

IMPACT EVALUATION
FINANCIAL ACTION TASK FORCE (FATF) ORGANIZATION

A Thesis

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by

Shabnam Amini

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Abstract

This paper provides a comprehensive study of the Financial Action Task Force (FATF) organization. FATF international organization prepares standards and policies to fight money laundering and terrorist financing. The paper focuses on FATF standards and recommendations on Anti Money Laundry and Counter Financing Terrorist AML/CFT, Afghanistan compliance with FAFT recommendations, and result-based management. The main purpose is to identify predominant obstacles that hinder the process of compliance and suggest a set of recommendations that serve as potential solutions.

Money laundering and terrorist financing can occur through many different avenues in different sectors of the economy. The avenue keeps changing and renovating, particularly with the latest advancements and the internet. Therefore, it is more important than ever to know the changes that challenge compliance with standards. It is significantly essential for all countries especially the least developed ones comply with FATF recommendations to keep their financial system's integrity. Money laundering, terrorist financing, and smuggling continue threatening the security of the world. They result in sluggish economic development in most of the least developed and developing countries. Part of the reason is that most of the economic activities are informal in these countries. Afghanistan is one of the least developed countries, and now the fact of Taliban taking over Afghanistan and being the world's largest producer of opium, it will lose its financial integrity and pose danger to countries in the region and overseas. Therefore, it is significantly important to find the gaps that result in supporting illicit activities

Biographical Sketch

Shabnam Amini is a graduate student in the M.P.S Global Development Program at Cornell University. Her research interests lie in building resilient financial and banking systems and avoiding the illicit flow of resources that can easily become the source of terrorist financing. Shabnam Amini was born in a typical family in Afghanistan. She lived and went to school in Kabul for most of her life. Shabnam Amini started primary school during the Taliban regime and graduated from the American University of Afghanistan majoring in Finance – BBA. Her journey was not an easy one but had a greater purpose. A purpose to be able to serve her community, country, and the world.

Before attending Cornell University, Shabnam was serving as the International Relations Advisor to the Afghanistan Central Bank. She previously served as the Chief of Staff for the Minister of Commerce and worked for the Office of the President as a Senior Research analyst. With over several years of experience in the public sector, she has realized that Afghanistan needs more women leaders and experts in the field of development and public service delivery in Afghanistan as well as the world. Therefore, she pursued the Master of Professional Studies in Global Development program at Cornell University.

After graduating from the American University of Afghanistan (AUAF), Shabnam decided to work for the government and started her career as a Research Analyst at the Economic Advisory Office of the President of Afghanistan. She prepared analytical reports for different sectors including education, agriculture, health, and economic related areas.

*To my Parents, especially my father,
who made me get educated,
especially getting my master's degree*

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List Of Abbreviations

AML – Anti Money Laundering
AML/CFT – Anti Money Laundering and Counter Financing Terrorist
BCBS - Basel Committee on Banking Supervision
CFT - Counter Financing Terrorist
DAB – Da Afghanistan Bank – Central Bank of Afghanistan
DNFBPs – Designated non-financial businesses and professions
EU – European Union
FATF – Financial Action Task Force
FIP – Financial Inclusion Plan
FXD - Foreign Exchange Dealers
IFI – International Financial Institutions
IMF – International Monetary Fund
KYC – Know Your Customer
LEAs – Law Enforcement Agencies
LDC – Least Developed Countries
ML – Money Laundering
MSPs - Money Service Providers
MVTS - Money or Value Transfer Services
NPOs – Non-profit Organization
NRA – National Risk Assessment
OECD – Organization for Economic Co-operation and Development
RBM – Result-based Management
RBA - Risk-Based Approach
STR - Suspicious Transaction Report
TF – Terrorism Financing
USD – United States Dollar
UN – United Nation
US – United States
WB – World Bank
WMD – Weapons of Mass Destruction

EXECUTIVE SUMMARY¹

FATF is an international Anti Money Laundering and Counter Financing Terrorism (AML/CFT) organization. This paper provides result-based management (RBM) analysis of FATF, and a reflection of my personal experience of working with the Central Bank of Afghanistan being the member of National Risk Assessment implementation committee. It will also assess the stated mission, vision, values, and current objectives of the organization. This will lead to several findings and recommendations. However, before this, it will first provide a background of the institution and the time series of its evolution.

What are money laundering and terrorist financing?

At the beginning of the 1980s, many western countries were dealing with the growing catastrophe of drugs trafficking and money laundering. Money laundering is an action when a person changes money gained illegally into manageable form while hiding its origin (1). However, with the evolving financial system, innovations, and latest technology this sector is much more enormous and broader than the above definition. Through its evolving process, it becomes a good source of terrorist financing. The below table provides a summary and involves indicators in both acts.

Criteria	Money Laundering (ML)	Terrorism Financing (TF)
Motivation	Profit-Making	Ideological Purposes
Intention	Disguise the origin of the funds	Intimidate through violence
Source of Financing	<u>Illegal Resources</u> Extorsion Kidnapping Drug-trafficking Smuggling Fraud (Bribe)	<u>Illegal Resources</u> Extorsion Kidnapping Drug-trafficking Smuggling Fraud (Bribe)

¹ Note: Information on this paper is used on some of my other projects too

	Theft	Theft <u>Legal Resources</u> Donations Government Sponsorship Controlled Companies
Methods	Placement Integration Concealment	Placement Integration Concealment
Life Cycle	Circular	Linear

Table 1: *piranirisk.com*

Both acts share similarities and differences. The differences are: (1) motivation for money launderers is making money, while TF is ideological purposes, (2) intention for ML is disguising the source of funds while TF intimidates everything through violence, (3) life cycle for ML is circular while for TF is linear (Calle, 2020). They share a similar method of laundering; the source of funds is pretty much the same except for TF that which uses legal sources as well listed in the table above.

BACKGROUND AND HISTORY

The international community has established a long-lasting and far-reaching global governance regime intending to prevent illegal financial activities. Of which, the creation of the Financial Action Task Force (FATF) is one of their main achievements. This is not a very well-known organization to many unless they are involved with them, in one way or another. However, its activities encompass combating money laundering and terrorist financing and creating rules and regulations at the national and international levels. This section will provide a summary of FATF history, a summary of FATF activities, membership model, and mutual evaluation approach (method).

FATF HISTORY

As a response to the growing money laundering activities in 1980, the Council of Europe adapted and promoted a new principle called “Know Your Customer – KYC.” It obliged banks to ensure any bank account created shows the original beneficial owners of the fund. It was believed that banks unwittingly were used as intermediaries for the transfer of money which were potentially accumulated from criminal or illegal activities. Criminals were and still are using financial systems, making a deposit, sending it from one account to another to veil the beneficial owner. It is worth mentioning that until 2001, counter-terrorist financing was not under FATF mandate

The below timeline shows a snap of the FATF establishment timeline.

