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Report Questions Global Fight against Money Laundering and Terrorism

First independent study finds international regulation at crossroads

Chicago, IL - A report released today questions the effectiveness of the fight against worldwide money laundering and terrorist financing.

In the first independent assessment of the global system, a study conducted by the Center on Law and Globalization, titled *Global Surveillance of Dirty Money*, appraises efforts to rate countries by the International Monetary Fund (IMF) and Financial Action Task Force (FATF), an organization of advanced economies that sets the rules for control of money laundering and combating the financing of terrorism.

The FATF, IMF and other bodies rate more than 150 countries on whether they meet the FATF's global standards by enacting laws, creating regulatory agencies, prosecuting offenders and confiscating moneys. The IMF, one of the largest of these assessing bodies, has had substantial influence on methods and practices of assessment in the worldwide regulation of moneys flowing from crime or to terrorists.

The fight against money laundering is costly. A full-scale system consumes extensive government resources in participating countries and makes heavy demands on the private sector. The report finds that the struggle to control money laundering is at a turning point.

Major international banks in the UK, US and Europe have admitted to massive violations of money laundering controls over long periods, indicating that highly developed anti-money laundering systems have not worked well in countries whose economies are systemically important to international financial markets.

The methods and scope of global surveillance of financial transactions by individuals, companies and non-profits are also engendering public debate. Just last year, the FATF revised its ratings system to place a much heavier emphasis on whether nations are in fact controlling money laundering and terrorist financing. In dozens of interviews with IMF and FATF staff, country officials, and private sector specialists, the Center on Law and Globalization studied country assessments conducted by the IMF before 2012 and appraises the promise of reforms under the new standards and methods.

The IMF has welcomed scrutiny of its practices. Global regulation specialist, Terence Halliday, co-author of the report, points to hard questions the IMF has posed in recent years about the goals and effectiveness of the Anti-Money Laundering and Combating the Finance of Terrorism (AML/CFT) system. Said Halliday, "The Fund has been self-critical and experimental in efforts to refine methods, and to examine from the 'bottom-up' whether AML/CFT interventions do what they promise."

The report examines five critical questions in the assessment of anti-money laundering standards:

1. What are the goals of global surveillance?

Until as recently as 2012 the precise objectives were unclear.

The FATF assumed that more regulations and stiffer penalties applied to more and more areas of economic life would make it noticeably much harder to launder money or finance terrorism.

The IMF expected that if countries adopted the global standards, then crime would decline, corrupting effects of dirty money would be contained, and the result would be heightened integrity and stability of country financial systems.

The 2013 Methodology adopted recently by the FATF, with the substantial input of the IMF, has significantly sharpened objectives. Most importantly, says European specialist on economic and organized crime, Michael Levi, co-author of the report, "countries will be required to show that new laws and practices actually make a difference to the level of crime, proceeds of crime, and extent of money laundering."

While this shift in emphasis offers better chances to judge whether positive outcomes result from implementation of the standards, the report warns that it will take years to test whether objectives are met and investments in financial regulation yield a net positive return.

2. What do assessments of anti-money laundering standards tell us?

Past methods for doing national assessments may reveal very little about what works.

There is no doubt that since 2000 most countries have more AML laws and have extended the scope of their surveillance activities. More people are convicted of money laundering, and countries are better prepared to cooperate with each other against serious crimes and to seize proceeds.

There is considerable doubt about the quality of data employed to judge success. The state of the art on determining how much money is generated from criminal activity is weak.

A future focus on risk analysis has promise, states Peter Reuter, a policy researcher specializing in illegal markets, and co-author of the report, "because it sharpens policy decisions and permits efficient allocations of resources." He added, "However, the science of risk analysis is poorly developed for money laundering, and it is currently impossible to judge relative risk on an objective and systematic basis."

Methods for collecting data between 2001 and 2012 were "well behind the state of the art." Although the FATF has signaled that assessments through 2020 will rely on better data, it does not say how. Data gathering problems will continue for the foreseeable future.

3. What works?

The large political effort to create AML regimes has established a better basis for avoiding the 'beggar my neighbor' global deregulation in which financial services and others had little or no responsibility for harms inflicted elsewhere, whether inside or outside their countries.

Yet, the report states that "no credible scientific evidence has yet been presented that there is a direct relationship between installation of effective AML/CFT regimes and the IMF mandates to produce domestic and international financial stability." Neither is there convincing evidence, said Reuter, "that proceeds of crime are reduced or crime itself is better controlled with anti-money laundering measures."

Despite the lack of convincing evidence, "it is entirely possible," said Levi, "that better laws and better tools for fighting the circulation of dirty money do lower certain crimes. But they have not been successful in stopping some huge money laundering schemes by big banks in the U.S. and Britain."

4. Can global standards work everywhere?

The report questions whether all countries, sooner or later, will be able meet global standards. Critics charge that a "one-size-fits-all" approach makes little sense. Assessors are required to assume, said Halliday, "that a system will work no matter how corrupt a government, how weak its public administration, how flawed its justice system." The IMF and the FATF believe that a more tailored approach to countries is more realistic and more likely to succeed.

The report recommends that national leaders should have more discretion to create alternative ways to meet the FATF standards so that local solutions can be fitted to particular circumstances. "From now on," said Reuter, "assessors need to look for new ideas and applaud new ways of reducing crime and the circulation of dirty money."

5. What are the costs and benefits?

Surprisingly, the report finds that no cost-benefit analysis has ever been undertaken of anti-money laundering efforts globally or even regionally. The report states that "the FATF system has proceeded as if it produces only public and private 'goods,' not public or private 'bads.'" There is no evidence that any governments have made rigorous efforts to weigh costs against benefits.

The report concludes that if the FATF system cannot show benefits it will risk a loss of legitimacy: "failure to show that benefits outweigh costs may lead to greater passive and active efforts not to comply."

Anti-money laundering systems can produce political harms. Humanitarian harms may be inflicted, says a report to the Nairobi Forum, when efforts to control money laundering lead banks to cut down overseas remittances "to the most vulnerable populations in the poorest countries."

Overall, the report cites the forthright recognition of many problems that the IMF and the FATF have identified from their experiences of assessments in the past decade. Some significant changes to the methods for assessments offer much promise for more flexible, adaptive and appropriate responses to dirty money that might harm economies or support terrorism.

The IMF has shown itself to be an innovator. Halliday believes this openness "augurs well for fresh approaches to tough issues." The next few years, he said, "will begin to provide answers to the hard questions. Will objectives be met? Can flexible adaptations of the standards to local circumstances reduce money laundering? Will the new methods of assessing countries help or hinder the global fight against terrorism and money laundering?"

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