

Consultation Paper

The Review of the
Standards –
Preparation for the 4th
Round of Mutual Evaluation
Second public consultation

June 2011



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.

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

Consultation Paper, JUNE 2011

Foreword

The FATF has now completed its third round of evaluations, and is currently conducting a review of the 40+9 Recommendations to ensure they remain up-to-date and relevant, and to learn any lessons from implementing and evaluating the current Standards. This is a limited and focused review, seeking to address any deficiencies and emerging threats but to maintain the necessary stability in the Standards as a whole.

Work on this review has been underway for two years, and between October 2010 and January 2011, the FATF undertook a public consultation on the first phase of its review of the FATF Standards. The FATF would like to thank all those who submitted comments. The response to the consultation was very significant, both in terms of the number of submissions received and their content; and the FATF greatly values this input from the private sector and civil society.

Detailed work has continued since then on a second phase of the review of the Standards, and the results of that work are set out in this paper for consultation. The FATF is committed to maintaining a close and constructive dialogue with the private sector, civil society and other interested parties, as important partners in ensuring the integrity of the financial system. Following this consultation we will take the opportunity to have further discussions on the proposed revision of the Standards with the FATF's Consultative Forum later this year. I look forward to seeing our dialogue lead to stronger, clearer, and more effective FATF Standards.



**Luis Urrutia,
FATF President**

Preparation for the 4th Round of Mutual Evaluation

1. The FATF 40+9 Recommendations have been endorsed by more than 180 countries and jurisdictions, are recognised as the international AML/CFT Standards, and have been, or are being, successfully implemented. The FATF has now completed its 3rd Round of Mutual Evaluations, and is completing a review of its Standards. This review, which is taking place over a two-year period, is principally focused on addressing certain issues that have been identified during the 3rd round of mutual evaluations and from the practical implementation of the current FATF Standards.

2. In October 2009, the FATF Plenary agreed on a list of issues to be considered under the preparation for the 4th Round of Mutual Evaluations, and the work on that set of issues has been structured over two years. A public consultation was held in October 2010 based on the preliminary conclusions of the first year of work on the review of the FATF Standards, including the risk-based approach; customer due diligence, in particular measures relating to legal persons and arrangements, and life insurance; Politically Exposed Persons; reliance on third parties and reliance within financial groups; tax crimes as a predicate offense; wire transfers; and the usefulness of FATF reports.

3. A second phase of the review was undertaken between October 2010 and June 2011 and considered the following issues: the risk-based approach in supervision; Beneficial Ownership, including Recommendations 5, 33, and 34; Politically Exposed Persons; data protection and privacy; SRVII and wire transfers; International cooperation in the context of Recommendation 40; and adequate/inadequate implementation of the FATF Recommendations; and the role and functions of financial intelligence units. This document sets out the FATF's current proposals on each of these issues as a basis for comment.

4. The FATF wishes to receive the views of all interested parties on the proposals contained in this paper. Comments (in English or French only) should be sent to the FATF Secretariat **no later than Friday 16 September 2011**, preferably in electronic form to: fatf.consultation@fatf-gafi.org. Contributors should note that comments received will be made publicly available through the FATF Website.

5. The FATF will continue to consider its proposed revisions to the Standards, and the contributions to the consultation process, in the months after September, and will provide substantive feedback on its response to both rounds of consultation when the revised Standards are adopted in February 2012. The FATF expects to commence a new round of assessments towards the end of 2013.

1. *Beneficial Ownership: Recommendations 5, 33, and 34*

6. The current FATF Standards require transparency about legal persons and legal arrangements, including through Recommendation 5 which requires financial institutions to identify the beneficial owners of customers which are legal persons or legal arrangements; and through Recommendations 33 and 34 which require countries to prevent the misuse of legal persons and legal arrangements. However, the generally low level of compliance with these requirements in the third round of mutual evaluations has signalled some problems implementing the measures required.

7. It is not proposed to change the FATF Recommendations on beneficial ownership, but the FATF has sought to clarify what countries and financial institutions are expected to do to implement the requirements; and the types of measures which could be used to ensure beneficial ownership information is available.