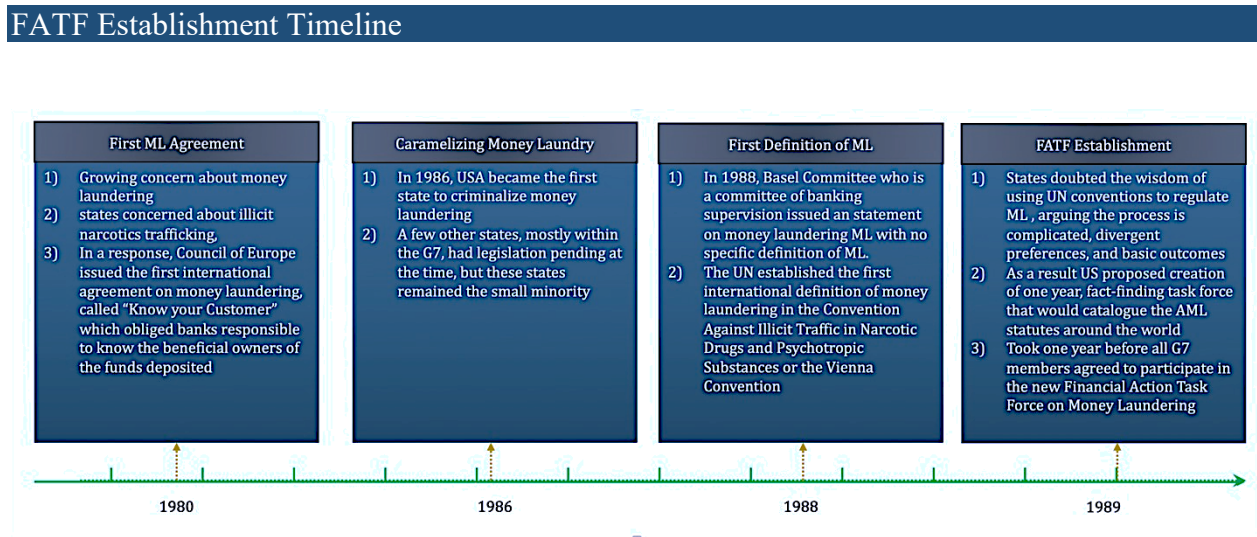


Figure 1: FATF Establishment Timeline - source²

In 1986, The United States of America, as a pioneer, criminalized money laundering, and in the same year, the US has passed the Money Laundering Control Act. However, the law still has some deficiencies as stated by Matthew R. Auten from Pace University School of Law, “Although the current money laundering statute is broad, there is widespread agreement that it

² <https://d-nb.info/1153291886/34>

does not criminalize the mere act of spending money generated by illegal criminal activity” (Auten, 2013, p. 2). In other words, the law does not criminalize purchases with illegally earned cash.

In 1988, Basel Committee on Banking Supervision (BCBS) published a money laundry statement with the following purpose: “This Statement of Principles is intended to outline some basic policies and procedures that banks’ managements should ensure are in place within their institutions to assist in the suppression of money-laundering through the banking system, national and international. The Statement thus sets out to reinforce existing best practices among banks and, specifically, to encourage vigilance against criminal use of the payments system, implementation by banks of effective preventive safeguards, and cooperation with law enforcement agencies.” (Supervision, 1988). However, it didn’t define what money laundry was. Therefore, the UN in the Convention Against Illicit Traffic in Narcotics, Drugs, and Psychotropic Substances or Vienna Convention defined Money Laundry for the first time in history.

“Article 3(1)(b) and (c) of the United Nations (UN) Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (the Vienna Convention) defines money laundering as:

- the conversion or transfer of property, knowing that such property is derived from any offense or offenses related to narcotic drugs and psychotropic substances or from an act of participation in such offense or offenses, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions.*
- the concealment or disguise of the true nature, source, location, disposition, movement, rights concerning, or ownership of property, knowing that such property is derived from an offense or offenses related to narcotic and psychotropic substances or from an act in participation in such an offense or offenses; and*
- the acquisition, possession, or use of property, knowing at the time of receipt of such property was derived from offense (s) related to trade in narcotic drugs and*

psychotropic substances or from an act of participation of such offense (s).” (Nations, 1988)

Regulating money laundering has raised the issue of UN wisdom among states. They were arguing that the process is complicated, and outcomes are basic. Therefore, the United States proposed the establishment of a one-year Financial Action Task Force to assess the process globally and come up with solutions. As a result, in 1989 FATF was created to exist only for one year while it has lasted until now.

FATF ACTIVITIES

The Financial Action Task Force (FATF) is an international organization with more than 200 member countries that are committed to combating Money Laundering and Terrorist Financing (ML/TF). It is the world ML/TF watchdog. “As part of its mandate, FATF creates Standards, Recommendations, Mutual Evaluation procedures to prevent illegal financial activities and the harm they will cause to a region” (FATF, 2012). The illegal activities include but are not limited to organized crime, corruption, and terrorism, human trafficking, dealing illegal drugs. It recently started working to stop funding of WMD. It also holds countries mutual evaluation to review their compliance with standards and recommendations.

The Financial Action Task Force constantly reviews and amends its standards and relevant documents to strengthen and richen their contents to meet the current global demands. The below chart shows a timeline of its activities.

