

## EVALUATION OF STRATEGIC APPROACHES TO FATF COMPLIANCE: MITIGATING MONEY LAUNDERING AND TERRORIST FINANCING IN HIGH-RISK COUNTRIES

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### ABSTRACT

*This study investigates the effective implementation of the Financial Action Task Force (FATF) recommendations to combat money laundering and terrorist financing in high-risk countries. The study emphasizes the crucial role of Designated Non-Financial Businesses and Professions (DNFBPs) in maintaining financial integrity and adhering to FATF's 40 recommendations. By analyzing Mutual Evaluation Reports (MER) and Follow-Up Reports (FUR) from 20 high-risk nations, the research evaluates the extent of compliance with FATF's standards. The findings reveal significant shortcomings in several areas, including risk assessment, targeted financial sanctions, and transparency of beneficial ownership. The study concludes that while some progress has been made, substantial improvements are needed to ensure comprehensive compliance with FATF guidelines. The study suggests that high-risk countries adopt more stringent measures to strengthen financial security and mitigate the risks associated with money laundering and terrorist financing. Future research should focus on the role of DNFBPs in implementing AML policies at the country and continent levels.*

**Keywords:** FATF, DNFBPs, MER, FUR, AML Policies.

### Introduction

Globally, the economy of every country is governed and overseen by financial regulators and institutions. Additionally, the economic integrity and adherence to ethical standards of Designated Non-Financial Businesses and Professions (DNFBPs)—such as lawyers, accountants, company secretaries, real estate agents, and jewelry traders—play a crucial role. A nation's GDP reflects the contributions of all sectors, but the overall economic performance hinges on the compliance with regulatory recommendations.

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DNFBPs are vital in safeguarding the economy from money laundering activities and ensuring strict adherence to the 40 recommendations issued by the Financial Action Task Force (FATF). High-risk third countries, as defined in Schedule 3ZA of the MLRs, are those with strategic deficiencies in their national anti-money laundering and counter-financing of terrorism (AML/CFT) frameworks.

Money laundering involves converting illicit money into legal currency, enabling criminals to use the funds without revealing their illegal origins. Anti-Money Laundering (AML) encompasses the laws, regulations, and procedures businesses must follow to combat financial crime. The FATF, an independent intergovernmental body, aims to protect the global financial system from money laundering and terrorist financing. It has established 40 recommendations, including measures for international cooperation and preventive actions by financial institutions and other entities such as casinos, real estate dealers, lawyers, and accountants. The FATF assesses the compliance of member countries during its three annual meetings, identifying strategic deficiencies and applying pressure to prompt meaningful progress. Failure to comply can result in severe consequences, including blacklisting.

The 20 high-risk third countries are:

High-risk (3rd) countries	
Albania	Mauritius
Barbados	Morocco
Botswana	Myanmar
Burkina Faso	Nicaragua
Cambodia	Pakistan
Cayman Islands	Panama
Democratic People's Republic of Korea (DPRK)	Philippines
Haiti	Senegal
Jamaica	Uganda
Malta	Zimbabwe

Source: As per the Schedule 3ZA of MLRs

### Review of Literature

Money laundering is a global threat, regardless of the country involved. The FATF has issued 11 immediate outcomes and 40 recommendations to combat this threat and curb terrorism financing. This study seeks to address the research gap by analyzing the compliance with FATF recommendations in high-risk countries.

Normah Omar and Zulaikha 'Amirah Johari (2015) found that most countries failed to comply with FATF recommendations, particularly recommendations 12, 16, 17, 24, and 25, due to a lack of monitoring systems.

The Asia Pacific Group's (2014) report on money laundering typologies revealed that the proceeds of financial crimes were often invested in immovable properties.

In light of these findings, this study aims to analyze the compliance with FATF recommendations in high-risk countries, focusing on the effectiveness of AML/CFT systems.