1.1 *Recommendation 5*

8. The main change proposed in Recommendation 5 is to specify more clearly the types of measures that financial institutions (and through R.12, DNFBPs) would be required to undertake in order to (a) identify and verify the identity of customers that are legal persons or legal arrangements, and (b) understand the nature of their business and their ownership and control structure. The information that would normally be needed in order to satisfactorily perform these functions would include:

- To identify the customer and verify its identity: - the name, legal form, and proof of existence; the powers that regulate and bind the entity (*e.g.*, the memorandum and articles of association of a company) and the names of persons holding senior management positions (*e.g.*, senior managing directors); and the address of the registered office (or main place of business).
- To identify the beneficial owners of a legal person and take reasonable measures to verify their identity: - the identity of the natural persons (if any, whether acting alone or together) who ultimately have a controlling ownership interest in a legal person. If no natural person exerts control through ownership interests (*e.g.*, if ownership interests are widely dispersed), information would be required on the identity of the natural persons exercising control through other means; or in their absence on the identity of the senior managing official. These requirements would not apply if the customer or its owner is a company listed on a recognised stock exchange and subject to proper disclosure requirements.
- To identify the beneficial owners of a legal arrangement and take reasonable measures to verify their identity: - the identity of the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries and any other natural person exercising ultimate effective control over the trust (including through a chain of control or ownership).

9. The types of information listed above will in effect define what is meant by beneficial ownership, and what should be considered to be adequate information concerning beneficial ownership of a legal person or arrangement.

1.2 *Recommendation 33 – Legal Persons*

10. On Recommendation 33, the intention is to clarify the steps countries should take to ensure compliance – in particular the types of mechanisms which should be used to ensure timely access to beneficial ownership information regarding legal persons. An interpretative note is being considered which

would specify in more detail what is involved in an effective set of measures to prevent the misuse of legal persons, and what should be considered adequate, accurate, and timely information about beneficial ownership. These would include the following:

- The FATF is considering whether:
 - (a) Companies should be responsible for holding both basic information and information about their beneficial ownership (as noted above in the context of Recommendation 5); and that beneficial ownership information should also be accessible in the jurisdiction to competent authorities through one or more other mechanisms, including financial institutions, professional intermediaries, the register of companies, or another body or authority which holds such information (*e.g.*, tax authorities or regulators), or
 - (b) That competent authorities should be able to access beneficial ownership information from one or more of: the company itself; financial institutions, professional intermediaries, the register of companies, another body or authority which holds such information (*e.g.*, tax authorities or regulators); or by using the authorities' investigative and other powers.
- Requiring that certain basic information on legal persons should be available from Registers of Companies, including, at a minimum, the company name, proof of incorporation, legal form and status, the address of the registered office, basic regulating powers (*e.g.*, memorandum & articles of association), a list of directors.
- Preventing the misuse of bearer shares and bearer share warrants by either (a) prohibiting them; (b) converting them to registered shares or share warrants (for example through dematerialisation); (c) immobilising them by requiring them to be held with a regulated financial institution or professional intermediary, or (d) requiring shareholders with a controlling interest to notify the company, and the company to record their identity.
- Preventing the misuse of nominee shareholders by either (a) requiring nominee shareholders to disclose the identity of their nominator to the company and to any relevant registry, and for this information to be included in the register of directors, or (b) requiring nominee shareholders to be licensed, for their nominee status to be recorded in company registries, and for them to maintain information identifying their nominator.

11. Similar measures should be applied to foundations, anstalt, and limited liability partnerships as apply to companies, while for other types of legal person there should be some additional flexibility in interpreting the requirements of R.33. The following types of companies could be exempted from the requirements above, on the basis that they are subject to other requirements that ensure adequate transparency: companies listed on a recognised stock exchange; state-owned enterprises; and financial institutions or DNFBPs which are subject to AML/CFT supervision. Work is continuing on Recommendation 33.