FATF Activities Highlights Since Its Establishment

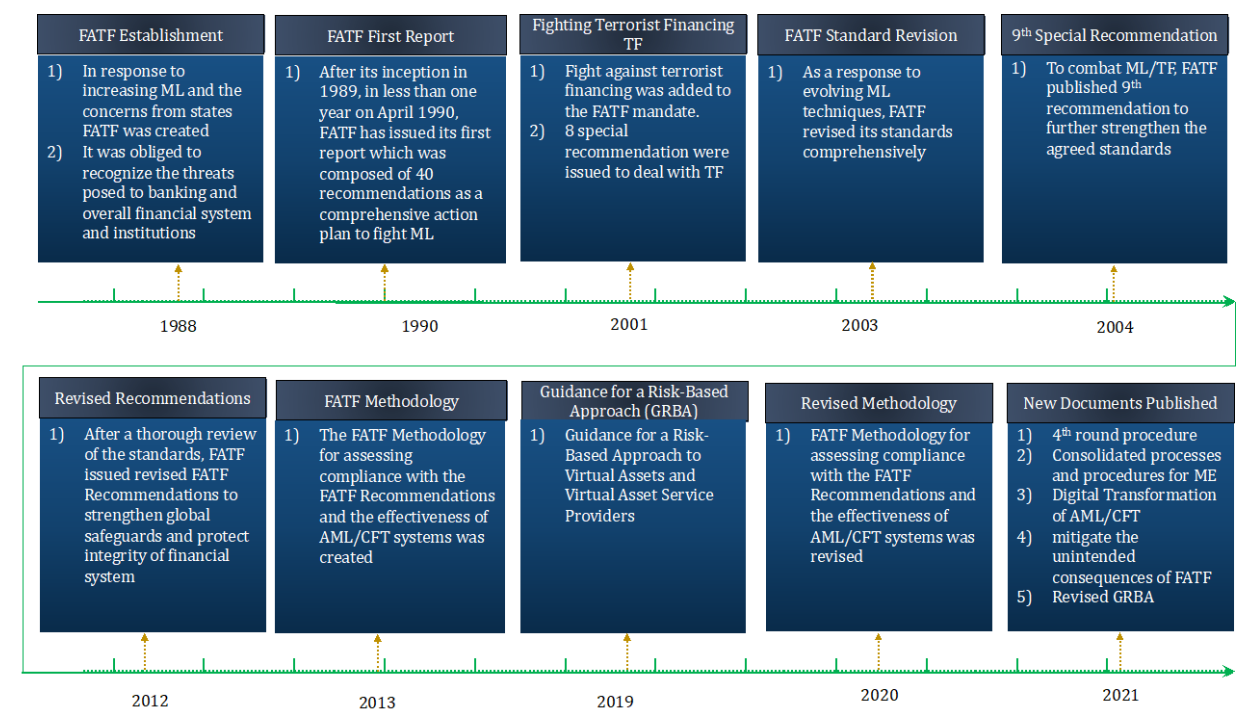


Figure 2: FATF Activities – Source³

MEMBERSHIP MODEL

FATF has 36 full members, nine regional groupings as associate members, European Union, and 28 observer bodies. It is a cross-national and multi-level organization

Criteria	Summary	Total
States - Member	FATF is composed of large and small states, powerful and weak states, developed and developing countering. Each state delegation is composed of different domestic administrations such as ministries of finance, law enforcement agencies, and central banks	36
Non-State Member	European Union	1

³ : <https://d-nb.info/1153291886/34>

Observers	The observers are global organizations like International Monetary Fund - IMF and World Bank - WB and World Customs Union	28
Consultative groups	Representatives from private sector industries who are directly affected by FATF activities	--

Table 2: Membership Model – Source⁴

FATF RECOMMENDATIONS [STANDARDS] REVIEW

FATF, as part of its mandate of setting standards and promoting effective implementation of AML/CFT legal, regulatory, and operational measures has prepared recommendation (Standards). The document has a list of comprehensive 40 recommendations that countries should implement. Based on FATF, “The FATF Recommendations, set an international standard, which countries should implement through measures adapted to their particular circumstances” (Force, 2022).

The main benchmarks set forth are: “(1) identify the risks, and develop policies and domestic coordination, (2) pursue money laundering, terrorist financing and the financing of proliferation, (3) apply preventive measures for the financial sector and other designated sectors, (4) establish powers and responsibilities for the competent authorities and other institutional measures, (5) enhance the transparency and availability of beneficial ownership information of legal persons and arrangements, and (6) facilitate international cooperation” (Force, 2022) . The following table provides a summary activity for each benchmark.

Recommendations	Summary
AML/CFT Policies and Coordination	
1. Assessing risks & applying a risk-based approach	Countries should identify their ML/TF risks and vulnerable areas, based on which they should apply a risk – based approach to ensure preventing

⁴ <https://www.fatf-gafi.org/about/membersandobservers/>

2. National cooperation and coordination	Countries should have policies on AML/CFT and regularly review them.
Money Laundering and Confiscation	
3. Money laundering offence	Criminalizing money laundering
4. Confiscation and provisional measures	Countries should adopt measures similar to those issues in the Vienna Convention, the Palermo Convention, and the Terrorist Financing Convention, and legislative measures, to enable freezing or seizing and confiscation: (a) property laundered, (b) proceeds from, or instrumentalities used in or intended for use in money laundering or predicate offences, (c) property allocated for use in, the financing of terrorism, terrorist acts or terrorist organizations, or (d) property of corresponding value
Terrorist Financing and Financing of Proliferation	
5. Terrorist financing offence	Criminalize terrorist financing and terrorist financing organization based on the Terrorist Financing Convention,
6. Targeted financial sanctions related to terrorism and terrorist financing	Implement targeted financial sanctions regimes to comply with United Nations Security Council resolutions relating to the prevention and suppression of terrorism and terrorist financing
7. Targeted financial sanctions related to proliferation	Implement targeted financial sanctions to comply with UN Security Council resolutions relating to the prevention, suppression, and disruption of proliferation of weapons of mass destruction and its financing
8. Non-profit organizations	Review the adequacy of laws and regulations that relate to non-profit organizations
Preventive Measures	
9. Financial institution secrecy laws	Ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations

10. Customer due diligence	Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names
11. Record keeping	Maintain, for at least five years, all necessary records on transactions
12. Politically exposed persons	Financial institutions should be required, to know beneficial owner, in addition to performing normal customer due diligence measures
13. Correspondent banking	Performing normal customer due diligence
14. Money or value transfer services	Ensure that natural or legal persons that provide money or value transfer services (MVTs) are licensed or registered
15. New technologies	Assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of new products and new business practices, and (b) the use of new or developing technologies
16. Wire transfers	Ensure that financial institutions include required and accurate originator information
17. Reliance on third parties	May permit financial institutions to rely on third parties to perform elements (a)-(c) of the CDD measures set out in Recommendation 10
18. Internal controls and foreign branches and subsidiaries	Financial institutions should be required to implement programs against money laundering and terrorist financing
19. Higher-risk countries	Enhanced due diligence measures to business relationships and transactions with natural and legal persons
20. Reporting of suspicious transactions	If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, by law, to report promptly
21. Tipping-off and confidentiality	Financial institutions, their directors, officers, and employees should be: (1) protected by law from criminal and civil liability (2) prohibited by law from disclosing (“tipping-off”) the fact that a suspicious transaction report (STR) or related information is being filed with the FIU