### **Objectives**

- To comprehend the concepts related to high-risk countries, money laundering, terrorism financing, assessment bodies, immediate outcomes, and FATF's 40 recommendations.
- To evaluate the technical requirements of the AML/CFT system concerning the implementation of FATF's 40 recommendations in high-risk countries, particularly in addressing strategic deficiencies.
- To assess the compliance of AML/CFT systems with 11 key goals in high-risk countries when addressing strategic deficiencies.

### **Research Methodology**

High-risk countries, also referred to as third countries, are those exposed to money laundering and terrorism financing. The population for this study consists of high-risk countries identified in Schedule 3ZA of the Money Laundering Regulations (MLRs) 2017. Data for 20 such countries were collected from Mutual Evaluation Reports and Follow-Up Reports (MER and FUR) for the years 2020-21. The bodies regulating and monitoring AML compliance in these countries, referred to as assessing agencies, include the Asian Pacific Group (APG), the FATF, and the Financial Action Task Force of Latin America (GAFILAT). Sample units include high-risk countries, and variables include the 11 immediate outcomes (key goals) and 40 FATF recommendations. These variables were assessed by the agencies using a five-point rating scale, where key goals were rated based on effectiveness (HE, SE, ME, LE, and NA) and the 40 recommendations were rated based on compliance (CLC, PC, MC, NC). The benchmark for comparing the effectiveness of AML compliance in high-risk countries is the 4th rating (largely compliant). Statistical tools, including a one-sample t-test with a test sample value of 4 (largely compliant), were used to analyze the MER and FUR data to determine the extent to which key AML system goals were achieved and global compliance with the 40 recommendations was attained in high-risk countries.

### **Scope of the Study**

Future research could explore the role of DNFBPs in implementing AML policies and compliance on a country-by-country and continent-wide basis.

### **Data Analysis**

**Null Hypothesis (H0):** There are minor shortcomings (Largely Compliant) in the implementation of FATF's 40 Recommendations to combat financial terrorism in high-risk countries.

**Alternate Hypothesis (H1):** There are major shortcomings (Partially Compliant) in the implementation of FATF's 40 Recommendations to combat financial terrorism in high-risk countries.

**Table 1: One-Sample t test**

Variables	Test Value = 4			
	t	df	Sig. (2-tailed)	Mean Difference
Policies and coordination				
(R1) Assessing risks	-2.101	19	0.049	-0.35
(R2) National cooperation	-0.623	19	0.541	-0.1
(R3) Money laundering offence	2.042	19	0.055	0.3
(R4) Confiscation and provisional measures	0.326	19	0.748	0.05
Proliferation of terrorist financing				
(R5) Terrorist financing offence	-0.295	19	0.772	-0.05
(R6) Targeted financial sanctions related to terrorism & terrorist financing	-1.453	19	0.163	-0.3
(R7) Targeted financial sanctions related to proliferation	-3.387	19	0.003	-0.8
(R8) Non-profit organisations	-5.107	19	0	-0.9
Preventive measures				
(R9) Financial institution secrecy laws	5.48	19	0	0.7
(R10) Customer due diligence	0	19	1	0
(R11) Record keeping	2.042	19	0.055	0.3
(R12) Politically exposed persons	0.271	19	0.789	0.05
(R13) Correspondent banking	0.767	19	0.453	0.15
(R14) Money or value transfer services	-0.525	19	0.606	-0.1
(R15) New technologies	-4.677	19	0	-0.85
(R16) Wire transfers	-0.825	19	0.419	-0.15
(R17) Reliance on third parties	-1.064	19	0.301	-0.3
(R18) Internal controls and foreign branches and subsidiaries	0	19	1	0
(R19) Higher-risk countries	-0.847	19	0.408	-0.2

Source: Author compilation from the mutual evaluation reports of high-risk countries.

