

*Consultation Paper*

# The Review of the Standards – Preparation for the 4th Round of Mutual Evaluations

*October 2010*



## THE FINANCIAL ACTION TASK FORCE (FATF)

The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering and terrorist financing. Recommendations issued by the FATF define criminal justice and regulatory measures that should be implemented to counter this problem. These Recommendations also include international co-operation and preventive measures to be taken by financial institutions and others such as casinos, real estate dealers, lawyers and accountants. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

For more information about the FATF, please visit the website:

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## FOREWORD

The FATF exists to develop and promote global standards for combating money laundering and terrorist financing, which are set out in the FATF 40 Recommendations and the 9 Special Recommendations on Terrorist Financing. The FATF's evaluations of compliance by member countries with these standards provide a rigorous and transparent source of analysis, and a powerful incentive for countries to continue strengthening their national anti-money laundering / counter-terrorist financing (AMF/CFT) regimes.



The FATF is nearing the end of its third round of mutual evaluations: by February 2011 all of its members will have been assessed, and the eight FATF-Style Regional Bodies are also near to completing evaluations of their members, using the common AML/CFT Methodology 2004. It is good practice for any standard-setter to re-examine its standards periodically, and so the FATF is currently conducting a review of the 40+9 Recommendations, to ensure that they remain up-to-date and relevant, and to benefit from lessons learnt from implementing and evaluating the current standards.

The current review is a focused and balanced exercise, aiming at maintaining the necessary stability in the standards while addressing new or emerging threats and any deficiencies or loopholes in the current FATF standards. It is based on the principles of maintaining a level playing field with equal treatment for all countries; and of openness and transparency. In particular it will look to place more emphasis on effective implementation of the FATF Standards by countries. Work has been undertaken on the first phase of this review over the last year, considering issues including the Risk Based Approach; Customer Due Diligence and Reliance on Third Parties. The initial proposals emerging from this work are set out for consultation in this document.

We are committed to conducting this review in an open and transparent manner, and the FATF is keen to involve the private sector, in particular members of the Consultative Forum, and other interested parties in order to ensure that all the proposals receive proper consideration by all stakeholders. The financial sector and other businesses and professions are key partners in the FATF's efforts to combat money laundering and terrorist financing: financial institutions and other gatekeepers are the lead actors in the daily fight against this criminality. It is therefore essential for us to reflect that practical knowledge and experience in our review of the standards and how they are implemented.

The review of the standards, and this consultation, will ultimately lead to more effective AML/CFT systems worldwide. I believe this consultation is also an opportunity to further strengthen the close and constructive dialogue between the FATF and its partners across the globe.

Luis Urrutia  
FATF President, 2010-2011

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## INTRODUCTION

### *The Preparation for the 4<sup>th</sup> Round of Mutual Evaluation*

1. The FATF 40+9 Recommendations have been endorsed by more than 180 countries and jurisdictions, are recognized as the international AML/CFT Standards, and have been, or are being, successfully implemented. The FATF is now moving towards the end of its 3<sup>rd</sup> Round of Mutual Evaluations, and has started a focused review of its Standards. This review, which is taking place over a two-year period, is principally focused on addressing the issues that have been identified as part of the 3<sup>rd</sup> round of mutual evaluations and from countries implementing the current FATF Standards. The review is based on several fundamental principles, which include:

- ***Focussed exercise*** – the FATF has identified a limited number of issues, and is dealing with them on a prioritised basis. There should be a balance between the desirability of maintaining stability in the standards and the need to address new or emerging threats, or obvious deficiencies or loopholes in the standards.
- ***Inclusiveness, openness and transparency*** – the review process should allow for the full involvement of all FATF and FSRB members and also all FATF observers. In addition there is the current public consultation exercise, including close engagement, in particular, with private sector partners.
- ***Increased focus on effectiveness*** – the 4<sup>th</sup> Round of Mutual Evaluations should give a higher emphasis to effective implementation of the AML/CFT requirements by countries, which could in the future lead to restructuring the evaluation process, with a greater focus on risks and vulnerabilities faced by particular jurisdictions.