22. DNFBPs: Customer due diligence	Due diligence and record-keeping requirements set out in Recommendations 10, 11, 12, 15, and 17
23. DNFBPs: Other measures	The requirements set out in Recommendations 18 to 21
Transparency and Beneficial Ownership of Legal Persons and Arrangements	
24. Transparency and beneficial ownership of legal persons	Assess the risks of misuse of legal persons for money laundering or terrorist financing and take measures to prevent their misuse
25. Transparency and beneficial ownership of legal arrangements	Prevent the misuse of legal arrangements for money laundering or terrorist financing
Powers and Responsibilities of Competent Authorities and Other Institutional Measures	
26. Regulation and supervision of financial institutions	Ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations
27. Powers of supervisors	Supervisors should have adequate powers to supervise or monitor, and ensure compliance by, financial institutions
28. Regulation and supervision of DNFBPs	Designated non-financial businesses and professions should be subject to regulatory and supervisory measures too
29. Financial intelligence units	Establish a financial intelligence unit (FIU) that serves as a national center for the receipt and analysis of: (a) suspicious transaction reports; and (b) other information relevant to money laundering, associated predicate offences and terrorist financing, and for the dissemination of the results of that analysis
30. Responsibilities of law enforcement and investigative authorities	Ensure that designated law enforcement authorities have responsibility for money laundering and terrorist financing investigations within the framework of national AML/CFT policies

31. Powers of law enforcement and investigative authorities	Competent authorities should be able to obtain access to all necessary documents and information for use in those investigations, and in prosecutions and related actions
32. Cash couriers	Measures be in place to detect the physical cross-border transportation of currency and bearer negotiable instruments, including through a declaration system and/or disclosure system
33. Statistics	Countries should maintain comprehensive statistics on matters relevant to the effectiveness and efficiency of their AML/CFT systems
34. Guidance and feedback	Supervisors and SRBs should establish guidelines, and provide feedback, which will assist financial institutions and designated non-financial businesses and professions in applying national measures to combat money laundering and terrorist financing
35. Sanctions	Supervisors and SRBs should establish guidelines, and provide feedback, which will assist financial institutions and designated non-financial businesses and professions in applying national measures to combat money laundering and terrorist financing
International Cooperation	
36. International instruments	Take immediate steps to become party to and implement fully the Vienna Convention, 1988
37. Mutual legal assistance	Rapidly, constructively, and effectively provide the widest possible range of mutual legal assistance in relation to money laundering
38. Mutual legal assistance: freezing and confiscation	Ensure that they have the authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and confiscate property laundered
39. Extradition	Countries should constructively and effectively execute extradition requests in relation to money laundering and terrorist financing, without undue delay

40. Other forms of international cooperation	Countries should ensure that their competent authorities can rapidly, constructively, and effectively provide the widest range of international cooperation in relation to money laundering, associated predicate offences and terrorist financing
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Table 3: FATF Recommendations (source)

FATF has been updating and upgrading its documents over the course of years to ensure the evolving financial market and new products introduced are not source for ML/TF. Therefore, in 2021 and 2022, FATF has adapted or amended some of its documents to further strengthen its AML/CFT regime, the list a summary is added to the table below:

Documents	Summary
2020-2021 Report	FATF in their report showed interest in focusing on the illegal trade in wildlife, forestry crime, illegal mining, and waste trafficking. These crimes, based on FATF report, generates billions per year, but even worse than that is creating financial costs and health damages, and exacerbating climate change.
Digital Transformation of AML/CFT for Operation Agencies	<p>Detection of Suspicious Activities and Analysis of Financial Intelligence</p> <p>“Technology has immense potential to increase the efficiency of anti-money laundering (AML) and counter terrorist financing (CFT) workflows and the effectiveness of AML/CFT efforts. In recent years, operational agencies across the Financial Action Task Force (FATF) Global Network and Egmont Group of Financial Intelligence Units (Egmont Group), regardless of their development and size, have been incorporating different digital tools to assist their operational efforts. These tools range from automation to the use of large datasets, big data and advanced analytics such as artificial intelligence (AI) and machine learning” (FATF, FATF , 2021)</p>

<p>Procedures for the FATF Fourth Round of ALM/CFT Mutual Evaluations</p>	<p>“The FATF is conducting a fourth round of mutual evaluations for its members based on the FATF Recommendations (2012), and the Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems (2013), as amended from time to time. This document sets out the procedures that are the basis for that fourth round of mutual evaluations.” (FATF, PROCEDURES FOR THE FATF FOURTH ROUND OF AML/CFT MUTUAL EVALUATIONS, 2018)</p>
<p>Consolidated Processes and Procedures for Mutual Evaluations and Follow-up</p>	<p>“Based on the Procedures for the FATF 4th Round of AML/CFT evaluations, these are the “Universal Procedures” that should form the basis for the evaluations conducted by all assessment bodies. Assessment bodies should periodically review their procedures to identify on-going challenges and update their procedures to address those challenges.” (FATF, Consolidated Processes and Procedures for Mutual Evaluations and Follow-Up, 2021)</p>
<p>High-Level Synopsis of the Stock take of the Unintended Consequences of the FATF Standards</p>	<p>“The FATF dedicates significant resources to examining and mitigating de-risking and financial exclusion, as well as ensuring that countries’ measures to protect NPOs from terrorist financing abuse are focused and proportionate. These efforts include amendments to the FATF Standards in 2012 and 2016 to ensure that they are in line with the risk-based approach (RBA), including measures aimed at protecting NPOs vulnerable to terrorist financing abuse; as well as multiple guidance and best practices papers and continuous engagement with relevant external stakeholders.” (FATF, High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards, 2021)</p>

Table 4: FATF Recent Documents

FATF RECOMMENDATION IN THE CONTEXT OF AFGHANISTAN

This section will provide a summary of my personal experience of FATF recommendation implementation in the context of Afghanistan (2020). In 2020, I was appointed as head of the committee for implementation of the Afghanistan National Risk Assessment action plan. I will

first provide a summary of NRA action plan and then will focus on FATF recommendations that I found difficult to comply with. I would like to indicate how these recommendations can be a hinder on achieving other national economic development goals.

Afghanistan National Risk Assessment Summary

The national ML/TF risk assessment was conducted based on the Da Afghanistan Bank (Central Bank of Afghanistan) strategic plan and FATF Recommendation to identify, assess and understand Afghanistan ML/TF risks, and ensure that an adequate AML/CFT regime is applied to address such risks. The deficiencies and gaps outlined in the national risk assessment are scrutinized, and for the areas where rooms for improvement are identified, this action plan is developed. The action plan consists of 7 main pillars summarized in the table below.

