Destination 2018
Towards the FATF Evaluation of the UK

Helena Wood
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Executive Summary

The anti-money laundering (AML) and counter-financing of terrorism (CFT) agenda appears, at least from the rhetoric, to be high on the current government’s agenda. Recent announcements regarding greater measures to increase transparency in property ownership and proposed powers to tackle unexplained wealth suggest that the UK is seeking to challenge its reputation as a haven for global money laundering. But are these efforts enough to achieve the global standard in this field, as set by the Financial Action Task Force (FATF)?

The FATF is responsible for formulating and updating the global standards on AML/CFT and regularly reviews its members’ compliance with these standards, encompassed in the ‘40 Recommendations’, through their peer-review evaluation process. The UK’s compliance with these Recommendations was last evaluated by FATF in 2007. Despite the UK achieving the required FATF standard in a wide range of areas, certain critical aspects of the UK’s financial-sector compliance and supervisory regime, such as customer due diligence requirements, fell short, largely due to the disputed status of the Joint Money Laundering Steering Group (JMLSG) guidance.

By 2009 the FATF plenary deemed the UK to have made sufficient progress on a number of the deficiencies identified, mainly through the transposition into UK law of the EU Third Money Laundering Directive, in the form of the Money Laundering Regulations 2007, and removed the UK from the FATF’s ‘regular follow-up process’.

Based on the resolution of the issues raised by the FATF during the previous evaluation, it might be reasonable to conclude that the UK does not have cause for concern when it next faces the FATF assessors in 2018. But this paper, based on a literature review and a number of interviews with current and former AML/CFT practitioners and policy-makers, notes why this may not be the case for a number of reasons.

Firstly, the status of the JMLSG guidance has not been formally assessed as compliant by FATF; it is merely presumed to meet the standard. If this guidance is not accepted as ‘enforceable means’ by the assessors, a number of the UK’s technical compliance ratings may again be called into question.

Secondly, since 2007 there have been extensive changes to the FATF Recommendations and Methodology. Whereas the criteria on which the UK was judged in 2007 related, in large part, to a review of whether the UK had certain legislative, regulatory and institutional frameworks in place,

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this is no longer the case. Two key changes in the FATF approach represent a significant shift in the assessment criteria, namely the expansion of the ‘risk-based approach’ from a limited component to fundamental cornerstone of the FATF AML/CFT model and the advent of standalone ‘effectiveness measures’ in the form of the eleven ‘Immediate Outcomes’.

On this basis, and coupled with changes in the UK AML/CFT landscape, this paper proposes that, whilst the UK has made reasonable steps to rectify some of the purely technical deficiencies identified in 2007, there is reasonable cause for concern regarding the UK’s ratings in relation to a number of the effectiveness measures. These concerns relate to four main thematic areas: the UK approach to supervision; implementation of the risk-based approach throughout the UK’s AML/CFT regime; public-sector resourcing of AML/CFT response (particularly in the context of government budget cuts); and data and measures of success (with issues over data quality and an outcome- rather than output-focused approach).

Under these themes, this paper highlights five particular FATF Immediate Outcomes (IOs) – which are overarching demonstrations of effectiveness – that may give policy-makers cause for concern in the run-up to the 2018 evaluation. These are:

- IO3 – AML/CFT supervision
- IO4 – Regulated sector compliance
- IO6 – Financial intelligence
- IO7 – Money laundering
- IO8 – Confiscating the proceeds of crime.

This paper proposes that it may be time for some consolidation within the supervisory regime and for the Treasury to consider its role as a guiding hand in the supervisory process; for the regulated sector to ensure it has fully appreciated the risks it is exposed to and is basing its response on this; for the government to reconsider certain public-sector resourcing priorities to ensure the response reflects the risks; and for the government to improve its data quality and measures of success. Furthermore, this paper notes the potential discord between the government’s increased rhetoric on AML/CFT and its review of the UK’s AML/CFT regime by the Better Regulation Executive, a body concerned with reducing regulation.

This paper concludes that policy-makers face significant, but not insurmountable, challenges in the run-up to 2018 if they wish to demonstrate that their approach to AML/CFT is having a demonstrable effect and, in turn, meets the FATF standard. With a more intelligent approach to supervision and compliance, better prioritisation of resources and the forming of a coherent narrative across the public and private sectors, the UK may well reach the internationally-agreed level set by the FATF. This is, however, not assured.

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Introduction

WETHER FOUNDED ON fact or not, the reputation of the UK as a global haven for money laundering is becoming increasingly entrenched and is a cause of concern for a government under pressure to clean up the UK’s financial system and wider ‘regulated sector’,¹ which includes law and accountancy firms and practitioners, trust and company service providers. Adding to this pressure is the forthcoming evaluation in 2018 of the UK’s anti-money laundering (AML) and counter-financing of terrorism (CFT) regime by the international standard-setter, the Financial Action Task Force (FATF).

It has long been recognised that finance is the lifeblood of a range of transnational security threats, such as organised crime, terrorism and nuclear proliferation. It therefore follows that tackling the financial flows associated with these threats and limiting the access of illicit organisations to the licit financial economy is a fundamental tool in enhancing global security – and this requires a common set of global standards. Following increasing concerns regarding the impact of illicit financial flows, at the meeting of the G7 in Paris in 1989 the FATF was established as the body responsible for formulating these standards.

Since this meeting, the FATF has evolved into an independent inter-governmental body that ‘develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction’.² It currently has thirty-six members representing the vast majority of major states in the global financial system. This membership is supplemented by a range of associate members, including the FATF-style regional bodies (FSRBs),³ covering large areas of the rest of the world, and by observer organisations such as Europol and the World Bank.

It is these thirty-six members who have formed a consensus view as to what constitutes an effective AML/CFT regime, and from this have developed the ‘40 Recommendations’.⁴ These Recommendations have been regularly reviewed and updated – most recently in 2012 – since the inception of the FATF and cover legislation, regulation, policy and law-enforcement architecture. The FATF Recommendations have become the global standard for AML/CFT and it is around these that countries are encouraged to frame their domestic AML/CFT regime.⁵

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¹. ‘Regulated sector’ means those bodies who must comply with the UK Money Laundering Regulations 2007. This includes solicitors, accountants, estate agents and trust and company service providers, among other bodies.
⁵. As the UK is subject to the EU Money Laundering Directives described in this paper, implementation of the FATF standards becomes mandatory.
The Evaluation Process

The FATF is not merely a talking shop; it rigorously tests global compliance with standards on a rolling basis through the FATF Mutual Evaluation process. This process involves a panel of experts, selected specifically for the context of each evaluation from FATF members, which visits countries to critically assess their compliance with the Recommendations based on the FATF assessment Methodology (most recently updated in 2013). Following an on-site assessment and subsequent follow-up work, the panel deliver a report highlighting a country’s AML/CFT strengths and shortcomings to the subsequent FATF plenary for debate and approval. Once accepted, the report is publicly available on the FATF website. This process is not new – the FATF is currently undertaking its fourth round of evaluations since 1989.

The implications of the evaluation are mainly reputational; how a country fares in the evaluation process is increasingly taken as a measure of a country’s commitment to tackling the growing complexity of disrupting the access of illicit finance to the licit economy there is no legal sanction available to FATF to force this issue. However, should a country fall short of the standards, the FATF can require it to implement appropriate reforms and report back to the FATF through its ‘regular’ or ‘enhanced follow-up’ process until such time as the standard is met.

In extreme circumstances, where FATF standards are being repeatedly or deliberately flouted, the FATF can add a county to its list of ‘High Risk and Non-Cooperative Jurisdictions’ (otherwise known as the FATF blacklist). Whilst this list has no international legal status per se, in practical terms this means that the leading global financial institutions will apply enhanced risk measures against the jurisdiction, thus limiting the country’s ability to operate in global markets.

The UK 2018 Evaluation

The UK evaluation on-site visit under the fourth round of evaluations is scheduled to take place in spring 2018, with a report to the FATF plenary in the autumn of that year. The evaluation will assess the UK’s technical compliance with the Recommendations and also take a measure of its ‘effectiveness’ under the new ‘Eleven Immediate Outcomes’ (non-technical standards, discussed later). Publication of the report will follow shortly after the plenary. Preparation for the visit will start well in advance of this, with the Treasury submitting its initial preparatory papers to the FATF Secretariat in autumn 2017, six months in advance of the on-site visit.

The UK was last assessed by the FATF under the third round of evaluations in 2007, albeit under the previous set of Recommendations and under a different Methodology. The results of the 2007 evaluation and the new FATF Recommendations/Methodology and their implications for the UK will be explored as part of this paper.

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6. A peer-group meeting held three times a year, involving all FATF members, who must challenge or accept the contents of the report.
Aims and Scope

The overarching aim of this paper is to identify potential challenges and pitfalls facing the UK during the 2018 Evaluation, in particular by highlighting specific examples of where the UK system may not meet the FATF standard.

In order to reach this conclusion, this paper seeks to answer the following four questions:

- What areas of weakness were identified in the 2007 evaluation? What progress has been made to rectify these weaknesses?
- What commitments were made during the 2007 evaluation? Have these been fulfilled?
- What changes have been made to the FATF Recommendations and Methodology (in 2012 and 2013, respectively) and what are the implications of these changes for the UK?
- To what extent might changes in government budgets and policy affect the results of the 2018 evaluation?

This study is based on an extensive literature review, including analysis of the Mutual Evaluation Reports for Norway, Spain, Belgium and Australia assessed under the new Methodology over the past eighteen months. It also draws on a number of semi-structured interviews with current and former practitioners and policy officials, as well as the author’s experience as a participant in the 2007 UK evaluation.

This paper is largely observational rather than prescriptive, but does highlight areas for further consideration by policy-makers.

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7. It is important to note that these Evaluations Reports do not set a precedent for future such reports. Furthermore, the new FATF Methodology is currently under review to ensure it is being appropriately meted out in practice. This review may lead to subtle changes in the criteria and methods under which the UK is assessed.
I. The 2007 Mutual Evaluation of the UK

The UK’s on-site visit under the FATF third round of evaluations took place in summer 2007. The revisions to the FATF Recommendations and assessment Methodology mean that the results of the 2018 evaluation will not be directly comparable (especially given the addition of standalone ‘effectiveness measures’, discussed later). Despite this, significant technical requirements remain in the Recommendations and though the assessors in 2018 will not be bound by the results of previous evaluations, they will draw upon the previous source material in their preparation. On this basis, a review of the 2007 evaluation is relevant to the aims of this paper.