2. In October 2009, the FATF Plenary agreed on the list of issues to be considered under the preparation for the 4<sup>th</sup> Round of Mutual Evaluations, and the work on that set of issues has been structured over two years. Based on that work certain preliminary conclusions have been reached and the FATF is consulting on proposals regarding the following topics: the Risk-Based Approach and certain related Recommendations, Recommendation 1 (tax crimes as a designated category of predicate offence for money laundering), Recommendation 5 (Customer Due Diligence), Recommendation 6 (Politically exposed persons), and Recommendation 9 (Third party reliance). Work on Recommendations 33/34 and 40 is continuing. Further work has also been done on SR.VII and the issue of possible changes to this recommendation on wire transfers, and the FATF is also consulting on that issue.

3. Further issues will be considered in the year ahead, including the structure of the Standards; the distinction between law, regulation and other enforceable means; adequate or inadequate implementation by countries of the FATF Recommendations; intra-group cross-border exchange of information; and the potential impact of data protection and privacy laws on AML/CFT. Initial consideration is due to be completed in July 2011, at which time the FATF will set out its preliminary conclusions on these issues, as well as issues carried forward such as Recommendations 33 and 34, for public consultation. The FATF will review and refine the potential revisions to the Standards in the light of responses and comments, and expects to conclude the revision of the Recommendations in October 2011.

### *The public consultation*

4. The FATF wishes to receive the views of all interested parties on the proposals contained in this paper. Comments should be received, in English or French, by the FATF Secretariat **no later than Friday 7 January 2011**, and if possible the comments should be sent electronically to: [fatf.consultation@fatf-gafi.org](mailto:fatf.consultation@fatf-gafi.org). Persons providing comments should note that a compendium of comments received will be made publicly available following the consultation.

## 1. THE RISK-BASED APPROACH

5. In 2003, when the FATF 40 Recommendations were last revised, the intention was to introduce appropriate risk-based flexibility into the Recommendations in a manner that would allow resources to be allocated in the most efficient way to address the most pressing ML/TF risks. However, the current text on the Risk-Based Approach (RBA) may lack sufficient clarity, and is located in several different parts of the FATF Standards. The different components are brought together more clearly in the RBA Guidance developed in cooperation with industry since June 2007, but such guidance does not form part of the Standards.

### 1.1 The Risk-Based Approach

6. Consideration is being given to developing a single comprehensive statement on the RBA, which could be incorporated into the FATF Standards as a new Interpretative Note dedicated to the RBA and applicable to a set of Recommendations - R.5, 6, 8-11, 12, 15, 16, 21 & 22. The general principles set out in the Interpretative Note on the RBA (INRBA) would apply to all the Recommendations it refers to, except where a specific Recommendation provides for a different approach. It should be noted that many of the elements set out below, for example the measures relating to higher and lower risk are already part of the existing FATF Standards.

7. The proposed draft Interpretative Note would comprise the following elements:

- a) A statement on the basic principles and objectives of a risk-based approach.
- b) **The obligations and decisions for the countries** – there are five elements, with items (i), (ii) and (v) being mandatory obligations, and items (iii) and (iv) being optional :
  - i. **Risk assessment** - A country should take appropriate steps to identify and assess the ML/TF risks for the country.
  - ii. **Higher risk** - A country should ensure that their AML/CFT regime addresses the higher ML/TF risks, and that financial institutions and DNFBPs apply enhanced measures in relation to these higher risks.
  - iii. **Lower risk** - If a country identifies lower ML/TF risk, it may allow financial institutions and DNFBPs to apply simplified measures for certain recommendations.
  - iv. **Exemptions** - Where there is proven low ML/TF risk, and in strictly limited and justified circumstances, a country may exempt financial institutions or DNFBPs from applying certain FATF Recommendations.
  - v. **Supervision/monitoring** - Competent authorities or SROs should supervise or monitor the appropriate implementation of the RBA by financial institutions and DNFBPs, in particular the ML/TF risk assessments prepared by financial institutions and DNFBPs.
- c) **The obligations and decisions for financial institutions and DNFBPs** - there are four elements, with items (i)-(iii) being mandatory and item (iv) being optional:
  - i. **Risk assessment** - Financial institutions and DNFBPs should be required to take steps to identify and assess their ML/TF risks for customers, countries or geographic areas, and products/services/transactions/delivery channels.