**Table 2: One-Sample t Test Contd**

Variables	Test Value = 4			
	t	df	Sig. (2-tailed)	Mean Difference
(R20) Reporting of suspicious transactions	3.249	19	0.004	0.5
(R21) Tipping-off and confidentiality	3.249	19	0.004	0.5
(R22) DNFBPs: Customer due diligence	-1.789	19	0.09	-0.35
Transparency of Beneficial ownership				

(R23) DNFBPs: Other measures	-1.165	19	0.258	-0.2
(R24) Transparency and beneficial ownership of legal persons	-6.282	19	0	-0.9
Powers and responsibilities of competent authority				
(R25) Transparency and beneficial ownership of legal arrangements	-5.146	19	0	-0.95
(R26) Regulation and supervision of financial institutions	-2.979	19	0.008	-0.55
(R27) Powers of supervisors	1.165	19	0.258	0.2
(R28) Regulation and supervision of DNFBPs	-4.158	19	0.001	-0.9
(R29) Financial intelligence units	0.9	19	0.379	0.15
(R30) Responsibilities of law enforcement and investigative authorities	0.9	19	0.379	0.15
(R31) Powers of law enforcement and investigative authorities	-1	19	0.33	-0.15
(R32) Cash couriers	-1.314	19	0.204	-0.25
(R33) Statistics	-1.301	19	0.209	-0.3
(R34) Guidance and feedback	-2.042	19	0.055	-0.3
(R35) Sanctions	-2.333	19	0.031	-0.35
International cooperation				
(R36) International instruments	0.623	19	0.541	0.1
(R37) Mutual legal assistance	-0.567	19	0.577	-0.1
(R38) Mutual legal assistance: freezing and confiscation	-2.101	19	0.049	-0.35
(R39) Extradition	-0.295	19	0.772	-0.05
(R40) Other forms of international cooperation	-2.666	19	0.015	-0.35

Source: Author compilation from the mutual evaluation reports of high-risk countries.

### Policies and Coordination

The data processed through t-tests, as shown in Table 1, reveals the calculated t-value and mean difference for assessing risks to be -2.101 and -0.35, respectively, with a significance value of 0.049, which is below the critical value of 0.05. Therefore, the null hypothesis is rejected, and the alternate hypothesis is accepted, indicating significant shortcomings in the risk assessments conducted by competent authorities in high-risk countries, resulting in partial compliance.

For the recommendations on national cooperation, money laundering offenses, and confiscation and provisional measures, the calculated mean differences and significance values are -0.1 (0.541), 0.3 (0.05), and 0.05 (0.748), respectively. Since the significance values exceed 0.05, the null hypothesis is accepted, indicating that these recommendations are largely compliant with minor shortcomings. In summary, except for risk assessments, the compliance with policies and cooperation in high-risk countries has largely met the requirements to combat terrorism financing.

### **Proliferation of Terrorist Financing**

The data processed for compliance with targeted financial sanctions related to proliferation, as shown in Table 1, reveals a t-value of -3.387 and a mean difference of -0.8, with a significance value of 0.003, which is below 0.05. Thus, the alternate hypothesis is accepted, indicating significant shortcomings in implementing targeted financial sanctions in high-risk countries. The t-value and mean difference for non-profit organizations are -5.107 and -0.9, with a significance value of 0.000, which is also below 0.05. The alternate hypothesis is accepted, showing that non-profit organizations have been exploited for terrorism financing in high-risk countries.

The recommendations on terrorist financing offenses and targeted financial sanctions related to terrorism and terrorist financing have mean differences and significance values of -0.05 (0.772) and -0.3 (0.163), respectively. As these significance values exceed 0.05, the null hypothesis is accepted, indicating that these recommendations are largely compliant with minor shortcomings. In summary, except for issues related to terrorist financing offenses and non-profit organizations, compliance with recommendations to curb terrorist financing in high-risk countries has been largely effective.

