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Briefing paper

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Laundry-wash

FATF ratings clean the toughest stains

More than 120 jurisdictions' anti-money laundering systems will be evaluated in the next decade. Leaked results from the UK's 'mutual evaluation' reveals an effectiveness deficit flagged in scientific research, and opportunities for countries to boost FATF ratings.

Update: Incredulity mounts. UK ratings apparently upgraded during plenary. Sources confirm that the UK's scores for 'Immediate Outcomes' 10 and 11, rated 'Substantial" by independent assessors were upgraded to 'High' in response to lobbying by English officials during October's plenary. This would place the UK first amongst 60 nations, one above the United States, from one place below.

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More than 120 jurisdictions' anti-money laundering systems will be evaluated in the next decade. Leaked results from the UK's 'mutual evaluation' reveal an effectiveness deficit flagged in scientific research, and opportunities for countries to boost FATF ratings.

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Gold-plated regime validated?

Compliance professionals often regard 'mutual evaluations' under the aegis of the Paris-based Financial Action Task Force ([FATF]) the gold-standard in assessing the effectiveness of anti-money laundering regimes.

The United Kingdom's anti-money laundering regime is also commonly regarded amongst the world's strongest, termed 'gold-plated' for its longstanding comprehensive coverage of lawyers, accountants and real estate agents.

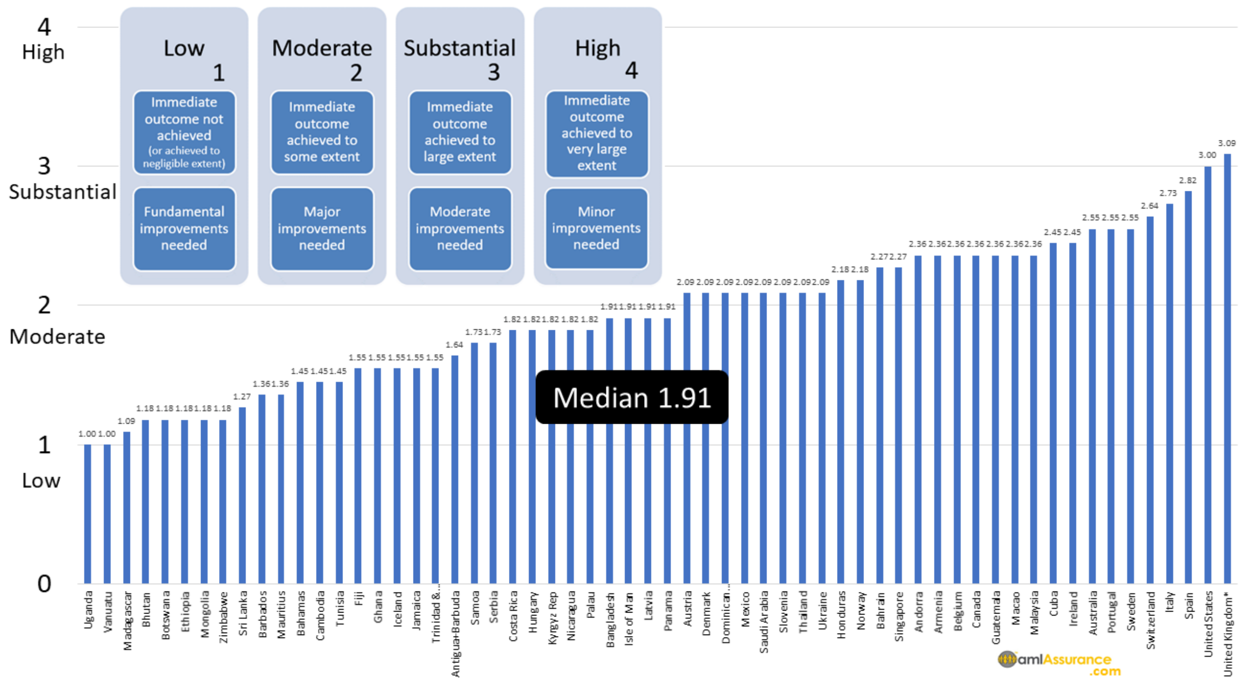
(New Zealand recently extended its AML laws to the professions, Canada only partly does so, the United States does so mostly with voluntary guidelines, and Australia largely exempts the professions from anti-money laundering obligations).