1.3 Recommendation 34 – Legal Arrangements

12. For Recommendation 34, the FATF has broadly the same intention as R.33 – to clarify the types of measures which should be used to ensure timely access to beneficial ownership information, on the basis of the principle that there should be an equivalent level of transparency about the beneficial ownership of trusts and other legal arrangements, as there is about the companies and other types of legal persons. The FATF has also considered whether and how the requirements of R.34 should be applied in those countries whose laws do not provide for the creation of legal arrangements such as trusts. The FATF continues to

work on what would be required by Recommendation 34 and what would be an effective set of measures to prevent the misuse of trusts. This could include:

- Giving trustees a legal obligation to obtain and hold beneficial ownership information about trusts (as noted above in the context of Recommendation 5);
- Ensuring that competent authorities in all countries are able to access information on the identity of the trustee, the beneficial ownership of the trust, and the trust assets from one or more sources including financial institutions and DNFBPs; registries of assets or trusts; or other competent authorities (*e.g.*, tax authorities); of any trusts with a nexus to their country (*i.e.*, where trusts are managed; trust assets are located, or where trustees live in the country).
- Requiring trustees to disclose their status to relevant authorities; and to financial institutions and DNFBPs when entering a business relationship.
- Competent authorities should have powers to obtain information regarding trusts and share it as necessary; and
- Analogous requirements should also apply to other legal arrangements including Treuhand, Fiducie, and Fideicomisos.

13. The FATF will continue work to work on this issue. In particular, the FATF will consider what is the right balance of responsibilities between countries which are the source of law for legal arrangements and those which are not; what scope there is to apply additional measures (*e.g.*, registration) in the countries which are the source of trust law to ensure the availability of beneficial ownership information; and how these requirements should be adapted to the particularities of other types of legal arrangement.

2. *Data protection and privacy: Recommendation 4*

14. The FATF has considered the impact of data protection and privacy on the implementation of AML/CFT measures, and the potential for changes to the Standards to mitigate any conflicts between them. Data protection and privacy rules can in some cases limit the implementation of AML/CFT requirements, and a number of different FATF Recommendations may be affected. The FATF is aware that the interplay between AML/CFT and data protection requirements is of particular concern for international financial services groups seeking to transfer information across borders for consolidated AML/CFT risk management, and has considered how to ensure that such cross-border flows of information are permitted, subject to appropriate safeguards. It was also noted in the course of work on this issue that there is considerable scope to reduce any potential conflicts between AML/CFT objectives and data protection rules in many countries through better coordination.

15. The FATF is therefore considering adding a general requirement to Recommendation 4 that will address the issues raised above, including by requiring that the authorities responsible for AML/CFT and those responsible for data protection should have effective mechanisms in place to enable them to cooperate and coordinate on this issue.

3. *Group-wide compliance programmes: Recommendation 15*

16. Following earlier work on intra-group reliance, the FATF has considered changes to Recommendation 15. It is proposed that financial groups (which are subject to group supervision under the Core Principles) should be required to have group-wide programmes against money-laundering and

terrorist financing; and that these should include policies and procedures for sharing information within the group for purposes of global risk management. It is proposed that, at a minimum, group-level compliance, audit, and/or AML/CFT functions should be provided with customer, account, and transaction information from branches and subsidiaries when necessary for AML/CFT purposes. The FATF has sought to ensure its requirements on this issue are consistent with those of the Basel Committee on Banking Supervision.

4. *Special Recommendation VII (Wire transfers)*

17. On Special Recommendation VII, the objective is to enhance the transparency of electronic funds transfers (EFT), taking into consideration the following:

- SRVII should be applicable to all types of EFT, including serial and cover payments, taking into account the guidance issued by the Basel Committee on Banking Supervision¹.
- Ordering financial institutions (FIs) should be required to include, on all cross-border EFT, full originator information (name, account number or unique transaction reference number, and address, as currently required) and full beneficiary information (name, and account number or unique transaction reference number).
- Intermediary financial institutions (FIs) should be required to screen cross-border transactions in a manner which is consistent with straight-through processing².
- Beneficiary FIs receiving EFT which do not contain full originator or beneficiary information, as required, should be required to take measures that are consistent with automated processes.
- While FIs are expected to verify the identity of and relevant information about their customers³, they are not in a position to verify the identity of parties to a transaction who are not their customer. For example, ordering FIs are not able to verify the identity of the beneficiary. Beneficiary FIs are not able to verify the identity of the originator. Intermediary FIs are not able to verify the identity of either the originator or beneficiary.