This section will focus on areas highlighted during the 2007 evaluation as technically deficient and will examine the UK’s efforts to rectify these weaknesses. It will also draw attention to some areas where the UK was deemed technically compliant in 2007, in order to inform analysis later in this paper on areas where changes in the UK’s AML/CFT landscape may affect these ratings.

Overall UK Scoring

During the third round of evaluations the UK was assessed against the 2003 ‘40 plus 9 Recommendations’. Overall, the UK was comparatively strong, with thirty-six Compliant (C) or Largely Compliant (LC) ratings. By way of comparison, of the five FATF members evaluated in 2007, the UK received the highest number of C or LC ratings. However, the UK was judged Non-Compliant (NC) on three of the Recommendations and Partially Compliant (PC) on a further ten.

Although some other minor technical deficiencies were noted, the root cause of a large number of the NC/PC ratings related to the regulatory framework and the status of the AML/CFT guidance issued to the financial sector by the Joint Money-Laundering Steering Group (JMLSG). This led to the UK receiving a PC rating in one of the core areas – customer due diligence. Under the third round of evaluations, this was a trigger for the UK to enter the regular follow-up process. Furthermore, deficiencies were highlighted in aspects of the UK’s supervisory regime.

1. Forty recommendations on anti-money laundering and nine ‘special recommendations’ on counter terrorist-financing. The terror-finance recommendations have since been mainstreamed into the updated FATF 2012 Recommendations.
2. Other countries assessed in 2007 were Finland, China, Turkey and Greece.
3. The UK was not alone in this area: of the eighteen evaluations of FATF members between 2006–08 only two countries achieved an LC rating and no countries a C rating.
4. These are set out in the third-round procedures document and differ significantly from the triggers the UK will be seeking to avoid in 2018.
Identified Deficiencies

Financial Regulation: JMLSG Guidance

The AML/CFT oversight of the financial sector in the UK is set out in a tripartite system.

Primary legislation – in the form of the Proceeds of Crime Act 2002 and the Terrorism Act 2000 – sets out the primary offences for non-disclosure of money-laundering suspicions by the ‘regulated sector’ and provides the legal basis for the Money-Laundering Regulations and industry-led guidance (see Box 1).

Secondary legislation – currently in the form of the Money Laundering Regulations 2007 (MLRs) – sets out who is included in the regulated sector and gives details as to the regulatory requirements for AML/CFT which must be followed, and the supervisory powers available in the event of non-compliance with the regulations.5

Box 1: JMLSG Guidance

The JMLSG is made up of the leading UK trade associations in the financial-services industry. It is responsible for formulating industry guidance to support practical implementation of the MLRs. The JMLSG guidance, approved by a Treasury minister, is significant in the UK’s tripartite system in three ways:

- The Proceeds of Crime Act 2002 and the Terrorism Act 2000 require that a court take note of industry guidance when deciding if a reporting entity has failed to meet its obligations to report suspicious activity to the UK authorities
- The Money Laundering Regulations require a court to take note of industry guidance when deciding whether a person has met their requirements under the regulations
- The Financial Conduct Authority (FCA), the regulator for the majority of the financial-services industry, takes industry guidance into account when deciding whether AML/CFT regulatory breaches have occurred.

Both the primary and secondary legislation references ‘relevant guidance’ that is issued by an industry body or supervisor and approved by the Treasury, which should be referred to when considering whether a criminal or regulatory offence has occurred. Guidance is intended to have the force of regulation, but be sector-specific and provide a more granular level of detail as to how the specific sector should implement the MLRs. Industry or supervisor-led guidance is issued by a range of bodies across the AML/CFT spectrum.6 In the case of the financial sector, this guidance comes in the form of the Joint Money Laundering Steering Group (JMLSG) guidance.

The FATF 2003 Recommendations relating to the regulated sector dictated that the basic rules governing AML/CFT compliance should be set out either in ‘law or regulation’ and that more

6. Such as the Law Society for lawyers and CCAB for accountants.
detailed matters could be set out in ‘other enforceable means’. These ‘other enforceable means’ include ‘guidelines, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for non-compliance, and which are issued by a competent authority (e.g. a financial supervisory authority) or a self-regulatory organisation’.8

In the UK, the JMLSG guidance covers a number of the essential standards as set out in the FATF Recommendations. For example, at the time of the 2007 evaluation, the guidance covered the detailed requirements in the FATF Recommendations in relation to customer due diligence, politically exposed persons9 and beneficial ownership. The status of this guidance is therefore vital in UK–FATF compliance terms, and was a disputed point between the UK and the assessors in 2007, the debate was only finally concluded – in the assessors’ favour – at the FATF plenary session in Paris in autumn 2007.

The crux of the assessors’ assertions centred on two issues: firstly, whether the JMLSG could be considered as ‘other enforceable means’; and, secondly, whether the core requirements were set out in ‘law or regulation’. As regards the first, the UK argued that, in practice, the financial industry viewed the guidance as de facto regulation. The courts took the guidance into account when making their judgements and the Financial Services Authority (FSA – now replaced by the Financial Conduct Authority, FCA) took the guidance into account when making regulatory decisions. Yet the assessors took an alternative view, which had a significant and detrimental impact on the UK’s ratings in a number of key areas. The assessors concluded that:

…these guidance notes as a whole cannot be considered as ‘other enforceable means’ as defined by the FATF. However, parts of the guidance are linked to specific Rules, and when those Rules are read inclusively with the guidance, the content of the guidance on those particular points could be regarded as part of the enforceable means. Other parts of the guidance are not linked to specific Rules and are therefore only guidance.10

As the UK system had relied on the JMLSG Guidance as its means of meeting the standards, this ruling led to PC or NC ratings in five areas, including customer due diligence, politically exposed persons, correspondent banking, beneficial ownership and shell banks – all issues still of concern in terms of the UK’s AML/CFT risk exposure. The most significant PC rating was in relation to customer due diligence, a core FATF requirement.

9. This term broadly covers persons currently or previously holding political office or government positions and their relatives and associates.
Customer Due Diligence

The MLRs 2007 contain a high-level obligation that the regulated sector carry out ‘customer due diligence’ on all their customers. In practice this means taking steps to identify a customer and check their identity, by seeking official photograph identification and proof of address.

Where someone is acting on behalf of someone else, the regulated sector is obliged under the regulations to identify the ‘beneficial owner’, the person on whose behalf the transaction is being carried out, or the ultimate owner of the business.

In the FATF 2007 UK Evaluation Report, assessors concluded that while the Money Laundering Regulations contained basic customer-identification requirements further to the Second EU Money Laundering Directive, overall they had some gaps, including a requirement in law or regulation to identify the beneficial owner.\(^\text{11}\)

It was these specific gaps that led the UK to receive its NC rating in this field, leading to its inclusion in the FATF regular follow-up process, which requires members to regularly report back to the FATF plenary on progress to mitigate the deficiencies.

AML/CFT Supervisory Regime

In relation to the FATF Recommendations, the UK is required to have in place a regulatory oversight regime to police compliance with the Money Laundering Regulations. Under this regime, certain sectors are required to be supervised by either state bodies, arms-length bodies or industry-led self-regulating bodies. The 2007 evaluation highlighted some concerns regarding the UK’s supervisory approach.

In relation to the supervision of Designated Non-Financial Businesses and Professions (such as law and accountancy firms or the gambling industry), the analysis was largely confined to whether certain sectors were fully captured by the supervisory regime, rather than whether the supervisory regime was adequate. For example, it was noted that estate agents, trust and company service providers and certain sections of the accountancy sector did not come under the regime’s purview, but that this would be rectified following the transposition of the EU Third Money Laundering Directive into UK law in 2007.

However, more fundamental concerns were raised regarding the supervisory regime for money-service businesses (MSB).\(^\text{12}\) The assessors found that, whilst technically compliant, Her Majesty’s Revenue and Customs (HMRC) supervision was lacking in some areas. For example, the assessors noted ‘minor concerns about the effectiveness of the sector’s supervision due to the large size of this sector particularly exposed to ML [money-laundering] and FT [financing of terrorism] risks.’ They recommended that HMRC should employ more resources to monitor the

\(^{11}\) Ibid., p. 8.

\(^{12}\) The MSB sector includes money remitters, bureaux de change and cheque-cashing businesses.
compliance of the sector with the Money Laundering Regulations. They also raised concerns about the limited sanctions that HMRC could issue against companies or individuals found to be flouting the regulations.

**Significant Areas of Compliance**

Despite the deficiencies identified above, the assessors recognised several strengths in the UK AML/CFT regime. A number of these areas of compliance are notable in the context of this study, particularly in terms of the impact of more recent changes both in terms of the FATF Recommendations and Methodology, and in UK government spending. These areas are:

- The UK law relating to money laundering, under the Proceeds of Crime Act 2002, was noted to be comprehensive in scope and well used in practice. In particular, the assessors highlighted that ‘in England and Wales, the number of investigations, prosecutions and convictions under [the Act] have each been increasing substantially each year since [it] first came into force in 2003.’

- The UK’s system for confiscating criminal proceeds was noted as working well. The assessors commented that ‘the introduction of [the Act] has had a significant and positive impact on the UK’s ability to restrain, confiscate and recover the proceeds of crime. The provisions of the Act, particularly on the criminal confiscation side, appear to be working reasonably well in practice’.

- The assessors found that the UK Financial Intelligence Unit (FIU) substantially met the FATF Recommendation criteria and was well structured and effective. However, the assessors pointed to the FIU’s resources and analytical output as an issue and recommended that ‘the UK FIU could also conduct more proactive [Suspicious Transaction Report] analysis. The FIU now has 97 staff; however the UKFIU should continue to increase its staff, especially its analytical staff’. During the evaluation, the FIU noted its intention to increase its staff to 200.

These results and commitments were, to an extent, predicated on pre-austerity resourcing and budget levels. In this context, Chapter III examines whether momentum in these areas has been maintained.

**Progress since 2007**

Many of the deficiencies noted above – such as technical gaps in the supervisory regime, concerns regarding customer due diligence and the standing of the JMLSG guidance – were rectified with the transposition into UK law of the EU Third Money Laundering Directive, in the form of the Money Laundering Regulations 2007.