Pillar Name	Summary	Total	2020	2021	2022	2023
(1) AML/CFT legal and regulatory framework	The NRA report revealed that the residing AML/CFT legal and regulatory framework in Afghanistan is comprehensive. However, the findings of the NRA suggest that certain key areas in the AML/CFT regulatory framework need to be built upon and further improved	18	3	12	3	--
(2) Developing & Strengthening Operational Frameworks and Performance of AML/CFT Regime's Stakeholders	The financial intelligence, supervisory authorities, LEAs, and criminal justice system are the key players of the AML/CFT regime and serve as implementing bodies of the regime in the country. Following the assessment, it has been noticed that at some agencies their operational frameworks or mechanisms in fight against ML, TF and financial crimes need further enhancement	22	9	10	3	--

	while at some other agencies such tools and frameworks do not exist, and they should develop such mechanisms from scratch					
(3) Developing & Enhancing Reporting Entities' AML/CFT Policies, Procedures, And Solutions	Moreover, the NRA findings suggest that reporting entities to discharge their responsibilities effectively and efficiently and to be fully compliant with AML/CFT requirements they need to designate and equip themselves with AML/CFT solutions. Different sectors alongside their relevant needs for development of policy and procedural frameworks have been outlined in the findings of the NRA	14	6	5	2	1
(4) Capacity Building of AML/CFT Regime's Stakeholders	Capacity building of LEAs, prosecutors, reporting entities and supervisory authorities is a key requirement for effective investigation, prosecution and conviction of financial crimes including money laundering and terrorist financing. As per the NRA findings, the current capacity levels of these entities are not sufficient to effectively combat money laundering, terrorist financing and other financial crimes	21	9	11	3	14
(5) Awareness Programs	For a comprehensive application of a strict AML/CFT regime, it is of utmost importance that a general awareness program is undertaken to create and enhance compliance aware culture across the different sectors and their related customers	6	3	3	--	--

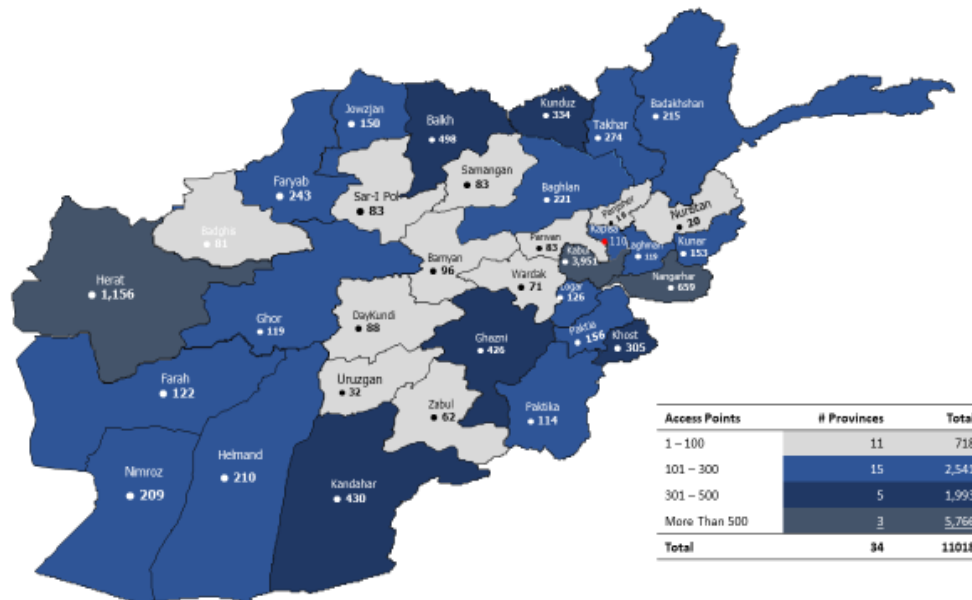
(6) Strengthening Counter Financing Terrorism Operational Framework and Efforts	The NRA report revealed that there is an effective mechanism and regulatory framework for combating financing of terrorism in the country. Also, the measures adopted to combat TF have been effective and dissuasive	9	4	5	--	2
(7) Enhancing & Coordination National and International Cooperation	Inter-agency cooperation and coordination mechanism is a key requirement for effective application of AML/CFT regime in the country. Such mechanism facilitates the much-needed flow of intelligence information which would result in significant improvement in value added products related to financial crime investigation, prosecution, and convictions. To further enhance the existing inter-agency cooperation and coordination	<u>10</u>	<u>10</u>	<u>8</u>	<u>8</u>	<u>8</u>
Total		100	44	54	19	25

Table 5: NRA Afghanistan

Now, let’s look at the recommendation that I found them hard to comply based on my experience.

Recommendation 10: this recommendation requires financial institutions to know their customers and should not keep anonymous accounts. The implication of this recommendation is in contradiction with financial inclusion of Afghanistan where financial excluded population stands at ~85%, based on Financial Inclusion Plan of

Afghanistan. The sector currently hosts 3.9 million accounts with a card holder base of 891 K card holders expended across the country with Azizi Bank issuing 58% followed by New Kabul Bank at 18% and AIB at 14%. Of the 3.9 million account holders 44% is reported to be in Kabul, followed by Balkh at 8%, Herat at 6%, Kandahar at 5% and Nangarhar at 4% followed by Kunduz at 3% with access points placement 36% in Kabul,



10% in Herat, 6% in Nangarhar, 5% in Balkh, 4% in Kandahar, and 3% in Kunduz⁵.

Access points across country

Figure 3: Financial Inclusion Plan (FIP)

There are two main issues for lower financial inclusion in Afghanistan, first their nature of operating in isolation which we will not cover in this report, and second the issue of

⁵ The information on financial inclusion is taken from Financial Inclusion Plan which is not published

FATF recommendation # 10 which requires thorough due diligence of the customer.

Here, it seems like several issues have not been taken into consideration: (1) Afghanistan is a least developed country, (2) most of the people do not even have a national ID, and (3) most of the daily routines are done manually not digitally, (4) most of the information is scattered and it hard to verify. Therefore, all these problems with FATF Rec #10 made it hard for financial institutions to bank more and more people.