Surely, then, a resounding tick from FATF should be unremarkable.

But many practitioners were baffled by a [leaked report] over the weekend. First, when it appeared that the UK's anti-money laundering regime was due to receive the second highest rating among 61 countries assessed to date. (Israel's report, also concluded and not yet published, was not leaked).

Then, that English officials lobbied in plenary for two measures to be re-rated upwards, ranking the UK's 'effectiveness' measure just ahead of the US. [If only there was a good measure of incredulity to match the response from practitioners to that news: both as to the results and to officials' judgment in straining the boundaries of reality].

FATF effectiveness ratings: consolidated, ranked: 59 published + UK (leaked)



Source: [Visualising all AML/CFT evaluations]

Leaked UK report baffles experts

The UK's reported scores rank its anti-money laundering regime ahead of the United States, yet both countries feature prominently in nearly every major money laundering scandal.

With hundreds of known cases with staggering sums involved, both countries are widely regarded major centres for illicit funds, from domestic profit-motivated crime and as attractive destinations for the profits from drugs-, arms- and human-trafficking, sex- and labour-exploitation, corruption, illicit gem- and wildlife-smuggling, tax evasion and more.

Practitioners' messages and social media postings reflect incredulity:

- "How the hell did they manage to get rated so highly?"
- "What a frustrating paradox."
- "If their controls are so 'effective', then why are they having/have they had that parliamentary inquiry into Economic Crime?"
- "Glaring contradictions between what we, as practitioners, observe and government flunkies seem to be shovelling the FATF".
- "Garbage in garbage out is an adage we are all familiar with so no surprises."
- "I thought this was supposed to be an objective assessment of the UK plc governance framework for AML and we know it to be broken and the system not fit for purpose. I used to hear a phrase 'you can't make a silk purse out of a sow's ear'...evidently you can!!!"
- "We have (according to the report) the most effective AML regime in the world (alongside the US) and yet London property is the preferred asset of choice for corrupt and criminal operatives, and UK entities have been at the heart of every major money laundering story for years. Go figure."
- "the weaknesses are arguably very fixable if only there was the political will."

The apparent dichotomy between theoretical standards and observable activity is, however, unlikely to surprise those operating in the gritty reality of serious profit-motivated crime and its requisite laundering.

Major money laundering country, meet theoretical standards

The US State Department labels the US and UK "major money laundering countries". Plainly stated, US and UK "financial institutions engage in currency transactions involving significant amounts of proceeds from international narcotics trafficking".

Noting how its approach differs from the global standard-setter, in 2016 the State Department described FATF's methodology as focused on "compliance with stated criteria".

In contrast, the State Department explicitly recognises that a country may have "comprehensive anti-money laundering laws" yet still be "a major money laundering jurisdiction". Its 2018 report adds that inclusion on its list isn't about whether a country makes "strong efforts" to combat laundering, or if it meets "relevant international standards"; but simply whether it is a major money laundering jurisdiction.

Before a new US administration in 2016 narrowed the definition to its legislative minimum, the State Department identified jurisdictions enabling significant amounts of proceeds from "all serious crime". By that more expansive definition likewise, the UK and US featured as major money laundering countries every year since at least 1999. As the State Department regards them both still.

Nor is the apparent dichotomy likely much surprise to many in the scientific community.

Scarcely a rounding error impact on criminal finances

Reminiscent of climate change science (dismissed by industry elites and policymakers for a decade or so, and for roughly another decade couched in 'arguable', 'debated' and 'contested' terminology, what was long-known to many scientists eventually became so blindingly obvious that politicians began confronting reality), academic literature has also long exposed failings in the effectiveness of money laundering controls, since at least 1994.

