

MEMO# 24724

November 19, 2010

FATF Review of Recommendations in Preparation for the 4th Round of Mutual Evaluations; Call on December 7th at 2 PM EST

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TO: AML COMPLIANCE WORKING GROUP No. 17-10 RE: FATF REVIEW OF RECOMMENDATIONS IN PREPARATION FOR THE 4TH ROUND OF MUTUAL EVALUATIONS; CALL ON DECEMBER 7TH AT 2 PM EST

In October 2010, the Financial Action Task Force ("FATF") issued a Consultation Paper ("Paper") seeking input on a list of issues to be considered in reviewing the FATF 40+9 Recommendations ("Recommendations" or "Standards") in preparation for the 4th Round of Mutual Evaluations. [\[1\]](#) The Recommendations, endorsed by more than 180 countries and jurisdictions, have been recognized as the international standard for anti-money laundering measures and combating the financing of terrorism ("AML/CFT"). Comments are due January 7, 2011. Any revisions are expected to be issued by October 2011. The Institute intends to submit a comment letter.

FATF intends to use several fundamental principles as the framework for this review, including:

- **Focused Exercise:** FATF will prioritize issues identified during the 3rd Round of Mutual Evaluations and will seek to balance the desirability of maintaining stability in the Standards with the need to address new or emerging threats.
- **Inclusiveness, Openness and Transparency:** FATF's review will allow for the full involvement of interested parties, including close engagement with the private sector.

- Increased Focus on Effectiveness: FATF's review will emphasize effective implementation of the AML/CFT requirements by countries, which could result in a restructuring of the evaluation process with greater focus on risks and vulnerabilities faced by particular jurisdictions.

Key Proposals

FATF is seeking comment on the following areas:

- Development of a single comprehensive statement on the Risk-Based Approach ("RBA") that mandates, among other things, that the measures taken to manage and mitigate the risks depends on the level of Money Laundering/Terrorist Financing ("ML/TF") risks identified.
- Clarification of Customer Due Diligence ("CDD") requirements regarding legal persons and arrangements, and of measures in relation to beneficial owners.
- Adoption of measures based on whether the customer is a foreign or domestic Politically Exposed Person ("PEP") and reviewing obligations with respect to family members and close associates of PEPs.
- Changes in areas concerning third party reliance such as its sectoral coverage (i.e., who can rely and who can be relied upon), the delineation between third party reliance and outsourcing or agency, and intra-group reliance.
- The inclusion of tax crimes as a designated category for a predicate offence for money laundering.
- Other issues, e.g., strengthening international cooperation agreements.

The Risk-Based Approach and Recommendations 5, 8 and 20

FATF believes that the current RBA may lack clarity and is raised in too many different places in the Standards. FATF, therefore, is considering a single comprehensive statement on the RBA which would be a new Interpretative Note ("Note"). The proposed Note would include the following: (1) obligations and decisions for countries; and (2) obligations and decisions for financial institutions and Designated Non-Financial Businesses and Professions ("DNFBPs"). [\[2\]](#)

Under the Note, a country is expected to take appropriate steps to identify and assess the ML/TF risk for the country. The country's obligation to address the ML/TF risk depends on the level of the risk identified. If a country identifies higher ML/TF risks, it should ensure that its AML/CFT regime addresses those risks, and that financial institutions and DNFBPs apply enhanced measures in relation to the higher risks. In the case of lower ML/TF risks, however, a country may allow financial institutions and DNFBPs to apply simplified measures for certain Recommendations. In limited circumstances, where there is proven low ML/TF risk, a country may exempt financial institutions or DNFBPs from applying certain Recommendations. Authorities are expected to supervise and monitor the implementation of the RBA, including the ML/TF risk assessments, by financial institutions and DNFBPs.

Under the Note, financial institutions and DNFBPs must also take steps to identify and assess their ML/TF risks for customers, countries or geographic areas and products, services, transactions and delivery channels. Financial institutions and DNFBPs should have policies, controls and procedures in place to effectively manage and mitigate their ML/TF risks, which should be approved by senior management and be consistent with national

requirements and guidance. The magnitude of measures taken to manage and mitigate the risks depends on the level of ML/TF risks identified by the institutions. Where higher risks are identified, FATF would expect institutions to take enhanced measures. Lastly, in contrast to circumstances where a country may exempt institutions from applying certain Recommendations, FATF does not propose any specific exemptions to the obligations or responsibilities of financial institutions and DNFBPs.

