What is FATF and what is it for?

JULY 2023

EXECUTIVE SUMMARY

FATF GAFI

Researcher: Alí José Daniels Pinto

1. The Financial Action Task Force (FATF) is largely unknown in the sphere of civil society, particularly among non-profit organizations (NPOs). Despite its influence, it affects their performance, especially in autocratic countries.
2. The FATF is an international organization made up of the world's States and dedicated to the fight against money laundering and terrorist financing; it is, therefore, responsible for monitoring the financial system, both internationally and in each member country.
3. Although the work areas of civil society's different expressions are very diverse and deal with several other issues, they have a common element: they need to use the financial system to make each initiative become a reality.
4. The use of FATF policies in the fight against money laundering and terrorist financing has generated all kinds of reactions against organized civil society by autocratic States, using its premises to persecute, stigmatize and criminalize it.
5. In the 1980s, the issue of organized crime was on the agenda, primarily because of drug trafficking. In its preamble, the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances recognized that this was "an international criminal activity whose suppression requires urgent attention and the highest priority" and that "the eradication of illicit traffic is the collective responsibility of all States" so that, to achieve this goal, "coordinated action within the framework of international cooperation is necessary."
6. The most worrying expression of international crime is money laundering, which is nothing more than passing off as legitimate the capital generated by illicit drug trafficking and other crimes.

7. Laundering intends to give an appearance of legitimacy to money or goods obtained illicitly, which implies that this capital is always kept within the wealth of the person who carries out this concealment work, either directly through assets or accounts in his name or under the name of front men or legal persons.

8. The above definition makes it clear that this figure is generally not applicable to NPOs that receive contributions from private or governmental sources to be used for the different projects they carry out. Thus, these contributions are not kept within the assets or structure of the NPO, its representatives, or donors.

9. For an NPO to be used to launder capital, the following should apply: a criminal organization transfers to an NPO the proceeds of the illicit activities it commits, and the latter, in turn, passes them on to false beneficiaries, who are in reality front men for the donor organization, who then channel them to licit activities.

10. The FATF was created at the G7 summit in 1989, where it was decided to create a working group without the need for a prior international treaty, with the following commission:

> Evaluate the results of cooperation already undertaken to prevent the use of the banking system and financial institutions for money laundering purposes and consider additional preventive efforts in this field, including adaptating legal and regulatory systems to improve multilateral legal assistance.

11. The group departs from the institutionality of the United Nations (UN) or other international organizations of the same nature because the FATF was not created through an international treaty, but by the agreement of a group of countries, in addition to initially having a temporary and straightforward advisory nature in the fight against money laundering. However, its commission has been extended over the years until it was left open in 2019.

12. The FATF defines itself as "an independent intergovernmental organization that develops and promotes policies to protect the global financial system against money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction." However, this description falls short because, in addition to setting policies, the FATF also evaluates and rates the member's actions or lack concerning to the scope of its commission, and sets sanctions, although it does not call them as such, in cases of non-compliance.

13. Despite the irregularities pointed out, the FATF has been successful; the proof is that it groups more than 200 governments and "jurisdictions." The latter term refers that it includes not only independent nations, but also autonomous regions (such as the Turks and Caicos Islands) and other countries whose recognition is under discussion in the international community, such as Taiwan or Palestine. In its latest annual report, it counts a total of 210 members.

14. Another striking fact is related to compliance with its recommendations. According to its 2021-2022 Annual Report, there was an average technical effectiveness of 73% among members, although, as we shall see, this is different concerning the standards linked to NPOs.

15. The FATF has its headquarters in Paris and is made up of 39 member countries, one of which, the Russian Federation, is currently suspended, and 9 associate members, including regional groupings of the FATF itself, such as GAFILAT (Financial Action Task Force of Latin America, with 17 members) and the CFATF (Financial Action Task Force of the Caribbean, with 24 members, including Venezuela).

16. As for its internal structure, the FATF is composed as follows: the Plenary; the President (assisted by a Vice-President), the Steering Group; and the Secretariat. This structure is replicated in regional organizations such as the CFATF, of which Venezuela is a member.

17. The Plenary is the highest body of the FATF and is made up of the members and organizations that are part of the FATF network. In the Plenary, decisions must be taken by consensus, so there are no formal votes but rather negotiations. The Plenary determines the organization's agenda, its budget and organizational chart, the acceptance of new members, and appoints its President and Vice-President. It also approves the organization’s standards, guidelines, reports, and work programs.

18. The President, who serves a two-year term, convenes and chairs the Plenary and Steering Group sessions and supervises the FATF Secretariat. The President is the main spokesperson for the organization, represents it internationally, and is empowered to make all decisions to achieve its goals, but always following the instructions of the Plenary.

19. The Steering Group is a consultative corp whose composition is decided by the Plenary at the proposal of the Chairman, and its composition shall take "into account a balanced representation in terms of geographic regions." Among its duties are:

    a) Monitor and guide the progress of the FATF's work;

    b) Promote coordination among the working groups;

    c) Ensure the adequate flow of information among all Members; and

    d) Carry out any other work necessary for the FATF to fulfill its mandate after consultation with the Plenary.