- ii. **Risk management and mitigation** - Financial institutions and DNFBBPs should have policies, controls and procedures in place to effectively manage and mitigate their risks, which should be approved by senior management and be consistent with national requirements and guidance.
- iii. **Higher risk** - Where financial institutions and DNFBBPs identify higher ML/TF risks, they should be required to take enhanced measures to manage and mitigate the risks.
- iv. **Lower risk** - Where financial institutions and DNFBBPs identify lower risks, they may be allowed to take simplified measures.

## **1.2. Impact of the Risk-Based Approach on FATF Recommendations**

8. In addition to the development of the INRBA, the FATF has also examined how the RBA was dealt with in the current Standards, and proposes some amendments to several Recommendations linked to the RBA issue:

### **1.2.1. Recommendation 5 and its Interpretative Note**

9. Recommendation 5 (R.5) and its Interpretative Note (INR.5) contain important references to ML/TF risks. The main changes proposed for R.5 and INR.5 linked to the RBA consist in giving a more detailed and balanced list of examples of lower/higher ML/TF risk factors, as well as examples of simplified/enhanced CDD measures. The details of these proposed changes are explained below in section 2.

### **1.2.2. Recommendation 8: New technologies and non-face-to-face business**

10. FATF Recommendation 8 (R.8), which deals with specific risks, addresses two substantially different issues: (i) the misuse of new and developing technologies; and (ii) the potential risks associated with non-face-to-face relationships and transactions.

11. In working on the risk-based approach, the FATF reviewed R.8, and considered that non-face-to-face relationships and transactions should be a ML/TF risk factor to be considered by financial institutions and DNFBBPs when assessing the specific risk associated with a transaction or a business relationship. The issue of non-face to face business will therefore be incorporated into the INRBA.

12. FATF is thus considering focusing R.8 on new technologies and making more explicit the requirements on financial institutions/DNFBBPs, countries and competent authorities in relation to ML/TF risks that may arise in relation to the development of new products and new business practices, including new delivery mechanisms. These measures would be risk-based, and financial institutions and DNFBBPs would be required to have procedures in place to enable them to effectively manage and mitigate the risks. In addition, it is proposed to clarify that countries should also assess the potential risks that may arise from new technologies and inform financial institutions and DNFBBPs of these risks.

### **1.2.3. Recommendation 20: Other non-financial businesses and professions**

13. Recommendation 20 (R.20) provides (in part) that “countries should consider applying the FATF Recommendations to businesses and professions, other than designated non-financial businesses and professions, that pose a money laundering or terrorist financing risk”. R.20 only asks countries to consider other types of businesses and professions that are at risk, but not to consider other types of financial institutions.

14. It is proposed that other types of financial activities (other than those covered by the FATF Standards) should be added in R.20. This will give balance to the current R.20 which asks countries to consider applying the FATF Recommendations to other types of businesses or professions that present a ML/TF risk in a national context.

## **2. RECOMMENDATION 5 AND ITS INTERPRETATIVE NOTE**

15. The main changes proposed relate to INR.5 and address the following topics: the risk-based approach, the clarification of requirements regarding legal persons and arrangements and the issue of beneficiaries of life insurance or other investment related insurance policies.

### *2.1. The impact of the Risk-Based Approach on Recommendation 5 and its Interpretative Note*

16. Given the importance of the RBA in the FATF Standards the FATF is considering amending INR.5. First, in order to assist countries, as well as financial institutions and DNFBPs, FATF has prepared a set of examples of both higher and lower ML/TF risk factors. These risk factors are derived from examples contained in the FATF Standards or Methodology, or from the nine sets of sectoral RBA guidance developed with the private sector during recent years. Second, a list has been prepared of examples of enhanced CDD measures for higher ML/TF risks, and simplified CDD measures for lower ML/TF risks. The revised INR.5 provides for a flexible approach to the implementation of the RBA, but nevertheless stipulates that the CDD measures should be appropriate or commensurate to the ML/TF risks.

17. In addition, based on the model used for the sectoral RBA Guidance papers, new text is being considered relating to “Risk Variables”, which will provide that, when assessing ML/TF risks, financial institutions (and DNFBPs through R.12) should take into account risk variables that may increase or decrease the potential risk and result in changes to the level of CDD measures considered appropriate. There is also a recognition that ML/TF risks can vary and that a “one-size-fits-all” approach is not necessary, e.g. for certain customers, normal CDD measures may be perfectly appropriate at the customer acceptance stage, but higher level of due diligence measures may be required for ongoing monitoring of transactions.