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15. Ibid.
16. Ibid., p. 6.
The European Commission has responsibility for drawing up Money Laundering Directives to cover the requirements set out in the FATF Recommendations. EU member states are required to transpose these directives into their national legislation. (The EU’s Fourth Money Laundering Directive was adopted in May 2015 and will be transposed into UK law in 2016 in the form of new Money Laundering Regulations. The Directive aims to bring EU member states up to date with the new FATF standards.)

The Money Laundering Regulations 2007 introduced a range of measures, such as a regulatory compliance regime for estate agents, increasing legislative control over casinos, and measures covering shell banks, politically exposed persons and correspondent banking. They also sought to strengthen the standing of the JMLSG guidance by recognising its significance more specifically in the regulations.

These extensive enhancements to the UK regulatory regime meant that, following evidence presented to the FATF plenary in 2009, the UK was removed from the regular follow-up process because it was judged to have made sufficient progress on Recommendation 5 (Customer Due Diligence) as well as a range of other areas. The FATF UK 2009 follow-up report found that the UK had taken action to improve compliance with customer due diligence requirements and that the implementation of the Money Laundering Regulations 2007 had remedied a number of the identified shortcomings. 17

Although the Money Laundering Regulations 2007 more widely recognised the approved JMLSG guidance – in theory, giving it regulatory significance in the UK AML regime – it is unclear whether this move resolved its status fully as the FATF reserved judgment until the UK’s next evaluation. The follow-up report states that:

> The UK authorities indicate that a significant feature in the UK is that approved guidance is formally recognised in the Money Laundering Regulations and other provisions, and therefore carries a particular legal significance in the UK’s AML regime... However, the Secretariat has not done a full analysis as to whether the guidance now broadly constitutes “other enforceable means” as defined in the AML/CFT Methodology, as the UK agrees this would be considered in its next mutual evaluation.18

**Summary**

The UK achieved some strong ratings in its 2007 FATF evaluation. However, whilst recognising several strengths, the disputed status of the JMLSG guidance led to the UK failing to meet the standard in some core areas. This ultimately led to PC/NC ratings for a number of critical Recommendations and raised questions about the strength of the UK’s AML/CFT regime. The UK government will without doubt be keen to avoid a repeat of these ratings during the 2018 evaluation, particularly during an era of heightened media scrutiny regarding money-laundering risk in the UK.

The Money Laundering Regulations 2007 went some way to addressing certain technical deficiencies noted in the FATF 2007 evaluation, and led the FATF to conclude in 2009 that the UK had made substantial progress in rectifying the identified weaknesses. This, along with the planned transposition of the EU Fourth Money Laundering Directive into UK law in 2016,\(^\text{19}\) should bode well for the UK’s position when it faces the assessors in 2018.

However, a number of other issues must be considered. Firstly, as noted, the status of the JMLSG guidance has not been formally assessed; it is merely presumed to meet the standard. Secondly, the UK must maintain its previously strong standing in the areas of money laundering; the confiscation of the proceeds of crime; and the status of the FIU. Chapter III will consider whether this will be the case in light of the resource constraints currently facing government departments. Thirdly, as Chapter II demonstrates, the criteria against which countries are assessed by the FATF have evolved considerably. The primarily technical compliance standards on which the UK was previously judged are no longer the sole consideration of the assessment process.

II. The 2012 FATF Recommendations

The original FATF Recommendations were drawn up in 1990 and mainly focused on money laundering related to drug trafficking. These Recommendations were revised in 1996 to broaden their scope to other types of crime and, following 9/11, the FATF’s remit was expanded to include terrorist financing with the addition of the ‘Special Recommendations’.¹

The 2012 revision of the Recommendations and the accompanying 2013 assessment Methodology represent a more fundamental philosophical shift in the FATF approach by comprehensively redefining the terms on which a country should be judged.² Prior to 2012, countries were largely judged on a technical basis as to whether legislative and institutional frameworks were in place.³ There are two key changes in the FATF approach, which now require a more ‘active’ form of compliance with the standards:

• Effectiveness measures: Whilst the technical compliance elements remain an essential component of the evaluation process, the 2013 Methodology implemented a second pillar for assessors to consider – that of ‘effectiveness’ measures under the eleven Immediate Outcomes (IOs). This moves the FATF away from their previous primary focus on technical compliance and looks at AML/CFT success in terms of outcomes rather than outputs.

• The risk-based approach: Whilst the 2003 Recommendations contained risk-based elements, the 2012 Recommendations make this approach a fundamental cornerstone and introduce a specific requirement that governments formulate a national risk assessment, which should cascade down into a risk-based approach to supervision and regulated-sector compliance. Furthermore, risk-based elements have been introduced and/or strengthened in a number of other Recommendations and throughout the effectiveness measures.

As will be explored below, whilst ‘effectiveness’ and the ‘risk-based approach’ are not new concepts to the FATF, the elevated position they now take in the evaluation process, and the means adopted to assess them, represent a considerable evolution of the criteria against which the UK was assessed in 2007. Overlaying the findings of Chapter I, an understanding of the fundamental principles behind these core changes helps identify potential challenges for the UK during the 2018 evaluation process.

2. The FATF Assessment Methodology is guidance given to FATF assessment teams on areas to consider when carrying out an evaluation and is an iterative document pointing to specific features to look for in an effective AML/CFT system.
3. Whilst implementation was considered, guidance on methodology and weighting of this was minimal.
Effectiveness Measures: The Eleven Immediate Outcomes

Effectiveness measures now sit alongside the Recommendations as a separate assessment process. As noted, whilst effectiveness was considered as part of the previous evaluation Methodology, the weighting of this element was not clear and assessment guidance was lacking. With this update of effectiveness to a set of standalone measures, the FATF has recognised...
what has long been known to those operating in the criminal economy – that legislation and regulation are only as good as those measures put in place to enforce them.

Countries will continue to be assessed on their technical compliance against the Recommendations. In addition to this, the FATF has devised specific guiding questions in their 2013 assessment Methodology to help the assessment team evaluate effectiveness based on eleven Immediate Outcomes (IOs). These IOs cover a broad set of effectiveness indicators, as shown in Figure 1. Under the new Methodology, countries will be given an effectiveness rating against these eleven IOs. These ratings are High, Substantial, Moderate and Low Level.

Assessing ‘Effectiveness’

What is meant by effectiveness in the FATF context? Effectiveness, in its widest sense, is the extent to which a country’s systems and processes mitigate the risk of money laundering, terrorist finance and proliferation financing, in order to achieve the high-level objective: ‘Financial systems and the broader economy are protected from the threats of money laundering and the financing of terrorism and proliferation, thereby strengthening financial sector integrity and contributing to safety and security’.4

By their nature, the assessment of the IOs is largely subjective. This is to ensure that the effectiveness assessment is based on judgement rather than a one-size-fits-all approach. The Methodology makes clear that the means of assessing effectiveness are fundamentally different to the means of assessing technical compliance.5 Whereas the technical assessment can be seen as following a somewhat formulaic ‘box-ticking’ process, the effectiveness assessment should be more qualitative.

Whilst the final rating should be based on a subjective but informed judgement, the Methodology for assessing effectiveness against each IO sets out a broad framework to assist assessors in making this judgement. The methodological framework for each IO follows the same framework, namely:

- An overarching statement of ‘characteristics of an effective system’: a high-level statement setting out what a hypothetical, effective system would look like
- A set of ‘core issues’ to be considered to determine whether the IO is being achieved: broad open questions which the assessors should consider when making their judgement
- Examples of information which could support conclusions on ‘core issues’: this includes published policies and statistics
- Examples of specific factors which could support conclusions on core issues: this includes evidence of range of systems or processes in place to support achievement of the IO.

Whilst assessors do not have to demonstrate a specific answer to every question set out in the ‘core issues’, in practice demonstrating consideration of the ‘core issues’ is fundamental to

5. Ibid., p. 19.
determining if the IO is being achieved. In the context of the UK 2018 evaluation, it is notable that consideration of adequate resources being in place is noted as a ‘specific factor’ in the assessment methodology for all of the IOs.

**Outcomes not Outputs**

Although assessors are guided by the Methodology to seek statistics and outputs to support their assessment of the core issues, it makes clear that numbers alone do not equate to effectiveness; as stated in the Methodology, ‘assessment of effectiveness is not a statistical exercise’. Numerical results and narratives proffered must be interpreted critically and considered in the context of the country and the risks to which it is exposed.6

This guidance puts an onus on FATF assessors to critically challenge the statistical outputs presented to them by the host nation and to question any presumptions about their effect on reducing the risk of money laundering and terrorist financing. This presents a significant challenge to the assessed country, in a situation where the statistical output indicators are commensurately low, to demonstrate, through a narrative approach, how their approach is effective. For example, during the 2015 evaluation of Australia, assessors marked Australia’s disruption- rather than prosecution-focused approach on IO7 (money laundering) as only ‘moderately’ effective, as they were not convinced that this disruption-focused approach was effective in reducing the risk of money laundering; statistics showed only a (perceived) low level of actual money-laundering prosecutions.7

This demonstrates the significant burden placed on the assessed country by the new Methodology to build in means of measuring and demonstrating effectiveness over and above statistical outputs. As clearly stated in the Methodology, ‘it is essential to note that it is the responsibility of the assessed country to demonstrate that its AML/CFT system is effective. If the evidence is not made available, assessors can only conclude that the system is not effective’.8 How aspects of the UK regime measure up in this regard will be examined later in this paper.

**Relationship with Technical Recommendations**

The 2013 Methodology clearly states that the effectiveness measures are standalone and assessors are not expected to directly judge each of the Recommendations for ‘effectiveness’. It is, however, difficult to completely separate the two, due to the intrinsic links between technical compliance and effectiveness. This is acknowledged by the FATF in the 2013 Methodology: ‘The country’s level of technical compliance contributes to the assessment of effectiveness … It is
unlikely that a country that is assessed to have a low level of compliance with the technical aspects of the FATF Recommendations will have an effective AML/CFT system’.9

In terms of the weight given to the effectiveness measures in the overall evaluation process, the 2013 Methodology is clear that ‘the assessment of the effectiveness of a country’s AML/CFT system is equally as important as the assessment of technical compliance with the FATF standards’.10

The Risk-Based Approach

The second key development in the new FATF approach is the significant expansion of the risk-based approach (RBA). Although the previous Recommendations included risk-based elements and the Methodology allowed for an RBA in certain areas,11 the RBA was not fundamental to the FATF standards. The 2012 Recommendations change this and place the RBA front and centre of the FATF approach to AML/CFT.

