



High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards

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The FATF dedicates significant resources to examining and mitigating de-risking and financial exclusion, as well as ensuring that countries' measures to protect NPOs from terrorist financing abuse are focussed and proportionate. These efforts include amendments to the FATF Standards in 2012 and 2016 to ensure that they are in line with the risk-based approach (RBA), including measures aimed at protecting NPOs vulnerable to terrorist financing abuse; as well as multiple guidance and best practices papers and continuous engagement with relevant external stakeholders.

Despite these efforts, de-risking and financial exclusion remain challenges for many sectors and run contrary to the RBA promoted by the FATF and core philosophy of the RBA. Moreover, international commentary on these unintended consequences indicate that the FATF Standards and/or their incorrect implementation have an impact in furthering and sustaining these phenomena.

In February 2021, the FATF Plenary agreed to establish a project team to analyse and understand better the unintended consequences resulting from the FATF Standards and their implementation. This project examines the unintended consequences related to four broad themes: (1) De-risking; (2) Financial Exclusion; (3) Undue targeting of NPOs; and (4) Curtailment of Human Rights (with a focus on Due Process and Procedural Rights). The following is a synopsis of the stocktake of these unintended consequences conducted by the project team, informed by existing FATF analysis and significant external input.

This is being published to facilitate further discussion with stakeholders during the second phase of the project. The high-level synopsis summarises a longer stocktake report, which itself brings together existing knowledge from various sources as a basis for policy decisions. As such it is focused on a small number of topics of greatest concern, and is not an exhaustive academic analysis of these phenomena. Nor does not set out a formal FATF position and conclusion on any of them.

DE-RISKING

The FATF has previously defined de-risking as “the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF’s risk-based approach.”¹ De-banking, or the loss of any financial services, may or may not be de-risking depending on the reasons for it. De-risking has contributed to the reduction of correspondent relationships in some countries; as well as narrower access to banking services by MVTS operators and NPOs. The loss of access to financial services represents de-risking if it is not based on a case-by-case assessment of risk and ability to mitigate that risk. De-risking is by this definition inconsistent with a proper application of the RBA promoted by the FATF, which is central to the effective implementation of the FATF Recommendations.

De-risking can result in increased costs of payments and concentration for correspondent banking and remittance services - although the data are unclear on the extent and impact of these phenomena. NPOs may also face delayed and higher cost transactions and some financial transactions may be more likely to take place outside the regulated financial system as a result of de-risking. The effects of de-risking are not evenly distributed: some regions are perceived to be more impacted than other and smaller and more financially isolated economies, emerging market economies, as well as conflict zones, tend to be impacted more significantly.

De-risking results from a range of factors, complex and interwoven, which vary in importance depending on the particular case, but the analysis in the stocktake suggests that profitability concerns are the primary driver and are directly impacted, in some situations, by high compliance costs (including in other areas unrelated to AML/CFT). Improper implementation of AML/CFT requirements and failure to apply the risk-based approach are other contributing factors, although the extent that AML/CFT plays in de-risking is unclear. Other drivers of de-risking also include fear of supervisory actions, reduced risk appetite in banks, and reputational concerns.

It is difficult to identify a direct correlation between the FATF Standards and de-risking in the financial sector, even though failure to implement the risk-based approach of the FATF Standards at the national level could be one of the many drivers of de-risking, in particular for MVTS operators and some NPOs. The stocktake’s analysis suggests that AML/CFT rules are not the main cause of de-risking, but can be a related factor, and AML/CFT improvements can be part of the solution, along with a proper implementation of the risk-based approach. This view is also shared by the FATF’s ongoing work in the context of the G20 roadmap on enhancing cross-border payments. For example, weaknesses in a country’s regulation and supervision may contribute to decisions by financial institutions to cut off customers from that country as banks believe that they cannot effectively manage the risks.

¹ FATF clarifies risk-based approach: case-by-case, not wholesale de-risking, October 2014, www.fatf-gafi.org/documents/documents/rba-and-de-risking.html.