### *2.2. Legal persons and arrangements - customers and beneficial owners*

18. A number of changes are being considered for INR.5 in relation to identification and verification of the identity of customers that are legal persons or arrangements. These are intended to introduce more clarity regarding the information that is necessary in such circumstances. In particular, the proposed changes reorganise the measures and information that would normally be needed in relation to customers that are legal persons or arrangements, and make it clearer that details of the “mind and management” of the legal person or arrangement must be obtained.

19. Changes are also being considered to clarify the measures that would normally be needed to identify and verify the identity of the beneficial owners for legal persons and legal arrangements. Greater emphasis is being placed on financial institutions understanding the ownership and control structure of legal persons and arrangements.

20. As far as beneficial ownership information is concerned, the intention is to clarify that the information needed varies according to the ownership and control structure. Traditionally there has been a focus on beneficial ownership occurring through either an ownership interest (e.g. shareholding), or

through control (e.g. exercising the real “mind and management”). However, it may be possible that ownership interests can be so diversified that there are no natural persons (whether acting alone or together) exercising effective control of the legal person or arrangement through ownership.

21. It is proposed that, taking these elements into account, as well as the ownership or control structure of a legal person or arrangement, financial institutions should:

- First identify and take reasonable measures<sup>1</sup> to verify the identity of the natural persons who ultimately have a controlling ownership interest.
- Where the ownership interest is too dispersed to exert control or there are other persons who have control of the legal person or arrangement, then it would be necessary to identify and take reasonable measures to verify those other persons that have effective control through other means (e.g. by exerting influence over the directors of a company).
- If there are no other persons identified as beneficial owners, then in such cases the beneficial owners might be the “mind and management” that has already been identified.

22. Another small change that is being considered concerns the CDD measures that are required for persons acting on behalf of a customer. In the current FATF Standards financial institutions only have to verify that a person is authorised to act on behalf of a customer when the customer is a legal person or arrangement, but in fact this check is an important component of CDD measures for all customers. For anti-fraud and other reasons, financial institutions would already check that persons who seek to operate the account of any customer would have the proper authority to do so. It is proposed that this be made explicit.

### *2.3. Life insurance policies*

23. When developing the RBA guidance for the life insurance sector in 2009, the FATF noticed that requirements relating to the life insurance sector deserved further clarification. After carefully considering how life insurance policies operate, including policies that have investment components, FATF considers that beneficiary of life insurance policy cannot be satisfactorily considered as either a customer or a beneficial owner, in the sense that these two terms are used within the FATF Standards. It is proposed that this should be clarified, by recognising the beneficiary as a stand-alone concept, which should be separately defined in the FATF Glossary to the FATF Recommendations. FATF also recognises that the persons that are the final beneficiaries may not be identified until the end of the business relationship and that some policies have classes of beneficiaries that are designated by characteristics (e.g. all children at the time of the death) or by other means (e.g. under a will).

24. Taking all this into account, consideration is given to clarifying which CDD measures should be applied in relation to identification and verification of the identity of the beneficiary, and when this should occur. It is proposed that, in addition to conducting CDD measures on the policyholder and its potential beneficial owner, financial institutions should:

- Take the name of the beneficiary(ies) that is the specifically-named natural or legal person(s) or legal arrangement(s); or

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<sup>1</sup> The reasonableness of the beneficial owner identity/verification measures should be based on the ML/TF risk of the customer.

- Where there is a class of beneficiaries, obtain sufficient information concerning the beneficiary to satisfy themselves that they will be able to establish the identity of the beneficiary at the time of the payout or when the beneficiary intends to exercise vested rights.
- For both cases, the verification of the identity of the beneficiary(ies) should occur at the time of the payout or when the beneficiary intends to exercise vested rights.

25. In addition, consideration is given to requiring financial institutions, in cases of higher risk, to identify the beneficial owner of the beneficiary that is a legal person or arrangement. This should occur at the time of the payout or when the beneficiary intends to exercise vested rights.

26. Similarly, and because of the higher risk involved, it is proposed that financial institutions should have risk management systems to determine whether the beneficiary of a life insurance policy, or any beneficial owner, is a politically exposed person (PEP), and if so should conduct appropriate CDD measures, such as informing senior management before the payout, conducting enhanced scrutiny of the whole previous business relationship with the policyholder, and considering making a suspicious transaction report.