In the latest 'effectiveness' research published this year ("Uncomfortable truths? ML=BS and AML=AML=BS^2", and here), despite nearly 30 years and now global ubiquity of AML/CFT controls (204 countries are part of the global order, according to FATF), and billions of dollars spent on compliance costs annually ($25 billion a year in the US, according to LexisNexis), I found the impact of money laundering controls barely a rounding error on criminal accounts in every country surveyed.

Based on official figures, the UK's 'success rate' by UN standards was the lowest of all countries surveyed. UK authorities successfully intercepted 0.1 percent (one tenth of one percent) of criminal proceeds, less even than the dismal 0.2 percent global 'success rate' calculated by the United Nations with US State Department assistance, and far less than across Europe, according to Europol.

(It would have been interesting to be a fly on the wall in parliamentary offices in European countries saddled with poor FATF ratings, when delegates returned from last week's plenary and shared the results of the UK's evaluation).

In practical terms, many lessons for developing more effective strategies can be gleaned from a long line of scholarship revealing manifold flaws and an apparent dearth of scientific rigour in FATF's stylistic 'outcomes' methodology.

Measuring effort, not outcomes

In the first in-depth, independent, peer-reviewed assessment of the new global methodology for assessing the effectiveness of AML/CFT regimes ("Anti-money laundering effectiveness: Assessing outcomes or ticking boxes?") I found that misapplication of *outcome* labels for what are, in truth, *output* and *activity* measures miss an opportunity to evaluate the real impact of anti-money laundering rules.

The uncomfortable truth is that the current measures (no doubt inadvertently, and with good intention) are misleadingly labelled 'outcomes.' In truth, they mostly reflect the *efforts* of regulatory and enforcement authorities, not *outcomes* in the usual sense of whether those efforts have any meaningful *effect or impact* on serious crime.

The line of scientific discourse runs long and deep, albeit largely in a parallel universe, steadfastly ignored by policymakers and their advisers; seemingly content with the ease of policymaking founded on untested assumptions and beliefs.

Ad-hoc, impressionistic, politicised

In another recent analysis, a trio of professors observed that a lack of meaningful data exposes FATF's rating methodology to claims that it is ad hoc, impressionistic or politicised, adversely affecting its perceived legitimacy.

Strong words. Justifiably. By established evaluation principles, FATF's process barely represents "minimal effort at AML evaluation."

Recent reporting on the UK's leaked FATF evaluation offers an illustration of the politicisation they foresaw potentially threatening the legitimacy of mutual evaluations.

During last week's plenary (FATF's peak decision-making body and the industry's pinnacle triannual gathering of insiders: nations, transnational networks and financial intelligence units socialised in the industry's stylised lexicon and formal ratings system), the British delegation reportedly "lobbied to have the UK's moderate ratings - a failing score - for anti-money laundering supervision and use of financial intelligence upgraded", according to an exclusive report by ACAMS moneylaundering.com.

"The UK got a lot of Commonwealth countries to support them but it wasn't enough," said an anonymous source. "Brexit was in the air…and Germany, France and the EU were against them…The US was also against."

In another recent example, Pakistan's grey-listing was also reportedly driven less by objective application of rules than at the behest of powerful countries, with "the US and its European allies" (UK, Germany, France) working together "to put Pakistan on a global terrorist-financing watchlist."

Predictably, with powerful geopolitics at play, no leaders appear openly to have sought to reassess the ratings system. Nor frankly to address the industry's overgrown pachyderm (the monumentally ineffective results of the AML/CFT movement), despite frankly-spoken attempts by the United Nations and Europol to lift the invisibility cloak cast over anything contrary to the 'official' line.

I was reminded recently of the shroud protecting the industry's apocryphal elephant even as its unchecked growth makes it more of a woolly mammoth nearly breaking through the walls and ceilings of the industry's most sacred cathedral, the 'compliance with standards' mantra and ratings system.