Box 3: The Risk-Based Approach

‘The FATF Standards have also been revised to strengthen the requirements for higher risk situations, and to allow countries to take a more focused approach in areas where high risks remain or implementation could be enhanced. Countries should first identify, assess and understand the risks of money laundering and terrorist finance that they face, and then adopt appropriate measures to mitigate the risk. The risk-based approach allows countries, within the framework of the FATF requirements, to adopt a more flexible set of measures, in order to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way’.


Given this new approach, it follows that a starting point from which to begin framing AML/CFT architecture should be an assessment of how the response tackles the risk. This is a challenge for the UK, whose system has developed organically over the years and whose domestic and international risk exposure is complex given its position as a global financial centre. As noted in the UK’s National Risk Assessment on Money Laundering and Terrorist-Financing (hereafter ‘National Risk Assessment’), ‘the size and complexity of the UK financial sector mean it is more exposed to criminality than financial sectors in many other countries’.12

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9. However, the Methodology concedes that there may be limited circumstances where this is the case.
11. Most notably in some areas of financial-sector compliance.
The all-pervading nature of the RBA in the new standards is clear. There are three interlinking elements of the RBA in the 2012 Recommendations and 2013 Methodology:

- Recommendation 1, which specifically sets out that countries demonstrably adopt an RBA throughout their AML/CFT architecture (regulation, investigation, supervision and compliance)
- The risk-based elements of other Recommendations, including (but not exclusively) Recommendations 26 and 28 (regulatory supervision)
- The risk-based elements of the IOs.

This paper considers aspects of the above, including some of the ways in which the evaluation Methodology has been put into practice so far under the fourth round of evaluations. This analysis will inform some of the challenges identified for the UK in 2018.

**Recommendation 1: The Risk-Based Approach**

Recommendation 1 is broad in its scope and demonstrates the all-pervading nature of the RBA in the new evaluation process. The Recommendation components can be précised as:

- Assessment and communication of national risk
- Allocation of supervisory and law-enforcement resources and response according to risk
- Requirement for the regulated sector to take an RBA to comply with AML/CFT requirements.

The founding element of this – the assessment of national risk – is explored in detail below, as it is the degree of success in adopting this measure which will set the context for the UK’s 2018 evaluation.
Box 4: Recommendation 1

‘Countries should identify, assess, and understand the money laundering and terrorist financing risks for the country, and should take action, including designating an authority or mechanism to coordinate actions to assess risks, and apply resources, aimed at ensuring the risks are mitigated effectively. Based on that assessment, countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified.

This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk-based measures throughout the FATF Recommendations. Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions.

Countries should require financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks.’

Source: FATF 2012 Recommendations

Understanding National Risk

The national assessment of risk is the cornerstone from which all other aspects of RBA compliance are judged. For example, without an accepted assessment of risk, the decisions on allocation of resources at a law-enforcement and AML/CFT supervisory level cannot be made.

As this Recommendation makes clear, understanding the risk alone is not enough; it must be put into practice and this understanding must clearly run throughout the AML/CFT regime as a whole – from informing government decisions on resourcing, to determining the nature and frequency of AML supervisors’ regulatory visits to informing the approach taken by the regulated sector in fulfilling their AML/CFT obligations.13

The FATF does not prescribe the format and style in which a country should formulate and communicate its understanding of risk. Whilst the majority of FATF members, including the UK,14 appear to choose the format of a single national risk assessment – a holistic document setting out a root-and-branch understanding of the risk as a whole – it is not the format but the

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13. The FATF requires that financial and specified non-financial sectors (collectively known as the regulated sector) comply with AML/CFT identification and reporting measures. Their compliance with these measures should be rigorously monitored by supervisors. These can be government, quasi-government or self-regulated bodies, such as trade bodies. These requirements are set out in the UK in the 2007 MLRs.

content which is important. A series of interlinked risk assessments, if well formulated, could equally meet the standard. What is equally essential is that the risk assessment quantifies both domestic and international risk exposure.

The Methodology guides assessors to cast a critical eye on a country’s assessment of the risk it faces and guides the assessors to look at other sources of information to quality-assure this process. As stated in the 2013 Methodology, ‘assessors should use the country’s own assessment(s) of its risks as an initial basis for understanding the risks, but should not uncritically accept a country’s risk assessment as correct, and need not follow all its conclusions’. Whilst the UK’s first National Risk Assessment, published in October 2015, is seemingly frank and honest about the high level of international and domestic risk exposure facing the UK, the government will need to ensure this assessment keeps pace with change in the run-up to 2018.

**Risk-based Elements of the Recommendations and Immediate Outcomes**

Risk-based elements are threaded throughout many of the 2012 Recommendations and 2013 IOs. Analysis of recent evaluation reports under the new Recommendations/Methodology demonstrates that the risk-based elements in the field of supervision (Recommendations 26 and 28 and IO3) have been a specific factor in the low ratings achieved by Norway, Australia and Belgium. The following section of this paper therefore explores this field and draws out some of the results for wider analysis.

**Box 5: Immediate Outcome 3**

‘Supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks’.

*Source: FATF 2013 Methodology*

**Risk-based Approach to Supervision**

An ongoing tenet of the FATF Recommendations is the requirement for a system to supervise and monitor the compliance of the regulated sector with AML/CFT requirements. Whilst many aspects of Recommendations 26 and 28 are analogous to the 2003 Recommendations, the centrality of the RBA to the supervisory response under the current process provides a clear distinction between the two. Whilst the 2003 Recommendations allowed for an RBA in certain circumstances, the 2013 Methodology clearly notes that the frequency and intensity of the

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16. Including but not confined to Recommendations 10 and 22 (customer due diligence); Recommendation 15 (new technologies); Recommendations 26 and 28 (regulated sector supervision); IO1 (risk and co-ordination); IO3 (supervision); and IO4 (regulated sector compliance).
17. Supervision was previously covered by Recommendations 23 and 24 under the 2003 Recommendations.
supervisory visit process should be linked not only to the national understanding of risk, but also to the diversity and size of the sector and the risk profile of individual institutions.

Furthermore, a significant element of the new IO3 (supervision of the regulated sector) focuses on the RBA. The overarching IO requires that ‘Supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks’ [emphasis added].

More specifically, the Methodology guides assessors to question whether supervisors ‘identify and maintain an understanding of the ML/TF risks in the financial and other sectors as a whole, between different sectors and types of institution, and of individual institutions’. It also guides assessors to seek evidence that the frequency, intensity and scope of on- and off-site visits by supervisors relate to the risk profile of the sector.

Box 6: Recommendations 26 and 28 – The risk-based approach to supervision

‘The risk-based approach to supervision refers to: (a) the general process by which a supervisor, according to its understanding of risks, allocates its resources to AML/CFT supervision; and (b) the specific process of supervising institutions that apply an AML/CFT risk-based approach.

Adopting a risk-based approach to supervising financial institutions’ AML/CFT systems and controls allows supervisory authorities to shift resources to those areas that are perceived to present higher risk. As a result, supervisory authorities can use their resources more effectively’.

Source: FATF 2012 Recommendations – Interpretive Notes

Application under the Fourth Round of Evaluations

As Table 1 demonstrates, supervision has been an area of low grading for most countries examined as part of the study.

Table 1: Country Gradings in the Fourth Round of FATF Evaluations

<table>
<thead>
<tr>
<th>Country</th>
<th>Recommendation 26</th>
<th>Recommendation 28</th>
<th>Immediate Outcome 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>PC</td>
<td>NC</td>
<td>Moderate</td>
</tr>
<tr>
<td>Belgium</td>
<td>PC</td>
<td>PC</td>
<td>Moderate</td>
</tr>
<tr>
<td>Norway</td>
<td>PC</td>
<td>PC</td>
<td>Moderate</td>
</tr>
<tr>
<td>Spain</td>
<td>LC</td>
<td>LC</td>
<td>Substantial</td>
</tr>
</tbody>
</table>

For the majority of the low ratings, the implementation of the RBA within the supervisory context was a contributory factor. For example, in relation to the evaluation of Australia, whilst the report concluded that ‘licensing, registration and other controls implemented by Australia to a large extent adequately prevent criminals and their associates from entering the financial...

19. Ibid., p. 96.
sector’, it was marked only Partially Compliant in 2015 – partly due to its understanding of risk. The report noted that ‘materials and other information on ML/TF risks are limited and somewhat outdated’ and highlighted AUSTRAC’s (the Australian Financial Intelligence Unit) perceived failure to understand the risks posed by individual financial institutions.\textsuperscript{20}

In relation to IO3, again the risk-based elements of the Methodology strongly contributed to the lower ratings across the board. For example, the evaluation of Belgium stated that ‘in the financial sector, supervisors have generally identified the main high risks. However, the understanding of the risks is too irregular due to insufficient controls, particularly on-site inspections’.\textsuperscript{21}

Conversely, Spain’s strong ratings in the field of supervision can be more directly linked to its perceived strong focus on risk analysis.\textsuperscript{22} Spain’s comprehensive appreciation of its risks was then deemed to translate fluidly into its subsequent supervisory response, in terms of the tempo and intensity of its supervisory approach to different sectors and individual institutions. This was perhaps aided by the fact that the national risk assessment is undertaken by the same body responsible, in the main, for regulated sector supervision. As noted by the assessors, ‘SEPBLAC’s approach to risk analysis is elaborate. It drives both the risk assessment process and the supervisory approach’.\textsuperscript{23} Having a demonstrable and direct link between the national risk assessment and the supervisory response is vital under the new FATF approach.

**Summary**

Both the implementation of the standalone effectiveness measures and the expansion of the RBA mark a significant evolution in the FATF approach to evaluation. Put simply, countries can no longer seek to rely on technical compliance, through implementation of legislation and regulation, as a means of achieving the FATF standard.\textsuperscript{24}

In relation to effectiveness, it is incumbent on countries to demonstrate clearly how their approach across the system is effective, and not just in numerical terms. Whilst data is one means of demonstrating effectiveness, this must be supplemented by a strong ‘narrative’, in the form of qualitative case studies and impact assessments, and closely linked to the country’s context, particularly its domestic and international risk exposure.