Recommendation 11: This recommendation requires financial institutions to keep a record of any transaction for up to 5 years. However, now let's look at the Kabul Bank scandal case. The Brain George book on the Kabul Bank scandal, "The Kabul to Dubai Pipeline: Lessons Learned from the Kabul Bank Scandal", shows how some people believe that the scandal had roots in the 1980s when Sherkhan Farnood started the Hawala system from his dorm room in Moscow while pursuing education in the textile institute. This system was transferring money between Afghanistan Russia and Central Asia. Based on the book authorities late suspected that he was involved in Money Laundering activities. He was lucky and got a banking license from the government of Afghanistan, however, back then his involvement with ML was not known to officials in the country. Hence, he opened the bank when international aid was abundant, and businesses were growing in Afghanistan. After a couple of years of operation in 2010, the Kabul Bank scheme resulted in \$1 Billion in illicit financial outflows from Afghanistan. Based on the information from the same book, \$ 410 Million was transferred to the United Arab Emirates. Although there is a lot involved in the Kabul Bank case, my whole point is that keeping records for 5 years is not just enough, it should be increased to 10-15

years at least since now keeping records is much easier and takes less space with the new technology.

Recommendation 15: the recommendation obliges countries and financial institutions to identify and assess the money laundering or terrorist financing risks of new products, new business models, and developing technologies. Putting such responsibility on a country like Afghanistan or any other least developed country is expecting too much. It is important to mention that in the public sector in our case The Central Bank employees' capacity is too low to be able to identify the risk of any given technology and new services and products in the financial market. A country with the lowest technological skills, low capacity, and least formal economy will not be able to complete such a commitment. As a result, it will be non-compliant. Therefore, to address this problem FATF can either train some of the key employees and/or send some technical delegation to assess the risk of a new product.

Recommendation 22: this obliges due diligence for non-financial businesses and professions (NFBPs). Again, conducting due diligence in this sector is extremely challenging in a country with no formal economy and where any transaction is cash-based. This sector includes businesses like casinos, real estate agents, stone and metals dealers, lawyers, and notaries. These businesses were operational for decades and suddenly conducting due diligence can result in several problems: (1) political problems if the sector is strong and have politician support, (2) the stakeholders are not exposed to the new financial systems where they could record their information on enhanced

computerized systems, but rather the record everything on a notebook, and (3) social unrest.

One of the examples of political unrest is when DAB was trying to formalize the activities of non-banking financial institutions like money exchange service providers and money transfer companies, it resulted in a high political tension between the executive and parliament branches of Afghanistan in 2020, and forex companies strike and dollar appreciation against Afghani, shops close-down, and money transfer problems for civilians. A detailed example of this problem is stated under “Private Sector Influence” on pages 15-16. Therefore, to address this issue, FATF should categorize countries and expect them to comply based on their resources, access to information, and skills.

METHOD | MUTUAL EVALUATION | COMPLIANCE CHECK

This section will provide a brief about FATF methodology regarding countries compliance with “FATF Recommendation” or standards. For technical compliance, FATF has adopted complementary to assess the AML/CFT regime effectiveness. The methodology has two sections:

- (1) “*The technical compliance* assessment addresses the specific requirements of the FATF Recommendations, principally as they relate to the relevant legal and institutional framework of the country and the powers and procedures of the competent authorities. These represent the fundamental building blocks of an AML/CFT system.” (FATF, Methodology For Assessing Technical Compliance with The FATF Recommendations And The Effectiveness Of AML/CFT Systems , 2020)
- (2) “*The effectiveness assessment* differs fundamentally from the assessment of technical compliance. It seeks to assess the adequacy of the implementation of the FATF Recommendations and identifies the extent to which a country achieves a defined set of outcomes that are central to a robust AML/CFT system. The focus of the effectiveness assessment is therefore on the extent to which the legal and institutional framework is

producing the expected results.” (FATF, Methodology For Assessing Technical Compliance with The FATF Recommendations And The Effectiveness Of AML/CFT Systems , 2020)

The results of both methods will show the extent to which a country is compliant with the Standards and how successful it is in maintaining a strong AML/CFT regime. The process includes preparation for the on-site visit, quality and consistency view, interaction with the country before the plenary discussion, plenary discussion, publication, the follow-up process, joint Mutual evaluation process, and IFI led assessment (FATF, Consolidated Processes and Procedures for Mutual Evaluations and Follow-Up, 2021). Please see Annex #2 for details of the mutual evaluation process.

MANAGEMENT ANALYSIS

This section will provide an analysis of FATF’s management and operation issues. The main objectives of FATF are: (1) setting international standards to prevent illegal activities that result in harming the society, and (2) “working to generate the necessary political will to bring about national legislative and regulatory reforms in these areas” (FATF, FATF, n.d.). The below section will provide an analysis of issues if solved will make achieving the above goals easier.

ENSURING COMPLIANCE

As part of FATF efforts, it has prepared and published the “FATF 40 Recommendation” to meet the objective of setting international standards for a sound AML/CFT regimen (FATF, FATF 40 Recommendations, 2010). The recommendations are general and open-ended, and countries can develop their legal documents. This creates a documents pile-up, a waste of time for both countries and evaluators, and a waste of resources.

Next, after countries agreed with the norms, they will prepare laws and regulations to show compliance, but this does not mean there will be no further violation. Thus, how can FATF ensure that new laws are implemented, violators are arrested, prosecuted, and held accountable, and there are no loopholes.

Therefore, the first problem can be solved if FATF comes up with sample laws and regulations with some parts that could be adjusted by countries. The second problem is still very challenging, however, if a violation is reported FATF can follow up the case until the end, which may allow them to find connected violators as well. In addition, FATF can adapt a new ranking system, where it could rank countries as first and last in terms of compliance and AML/CFT regimes (i.e., Afghanistan is 10th best country or another as 200th). The latter shows a weaker AML/CFT regime and less compliance.

FATF RAPID ADJUSTMENT TO INNOVATIVE FINANCIAL SYSTEM

With an increased and rapid change of the financial system in the world, the new technology, and financial innovations, FATF must also keep updating its recommendations and promote financial integrity. For instance, it is commonly known that online banking, transfer of money, cryptocurrency are the current century's financial innovations that can pose a greater risk to the financial system in the world. This needs a systematic and much more technical approach to be addressed. Therefore, in 2019, FATF adopted guidance for a risk-based approach to virtual assets and virtual asset service providers. The document was revised in 2021, however, the question is how effective this new document is in terms of tackling down the existing virtual problems. In addition, it does not mean that this is the peak of innovation for the financial system and will not further grow or change. Therefore, any changes in the financial system need FATF's attention.

It is recommended that FATF create a new division that will be responsible for assessing the existing and new financial innovations. It should identify the vulnerable areas and propose solutions. Therefore, it will help with tackling the potential risk in the earlier stages to avoid greater harm to the world financial system. This will also help FATF to evolve along with an innovative financial system.