20. Of the bodies mentioned, the most striking, due to the lack of information, is the Steering Group, since the official FATF documentation does not indicate the number of its members or who makes it up. A search for this group on the official FATF website yields only seven documents that barely mention it, without providing any information on how its composition is determined, or who its current members are.

21. The organization's main standards are the so-called 40 recommendations, which since their creation in 1990, have undergone several modifications and extensions. Their last general revision dates back to February 2012, although there have been occasional changes since then, the most recent being in November 2022.

22. FATF defines NPOs as "a person or legal structure or organization primarily engaged in the raising or disbursement of funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes or the performance of other types of "good works."

23. FATF Recommendation Number 8 stipulates that

    Countries should review the adequacy of laws and regulations relating to non-profit entities that the country has identified as vulnerable to terrorist financing abuse. Countries should establish targeted and proportionate measures, in line with the risk-based approach, to such non-profit organizations to protect them from abuse for terrorist financing, including:

    (a) by terrorist organizations presenting themselves as legitimate entities;

    (b) to exploit legitimate entities as conduits for the financing of terrorism, including to escape asset-freezing measures; and

    (c) to hide or conceal the clandestine diversion of funds intended for legitimate purposes to terrorist organizations.

24. The recommendation concludes that not all NPOs are vulnerable to being used or exploited to finance terrorism. Hence the State must identify those that are. Therefore, any generic qualification in that context involving all organizations is contrary to Recommendation Number 8.

25. The identification of those NPOs that are vulnerable is not left to the discretion of the State, as this must be done after a risk-based analysis. Thus, for example, an NPO that receives only public funds, whose risk is practically nonexistent, differs from one that receives its budget from an anonymous account in a tax haven.

26. Once the risk analysis objectively imposes the need for a measure, both the determination of what it should be and its imposition is not subject to the free will of the State but is conditioned, per Recommendation No. 8 (R8), to be targeted and proportionate.

27. The interpretative note to FATF Recommendation Number 8 emphasizes the importance of NPOs, as they "play a vital role in the global economy and many national economies and social systems" as the actions of NPOs "complement" the public and corporate sectors "in the provision of essential services."

28. Although the interpretative note recognizes that there have been cases of NPOs being used to serve the purposes of terrorism, measures to combat this possibility "should be targeted and in line with the risk-based approach," as stated in R8, and adds that "such measures should be set in a manner that respects the obligations of countries under the Charter of the United Nations and international humanitarian law."

29. The State cannot make accusations or accusations without complying with the rigor required by the presumption of innocence. Any investigation must respect all the rights derived from the right to due process (right to defense, to be judged by the natural judge, to have legal assistance, among others). Before all this, the environment for exercising freedom of association shall be compatible with international standards on the matter. Any limitation to it is per democratic principles and legal reserve, among other considerations.

30. No less important is the mention of international humanitarian law, which not only implies respect for treaties related to armed conflicts (Geneva Conventions and others), but also other norms, such as the Code of Conduct for Disaster Relief, Article 1 of which states that "the right to receive and provide humanitarian assistance is a fundamental humanitarian principle that applies to every citizen in every country"; Therefore, any action taken to implement Recommendation Number 8 must respect this principle and, consequently, avoid affecting in any way the humanitarian aid provided by any NPO.

31. The FATF is going through its fourth round of mutual evaluations. Just as the 40 recommendations have been evolving, the FATF has been adapting the evaluation process to these changes, including those necessitated by introducing of new elements in the international financial system, such as new technologies or financial products such as cryptocurrencies.

32. The technical compliance evaluation assesses the country's legal and institutional framework as it is relevant to the FATF's specific mandate, i.e., banking, financial and, more specifically, money laundering. Thus, the governance system or compliance with international human rights standards is not evaluated.

33. To assess compliance in this first component, each of the 40 recommendations is evaluated, and the following scale is applied: compliant (C), meaning that there is no deficiency; mostly compliant (MC), which implies that there are minor deficiencies; partially compliant (PC), which is when there are moderate failures; not compliant (NC), when there are significant deficiencies; and not applicable (NA), which applies due to the structural, legal or institutional characteristics of a country.

34. The second component is the so-called effectiveness evaluation, which is the assessment of the implementation of the recommendations and, in particular, the determination of the degree of compliance with the immediate results of their application.

35. According to the FATF website, the procedure for the mutual evaluation is as follows:

    1) The legal and financial experts, who will constitute the evaluation team, are selected.
    2) The country submits information on laws relevant to the FATF mandate and regulations to prevent crimes and abuses against the financial system.
    3) The experts analyze the information.
    4) The assessment team drafts a report to identify areas of interest for the purposes of the on-site visit and submits it to the State.
    5) The State or FATF member may comment on the draft report.
    6) The on-site visit is conducted, which, according to the FATF, may take two weeks.
    7) The assessors draft their findings on the State's implementation.
    8) A draft report includes both the technical and effectiveness evaluation.
    9) The draft report initiates a consultation cycle of consultation with the country under evaluation and the independent experts.
    10) At the end of this cycle, the report is presented to the FATF plenary for approval.
    11) Once approved, the mutual evaluation report is made public.
    12) Follow-up of the evaluation recommendations, which vary according to the outcome of each country, is then initiated.