### **Preventive Measures**

FATF has established 14 recommendations as part of AML compliance to safeguard financial institutions from money laundering activities. The t-values and mean differences calculated for financial institution secrecy laws (5.48 and 0.7), new technologies (-4.677 and -0.85), reporting suspicious transactions (3.249 and 0.5), and tipping-off and confidentiality (3.249 and 0.5) are significant, with values less than 0.05. Hence, the alternate hypothesis is accepted, indicating major shortcomings in implementing recommendations R9, R15, R20, and R21.

The remaining preventive measures (R10, R11, R12, R13, R14, R16, R17, R18, R19, and R22) have largely met compliance, as their respective significance values exceed 0.05. The calculated t-value and mean difference for transparency and beneficial ownership of legal persons are -6.282 and -0.9, with a significance value of 0.000, indicating non-compliance with the transparency and beneficial ownership of legal persons.

### **Powers and Responsibilities of Competent Authorities**

FATF has set 10 recommendations to enhance the monitoring capacities of competent authorities over money laundering activities in high-risk countries. The calculated t-values and mean differences for transparency and beneficial ownership of legal arrangements (-5.146 and -0.95), regulation and supervision of financial institutions (-2.979 and -0.55), regulation and supervision of DNFBPs (-4.158 and -0.9), and sanctions (-2.333 and -0.35) all have significance values below 0.05. Hence, the alternate hypothesis is accepted, indicating major shortcomings in implementing recommendations R25, R26, R27, and R35. However, the remaining recommendations (R28, R29, R30, R31, R32, R33, and R34) have largely met compliance, as their significance values exceed 0.05.

### International Cooperation

The recommendations on international cooperation (R36, R37, R38, R39, and R40) have largely met compliance, as their respective significance values exceed 0.05. In other words, international instruments, mutual legal assistance, freezing and confiscation, extradition, and other forms of international cooperation have been strictly adhered to in high-risk countries.

### Hypothesis 2

**Null Hypothesis (H0):** Moderate improvements are not required for effective control (Substantial level of effectiveness achieved) on immediate outcomes of AML compliance in high-risk countries.

**Alternate Hypothesis (H1):** Moderate improvements are required for effective control (Substantial level of effectiveness not achieved) on immediate outcomes of AML compliance in high-risk countries.

**Table 3: One-Sample Test**

Immediate outcomes	Test Value = 4			
	T	df	Sig. (2-tailed)	Mean Difference
Actions on MLTF risks	-11.461	19	0	-1.55
Actions against criminals and their assets	-10.162	19	0	-1.25
Appropriately regulate/monitor the FIs	-16.17	19	0	-1.7
Report suspicious transactions	-11.461	19	0	-1.55
Legal persons prevented from misuse of ML	-19.615	19	0	-1.8
Financial intelligence used for ML investigations	-10.466	19	0	-1.4
ML offenders prosecuted	-19.615	19	0	-1.8
Confiscation of proceeds from criminals	-10.514	19	0	-1.6
Terrorist Financing persons prosecuted and sanctions	-10.514	19	0	-1.6
Terrorist financiers prevented from raising funds	-11.461	19	0	-1.55
Persons involved in proliferation of weapons, from raising funds	-12.254	19	0	-1.75

Source: Author compilation from the mutual evaluation reports on high-risk countries.

From the data in the above Table 3, it is evident that the 11 key goals (immediate outcomes) of AML compliance have been moderately achieved and are far from reaching a substantial level of effectiveness in high-risk countries. AML compliance regarding actions against criminals and their assets, and confiscation is reasonably met, as the mean difference (-1.25) is closer to the substantial level of effectiveness. However, the remaining 10 immediate outcomes have calculated significance values of 0, which is less than the critical value of 0.05. Therefore, the null hypothesis is rejected, and the alternate hypothesis is accepted. This

indicates that while some progress has been made against money laundering activities, the financing of terrorism and terrorist acts has significantly increased across high-risk countries.