18. The FATF is also seeking input on: (i) what types of procedures are currently being used by intermediary FIs for dealing with EFT which lack full originator information as required, and whether any of these procedures are risk-based; (ii) whether and what kind of procedures FIs apply to cross-border EFT to detect whether information with respect to parties that are not their customers is meaningful⁴; and (iii) whether financial institutions apply screening procedures to cross border EFT below the threshold, and if so, how such procedures are applied.

¹ *Due diligence and transparency regarding cover payment messages related to cross-border wire transfers* (May 2009).

² To take freezing action and comply with prohibitions from conducting transactions with prohibited parties, as per the obligations which are set out in the relevant UNSCRs, such as S/RES/1267(1999) and its successor resolutions, and S/RES/1373(2001).

³ Subject to a *de minimis* threshold for verification purposes, absent an indication of higher risk.

⁴ The term *meaningful* is used to describe information which has meaning on its face, but has not been verified for accuracy

5. *Targeted financial sanctions in the terrorist financing and proliferation financing contexts*

19. The main change proposed to Special Recommendation III is to focus entirely on the implementation of targeted financial sanctions (TFS) in the terrorist financing context, as prescribed in United Nations Security Council Resolutions (UNSCRs) 1267 and its successor resolutions, and UNSCR 1373. The obligation to take provisional measures and confiscate terrorist assets in other contexts (*e.g.*, in the course of an ordinary terrorist financing investigation or prosecution) would be made more explicit in Recommendation 3. The objective is not to widen the scope of the existing requirements. It is aimed at updating SR III and its Interpretative Note (INSR III) to explicitly reflect existing obligations to implement relevant UNSCRs that were issued after the current INSR III was adopted in 2003.

20. To implement these obligations, countries should require all natural and legal persons within the jurisdiction, including financial institutions and DNFBPs, to:

- Freeze, without delay and without prior notice, the funds or other assets of designated persons and entities.
- Respect prohibitions on making any funds or other assets, economic resources, or financial or other related services, available, directly or indirectly, wholly or jointly, for the benefit of designated persons; entities owned or controlled, directly or indirectly, by designated persons; and persons and entities acting on behalf of or at the direction of designated persons, unless licensed, authorised or notified or otherwise, in accordance with the relevant UNSCRs.
- Report to the competent authorities of any assets frozen or actions taken in compliance with the prohibition requirements of the relevant UNSCRs, including attempted transactions.

21. Financial institutions and DNFBPs should be subject to monitoring for compliance with the relevant legislation, rules or regulations governing the obligations under SR III. Failure to comply should be subject to civil, administrative or criminal sanctions.

22. The FATF is also discussing whether and to what extent it would be useful to extend similar requirements to TFS in the proliferation financing (PF) context, in line with the relevant UNSCRs (*e.g.*, UNSCR 1718, 1737, 1747, 1803 and 1929), to assist jurisdictions in implementing the targeted financial sanctions requirements of such UNSCRs.

6. *The Financial Intelligence Unit: Recommendation 26*

23. During previous work to update the texts of Recommendations 27 and 28 relating to ‘law enforcement agencies’, it became apparent that the role of law enforcement agencies could not be considered in isolation from that of the ‘financial intelligence unit’ (FIU). Furthermore, it was felt that the current standard relating to FIUs (Recommendation 26 and its interpretative note) did not adequately describe the role and functions that an FIU should have. It was therefore decided to update the Recommendation and interpretative note to clarify the current standard, as has been done for R.27 and R.28. The proposed changes take account of the standards of the Egmont Group of FIUs and focus therefore on the core functions of such units: receipt and analysis of STRs and other information, and dissemination of the results of that analysis. The revised standard takes into account the different types of FIU (administrative, law enforcement or judicial) and is intended to apply to all of them. The proposed interpretative note emphasises the analysis function – including both operational and strategic – and indicates that the FIU should be able to obtain additional information from reporting entities as needed to

perform this function properly. The note also incorporates more detail into the standard in such areas as access to and dissemination of information, information security, confidentiality, operational independence, undue influence and membership in the Egmont Group.