As regards the RBA, this new approach denotes that a starting point for a functioning and effective AML/CFT regime should be an understanding of risk. Whether this is through a single

\begin{itemize}
  \item \textsuperscript{23} FATF, ‘Mutual Evaluation of Spain’, 2014, p. 12. SEPBLAC is Spain’s financial intelligence unit which holds dual responsibility for the national risk assessment and for supervision of many of the sectors denoted by FATF.
  \item \textsuperscript{24} Though, as noted, the 2003 Methodology did consider effectiveness and the RBA to a certain extent, though this was not in a fundamental or standalone way as per the current 2013 Methodology.
\end{itemize}
national risk assessment or through a series of thematic reports is irrelevant – content is key. If this fundamental cornerstone is not put in place effectively, then many other elements, such as supervisory response, fall down.

Furthermore, it is not enough to understand risk. This risk must clearly and demonstrably translate into a response at all levels – namely law-enforcement, supervisory and regulated-sector levels – particularly as regards resource provision and supervisory response.

Understanding these issues in the context of the UK’s current AML/CFT regime, and overlaying them with the findings of the UK’s 2007 evaluation, reveals the challenges facing the UK ahead of the 2018 evaluation.
III. Challenges and Implications

This paper proposes that, through the implementation of the Money Laundering Regulations 2007, the UK has taken reasonable steps to address the technical deficiencies in its legislation and regulation identified in the 2007 evaluation. Subject to clarification of the status of the JMLSG guidance and timely implementation of the EU Fourth Money Laundering Directive, the UK is likely to achieve a high level of positive ratings in relation to the technical compliance elements of the forthcoming evaluation, as set out in the 40 Recommendations.

However, as noted in the UK National Risk Assessment, the size and complexity of the UK regulated sector compared to other jurisdictions gives rise to a high level of domestic and international risk exposure. This, in turn, demands a high level of response from the UK in order to reach the FATF benchmark. This study proposes that, on this basis, the UK faces particular challenges regarding its ratings for a number of the effectiveness measures. This includes areas that were previously noted as strengths in the UK’s AML/CFT regime by the 2007 evaluation.

Four thematic areas merit the attention of policy-makers in the run-up to 2018:

- The supervisory regime
- The implementation of the risk-based approach
- Public-sector resourcing of AML/CFT response in the context of risk
- Data and the measurement of outcomes.

Based around these themes, whilst not covering all potential weak points, this paper analyses five specific IOs, for which the UK is at risk of only receiving a Moderate rating if steps are not taken to strengthen the UK’s approach.

The Supervisory Regime

Following the implementation of the Money Laundering Regulations 2007, the UK’s supervisory regime now covers the vast majority of bodies and professions requiring regulation and supervision under the FATF Recommendations. From a technical perspective the UK is therefore in a reasonably good position. However, the new FATF approach to effectiveness presents some challenges in relation to the achievement of the standard under IO3.

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1. A sub-section of accountancy professionals are currently not subject to supervision.
Immediate Outcome 3

Immediate Outcome 3 requires that ‘Supervisors appropriately supervise, monitor and regulate financial institutions and Designated Non-Financial Businesses and Professions (DNFBPs) for compliance with AML/CFT requirements commensurate with their risks’.²

Whilst the FATF Methodology does not specifically give preference to a unitary over a multi-player supervisory regime, the UK model for supervision could be criticised for its patchwork and fragmented mix of state, semi-autonomous and self-regulatory bodies (SRBs), of which, the National Risk Assessment notes, there are twenty-seven in total. For example, the National Risk Assessment details that the accountancy sector alone has thirteen different supervisory bodies and that, in this sector, ‘a lack of consistency between supervisors is likely to be a vulnerability’.³ Furthermore, it states that Trust and Company Service Providers ‘may be supervised by one of a number of different supervisors (financial services providers, legal service providers and accountancy service providers may all be TCSPs). This presents challenges in ensuring supervision of the sector is consistent’.⁴

Whilst some of the more established supervisors – who have many years of experience in AML/CFT supervision – have considerable expertise and capacity to monitor their sectors, it is perhaps inevitable that capacity and capability is variable across the regulated sector. Creating a consistent or at least comparable approach across this diverse range of players will, however, be a challenge during the evaluation process.

In this regard, there are three specific aspects of the Methodology supporting IO3 that may give policy-makers cause for concern: the measurement of the effects of supervisory approach, the risk-based approach to supervision and resourcing.

Firstly, in its 2013/14 Supervision Report of the AML/CFT regulated sectors, the Treasury ‘recognises that for many supervisors, the focus on measuring effectiveness is a significant change. Maximising the effectiveness of supervisory activities is a difficult and challenging task, but one we are determined to work in partnership with supervisors to achieve.’⁵

Secondly, the implementation of the RBA in the field of AML/CFT supervision has proven particularly challenging to those assessed so far under the new Methodology. It is therefore incumbent on the UK to demonstrate a direct link between the risks identified in the National Risk Assessment, the supervisor’s own assessment of risk and the resources and means deployed at a supervisory level. The size and diversity of the UK supervisory landscape would suggest that demonstrating this is the case, in a consistent fashion, will be particularly challenging. The Treasury’s 2013/14 Supervision Report states:

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⁴ Ibid., p. 52.
Implementation of the risk-based approach varies, and the level of sophistication of the risk-based models adopted by supervisors vary significantly. Some supervisors devote significant time and resource to designing and implementing the approach, others are still in the early stages with a number of supervisors stating that 2013–2014 was a year of transition in which they developed their risk-based approach.6

Furthermore, the October 2015 National Risk Assessment notes that:

The effectiveness of the supervisory regime in the UK is inconsistent. Some supervisors are highly effective in certain areas, but there is room for improvement across the board, including in understanding and applying a risk-based approach to supervision and in providing a credible deterrent. The large number of professional body supervisors in some sectors risks inconsistencies of approach.7

Following from this, the FATF Methodology for IO3 guides assessors to ask ‘to what extent do the frequency, intensity and scope of on-site and off-site inspections relate to the risk profile of the financial institutions and DNFBPs?’ HM Treasury, as the body responsible for appointing AML/CFT supervisors, has already identified this as a challenge as noted in its 2013/14 Supervision Report of the AML/CFT sectors.8 It states that ‘the majority of supervisors also had difficulty articulating how their assessment of risk translates into their monitoring approach, which is a vital step in demonstrating effectiveness.’

Thirdly, the IO3 guidance requires that assessors examine the resources allocated to conduct supervision and monitoring for AML/CFT compliance. It is noted that this should be commensurate with the size, complexity and risk profiles of the sector being supervised. Given the sheer number of supervisors – often there are multiple supervisors for a single sector – glaring inconsistencies are perhaps inevitable. Furthermore, although this report did not gather data in relation to public-sector supervisory resources, presentational issues could result should government budget constraints have an adverse impact on supervisory resources in the run-up to 2018, if this reduction is not linked to a commensurate risk reduction in the sector.

All of these challenges are compounded by the lack of a centralised guiding hand in the supervisory process. Whilst HM Treasury’s role is to appoint and monitor the work of supervisors, the UK does not take a centralised approach to supervision, preferring to leave supervisors to interpret and implement the guidance according to their judgement. Whilst this ensures a sector-specific, rather than a one-size-fits-all approach, it nevertheless presents particular challenges in ensuring consistency across sectors. This trade-off is inevitable in any multi-player approach to supervision, but is compounded in the UK context by the fact that there are even multiple supervisory bodies within as well as between sectors.

6. Ibid.
Efforts to share best practice and deliver a consistent approach may have improved since the establishment of the AML Supervisors’ Forum, a body set up to aid supervisors in sharing information and best practice. Yet this body is, by its nature, collegiate, and does not have a formal role in monitoring the quality of supervision across the board. The Spanish system, by comparison, was praised during its 2014 evaluation for the strong oversight and co-ordination role played by SEPBLAC in its dual-track supervisory regime. Whilst a more unitary approach to supervision is not necessarily favoured by the FATF, it does remove some of the obstacles to consistency presented by the UK model.

In sum, in the run-up to 2018, it is perhaps time for the UK government to review the supervisory landscape to ensure it remains fit for purpose, especially given the need to ensure a consistent application of the RBA. It may also be time to consider whether twenty-seven supervisors can meet the needs of the more rigorous FATF evaluation process or whether there is scope for consolidation in some areas. Although a reduction in the numbers of supervisors does not necessarily equate to a more effective approach, it does provide an opportunity for greater coherence.

The Risk-Based Approach

Although the UK is a strong advocate of the RBA and used this approach, albeit in a distinct variation, in its regulation of the financial sector prior to the expansion of this concept within the FATF standard, the approach nevertheless poses a number of challenges for the UK.

The UK admits in its National Risk Assessment that ‘the collective knowledge of UK law enforcement agencies, supervisors and the private sector of money laundering and terrorist financing risks is not yet sufficiently advanced’. Beyond this, however, this paper suggests that in the context of the 2018 evaluation, one area in which these challenges may be most keenly felt is in relation to IO4.

Immediate Outcome 4

Immediate Outcome 4 states an obligation that ‘Financial Institutions and DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions.’

The size and scale of the UK financial and DNFBP sector, largely due to the UK’s position as the second-biggest financial centre in the world, leads to a significant domestic and international

9. The Spanish AML/CFT supervisor and FIU holds the supervisory responsibility for all of the regulated sector, supported by a range of government regulators and SRBs. Spain had a single body (SEPBLAC) responsible for AML/CFT supervision working in co-operation with the prudential regulators for each sector.
10. Interview with official, July 2015.
Risk exposure not only in the financial sector but also across the full range of businesses and professions associated with it. Demonstrating a consistent and effective approach towards AML/CFT preventative measures across the board will therefore be a significant challenge in 2018.

This challenge will be felt particularly acutely in relation to the consistent application of the RBA by the regulated sector. Notably, two of the core issues to be considered by the assessors when looking at the effectiveness rating in relation to IO4 relate specifically to risk: the extent to which the regulated sector understands their risks, and the extent to which these institutions apply measures commensurate with them.

