institution with near universal membership, the IMF is a natural forum for sharing information, developing common approaches to issues, and promoting desirable policies and standards – all of which are critical in the global fight against money laundering and terrorist financing.

In July 2002, the executive board of the IMF discussed the paper "Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT): Proposals to assess a Global Standard and to Prepare Reports on the Observance of Standards and Codes (ROSCs)". ROSCs summarise the extent to which countries observe certain internationally-recognised standards and codes. They are used to clearly measure risk assessment in policy discussions between national authorities and the private sector. The IMF and World Bank have endorsed internationally-recognised standards and codes in 11 areas as important for their work and for which ROSCs are prepared.

Standards in the areas of data, fiscal transparency, and monetary and financial policy transparency have been developed by the Fund while other standard-setting bodies including the World Bank and the Basel Committee on Banking Supervision have developed other standards. Given the synergies with assessments of prudential supervisory standards, it was thought that the IMF Financial Sector Assessment Programme (FSAP) provided a suitable context to undertake AML/CFT assessments. Similarly, if the Financial Action Task Force (FATF) and FATF-style regional bodies (FSRBs) follow the agreed methodology and conduct AML/CFT assessments on a timely basis, there would be a significant savings in resources and the avoidance of duplication.

The outcome of the discussion was that the IMF directors agreed to:

- Conditionally add FATF's 40 recommendations against money laundering and its eight special recommendations on terrorism financing (FATF 40+8) to the list of areas and associated standards and codes useful to the operational work of the IMF;
- Endorse a 12-month pilot programme of AML/CFT assessments and accompanying ROSCs that involves participation of the Fund and the World Bank, the FATF and FSRBs, provided that several conditions are met.

One of these conditions is that FATF does not undertake a further round of the non co-operative countries and territories (NCCT) initiative, commonly referred to as the "Black List", at least during the period of the 12-month pilot project. At the October 2002 plenary,

FATF agreed to this and other conditions, by completing and endorsing the comprehensive and integrated methodology. It agreed that the new methodology would be used for future FATF and FSRB mutual evaluations and IMF and World Bank staff-led assessments, that it would undertake future mutual evaluations consistent with the ROSC process, and desist from naming new countries to its NCCT list.

The creation of the AML/CFT methodology came about as the result of a merging of two earlier draft documents that were attached to the World Bank and the IMF paper "Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT): Materials Concerning Staff Progress Towards the Development of a Comprehensive AML/CFT Methodology and Assessment Process".

The first document, "Fund and Bank Methodology for Assessing Legal, Institutional and Supervisory/Regulatory Aspects of Anti-Money Laundering and Combating the Financing of Terrorism", was prepared by Bank/Fund staff in consultation with FATF, the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS), the International Organisation of Securities Commissions (IOSCO) and the Egmont Group. This document covers the legal and institutional AML/CFT framework and AML/CFT preventive measures for the financial sector.

The second document, "Assessment of Implementation of Legal and Institutional Elements Outside of the Supervisory or Regulatory Framework", was prepared by a FATF working group in consultation with the Egmont Group. This document contained assessment criteria relating to the implementation of penal and repressive measures that are required for a comprehensive AML/CFT regime.

The IMF AML/CFT methodology, including the assessment criteria, is designed to guide the assessment of a jurisdiction's compliance with AML/CFT standards. It is based primarily on the FATF 40 and FATF 8, but also includes relevant elements from United Nations Security Council Resolutions and international conventions and from supervisory/regulatory standards for the banking, insurance and securities sectors. It is also drawn on by the assessment experience of FATF mutual evaluations, of the IMF and World Bank in the Financial Sector Assessment Programme (FSAP) and by the IMF in the Offshore Financial Center (OFC) Assessment Programme.

IMF Review methodology

According to the stated AML/CFT methodology, "an effective AML/CFT system requires an adequate legal and institutional framework, which should include: (i) laws that create AML/CFT offences and other penal measures, and that impose the required obligations on financial institutions (ii) an appropriate institutional or administrative framework, and (iii) laws that provide competent authorities with the necessary duties, powers and sanctions, including the ability to co-operate internationally. It is also essential that the competent authorities ensure that the whole system is effectively implemented."