In addition, FATF believes, after reviewing Recommendation 8, that non-face-to-face relationships and transactions should be a ML/TF risk factor considered by financial institutions and DNFBPs when assessing the specific risk associated with a transaction or business relationship. FATF is also considering more explicit requirements relating to ML/TF risks that may arise due to the development of new products and business practices, including new delivery mechanisms. FATF proposes to require financial institutions and DNFBPs to have procedures in place to enable them to effectively manage and mitigate such risks. In addition, FATF proposes clarifying that countries should assess the potential risks arising from new technologies and inform financial institutions and DNFBPs of these risks.

Recommendation 5 (Customer Due Diligence)

The main changes proposed in Recommendation 5 relate to Interpretative Note 5 (“INR 5”) and address the RBA and requirements regarding legal persons and arrangements. The revised INR 5 sets forth a flexible approach to the implementation of the RBA, but requires CDD measures that are appropriate or commensurate to the ML/TF risks.

For CDD, FATF is proposing to reorganize the measures and information needed for customers that are legal persons or arrangements and explicitly require the collection of information on the details of the “mind and management” of the legal person or arrangement. FATF is also considering the clarification of measures relating to beneficial owners for legal persons and arrangements. For beneficial ownership, FATF’s intention is to clarify that required information will vary according to the ownership and control structure of the customer. FATF states that the current approach to beneficial ownership has typically focused on an ownership or control relationship. However, FATF believes that ownership interests can be so diversified that there are no natural persons exercising effective control of the legal person or arrangement through ownership. Accordingly, FATF proposes that:

1. financial institutions identify and take reasonable measures to verify the identity of the natural persons who ultimately have a controlling ownership interest;
2. where the ownership interest is too dispersed to exert control, or there are other persons who have control of the legal persons or arrangement, financial institutions should identify and take reasonable measures to verify other persons that have effective control through other means, e.g., by exerting influence over the directors of a company; and
3. if there are no other persons identified as beneficial owners, then the beneficial owners may be the “mind and management” as initially identified.

FATF is also considering CDD measures for persons acting on behalf of a customer. Under current FATF Standards, financial institutions are required to verify that a person is authorized to act on behalf of a customer only when the customer is a legal person or

arrangement. FATF, however, believes that this verification is an important component of CDD measures for all customers. FATF therefore is proposing that financial institutions confirm that persons seeking to operate a customer's account have the proper authority to do so.

Recommendation 6 (Politically Exposed Persons)

Recognizing that money laundering risks differ if a customer is a foreign or a domestic PEP, FATF is considering the following:

1. making no changes to the current FATF requirement for foreign PEPs, i.e. foreign PEPs are always considered to be higher risk;
2. requiring financial institutions to take reasonable measures to determine whether a customer is a domestic PEP; and
3. requiring enhanced CDD measures for domestic PEPs if there is a higher risk.

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, FATF proposes to focus on cases where the PEP 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 in such a relationship.

Recommendation 9 (Third Party Reliance)

FATF is proposing changes in the following areas with respect to Recommendation 9:

1. the scope of coverage, i.e., who can rely on a third party and who can be relied upon;
2. improving the delineation between third party reliance, outsourcing, and agency; and
3. intra-group reliance.

Although FATF believes that each country should have the flexibility to determine whether reliance on a third party is allowed for financial institutions or DNFBPs, FATF is considering extending a country's discretion regarding the types of third parties that can be relied upon and to expand the scope of such entities. For example, FATF is considering whether it should permit reliance on a broader range of institutions, businesses or professions as long as they are subject to an AML/CFT requirement and to effective supervision or monitoring.

FATF admits that there is no clear test for differentiating between reliance, outsourcing and agency. FATF notes that, in particular, outsourcing and agency differ from one country to another and in some cases from one financial activity to another. Nevertheless, FATF states that there is support to clarify what constitutes outsourcing or agency relationships as compared to reliance on third parties. Rather than providing a definition for each of the three concepts, FATF proposes to better define or describe what constitutes third party reliance through what is described as a "functional definition" with a set of positive or negative elements describing situations or elements that are characteristic of a reliance relationship. For example, a third party in a reliance setting usually has an existing relationship with the customer, independent from its relationship with the relying entity and applies its own procedures to perform CDD. While in an outsourced or agency relationship,

the outsourced firm would apply CDD measures on behalf of the delegating firm in accordance with that firm's procedures and subject to the delegating firm's control over, and monitoring of, the implementation of those measures by the outsourced firm.

Lastly, with respect to intra-group circumstances, FATF supports a more flexible approach for reliance when the third party is part of a financial group. FATF therefore is considering encouraging countries to require financial groups to have an AML/CFT program at the group level, applicable to all branches and majority-owned subsidiaries and appropriate to the businesses of the branches and subsidiaries. FATF is also proposing that third party reliance not be limited to third parties that are based in countries that adequately comply with the FATF Standards. In addition, in the case of reliance between firms in the same financial group with effective group level supervision, reliance also would not be limited to intra-group firms in FATF compliant jurisdictions.