The new onus this approach places on individual firms and institutions in the regulated sector – to demonstrate that their systems do not apply a one-size-fits-all or box-ticking approach to AML/CFT, but follow a more active model – is a real challenge in the UK context. Although some sectors with significant AML/CFT compliance resources, such as the major banking institutions in the financial sector, may be able to apply their resources to this new approach by 2018, it will be important to ensure that they have made demonstrable progress away from a so-called ‘de-risking’ approach towards a risk-based approach.13

For example, the commercial secretary to the Treasury notes his concerns in this area in the 2013/14 supervision report for AML/CFT regarding the wholesale exiting of the money-service business sector by a number of prominent banks.14

Even where progress can be demonstrated in the financial sector, it may prove difficult to ensure the consistent application of the RBA across the diverse range of professions within the wider UK regulated sector. In contrast to certain financial-sector institutions’ previously over-enthusiastic application of risk factors under the de-risking approach, this may, in some sectors, manifest itself as a lack of appreciation of the true scale of risks they face. This may be especially pertinent in areas which have only latterly come under the purview of the Money Laundering Regulations 2007, such as the estate-agency sector. The size and breadth of the UK regulated sector perhaps inevitably leads to variations in the extent to which the RBA is adopted both within and between different sectors.

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13. Some sectors of the economy have been deemed to pose an increased risk in AML/CFT. Given the pressure on financial institutions to reduce AML/CFT risk in their activities, this led to the unintended consequence of certain financial institutions choosing to exit, wholesale, their relationships with certain sectors. Particular sectors affected included international charity work and the money-remittance sector. The government and financial institutions have since worked together to seek a solution to this issue. It is important to note that a ‘de-risking’ approach is not deemed by FATF to adhere to the ‘risk-based approach’, which should consider risk in a more nuanced fashion by managing rather than avoiding risk.

Linked to the RBA, an additional measure under IO4 – reporting of suspicious activity\textsuperscript{15} – is worthy of comment in the UK context. Whilst the Suspicious Activity Reports (SARs) regime in the UK is widely seen as no longer serving the aims of the system – namely to detect and prevent money laundering, which has led to the current review of the regime by the Home Office\textsuperscript{16} – in the context of IO4 the inconsistent adherence to the reporting requirements by the regulated sector may be of concern to the assessors.

Criticisms range from allegations of ‘defensive’ reporting by the banking sector, who file a commensurately high number of SARs,\textsuperscript{17} to concerns regarding the low number of SARs filed by others, despite their perceived high-risk status.\textsuperscript{18} For example, recent NCA reporting has highlighted the risk exposure of the UK property market to money laundering and has called on estate agents (those involved in marketing and sales of property) to do more to comply with its obligations. Furthermore, the National Risk Assessment notes that the number of SARs filed by the accountancy, legal and estate-agency sectors is low compared to their risk exposure.\textsuperscript{19} This recent coverage may go some way to elevating the AML agenda in the sector and to raise the number of SARs from a perceived low level. For example, only 179 SARs were submitted by the estate-agency sector in 2014/15,\textsuperscript{20} which is perceived to be low given the high risk exposure the sector faces.

Looking at the IO4 ratings achieved under the 2013 Methodology in the evaluation reports for Belgium, Norway, Spain and Australia, it is notable that no country received more than a Moderate effectiveness rating on IO4. Although reasons varied for this marking, a consistent factor was uneven and inconsistent application of the RBA across the whole of the regulated sector. For example, the assessors noted that Spain’s financial and notary sectors had a highly sophisticated approach to risk, but other areas of the regulated sector had a less-mature understanding.\textsuperscript{21} Belgium’s 2015 evaluation noted that financial institutions had a good understanding of risk, but that the wider DNFBP sector did not consistently appreciate their risk exposure.\textsuperscript{22} This demonstrates that, in FATF-effectiveness terms, one is, to an extent, only as strong as the weakest link within the regime.

In summary, whilst the larger and more mature institutions within the UK regulated sector can perhaps be relied upon to turn their expansive compliance resources towards a risk-based approach, the UK cannot automatically rely on this being consistent across the board. To achieve the required standard on IO4, the UK government should increase engagement with

\textsuperscript{15} FATF Recommendations require that the regulated sector reports suspicious activity to a central state body – in the UK case, the UK Financial Intelligence Unit.
\textsuperscript{18} Interview with official, July 2015.
\textsuperscript{22} FATF, ‘Mutual Evaluation of Belgium’, 2015, p. 8.
less mature elements of the reporting sector through increased sectoral-outreach programmes to give guidance and advice on the application of this new concept and to share best practice. If the government fails to do so, the UK risks following the trend of evaluations so far under the new Methodology and receiving a poor rating in this area.

Resourcing

Whilst resource allocation of budgets and personnel formed a minor component of the technical assessment criteria under the 2003 Recommendations and 2004 Methodology, its centrality to the new effectiveness measures is notable; the Methodology for assessing all eleven IOs guides assessors to ask questions in relation to the adequacy of the resources available to support the specific IO aims.

Furthermore, evaluations under the new Methodology illustrate the need to demonstrate a strong relationship between resources and risks. For example, the 2015 Belgium evaluation made specific comments in this regard in relation to the supervision of diamond dealers. The report stated that whilst diamond dealers were a particular high-risk feature of the Belgian system, ‘supervision of these players remains extremely limited, notably due to a lack of available resources’.23

The forthcoming visit of the assessors to the UK in 2018 is perhaps ill-timed, in light of the budget cuts many departments have faced since 2007. The key government agencies involved in the UK’s AML/CFT regime, such as law-enforcement and government regulators, were not subject to budgetary protection in the previous round of cuts and whilst the chancellor protected current police budgets in his November 2015 autumn spending review statement, considerable reductions in police budgets of around £1.5 billion have been made since 2010.24 Interviews carried out as part of this study indicate that decisions on resource cuts and prioritisation are not directly taking into account the risk-resource requirement set out in the FATF standard. To further compound this issue, commitments were made during the 2007 evaluation regarding expanding resource in certain areas, such as the FIU. These commitments were made before austerity measures were put in place. Whilst skills and technological advances can offset some of the presentational damage this may cause, the effect is likely to be evident in the results.

Even maintaining high outputs in numerical terms in the face of resourcing cuts will not be enough to achieve the FATF standard. Assessors will be encouraged to cast a critical eye over any statistics presented by the UK and, importantly, make a judgement as to the extent that operational outputs deliver desired outcomes. Any perceived selection of less-complex cases to inflate the statistics will therefore be subject to challenge. Within this context, this paper identifies three IOs where resourcing issues may have a direct impact on the UK’s effectiveness ratings: IO6 (financial intelligence), IO7 (money laundering) and IO8 (proceeds of crime).

23. Ibid.
Immediate Outcome 6

Immediate Outcome 6 states the obligation that ‘Financial Intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations.’\(^{25}\) It has two areas of focus: the functioning of the FIU, and the use of FIU products and financial intelligence by the relevant intelligence and investigatory authorities. It is specifically in relation to the functioning of the FIU that concerns have been raised in the context of this study. In particular, the assessors will pose the question of the extent to which FIU analysis and dissemination supports the needs of the authorities, and the availability of resources to support the FIU’s work.

The UK pledged to increase FIU capacity in 2007 – the FATF assessors will be seeking demonstrable progress on this issue in 2018. Most significantly, in 2007 the FIU noted its intention to increasing its staffing level from around 100 to 200.\(^{26}\) This has not yet been fulfilled and staffing levels have actually gone down from ninety-seven in 2007 to eighty in 2015.\(^{27}\) This staffing complement is juxtaposed with the rapid growth in the number of SARs submitted to the FIU, rising from 213,000 in 2006/07 to 316,000 in 2013/14.\(^{28}\) Whilst skills advances might support some limited decline in numbers, interviews carried out during this study suggest that the FIU is struggling to meet the analytical requirements of FATF standards.\(^{29}\) The NCA has publicly recognised the need for reform of the system and is actively engaged with the Home Office on its review of the SARs regime.\(^{30}\)

Furthermore, during the 2007 evaluation the assessors also welcomed the intention to replace the FIU’s main IT system, ELMER.\(^{31}\) The system, much maligned by many in the regulated sector, has still not been replaced despite NCA acknowledgement that the database requires urgent upgrading.\(^{32}\) Plans for an ELMER upgrade are currently under discussion as part of a wider review of the SAR regime. However, the funding base for a new system is far from secure and funding from existing government budgets is unlikely.

Some areas of IO6 could be considered to be world-leading – such as the public–private dialogue established under the Joint Money-Laundering Intelligence Taskforce (JMLIT), which aims to increase specific intelligence-sharing between the public and private sectors to increase operational outcomes.\(^{33}\) But unless resources are prioritised in the run-up to 2018 and a

\(^{26}\) Since then the Serious Organised Crime Agency has been closed down (2013) and the UK FIU moved to the National Crime Agency.
\(^{27}\) Response to request for information, 3 July 2015. No reference given.
\(^{29}\) Interview with official in July 2015.
\(^{31}\) ELMER is the National Crime Agency database used to collect and collate SARs.
budget is allocated for IT investment, the UK will struggle to defend the risk:resource ratio within the FIU model.

Immediate Outcome 7

Immediate Outcome 7 states the obligation that ‘Money laundering offences and activities are investigated and offenders are prosecuted and subject to effective, proportionate and dissuasive sanctions.’ The 2013 FATF Methodology on IO7 is broad and multifarious in order to ensure that the approach to money-laundering investigation and prosecution delivers a real and tangible impact on individual offenders and the criminal economy writ large.

Two aspects of the methodology may prove challenging for the UK in 2018: the guidance to assessors to consider the resources available to investigate money laundering, including the presence of dedicated units; and the need for the assessed country to demonstrate that the range of different types of cases selected for investigation matches the risk profile identified in the National Risk Assessment.

On resources, the Methodology guides assessors to consider investigatory capacity in the context of the national risk profile. Budgetary cuts to police forces between 2010 and 2015 have already had an impact on the ability of the police to investigate a number of types of reported crime, and whilst police budgets were protected in the chancellor’s autumn statement of 2015, these previous cuts still require ruthless prioritisation to ensure police are able to meet their basic policing responsibilities. Where money-laundering investigation will sit as it competes with increasing pressures on police to respond to a growing terrorist threat is unclear.