It is also observed that the risks of money laundering and terrorist financing are not fully understood, and the actions initiated domestically have failed to combat the financing of terrorism and proliferation. Supervisors monitor and regulate financial institutions to some extent for compliance with AML/CFT requirements, commensurate with their risks. However, financial institutions inadequately apply AML/CFT preventive measures and are slow to report suspicious transactions. Legal persons are not adequately prevented from misuse for money laundering, and the information on their beneficial ownership is often miscommunicated to competent authorities.

Financial intelligence is not effectively utilized by competent authorities for money laundering and terrorist financing investigations. Money laundering

### Findings

By analysing Mutual Evaluation Reports and Follow-Up Reports on aforesaid recommendations and immediate outcomes, it is found that some of them are largely comply and some other partially comply. Wherever the compliance is partial there the government and law enforcement agencies have to recognise the importance of DNFBPs in combat against money laundering and terrorism financing activities across high-risk countries. The summary of findings are furnished in the matrix which facilitate the FATF for deep understanding about the patterns of laundering transactions, suspicious transaction and its reporting to enforcement agencies and also helps to enlist the countries in the black list due to non-compliance of recommendations in the high-risk countries;

**Table 4: Matrix showing Compliance Level**

Recommendations on Policies and coordination:	LC*	PC*	Decision
R1		X	Rejected
R2,R3 & R4	✓		
Recommendations on Proliferation of terrorist financing			
R5 & R6	✓		
R7 and R8		X	Rejected
Recommendations on Preventive measures:			
R10, R11, R12, R13, R14, R16, R17, R18, R19 and R22	✓		
R9, R15, R20 and R21		X	Rejected
Recommendations on Transparency of Beneficial ownership:			
R23	✓		
R24		X	Rejected
Recommendations on Powers and responsibilities of competent authority:			
R27, R29, R30, R31, R32, R33, R34	✓		
R25, R26 and R35		X	Rejected

Recommendations on International cooperation:			
R36, R37, R39	✓		
R38 and R40		X	Rejected
LC* = Largely compliance, PC* = Partially Compliance			

**Table 5: Matrix Showing Effectiveness of Compliance**

Immediate outcomes on AML Compliance:	SE*	ME*	Decision
IO1	✓		
IO2, IO3, IO4, IO5, IO6, IO7, IO8, IO9, IO10 and IO11		X	Rejected
SE* = Substantially effective, ME* = Moderately Effective			

Out of 40 reviewed recommendations, there were 13 of them assessed as partially compliant and out of 11 reviewed immediate outcomes, there were 10 of them assessed as moderately effective to fight against financial terrorism. These compliance issues became as exploitative opportunities for criminals and organised crime groups to facilitate their money laundering activities. FATF need to be more stringent on these compliance issues because by doing so it could help to curb terrorism financing and money laundering.

### Suggestions

Counter measures should be insisted by FATF on those countries as they were partially comply on the following recommendations; R1, R7, R8, R9, R15, R20, R21, R24, R25, R26, R35, R38 and R40 for increased monitoring and protecting the international financial systems from strategic deficiencies of AML Compliance.

Counter measures should be insisted by FATF on those countries as they were moderately effective on the following immediate outcomes; IO2, IO3, IO4, IO5, IO6, IO7, IO8, IO9, IO10 and IO11 for increased monitoring on effective and immediate implementation in those countries.

### Conclusion

Strengthening financial security in high-risk nations through the effective implementation of FATF guidelines is crucial for combating money laundering and terrorist financing. By adopting strategic approaches to FATF compliance, these vulnerable countries can mitigate the risks associated with financial crimes. Despite the challenges inherent in adhering to international standards, it is imperative that high-risk nations develop and enforce effective strategies to ensure robust financial oversight and security. Implementing the FATF recommendations not only protects the global financial system but also enhances the integrity and stability of economies, ensuring a safer environment for international cooperation and economic growth.

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