The FATF's extensive work on the problem of de-risking has emphasised clear guidance from regulators and correct application of the RBA as the key elements of our response, including clarifying regulatory expectations on due diligence on correspondent banking. This includes several dedicated guidance documents issued by the FATF, as well as multi-organisation efforts coordinated through the FSB, regional initiatives led by FSRBs, and ongoing work by the IMF and World Bank. The issue of de-risking is also addressed through several strands of the current G20/FSB/CPMI work to improve cross-border payments.

FINANCIAL EXCLUSION

In 2019, the FATF formally articulated in its mandate its long-standing commitment to supporting and promoting financial inclusion. The requirement to implement risk-based and proportionate AML/CFT measures was designed to better allocate resources to mitigate risks and minimise financial exclusion. The FATF Standards, which promote a risk-based approach, make several important steps in this regard.

With the support of new technologies, international efforts have yielded notable progress in encouraging financial inclusion in the last decade. While 1.2 billion people opened a financial account between 2011-2017, there are still an estimated 1.7 billion adults worldwide who do not have a basic transaction account.²

Financial exclusion is a complex problem with a range of reasons why people cannot access or do not use regulated financial services, including many issues outside of the FATF's remit. Examples identified in the stocktake report include poverty, cost of accounts, limited access or digital infrastructure, and trust and privacy concerns.

In general, the misapplication of the FATF Standards, and in particular the failure to use the proportionality that is central to the risk-based approach, can lead to or compound financial exclusion. Rules-based requirements increase inclusion barriers as FIs and DNFBPs are not willing to take on or mitigate the ML/TF risks.

Within the universe of issues that relate to the FATF, the stocktake report identifies two main factors which contribute to financial exclusion. First, implementation issues at the country or private sector level, which leads to the misapplication of the FATF Standards, and in particular, the failure to use the proportionality that is central to the risk-based approach. For example, the risk-based tools within the Standards (such as exemptions and simplifications) are underutilised by the countries needing them the most to expand financial inclusion. Secondly, the FATF's Standards, evaluation processes

² The World Bank, The Global Findex Database, 2017, <https://globalfindex.worldbank.org/>

and other activities do not adequately encourage authorities, the private sector and assessment teams to understand the impact of financial exclusion on ML/TF risks. The FATF Standards are primarily focused on higher risk situations, so that enhanced measures are mandatory in high risk situations, while simplified measures are optional in low risk situations. Simplifications and exemptions are accompanied by conditions and warnings that signal that they should be applied with caution. This is appropriate in the context of the FATF's role as the international standard-setter for measures to combat ML/TF/PF, however it may be that national authorities and the private sector have been deterred by the optional status of simplified measures.

UNDUE TARGETING OF NPOS

In response to ongoing concerns that AML/CFT measures were having a chilling effect on NPOs' legitimate activity, in June 2016 the FATF revised its Standards and Methodology to clarify the subset of NPOs, which should be subject to supervision and monitoring. The revised Recommendation 8 aims to protect NPOs from potential TF abuse while also ensuring that focused risk-based measures do not unduly disrupt or discourage legitimate charitable activities. The Interpretive Note specifically states that "measures to protect NPOs from potential terrorist financing abuse should be targeted and in line with the risk-based approach. It is also important for such measures to be implemented in a manner which respects countries' obligations under the Charter of the United Nations and international human rights law." However there continue to be countries that incorrectly implement the Standards and justify restrictive legal measures to NPOs in the name of "FATF compliance", both unintentionally and, in some cases, intentionally.

The constraints reported to have been applied to NPOs and examined include: (1) intrusive supervision of NPOs; (2) restrictions on NPOs' access to funding and bank accounts; and (3) forced dissolution, de-registration or expulsion of NPOs. Within each of these categories are a variety of restrictions, burdens and requirements that impede the ability of NPOs to operate and pursue their missions effectively, to access resources, and in some cases, to continue their operations.