### 3. RECOMMENDATION 6: POLITICALLY EXPOSED PERSONS

#### 3.1. *Impact of the inclusion of a reference of the United Nations Convention Against Corruption in R.35 in relation to domestic PEPs*

27. At the highest levels of the international community it is recognised that AML/CFT measures are powerful tools that should be deployed in the fight against corruption and the laundering of corruption proceeds. The G20 leaders have asked the FATF to help deter and detect corruption by strengthening the FATF Recommendations, and in that context, the FATF proposes to include the United Nations Convention on Corruption 2003 (UNCAC) – the Merida Convention – in Recommendation 35.

28. The inclusion of the UNCAC in the FATF Standards also impacts Recommendation 6, which deals with politically exposed persons (PEPs). Specifically, Article 52 of the UNCAC relates to the prevention and detection of transfers of proceeds of crime, including by PEPs. The Convention does not distinguish between foreign or domestic PEPs, and refers to “individuals who are, or have been, entrusted with prominent public functions and their family members and close associates”. UNCAC leaves discretion to state parties regarding the types of natural persons to whose accounts enhanced scrutiny should apply. Based on the principle that a Convention should be interpreted in the widest sense possible, it is the understanding that Article 52 requires enhanced scrutiny on both domestic and foreign PEPs.

29. However, taking into account the fact that the money laundering risks differ, depending on whether the customer is a foreign or a domestic PEP, the FATF is considering the following approach: (i) to leave the FATF requirements related to foreign PEPs as they are, i.e. foreign PEPs are always considered to be higher risk; (ii) to require financial institutions to take reasonable measures to determine whether a customer is a domestic PEP; and (iii) to require enhanced CDD measures for domestic PEPs if there is a higher risk.

30. The FATF is also reviewing the obligation with respect to family members and close associates of PEPs. Instead of requiring financial institutions to determine whether a customer or beneficial owner is a family member or close associate of a PEP, it proposes to focus on the cases where the PEP (either foreign

or domestic) is a beneficial owner of the account, i.e. on situations where a family member or close associate has a business relationship with a financial institution and a PEP is the beneficial owner of the funds involved in such a relationship.

### *3.2. Beneficiaries of life insurance policy*

31. As detailed above (see section 2.3), the FATF is considering requiring financial institutions to have risk management systems to determine whether the beneficiary of a life insurance policy, or any beneficial owner, is a politically exposed person (PEP), and if so, to conduct appropriate CDD measures. This approach would follow the general approach for PEPs: enhanced CDD measures would always be required when the beneficiary is a foreign PEP, whilst a RBA would apply when the beneficiary is a domestic PEP.

## **4. RECOMMENDATION 9: THIRD PARTY RELIANCE**

32. The issue of reliance on third parties and introduced business as addressed by Recommendation 9 (R.9) was initially submitted by the private sector through the FATF Consultative Forum. An Expert Group on R.9, composed of FATF and private sector representatives, was set up to undertake preparatory work: a number of issues were identified by the R.9 Expert Group, and there are three issues where the FATF is proposing changes in the context of the 4<sup>th</sup> Round.

### *4.1. Sectoral coverage: who can rely on a third party and who can be relied upon?*

33. Who can rely on a third party? Currently under R.9 countries have a discretion to allow any type of financial institution (and under R.12 by extension, any type of DNFBP) to rely on a third party provided that the conditions in R.9 are met. The FATF considers that this should remain unchanged, and that each country will be free to decide whether reliance on a third party should be allowed for financial institutions or DNFBPs.

34. Who can be relied upon? Although there is no explicit indication in R.9 on who can be relied upon, the requirements to be “supervised” de facto limits the types of entities that could be relied upon as a third party. The FATF is considering amending R.9 to explicitly extend countries’ discretion regarding the types of third parties that can be relied upon, and to go beyond the banking, securities and insurance sectors to include other types of institutions, businesses or professions, as long as they are subject to AML/CFT requirement and to effective supervision or monitoring.

### *4.2. Delineation between third party reliance and outsourcing or agency*

35. Members of the R.9 Expert Group considered that there is no clear simple test between the three concepts of reliance, outsourcing and agency, and that these concepts, in particular the outsourcing and agency concepts, differ from one country to another, and even sometimes from one financial activity to another. Therefore, there was a general support to ask the FATF to consider clarifying what constitutes outsourcing or agency relationships as compared to reliance on third parties.