7. *International cooperation: Recommendation 40*

24. The FATF has looked at the exchange of information between competent authorities, and in particular at how Recommendation 40 can be revised in order to ensure more effective cooperation between competent authorities. This work has included clarifying the general principles applicable to all cooperation between competent authorities in general, and detailing the specific modalities for cooperation with their counterparts by FIUs, law enforcement authorities, and supervisors. This includes clarifying the safeguards on the use and confidentiality of the information exchanged; specifying more clearly what information competent authorities, including FIUs, law enforcement and supervisors, should be able to exchange; and describing the channels and mechanisms they should use.

25. Two particular difficulties have hindered cooperation in the past: the imposition of unduly restrictive measures or requirements by some competent authorities, and the lack of mechanisms or powers for some competent authorities to share information with non-counterparts. The FATF proposes to address these issues by setting out modalities for “diagonal cooperation” between non-counterpart authorities; and by prohibiting the use of unduly restrictive measures to constrain cooperation.

8. *Other Issues included in the revision of the FATF Standards*

8.1 *Adequate/inadequate implementation of the FATF Recommendations*

26. The current FATF Standards include several elements to be applied to countries which do not or do not adequately apply the FATF Recommendations, and to business relationships and transactions linked to such countries. These include, in particular, Recommendations 9, 21 and 22.

27. The proposed changes to the risk-based approach set out in the previous phase of consultation include strengthened obligations on financial institutions to identify and mitigate country risks, and these would overlap to some extent with existing obligations within the Standards. The FATF is, therefore, proposing to revise Recommendations 9, 21, and 22 to ensure that they are fully consistent with the risk-based approach. It is proposed that financial institutions should be required to apply enhanced due diligence measures on the basis of the overall risk posed by a country (taking into account its compliance with the FATF Standards), rather than only on the basis of adequate or inadequate compliance with the Standards; and that the type of enhanced due diligence measures applied should be effective and proportionate to the risks. This would take the place of the current requirement to apply “special attention” to countries that do not sufficiently apply the FATF Recommendations.

28. In addition, the FATF proposes to expand the set of examples of actions which countries could take when implementing countermeasures. Countries would not be required to be able to implement all such measures, but should have sufficient scope to enable a flexible response when a country is non-compliant and/or presents a risk to the financial system. The proposed additional examples of countermeasures include: prohibiting financial institutions from relying on third parties located in the country concerned; prohibiting the establishment of subsidiaries or branches or representative offices of financial institutions from the country concerned; enhanced relevant reporting mechanisms; constraining correspondent relationships with financial institutions in the country concerned; and applying increased supervisory examination and/or external audit requirements for branches and subsidiaries of financial institutions based in the country concerned.

8.2 *Risk-based approach in supervision*

29. The FATF has considered how the risk-based approach affects supervision, including risk as a basis for the allocation of supervisory resources, and the supervision of how financial institutions themselves apply a risk-based approach to AML/CFT. It is proposed that a risk-based approach should apply to the supervision of financial institutions and DNFBPs, including by Self-Regulatory Organisations.

8.3 *Further consideration of Politically Exposed Persons;*

30. Further to the consideration last year of the issue of PEPs, the FATF has considered two further issues regarding PEPs: the basis on which additional due diligence should be applied to family members and close associates of PEPs; and whether persons carrying out prominent functions for international organisations should be considered as PEPs. It is proposed that individuals who have been entrusted with prominent functions by an international organisation should be treated in the same way as domestic PEPs. It is also proposed that the requirements for foreign and domestic PEPs should apply equally to family members or close associates of such PEPs. This would mean that enhanced CDD measures would be required automatically for family members and close associates of a foreign PEP, and could be required (on a risk-based approach) for family members and close associates of a domestic PEP.