The AML/CFT methodology structure is divided into three sections. Two principal sections contain assessable criteria, and the first section deals with criminal justice measures, FIUs and international co-operation. The assessment criteria are set out in five sub-sections covering:

- Criminalisation of money laundering and the financing of terrorism;
- Confiscation;
- The FIU and processes for receiving, analysing, and disseminating financial information and other intelligence at both domestic and international levels;
- Powers and duties of law enforcement and prosecution authorities;
- International co-operation.

The second section covers preventive measures for financial institutions. The first part of the second section contains assessment criteria that are based on the FATF 40 + 8, and which are applicable to all financial institutions. The assessment criteria are set out in nine sub-sections, covering:

- General framework;
- Customer identification;
- Ongoing monitoring of accounts and transactions;
- Record-keeping;
- Suspicious transactions reporting;
- Internal controls, compliance and audit;
- Integrity standards;
- Enforcement powers and sanctions;
- Co-operation between supervisors and other competent authorities.

This is followed by three sub-parts that contain sector-specific measures for the banking, insurance and securities sectors, where the criteria are based on standards applicable to AML/CFT that have been issued by the Basel Committee, IAIS, or IOSCO, respectively.

Finally, the third section, which does not contain assessable criteria (e.g., where assessors should merely review any measures that have been taken, and should note any significant deficiencies), seeks information on any measures that a jurisdiction may have adopted regarding monitoring or reporting of large currency or cross-border transactions and the use of cash.

The AML/CFT methodology also refers to other conditions necessary for a truly effective AML/CFT system but that are not covered by the AML/CFT assessment criteria. It is interesting to note that, "these include sound and sustainable financial sector policies and a well-developed public sector infrastructure.

In particular, effectiveness depends on a proper culture of deterrence shared and reinforced by government, financial institutions, other providers of financial services, industry trade groups, and self-regulatory organisations. The infrastructure requires ethical and professional lawyers, examiners, accountants, auditors, police officers, prosecutors, and judges, etc., and a reasonably efficient court system whose decisions are enforceable. An essential aspect of assessing the adequacy of these conditions is the existence of a system for ensuring the ethical and professional behaviour on the part of examiners, accountants and auditors, and lawyers, including the existence of codes of conduct and good practices, as well as methods to ensure compliance such as registration, licensing, and supervisory bodies."

Again, since weaknesses or shortcomings in these areas may significantly impair the implementation of an effective AML/CFT

framework, and although the AML/CFT assessment criteria do not cover these conditions, apparent major weaknesses or shortcomings identified are to be noted in the detailed assessment report. The actual assessment scoring is as follows: a requirement is considered:

- Compliant whenever it is fully observed;
- Largely compliant whenever only discrete and non-systemic shortcomings are observed and corrective actions are readily identified and have been scheduled within a reasonable period of time; or
- Materially non-compliant whenever discrete or non-systemic shortcomings are observed that are not addressed, or whenever numerous or systemic shortcomings are observed and corrective actions are identified and have been scheduled within a reasonable period of time; or
- Non-compliant whenever the jurisdiction has not addressed the issue or has addressed it in a manner that can not reasonably lead to substantial observance.

Although not the emphasis of this article, it is important to restate that the IMF AML/CFT review methodology is more broadly based on many different international standards, especially in comparison to the FATF review criteria. In fact, two-thirds of the IMF review team will be dealing with Basel Core, IAIS, and IOSCO principles. In addition, an economist will be conducting a full review of the economy and commenting on trends. The team leader will co-ordinate a series of interviews with industry representatives as well and draft the final report. From experience, it appears that the final report is significantly influenced by the quality of the jurisdiction's initial response to the pre-visit questionnaire.

It is clear that the way of international regulation is becoming tougher and tougher. Suffice it to say that the IMF review methodology is by far the most stringent and comprehensive a jurisdiction could ever face.

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