36. Rather than defining each of these three concepts, the FATF considers that a definition of outsourcing or agency should not be introduced, but it proposes instead to better delineate what constitutes third-party reliance through a functional definition constituted by a set of positive or negative elements which describe situations or elements which are characteristic of a reliance context. For example, a third

party in a reliance scenario usually has an existing business relationship with the customer, independently from the relationship to be formed with the relying institution, and applies its own procedures to perform the CDD measures. This can be contrasted with an outsourcing/agency scenario in which the outsource entity applies the CDD measures on behalf of the delegating financial institution or DNFBP, in accordance with its procedures and subject to the delegating financial institution or DNFBP's control of the effective implementation of those procedures by the outsourced entity.

### *4.3. Intra-Group reliance*

37. One of the issues that was raised by the private sector and considered to be of some importance related to intra-group reliance, and the FATF is considering taking a more flexible approach for reliance where the third party is a part of a financial group. To this end, the FATF is considering encouraging countries to require financial groups to have an AML/CFT programme at the group level, which is applicable to all branches and majority-owned subsidiaries. These programmes should be appropriate to the business of the branches and subsidiaries.

38. Financial institutions which belong to a financial group that effectively implements AML/CFT group programmes, and that are effectively supervised at a consolidated or group level, could then be considered as meeting (through their group AML/CFT programme) some of the conditions normally required under R.9 (namely - to satisfy themselves that copies of identification data will be made available from the third party upon request, and to satisfy themselves that the third party is regulated and supervised and has measures in place to comply with R.5 and R.10). Another proposed change which will add flexibility to R.9 is that reliance on a third party would not be limited to third parties which are based in countries that adequately comply with the FATF Standards. It is proposed that competent authorities may decide that this last requirement is not applicable when the reliance is between financial institutions belonging to the same financial group that applies a group compliance programmes and that is effectively supervised at a group level.

## **5. TAX CRIMES AS A PREDICATE OFFENCE FOR MONEY LAUNDERING**

39. The FATF is considering including tax crimes as a predicate offence for money laundering in the context of Recommendation 1 (R.1). More precisely, it proposes to amend the list of designated categories of predicate offence for money laundering as follows:

- To clarify the current designated category of “smuggling” by referring to: smuggling (including in relation to customs and excise duties and taxes).
- To add a separate designated offence category: tax crimes - related to direct taxes and indirect taxes.

40. For the private sector, the key result of this change will not be the impact of this change on R.1, which concerns the predicate offences to money laundering, but in relation to the obligation to report suspicious transactions under Recommendation 13. Thus transactions related to the laundering of the proceeds of tax crimes would have to be reported as suspicious transactions.

## 6. SPECIAL RECOMMENDATION VII AND ITS INTERPRETATIVE NOTE

41. The FATF is seeking private sector input with respect to discussions to amend Special Recommendation VII (SR.VII) and its Interpretative Note (INSR.VII) for the purpose of enhancing the transparency of cross-border wire transfers.

42. Special Recommendation VII is aimed at enhancing the transparency of cross-border wire transfers by requiring ordering financial institutions to obtain and include originator information, which has been verified and subjected to applicable customer due diligence, in the message or payment form accompanying the transfer. Each intermediary and beneficiary financial institution in the payment chain is required to ensure that all originator information accompanying a wire transfer is transmitted with the wire transfer. Beneficiary financial institutions are required to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information.

43. Similar requirements apply in relation to domestic wire transfers. Alternatively, the ordering financial institution may include only the originator's account number or a unique reference number in the payment message, provided that the rest of the originator information can be made available to the beneficiary financial institution and the appropriate authorities within three business days.

44. The FATF is considering amendments to SR.VII and INSR.VII to further enhance the transparency of all types of wire transfers (other than those specifically exempt from the application of SR.VII) including, for example, serial payments (*i.e.* a direct sequential chain of payment, of the type originally contemplated by SR.VII, where the wire transfer and accompanying payment message travel together from the ordering financial institution to the beneficiary financial institution either directly or through one or more intermediary financial institutions such as correspondent banks) and cover payments (*i.e.* a particular type of payment that typically involves both (i) a transaction in a currency other than that of the country in which the originator's or beneficiary's bank is domiciled, and (ii) the originator's and beneficiary's banks not having a relationship with each other that allows them to settle with each other directly). The recent changes to cover payment message formats in the banking sector and related guidance issued by the Basel Committee on Banking Supervision in May 2009 (*Due diligence and transparency regarding cover payment messages related to cross-border wire transfers*) implement this standard.