Recommendation 1 (Tax Crimes as a Designated Category of Predicate Offence for Money Laundering)

FATF proposes to amend the list of designated categories of predicate offence for money laundering to include tax crimes. Specifically, FATF proposes to clarify the current designated category of "smuggling" by referring to "smuggling (including in relation to customs and excise duties and taxes)" and to add a separate designated offence category "tax crimes – related to direct taxes and indirect taxes." For the private sector, the key result of this change will be in relation to Recommendation 13 and the obligation to report suspicious transactions, meaning transactions related to the laundering of the proceeds of tax crimes would have to be reported as suspicious transactions.

Special Recommendation VII and its Interpretative Note VII

FATF is considering amendments to Special Recommendation VII and its Interpretative Note VII to enhance the transparency of all types of wire transfers (other than those exempt from Special Recommendation VII) including, for example, serial payments [\[3\]](#) and cover payments. [\[4\]](#) Special Recommendation VII requires financial institutions when processing cross-border wire transfers above a de minimis amount to include full originator information. It is also expected that institutions will include certain beneficiary information necessary to execute the transaction. To increase the transparency of the international payments system, FATF is considering incorporating beneficiary information into the international AML/CFT standard governing cross-border wire transfers. FATF sets forth three types of beneficiary information: (1) information to execute the transaction, i.e., beneficiary's account number; (2) customarily included information, i.e., name; and (3) additional information not required to execute, i.e., beneficiary's address, date of birth or place of birth. FATF recognizes that, unlike originator information, ordering institutions are not in a position to verify a beneficiary's identification information since the beneficiary is not a customer of the ordering institution. FATF seeks input on: (1) whether financial institutions require accurate information on beneficiary names to process a transaction; (2) whether it would be feasible and useful in managing ML/FT risks associated with the beneficiary for the institution to have additional beneficiary information; and (3) what additional beneficiary information could be required that would be feasible, useful to financial institutions, practical for originators and proportionate (so as not to push transactions under ground).

Consideration is also being given to incorporating into the international standard an obligation to screen all wire transfers in order to comply with United Nations Security Council Resolutions to combat terrorist financing, i.e., to identify and freeze terrorist financing-related transactions. FATF seeks input on: (1) whether institutions screen all wire transfers, including when they are an intermediary in the chain; (2) what actions are taken if there is a hit; (3) if there is beneficiary information in the message, how current processes might differ with respect to hits on beneficiary information versus hits on originator information; and (4) when screening wire transfers, whether financial institutions detect incomplete fields and, if so, how they react (e.g., file a suspicious activity report, process or suspend the transaction, request more information, etc.).

Generally FATF is seeking input whether there is a basis for making distinctions on the application of these requirements in different market contexts (such as where the payment provider of the originator is also the payment provider for the beneficiary). FATF also seeks comment on whether more guidance is needed in applying Special Recommendation VII to new payment methods.

Other Issues Included in the Preparation for the 4th Round of Mutual Evaluations

FATF also is 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 authorities (Recommendation 40) and clarifying that these requirements equally apply for ML and TF situations. FATF is also considering revisions to strengthen 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.

We will hold a conference call on Tuesday, December 7th at 2p.m. Eastern time to discuss the Paper. The dial-in number is 888-469-0504 and the passcode is 31059. If you plan to participate on the call, please r.s.v.p. to Ruth Tadesse at rtadesse@ici.org or 202-326-5836. If you are unable to participate on the call, you may contact Eva Mykolenko at emykolenko@ici.org or 202-326-5837 to discuss the Paper and your comments or concerns.

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endnotes

[1] FATF-GAFI, Consultation Paper: The Review of the Standards – Preparation for the 4th Round of Mutual Evaluations (October 2010), available at <http://www.fatf-gafi.org/dataoecd/3/30/46266717.pdf>. The purpose of the mutual evaluations is to assess, with respect to each member, whether the necessary laws, regulations or other measures required under FATF standards are in force, that there has been proper implementation of the measures and that the system in place is effective. The evaluations are conducted by the FATF Secretariat and a team of experts. Findings are compiled in a mutual evaluation report, describing the system in place and an assessment

and rating for effectiveness.

[2] Common examples of Designated Non-Financial Businesses and Professions include casinos, real estate agents, dealers in precious stones and precious metals, lawyers and accountants.

[3] A “serial payment” is a direct sequential chain of payment, of the type originally contemplated by the Special Recommendation 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.

[4] A “cover payment” is 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.

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