Interviewees for this study voiced concerns that money laundering may not feature highly during the next round of prioritisation, especially given the increased demands for police forces to meet local priorities following the introduction of police and crime commissioners in 2012. This further compounds the concerns raised in the October 2015 National Risk Assessment that ‘the law enforcement response to money laundering has been weak for an extended period of time. It has not been a priority for most local police forces.’

Regarding the existence of specialist teams, at a regional level the previous ring-fenced funding for Regional Asset Recovery Teams, which deal with cross-police-force money-laundering cases, was brought to an end in April 2015 with the budget being transferred into the general funding stream for the Regional Organised Crime Units (ROCUs) in which these teams are housed. Whilst this means that the individuals in these teams, with their skills and training in financial investigation, will still exist, it increases the risk that they will be used in more generic

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37. Interview with official, July 2015.
law-enforcement work or to bolster the wider work of the ROCU. An interviewee highlighted evidence that this was already happening.\textsuperscript{38}

Since the assessors’ last visit, a key change has been the creation of the NCA in 2013. At a national level, the NCA Economic Crime Command leads and co-ordinates the national response to national and multinational complex money laundering, which could be seen as a positive step forward. However, some interviewees concluded that the skills available to investigate complex money laundering were lacking and that the NCA would struggle, within its current resource allocation, to mount the complex cases it is charged with investigating.\textsuperscript{39}

Furthermore, whilst the assessors will not be purely considering figures as an indicator of success, they will be seeking clear and coherent data to support their conclusions. Interviewees suggest that data quality and data consistency between agencies can be found wanting,\textsuperscript{40} and where these figures are available they demonstrate a decline in numbers, in terms of investigations and prosecutions. For example, figures obtained from the Crown Prosecution Service (CPS) and shown in Table 2 suggest that the number of money-laundering investigations reaching first hearing in the courts is in decline.

Table 2: CPS Cases Reaching Charge and First Hearing in the Magistrate’s Court.

<table>
<thead>
<tr>
<th>Year</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>6,155</td>
<td>5,985</td>
<td>5,783</td>
<td>4,873</td>
<td>4,317</td>
</tr>
<tr>
<td>Change</td>
<td>(-2.8%)</td>
<td>(-3.4%)</td>
<td>(-15.7%)</td>
<td>(-11.4%)</td>
<td></td>
</tr>
</tbody>
</table>


Although raw data does not give a full appreciation of the facts – for example, some may argue that this may reflect more complex cases being taken on, rather than fewer money-laundering investigations being undertaken (this study was unable to analyse the types of cases being investigated) – interviewees suggest that this may reflect a reduction in police or prosecutorial capacity to take on cases. Whatever the reason, this example does illustrate the need for focused, case-study narratives to support statistics if the UK is to meet the standard on IO7.

As regards the guidance to assessors to question whether ‘the types of ML [money-laundering] activity being investigated and prosecuted are consistent with the country’s threat and risk profile’,\textsuperscript{41} the National Risk Assessment notes that a key area is the criminal use of ‘gatekeepers’, such as lawyers and accountants used to facilitate money laundering. Interviews carried out during the course of this study suggest that the UK continues to struggle to investigate and prosecute complex money-laundering cases, particularly of gatekeepers,\textsuperscript{42} in part due to a paucity of skills within law enforcement to tackle this sort of money laundering. This study understands that the NCA is charged with leading the work to identify and investigate these

\textsuperscript{38} Ibid.
\textsuperscript{39} Interview with official, August 2015.
\textsuperscript{40} Ibid.
\textsuperscript{41} FATF, ‘Methodology’, 2013, p. 108.
\textsuperscript{42} Interview with official, July 2015.
gatekeepers, and that the intention is to increase investigatory focus in this area. This, however, remains a challenge, and progress is slow.\textsuperscript{43}

In sum, declining statistical outputs in relation to money-laundering investigation – which may be perceived to be a result of reductions in police and law-enforcement budgets – will mean, at the least, a presentational challenge for the UK when faced with the assessors in 2018. Furthermore, whilst statistical outputs are not the sole measure of success in FATF terms – quality and a link to the risk profile is key – the predicted downturn in money-laundering statistics puts pressure on the UK to form a strong narrative – in the form of case studies with a demonstrable link to the UK’s risk exposure – to support its achievement of the standard on IO7. However, the resource-intensive nature of cases linked to the UK’s complex and often multinational risk exposure will prove a challenge, which even the most ruthless prioritisation may struggle to meet.

**Immediate Outcome 8**

Immediate Outcome 8 states the obligation that the ‘Proceeds and instrumentalities of crime are confiscated.’\textsuperscript{44} Evaluation of IO8 will involve analysis of the use of the full ambit of UK powers in relation to the proceeds of crime and seek evidence that their use is in line with the risk profile identified. The UK’s system for confiscating the proceeds of crime is covered largely by the Proceeds of Crime Act 2002. The Act allows for four means of confiscating the proceeds of crime: the criminal confiscation system (explored below), whereby the proceeds of crime are confiscated post-conviction; through the civil-recovery regime, in which assets can be confiscated in the absence of a conviction through the civil courts; criminal taxation (whereby the NCA can adopt HMRC powers to ‘tax’ criminal proceeds); and the cash-forfeiture system, which allows for cash to be seized on the basis of suspicion and confiscated, through the civil courts.

It is a specific area of this latter power, cash seizure at the border, which this study highlights as an area meriting consideration in the run-up to 2018, specifically in relation to resource prioritisation. The grounds for seizing cash at the border have strong links to the UK’s cash-declaration system (a FATF requirement under Recommendation 32), in that a false or absent declaration should, in most circumstances, provide grounds for a cash seizure.\textsuperscript{45}

The 2007 UK evaluation notes that cash still featured highly in the criminal economy and that levels of cash repatriation suggested that cross-border cash smuggling remained a high risk. The National Risk Assessment of 2015 notes that ‘cash is attractive for money laundering and

\textsuperscript{43} Interview with official, August 2015.
\textsuperscript{44} FATF, ‘Methodology’, 2013, p. 110.
\textsuperscript{45} Under EU regulations, a traveller must declare cash of €10,000 or more (or the equivalent in another currency) if taken between the UK and any non-EU country. This declaration should be made to HMRC. Failure to declare cash can lead to a £5,000 fine. If the lack of declaration gives grounds for suspicion that the funds are the proceeds of crime, the money can be seized by a border official under the Proceeds of Crime Act and its forfeiture can be sought through the courts.
terrorist financing because it is relatively untraceable, readily exchangeable and anonymous. The money-laundering risk associated with cash is assessed to be high, and the terrorist financing risk associated with cash couriering is also assessed to be high." The NRA goes on to note that ‘it is thought that criminal groups are successfully smuggling significant amounts of cash out of the UK’. Given the high volume of passenger, container and parcel traffic in and out of the UK, the challenge of cash detection at the border is unavoidable.

Despite this, since the 2007 evaluation the responsibilities at the UK border have become ever more fragmented, with an increasing number of agencies operating in this space. For example, whilst at the time of the 2007 evaluation HMRC held the responsibility for both the cash-declaration system and its enforcement, including cash seizures as a result of failure to disclose, since 2010 this responsibility has been split: HMRC retains the responsibility for administering the system, with the enforcement function largely the responsibility of the UK Border Force. Interviewees suggested that this has led to a fragmentation of responsibility, a lack of clarity in relation to the enforcement of non-declaration sanctions, including cash seizures, and in difficulties in data collection.

The diversity of the Border Force portfolio – with the tension between its passport-verification function and its wider role in protecting the integrity and security of the UK border, coupled with the budgetary constraints the agency continues to face – poses particular challenges to its ability to cover all threat areas. Given the Border Force’s front-line role in cash detection and seizure, the assessors will take note of the National Audit Office (NAO) report on the Border Force, which highlights the effects of £604 million of budget cuts between 2010 and 2015 and the increasing tension between the Border Force’s dual responsibilities. The report’s cautionary note about the effect these measures have had in relation to border security may be at the forefront of assessors’ minds when examining the UK’s effectiveness in this regard.

For countries assessed under the 2013 Methodology so far, cash seizure has in two cases been a stumbling block. Belgium was criticised in its 2015 evaluation report for its lack of central statistics on confiscation in cases of false disclosure at the border. The 2014 evaluation of Norway noted that ‘the system for cross border cash declaration and bearer negotiable instrument (BNI) declaration has only produced limited outputs relative to the risks in this area’.

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47. Ibid., p. 76.
48. There are now an increasing number of agencies: Border Force; Home Office Immigration and Enforcement; and NCA Border Policing Command.
49. Interview with official, July 2015.
Data and Measurement of Outcomes

The effectiveness Methodology focuses strongly on the need for accurate statistics to support conclusions. However, in contrast to the 2003 Methodology, these statistics must not merely be gathered, but must, if they are to meet the standard, be linked to the risk profile relating to the specific IO. Furthermore, the guiding principle of the new Methodology is that assessors should not purely rely on statistical outputs as a measure of success. A strong narrative, backed by impact assessment and case studies, must be formed to support and complement the statistics, placed firmly in the context of the risks facing the country. This places an onus on countries to put in place wider, more qualitative means of measuring success beyond the numerical and to ensure that success is measured as a risk-reduction effect.

Whilst this presents a challenge across a broad range of IOs for the UK, this paper suggests that a further element of IO8 presents a considerable challenge in this regard, namely in the field of criminal confiscation.

Criminal confiscation powers under the Proceeds of Crime Act are used by a wide range of law-enforcement and regulatory bodies – the police, HMRC, NCA, FCA and Trading Standards, to name but a few – to seek restitution following a criminal conviction. The 2007 evaluation praised the UK system of criminal confiscation, then in its infancy, as effective.

However, since 2007 the operation of the criminal-confiscation system has come under considerable criticism in the media and from the NAO.53 These criticisms focus not on the levels of use of the powers, but on the difficulties facing enforcement authorities in collecting criminal-confiscation orders from offenders following the making of an order. For example, whilst statistics show that enforcement receipts from criminal confiscation continue to increase year-on-year, with a record £154 million in criminal-confiscation receipts being collected in 2014/15,54 the HM Courts and Tribunals Trust Statement for 2014/15 shows £1.6 billion in confiscation orders which have not been collected from offenders.55

The reasons behind this high figure are complex and are due, in part, to the framing of the law rather than simply a lack of effort on the part of authorities. The Home Office has struggled to refute these criticisms and to gain recognition of the UK’s ‘asset denial’ model,56 despite the broadly acknowledged wider impact of criminal confiscation as a deterrent and disruptive law-

54. HM Courts and Tribunals Service statistics provided to RUSI, August 2015. No reference given.
56. A model which seeks to deny the criminal the assets, through asset-freezing, compensation to victims, taxation and other means, rather than focusing on criminal-confiscation order receipts to the exchequer.
enforcement tool. Interviewees suggest that the Home Office is aware of the need to measure criminal-confiscation success in more meaningful ways and is currently considering means by which they can do this.