36. The process described above may take up to one year.

37. Depending on the degree of compliance with the recommendations, there are two types of follow-up: regular and reinforced.

38. Regular monitoring involves the completion of a report three years before the start of the subsequent mutual evaluation and results from considering that a rationally acceptable degree of compliance has been achieved in the previous assessment.

39. Reinforced monitoring, as the name implies, involves more intense monitoring "for countries with significant deficiencies or which are not making sufficient progress."

40. The FATF flags members that do not strictly comply with its recommendations through documents published three times a year. These have been critical to the effectiveness of FATF compliance, and highlight how the term soft law is insufficient to qualify the nature of the FATF's regulatory framework. Thus, by February 2023, the FATF had examined 125 members and flagged 98 for non-compliance. Of these 98 members, 72 had made the necessary reforms to remedy their deficiencies and had therefore been removed from the monitoring process.

41. The FATF has two lists, a black one and gray one, where it lists countries or members that do not fully comply with its recommendations.
42. The first of these lists, formerly known as "public declaration", includes those members with gross deficiencies applying FATF principles and are therefore considered high-risk countries. Thus, the organization asks its members to take measures against the country in this situation, which implies excluding that member from the financial system. As of February 2023, North Korea, Iran, and Myanmar were on this list.
43. The FATF notes that enhanced due diligence measures should allow for "flows of funds destined for humanitarian aid, legitimate NPO activity and remittances."
44. The FATF's International Cooperation Review Group (ICRG) oversees this special monitoring, and reasons for qualifying a country as high risk include: not participating in a FATF-style regional body (FSRB) or not allowing the results of the mutual evaluation to be published in a timely manner; being nominated as such by a FATF member based on specific risks or threats; and having performed poorly in the mutual evaluation.
45. Despite having significant non-compliance to be considered for enhanced monitoring, the gray list includes countries that express their interest in correcting the deficiencies and coordinate with the FATF on the strategy for doing so.
46. Although the countries on the gray list should not necessarily face coercive measures, in practice, the other countries end up imposing controls that create obstacles to trade and exchange, affecting their competitiveness and raising their costs by having to generate more information to support their operations.
47. A study commissioned in 2008 by the European Commission concluded that there was "limited abuse of foundations" and that the UK Charities Commission had reported that "actual cases of abuse have been very rare."
48. The UN Working Group on Combating the Financing of Terrorism recommended that "States should avoid rhetoric linking NPOs to terrorist financing in general terms because it exaggerates the threat and unduly harms the NPO sector as a whole."
49. Finally, a 2010 U.S. Treasury Department report acknowledged that most of the 1.8 million U.S. charities "face little or no risk of terrorist financing."
50. A 2011 study by the Center on Global Counterterrorism Cooperation on FATF member countries' compliance indicated that only 5 of the 159 member countries assessed had complied with R8 (Belgium, Egypt, Italy, Tunisia, and the United States).
51. A further 17 countries received a rating of mostly compliant, and the vast majority (85%) received partially compliant or non-compliant ratings. The latter category represented 69 countries (43% of the total), which describes a dire security situation for NPOs.

52. For Latin America, the situation was even worse. Studies reveal that the 21 members of GAFISUD (now the Latin American Financial Action Task Force [GAFILAT]) were considered partially compliant or non-compliant with R8, and, in the case of the Caribbean Financial Action Task Force (CFATF), this was true of 26 of the 28 member states or jurisdictions.
53. In 2014, the fourth round of evaluation of the 40 recommendations began, and although this process continues, new data is already available. With updated information up to June 6, 2023, the FATF reports that, globally, of the total of 147 countries that have undergone the fourth round of mutual evaluations, 7 (5 %) have complied with R8, 53 have mostly complied, 57 (39 %) have had partial compliance and 30 have not complied at all.
54. Thus, although there was an improvement compared to the situation in 2011, when 85% had partial compliance or non-compliance, a figure that now stands at 59%, this still indicates that this group of countries and jurisdictions continues to be the majority, so although efforts have been made, they should be continued and strengthened.
55. In the case of the Americas, although there are still 13 countries to complete the fourth round, there have also been variations since of the 44 FATF member countries and jurisdictions, only 3 (7 %) have obtained the rating of compliant, 10 (23 %) mostly compliant, 16 (36 %) partially compliant and 15 (34 %) non-compliant.
56. Although the picture is much improved from the dire situation in 2011, where almost all members were in non-compliance with the R8 recommendation, the fact remains that 70% are in between non-compliance and partial compliance, which should continue to be of significant concern.