STRATEGIC PLANNING

It is not uncommon for an international organization like FATF to not have a “Countries Mutual Evaluation Plan” for upcoming years. However, such a plan is not available on their

website. It is believed that if FATF publishes countries' evaluation schedules online. It will keep countries alerted and probably result in faster compliance. In addition, FATF can send semi-annual notifications for upcoming evaluations to concern countries. Part of the reason is that senior officials in many governmental organizations keep rotating much faster. Therefore, the notification can attract the attention of the new person that is in charge.

PRIVATE SECTOR INFLUENCE

FATF is composed of member from different jurisdictions, small to large organizations, and those representing major financial centers all over the world. The private sector is also part of the members. “Inês Sophia De Oliveira argues that while powerful states historically determined the regime’s direction, today the private sector plays a much larger role, even challenging the primacy of the state. The private sector—in particular the financial services industry and its high-level representatives—is becoming a non-great power influencer in FATF.” (Nance, 2017)For example, Afghanistan's economy has been dominated mainly by cash-oriented activities, which have incorporated Money Service Providers (MSPs) and Foreign Exchange Dealers (FXD) as significant participants who have historically played a key role in Afghanistan's economy. Customers prefer this sector's services as it is often quick, cheap, conveniently accessible, involves simplified dealings, and is reliable. The sector has been enjoying a high level of customer trust and loyalty.

Although MSPs and FXDs utilize bank accounts to conduct operations and channel their transactions, mostly MSPs and FXDs dealings are cash oriented. This has resulted in difficulties in ensuring an effective due diligence process and, in some cases tracing transactions. MSP and FXD sectors in Afghanistan are perceived to have higher ML/TF risk affiliated with them. Based on the Afghanistan National Risk Assessment results, the MSP and FXD sector is flagged as a high-risk sector. To improve the formal financial channels, DAB has stopped issuing individual licenses and initiated the process to corporatize the individual MSPs and FXDs across the country.

The process of corporatization started in 2020 with too many pushbacks and political challenges. Besides other reasons, the main reason was government high officials’ involvement in

the market. Members of parliaments and even one of the deputies was a foreign exchange dealer. He was supposed to have many individual licenses, before coming to parliament, they had these businesses running for years.

Now this group had all political power and a good amount of money to resist the reforms. On different occasions, as a means of resistance, they closed the exchange market, stopped selling USD all over Afghanistan, protested in larger groups, and used political pressure to hinder the process. However, DAB was able to provide different kinds of legalized incentives, decrease the requirement for getting a corporate license, arrange training sessions for the FXDs, and develop and deploy systems for them. Finally, 75 money service providers who were attending the USD auction got corporate licenses. It can be inferred that governments are no longer autonomous, the private sector either backs the government or they are directly involved which makes compliance to international norms complicated, especially if they are white-collar criminals. Therefore, the Afghanistan money exchange license issue is a good example of what Inês Sophia De Oliveira argues in her article about the private sector.

LOCATION

FATF - is an international independent organization with absolute autonomy and more than 30 years of operation - is in the OECD building which questions its impartiality. Therefore, FATF better get a new location of its own.

CONCLUSION AND RECOMMENDATIONS

This section will provide a summary of findings and recommendations in the table below:

Findings	Recommendations	Deadline
General Recommendation		
<i>Recommendations</i> FATF 40 Recommendation is an incredible document, however, there are some challenges associated: 1. Recommendations are general and open-ended. This results in	1. FATF should prepare unified sample laws and regulations with some adjustment options where countries can revise the adjustable areas 2. The second problem is still very challenging, however, if a violation is	End 2022 Continues

<p>the creation of different kinds of legal documents by different countries. The outcome will be different documents with a similar purpose that which is a waste of time and resources</p> <p>2. There is no verification system available to verify full compliance</p>	<p>reported FATF should follow the case until it is prosecuted, it may even be able to identify a related and connected chain of violators.</p> <p>3. FATF can adapt a new ranking system, where it could rank countries as first and last in terms of compliance and AML/CFT regimes (i.e., Afghanistan is 10th best county or another as 200th). The latter shows a weaker AML/CFT regime and less compliance.</p>	<p>2023</p>
<p><i>FATF Rapid Adjustment to innovation</i></p> <p>The financial system is evolving faster with the new technology and internet. The cryptocurrency poses a higher risk to financial integrity and allows the opportunist to misuse it</p>	<p>FATF should create a new division that will be responsible for assessing the existing and new financial innovations. It TOR should be identifying the vulnerable areas of an invention and propose solutions.</p> <p>As a result, it can tackle the potential risk in the earlier stages to avoid greater harm to the world financial system. This will also help FATF adjust to an innovative financial system.</p>	
<p><i>Strategic Planning</i></p> <p>Lack of a “Countries Mutual Evaluation Plan” on the FATF website.</p>	<p>1. FATF publishes countries’ evaluation schedules online. It will keep countries alert and probably result in faster compliance.</p> <p>2. FATF should send semi-annual notification for upcoming evaluation to</p>	<p>Jan 2022</p>

	<p>concern countries. Part of the reason is that senior officials in many governmental organizations keep rotating much faster. Therefore, the notifications can attract the attention of the new person and will show its importance.</p>	
<p><i>Private Sector – influence</i></p> <p>“Inês Sophia De Oliveira argues that while powerful states historically determined the regime’s direction, today the private sector plays a much larger role, even challenging the primacy of the state. The private sector—the financial services industry and its high-level representatives—is becoming a non-great power influencer in FATF.” (Nance, 2017)</p>	<p>To address this problem, we may need to change policies internationally to avoid private funding of elections</p>	<p>2022</p>
<p><i>Location</i></p> <p>Location is another issue that FATF should work on to prove and ensure its independence as an international organization</p>	<p>Move to a place owned by FATF</p>	<p>2022</p>
	<p><i>Logical Framework</i></p> <p>Should be implemented</p>	
<p>Recommendations Least developed countries LDC</p>		

Recommendation 10: requires strong due diligence that hinder financial inclusion	FATF should encourage financial integration and as soon as a LDC banks at least 60% of its citizens, then stronger due diligence process should be imposed	2022
Recommendation 11: this recommendation requires financial institutions to keep record of any transaction for up to 5 years.	At this time where storing data is digitalized and is very easy, accessible with a lower cost, this recommendation should require keeping records for at least 10-15 years to make sure violators are being followed	2022
Recommendation 15: the recommendation obliges countries and financial institutions to identify and assess the money laundering or terrorist financing risks of new products, new business models, and developing technologies	To address this problem FATF can either train some of the key employees and/or send some technical delegation to assess the risk of a new product.	
Recommendation 22: this obliges due diligence for non-financial businesses and professions (NFBPs).	FATF should categorize countries and expect them to comply based on their resources, access to information, and skills. In other words, LDC should be given some flexible rulings	2022