### 6.1 Beneficiary information

45. Special Recommendation VII requires financial institutions, when processing cross-border wire transfers above the *de minimus* threshold, to include full originator information (meaning the originator's name, account number or unique identifier, and address). Additionally, it is expected that financial institutions will include certain beneficiary information necessary to execute the transaction.

46. To further enhance the transparency of the international payments system, the FATF is now considering incorporating beneficiary information into the international AML/CFT standard governing cross-border wire transfers. The FATF understands that there are, in general, three types of beneficiary information: (i) information that is required to execute the transaction (*i.e.* the beneficiary's account number or a unique reference number); (ii) information that is customarily included (*i.e.* the beneficiary's name); and (iii) additional information that could be included but is not necessary to execute the transaction (*i.e.* the beneficiary's address, national identity number, customer identification number, or date and place of birth). The FATF recognises that, unlike with respect to originator information, ordering financial institutions are not in a position to verify the beneficiary's identification information because the beneficiary is not the customer of the ordering financial institution.

47. In light of these policy interests, FATF seeks input from the private sector on: (i) whether financial institutions require accurate information on beneficiary names in order to process a transaction; (ii) whether it would be feasible and useful, in managing the ML/FT risks associated with the beneficiary party, for financial institutions to have additional beneficiary information (*i.e.* for the purpose of detecting suspicious activity and screening prohibited transactions); (iii) what additional beneficiary information could be required that would be feasible, useful to financial institutions, practical for originating parties, and proportionate so as not to push transactions underground.

### 6.2 Obligations to screen wire transfers against financial sanctions lists

48. In order to meet applicable laws and regulations implementing United Nations Security Council Resolutions (UNSCRs) to combat terrorist financing, financial institutions are required to take measures to detect and avoid transactions involving prohibited parties.

49. The FATF is considering incorporating into the international standard an obligation to screen all wire transfers in order to comply with the UNSCRs to combat terrorist financing (*i.e.* to identify and freeze terrorist financing-related transactions). The FATF seeks input from the private sector on: (i) whether financial institutions screen all wire transfers, including when they are acting as intermediary financial institutions in the payment chain; (ii) what financial institutions do if they get a hit; (iii) if beneficiary information were included in the payment message, how the current processes might differ with respect to hits on beneficiary information as opposed to hits on originator information; and (iv) when screening wire transfers, whether financial institutions detect incomplete data fields and, if so, how they respond when incomplete data fields are detected (*e.g.* file a suspicious transaction report, process the transaction, suspend the transaction, request complete information from ordering financial institution, etcetera)?

### 6.3 Other issues

50. The FATF is also seeking input from the private sector with respect to:

- (i) considering whether there are sound reasons for making distinctions as to how these requirements should be applied in different market contexts (*e.g.* in cases where the payment service provider of the originator is also the payment service provider of the beneficiary); and
- (ii) whether additional guidance may be needed to assist jurisdictions in applying SR.VII to new payment methods.

## 7. OTHER ISSUES INCLUDED IN THE PREPARATION FOR THE 4TH ROUND OF MUTUAL EVALUATIONS

51. In addition to the issues presented above, the FATF is also reviewing Recommendations related to international cooperation, with a view to reinforcing requirements for countries on mutual legal assistance, extradition (Recommendations 36-39) and cooperation/exchange of information between competent authorities (Recommendation 40) and clarifying that these requirements equally apply for ML and TF situations. The key proposals are: (a) to clarify the respective obligations for the requesting and requested countries to have and use clear and efficient processes to facilitate the execution of mutual legal assistance and extradition requests in a timely manner; (b) to strengthen requirements for countries to have

arrangements for sharing confiscated assets; (c) to require countries to be able to assist with requests based on foreign non conviction based confiscation orders in certain circumstances (such as death, flight, or absence of the perpetrator); (d) to require countries to render mutual legal assistance notwithstanding the absence of dual criminality when assistance does not involve coercive actions determined by countries. In addition, the FATF is considering Recommendation 40 – international cooperation/exchange of information between competent authorities – with a view to ensuring full, effective and timely co-operation in practice. This latter work is still at a preliminary stage.