The FATF's assessment on the global implementation of the RBA in relation to R.8 indicates that most countries are not yet conducting adequate risk assessments of their NPO sector, and fewer are conducting risk-based outreach and monitoring. These findings were further corroborated through a UN report noting that "fewer than 50 per cent of reporting States [to a UN questionnaire] indicated that their approach to NPOs was risk-based and in accordance with international human rights obligations".³

³ UN, Joint report of the Counter-Terrorism Committee Executive Directorate and the Analytical Support and Sanctions Monitoring Team pursuant to resolutions 1526 (2004) and 2253 (2015)

Analysis of Core Issue 10.2 in the 4th round has not included a consistent assessment of whether the measures applied by a jurisdiction avoided “disrupting or discouraging legitimate NPO activities”, nor is it clear how much weight has been given to this factor when rating IO.10 overall. As TFS implementation appears to be determinative in IO.10, this factor may be overshadowed. In the majority of cases, assessments note whether the measures were applied on a risk-basis, but do not consider if the measures were proportionate or focused, thereby impacting legitimate NPO activities.

The stocktake’s analysis concludes that the undue targeting of NPOs in the context of purported or real AML/CFT implementation (both legitimate or otherwise) may be related in some cases to poor or negligent implementation of the FATF’s RBA.

CURTAILMENT OF HUMAN RIGHTS

(WITH A FOCUS ON DUE PROCESS AND PROCEDURAL RIGHTS)

The FATF has not previously systematically studied this issue. Situations have arisen in the course of FATF evaluations concerning the interaction between the FATF Recommendations on combating TF (particularly R.5 and R.6) and due process and procedural rights (e.g. to legal representation, fair trial, and to challenge designations, etc.), which have been considered on a case-by-case approach as they arise in specific country contexts. In addition, the FATF has also been made aware of instances of the misapplication of the FATF Standards, which are allegedly introduced by jurisdictions to address AML/CFT deficiencies identified through the FATF’s mutual evaluation or ICRG process, potentially as an excuse measures with another motivation. This information often comes as a result of stakeholder input or when the attention of the FATF or its members is drawn to a particular issue, such as when another international body is reviewing legislation or actions are taken by national authorities. Analysis in the stocktake has therefore focused on the due process and procedural rights issues most often arising in evaluations or feedback.

The stocktake reviewed the specific provisions relating to due process and procedural rights in the FATF Standards, which include multiple references to relevant human rights and fundamental principles of domestic law (which embed human rights in national legal systems). It noted that there has been an inconsistent consideration of due process and procedural rights in the mutual evaluations conducted to date, though as with other unintended consequences this is not a core purpose of FATF evaluations. For example, most FATF MERs have not included analysis of this topic either in Chapter 1, in the chapters analysing effectiveness, or in the Technical Compliance Annex. The topic of possible infringements or abuses and their link to the FATF Standards has been largely omitted from MERs, even in cases when concerns about such issues have been widely reported by credible and reliable sources.

The analysis explores a number of ways in which misapplication of the FATF Standards may affect due process and procedural rights, including:

- excessively broad or vague offences in legal counterterrorism financing frameworks, which can lead to wrongful application of preventative and disruptive measures including sanctions that are not proportionate;
- issues relevant to investigation and prosecution of TF and ML offences, such as the presumption of innocence and a person's right to effective protection by the courts; and,
- incorrect implementation of UNSCRs and FATF Standards on due process and procedural issues for asset freezing, including rights to review, to challenge designations, and to basic expenses.

PHASE 2 ON POTENTIAL MITIGATING OPTIONS

The FATF's stocktake sought to compile, analyse and understand the nature of possible unintended consequences of the FATF Standards and to identify how, and how much, the FATF Standards and their implementation – legitimate or otherwise - do in fact contribute to these unintended and undesirable outcomes. In general terms, the analysis highlights that the FATF is already actively responding to unintended consequences, with a significant percentage of the FATF's activity and attention over recent years devoted to mitigating de-risking, financial exclusion, and undue targeting of NPOs. However, the FATF will now examine what more can be done to mitigate these unintended consequences, including issues related to due process and procedural rights. This may entail additional guidance, best practices, training, and possible revisions to the FATF's Methodology, Procedures and Standards, as well as continuing engagement on the FATF's work with key external stakeholders.

The FATF is grateful for the significant input from external stakeholders to date and will continue to engage with interested parties as the project progresses.

For more information, see www.fatf-gafi.org