The need to develop a narrative focusing not on increasing receipts, but on linking the case portfolio to the national risk profile, is evident when examining those assessed under the new Methodology so far. Spain, the only country to receive a ‘substantial’ rating for IO8 to date, was commended in 2014 for the link between its case portfolio and national risk profile. The assessors ‘gave less weight in this area to the statistics of the value of assets confiscated and frozen/seized. More emphasis was placed on the statistics of the number and type of assets involved and qualitative information such as case studies’.

In this way the assessors showed their appreciation of the fact that the value of assets frozen or seized can go up and down according to economic fluctuation and may not reflect action against the highest risk areas. The volume and type of asset taken from criminals is a more substantive measure, alongside case studies, which reflect the impact of this action on the criminal. For example, as noted in this paper, the UK property market has been highlighted as a destination for global illicit funds. It will be essential for the UK to demonstrate, via volume and asset-type statistics, that it has taken action on this issue.

The visit of the assessors in 2018, and the Methodology guidance that ‘confiscation results reflect the assessment of ML/TF risks and national AML/CFT policies and priorities’, should both therefore serve to focus minds towards a more qualitative means of measuring the success of criminal confiscation.

Wider Government Initiatives: Cutting Red Tape

The government’s announcement in the 2015 Summer Budget of a review of the AML/CFT regime means that this framework may change. In the budget, the chancellor announced a review of the effectiveness (not in the FATF sense of the word) of the AML/CFT regime by the Better Regulation Executive (BRE). This review will seek ‘evidence of the impact on business of the current anti-money laundering and terrorist finance regime, and specifically the role of supervisors in that regime’ and aims to improve the ‘efficiency and effectiveness of the anti-

60. FATF, ‘Methodology’, 2013, p. 111.
money laundering regime’. Furthermore, the review aims to look at the effectiveness of the supervisory response, which may create the conditions for a more coherent approach through some consolidation of the twenty-seven supervisors.

Whilst aspects of this may appear to bode well in terms of the 2018 Evaluation, it should be noted that the overriding objective of the BRE is to reduce the cost and burden of regulation on business. Furthermore, the government call for information encourages businesses to submit evidence of ‘over-complicated and ineffective requirements’, without noting that the UK’s ability to deregulate in this field is substantially constrained by EU directives, which the UK is legally bound to transpose into UK law.

The BRE’s objectives may give rise to a tension between its deregulation agenda and the AML/CFT objectives of the Treasury. The review should recognise that the government, in making any changes, should ensure that the FATF standards remain the global benchmark from which the success of the review will ultimately be judged. If it fails to do so, the UK will have substantial presentational issues to deal with in 2018.

Summary

The UK faces a number of challenges if it is to reach the effectiveness standards required by the FATF. However, none of these is insurmountable.

Firstly, with regards to the field of supervision, the BRE review of the AML/CFT regulatory regime, whilst perhaps incoherent, does offer an opportunity to consolidate an arguably fragmented supervisory network. This review should not, however, lose sight of the UK’s international commitments in this field. Key to ensuring compliance with the FATF standard will be to ensure that the response matches the risk across the board and that none of the smaller, less mature supervisory players are left behind. This requires a more active guiding hand from the Treasury.

Secondly, the UK regulated sector is, by dint of the UK’s position as a global financial centre, subject to high levels of risk exposure. It is essential that the regulated sector both understands this risk and demonstrably responds to it. For the financial sector, the challenge is to move from a de-risking to a risk-based approach. For other sectors, the challenge will be to increase their risk awareness from a previously low level.

Thirdly, in relation to the issue of public-sector resourcing, the reduction in budgets from 2010–15 may create both a real and a presentational problem for the government, and one which will require some tough decisions on prioritisation. The government needs to review FIU staffing levels and consider whether they meet the needs of the system; IT investment will also be vital. Furthermore, the UK must consider the prioritisation of money laundering following the impact of police and Border Force budget cuts.

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Fourthly, in relation to money-laundering prosecutions, this study raises concerns that the budget cuts of 2010–15 have impacted on the pipeline of cases reaching prosecution. Whilst police cuts have been halted in the chancellor’s autumn statement, it is unclear where money laundering will sit as it competes for priority with a growing terrorist threat. It is essential that the prominence of money-laundering investigation is raised by government and that this decline is halted in the run-up to 2018.

And finally, with regards to data collection, its centrality to the new FATF effectiveness measures is clear. At a basic level, the UK must improve its administrative abilities in this regard. But to gather statistics is not enough – it is essential that the UK moves quickly towards more qualitative means of measuring the effect of its actions. Only by demonstrating a link between case profiles and risk profiles will the UK reach the standard required under the new Methodology.
Conclusion

The 2018 FATF evaluation of the UK presents a good opportunity for the UK to challenge its reputation as a global centre for money laundering and to highlight some of its world-leading legislative and policy commitments, such as measures to increase transparency of beneficial ownership and its innovative moves to increase public–private information sharing under the JMLIT. But will these laudable initiatives be undermined by the FATF identifying weaknesses in other areas?

The 2007 FATF evaluation of the UK highlighted some key technical deficiencies, largely in relation to financial regulation. The majority of these technical deficiencies have since been rectified through the implementation of the Money Laundering Regulations 2007. The transposition of the EU Fourth Money Laundering Directive into UK law in 2016 will do much to ensure that the UK meets the additional technical requirements set out in the FATF 2012 Recommendations. On this basis, this paper proposes that the UK is likely to gain a high number of ‘compliant’ and ‘largely compliant’ ratings against the 40 Recommendations. This does not mean the UK can be complacent; given the centrality of the JMLSG guidance to the UK’s tripartite system of financial regulation, its status as ‘enforceable means’ is essential to achieving the standard in a number of areas.

It would therefore be reasonable to argue that the UK is on safe ground in the run-up to 2018. Yet, due to the fundamental changes in 2013 to the FATF Methodology, this is not necessarily the case. Despite its strides forward in technical compliance, the UK faces a further hurdle in 2018 in the form of the centrality of the risk-based approach to the FATF standards, and the implementation of standalone effectiveness measures, in the form of the eleven Immediate Outcomes.

The new FATF approach, coupled with changes in the UK context, means that it is in relation to the IOs that the UK risks receiving lower ratings in a number of areas (IOs 3, 4, 6, 7 and 8) because of a range of thematic issues: supervision; the risk-based approach; resourcing; and data and measurement of outcomes.

In relation to supervision, this paper highlights IO3 as the main area of concern. Specifically, given the size and diversity of the UK’s regulated sector and the twenty-seven supervisors charged with monitoring their compliance, the UK faces a challenge in ensuring consistency of approach, particularly with regard to implementation of the RBA. Whilst the AML Supervisors’ Forum is a step in the right direction, this paper suggests that the Treasury may wish to take a firmer guiding hand in aiding consistency across sectors and may wish to use the opportunity of the BRE review as an opportunity to consolidate supervision in some areas. Notably, the new FATF Methodology means that the UK cannot rely on strengths in the majority of areas to mask the deficiencies of the minority; if some supervisors are weak, where these cover high-risk areas will significantly impact on the UK’s rating.
In relation to the implementation of the RBA, this paper highlights IO4 as a specific concern, particularly given the high level of risk exposure facing the UK, given its role as a major global financial centre. The scale, size and diversity of the regulated sector again poses a challenge in ensuring a consistent understanding of risk as well as the application of an approach based on this. Concerns regarding the de-risking – as opposed to risk-based – approach by a number of banks, coupled with the converse problem of the under-appreciation of risk in the less mature sectors, both require equal consideration. This paper suggests the government may wish to do more to engage with the regulated sector and aid it in its application of this concept, including through sharing best practice.

As regards the issue of resourcing, the context in which the 2007 evaluation took place was markedly different and results viewed by and commitments made to the assessors came before the budgetary constraints facing government departments today. In this respect, this paper highlights elements of IOs 6, 7 and 8 as areas of specific concern, particularly given the need under the new methodology to link risk to response and a focus in the Methodology on adequate resources being available to mitigate risks. More specifically, this paper highlights the lack of staffing and IT resources available to the FIU as a particular concern, as well as the impact of the policing cuts of 2010–15 on the levels of money-laundering prosecutions and the availability of staff at the border trained to detect and seize cash. This paper proposes that the government should reassess its resource-prioritisation exercises and link these more firmly to money-laundering risk. If it fails to do so the impact on these particular IOs will be marked.

Finally, across the board the UK needs to focus on data and wider performance metrics as a means of demonstrating effectiveness, particularly given that current success metrics outside the numeric are notably lacking. This paper highlights the case of criminal confiscation IO8 as one example where more could be done to highlight the wider utility of these powers outside of pure income receipts.

In sum, whilst the UK’s efforts to increase technical compliance with the FATF Recommendations are positive, there is no room for complacency in the run-up to 2018. The UK faces a considerable but not insurmountable task if it is to reach the standard required by the new effectiveness measures. Key will be the ability to demonstrate that the UK response meets the risks it faces.
About the Author

Helena Wood is an Associate Fellow of RUSI. Her research focuses on the efficacy of the powers of the Proceeds of Crime Act (POCA) in the fight against organised crime and the UK’s anti-money-laundering architecture and its compliance with the Financial Action Task Force (FATF) standards.

Now working as an independent consultant on criminal-justice matters, Helena has over a decade of public-sector and law-enforcement experience, with a particular focus on the proceeds of crime and international law-enforcement co-operation.

During her public-service career Helena performed a variety of key roles, from policy development to law-enforcement intelligence and operations management in a number of government departments – such as the National Crime Agency, Serious Organised Crime Agency, the Treasury and the Charity Commission. These roles included leading SOCA’s civil-confiscation policy development, advising the Foreign Office on organised-crime matters and working on the 2007 Financial Action Task Force evaluation of the UK.