Table 6: Recommendation

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APPENDIX

#1: RESULTS-BASED LOGICAL FRAMEWORK

Out put	Outcome	Performance Indicator	Baseline	Data Source	Data Collection Strategy
Objective 1: Get countries agree on standards by December 2023					
<ul style="list-style-type: none"> ▪ Revise 40 recommendations ▪ Publish standards ▪ 	<ul style="list-style-type: none"> ▪ National risk assessment done by countries in consistent with the standards ▪ Countries prepared laws, regulations, action plans to comply with standards ▪ Universal approach for evaluation 	<ul style="list-style-type: none"> ▪ Timeline by which national risk assessment by countries is completed ▪ No. of countries who completed national risk assessment 	<ul style="list-style-type: none"> ▪ NA 	<ul style="list-style-type: none"> ▪ FATF Recommendations ▪ FATF Standards ▪ FATF Report 	<ul style="list-style-type: none"> ▪ FATF website
<ul style="list-style-type: none"> ▪ Countries should conduct national risk assessment 	<ul style="list-style-type: none"> ▪ Developed action plans ▪ Prepared new or amended existing laws, and regulations, as per the standards ▪ Countries have formed high committee to follow up on implementation of the standards 	<ul style="list-style-type: none"> ▪ No. of action plans prepared ▪ No. of countries that formulated laws, regulations ▪ Timeline by which committee is formulated ▪ No. of recommendations implemented ▪ 	<ul style="list-style-type: none"> ▪ NA 	<ul style="list-style-type: none"> ▪ Progress reports ▪ Administrative documents 	<ul style="list-style-type: none"> ▪ Retrieved from website
Objective 2: Have countries implement the standards by 2026					
<ul style="list-style-type: none"> ▪ Countries are mutually evaluated ▪ Economic sanction of certain countries 	<ul style="list-style-type: none"> ▪ Countries in grey and blacklist prepared new or amended their existing 	<ul style="list-style-type: none"> ▪ Which new laws are prepared, and which are amended? ▪ Any improvements 	<ul style="list-style-type: none"> ▪ NA 	<ul style="list-style-type: none"> ▪ Procedures for the FATF Mutual Evaluation 	<ul style="list-style-type: none"> ▪ FATF website

	<ul style="list-style-type: none"> ▪ laws and regulations countries receiving sanctions amend their AML/CFT Regime 	<ul style="list-style-type: none"> in their AML/CFT regime 			
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Table 7: Log Frame

The Mutual Evaluation Process

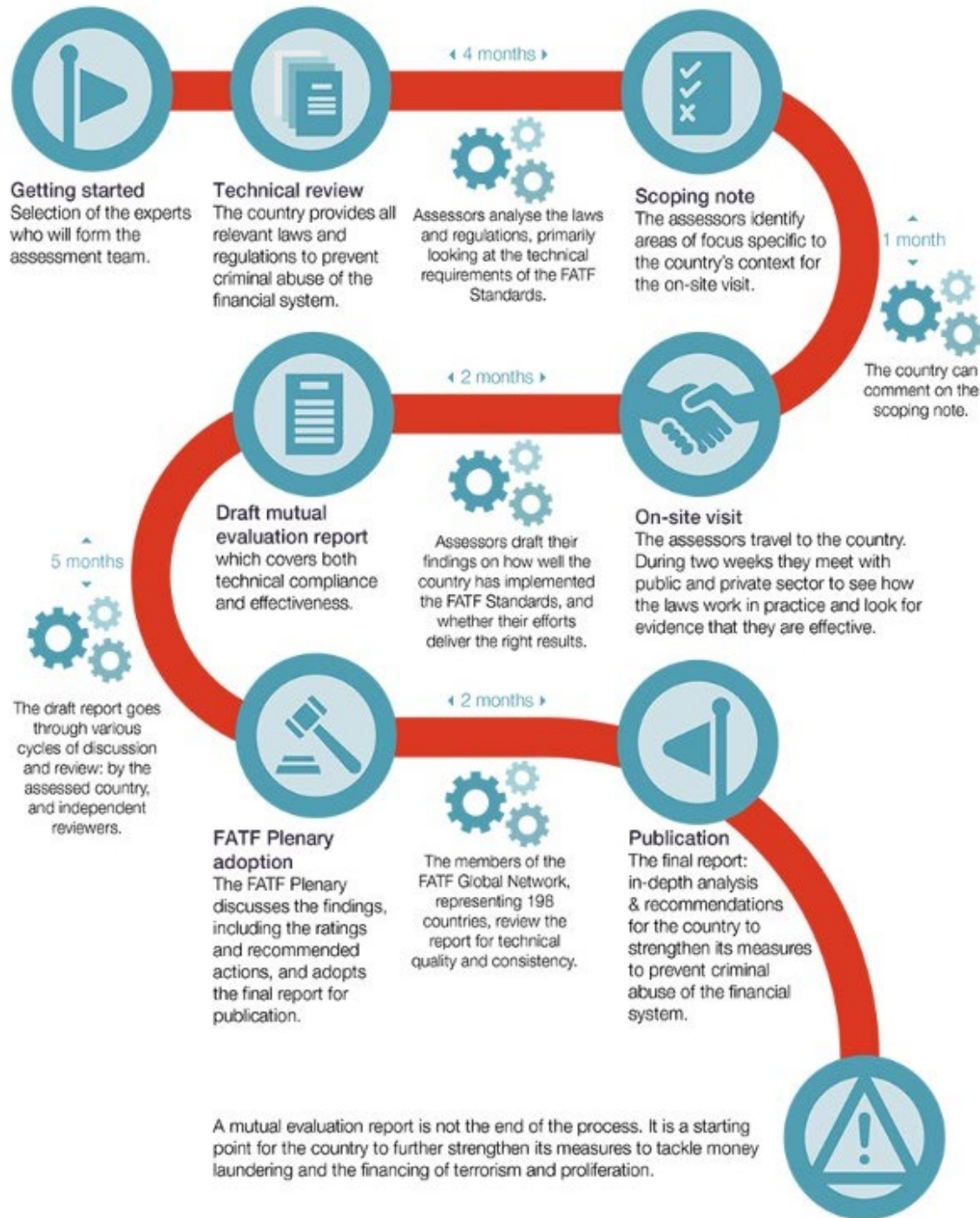


Figure 4Table 8: Mutual Evaluation process:

Source: [http://www.fatf-gafi.org/publications/mutualevaluations/more/more-about-mutual-evaluations.html?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/mutualevaluations/more/more-about-mutual-evaluations.html?hf=10&b=0&s=desc(fatf_releasedate))