52. The FATF is considering revising Recommendation 27 (law enforcement authorities) and Recommendation 28 (powers of law enforcement authorities), with a view to ensuring that appropriate AML/CFT enforcement and prosecution powers and mechanisms exist, with the necessary tools to effectively carry out their functions. The objective is to make these two Recommendations more effective.

53. The key proposals for R.27 are that: (a) there should be designated law enforcement authorities responsible for ML/TF investigations within the framework of a national AML/CFT strategy; (b) for major proceeds generating offences (at a minimum), law enforcement authorities should pursue proactive financial investigations in parallel to the investigation of the offence, and should be able to make use of specialised multi-disciplinary groups for the purpose; (c) competent authorities should be responsible for ensuring prompt action to identify criminal assets and to initiate action to seize and freeze such property. As regards R.28, the key proposals are that: (a) competent authorities are able to use a wide range of investigative techniques for ML/TF investigations, which at a minimum should include undercover operations, intercepting communications, accessing computer systems and controlled delivery; (b) countries should have effective mechanisms in place to identify in a timely manner whether persons hold or control accounts; (c) competent authorities should have a lawful process to identify assets without prior notification of the owner; and (d) competent authorities conducting ML/TF and other investigations should be able to request relevant information held by the FIU.

## 8. USEFULNESS OF MUTUAL EVALUATION REPORTS

54. FATF Mutual Evaluation Reports are intended to be used by the private sector and other stakeholders, as well as the FATF and its members, as a key source of information and analysis about national AML/CFT systems and their implementation. In the lead up to the 4<sup>th</sup> Round, the FATF will consider how the value of reports could be improved, both with respect to how they are used within the FATF, and how they could be made more useful to the private sector and others. Initial consideration has identified a number of issues which the FATF will consider, including:

- The focus of mutual evaluations, which has an impact on the overall length of reports. Reports could be made shorter, e.g. as a result of more focused evaluations which did not examine every recommendation in as much detail, or by including less background information.
- The executive summary. The contents of the executive summary could be adjusted to more clearly set out the overall level of compliance, and the key strengths and weaknesses, and include the most critical information for readers, potentially as a stand-alone document.
- Risk information: The content and structure of reports could give more emphasis to risk factors and how they are or could be mitigated, and such information could be the basis for readers' own risk assessments.

- **Timeliness.** The duration of the Mutual Evaluation process means that the publication of reports takes place some time after information is gathered. The FATF will consider whether this is a problem and whether the length of the evaluation process can or should be shortened.
- **Structure.** Could the structure of Mutual Evaluation reports be improved to make them easier to understand and navigate?
- **Sectoral Information.** Reports could include additional information in specific areas, e.g. for those recommendations which apply to several different types of actor (banking, securities, insurance, etc), conclusions on risk and compliance could potentially be set out for each type of institution.

55. In order to inform the FATF's work on these issues, it would be valuable to receive views on the proposals above, and on the following general questions:

- a) Do you use FATF reports and, if so, how?
- b) Which elements or features of current reports are most useful, and which least useful?
- c) How would you like to see the FATF's reports improved?

#### *The public consultation*

56. The FATF wishes to receive the views of all interested parties on the proposals contained in this paper. Comments should be received, in English or French, by the FATF Secretariat no later than Friday 7 January 2011, and if possible the comments should be sent electronically to: [fatf.consultation@fatf-gafi.org](mailto:fatf.consultation@fatf-gafi.org). Persons providing comments should note that comments received will be made publicly available unless they request otherwise.

**ANNEX 1: TABLE OF ACRONYMS**

AML/CFT	Anti-Money Laundering / Counter Financing of Terrorism
CDD	Customer Due Diligence
DNFBP	Designated Non-Financial Businesses and Professions
FATF	Financial Action Task Force
INRBA	Interpretive Note on the Risk-Based Approach
ML/TF	Money Laundering / Terrorist Financing
PEP	Politically Exposed Person
R.	Recommendation
RBA	Risk-Based Approach
SR.	Special Recommendation
SRO	Self-Regulatory Organization
UNCAC	United Nations Convention on Corruption 2003
UNSCR	United Nations Security Council Resolution