Heretics banned at the steak

Meeting with a professor in a hotel dining room recently, the regional leader of a global industry body recognised us. When asked if I was attending a nearby conference I replied that I'd not been invited to speak. "Of course not", he said, evidently referring to my "Uncomfortable truths" paper. "When you say that [the system's] not working, even if you're right, no-one wants to hear it."

He was, I think, unaware of a deeper irony. Months earlier, one of his overseas colleagues inquired after my availability to lead a discussion about the effectiveness of money laundering controls, to constructively help explore ways towards better outcomes. He just needed to speak with local board members "to get a consensus". Good luck with that I told him. I was pretty sure I knew how that discussion would go. And so it seemed.

It is unsurprising, then, if industry leaders and politicians repeat the party line, if that's the echo chamber from which they draw knowledge; seemingly untroubled by science, evidence or alternative viewpoints.

But, he was of course also right. The fact remains, whether it is gold-standard or barely bronze, the current ratings system is the industry standard.

It is then especially curious that, given their perceived paramountcy, the official ratings appear

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seldom used to inform decision-making; particularly notable in the wake of recent scandals.

Official ratings used as cudgel, but curiously not as decision aid

A series of European money laundering revelations in recent months fuelled a media and political furore, quickly developing into a chorus of demands for better international co-operation, identified by experts and commentators as a leading factor contributing to banks' and regulators' perceived failures to curtail cross-border money laundering.

It sounds plausible. But what does the official evidence-base say?

Hard to say. Despite scores of published reports in the "fourth round" of formal country-level anti-money laundering evaluations (since 2014) the sheer number of reports and the way ratings are presented makes it difficult to visualise results, compare countries, or compare ratings.

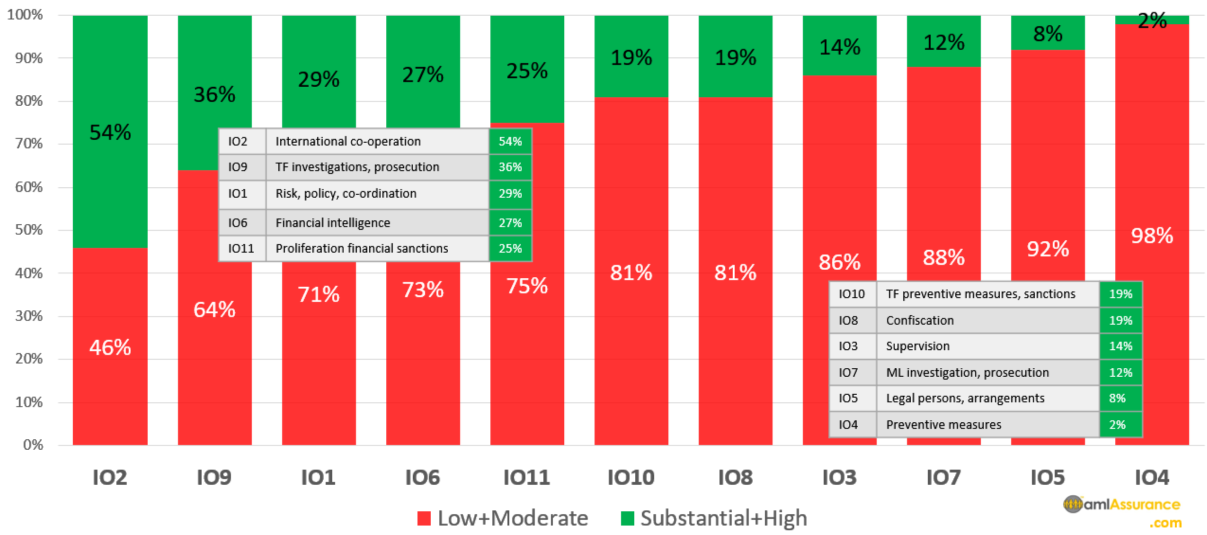
So, last week I [released some of my own resources](), enabling 'at-a-glance' system-wide insights.

Peering through the haze: Visualising AML/CFT evaluations

The following chart illustrates the consolidated results of country-level evaluations for compliance with 11 'immediate outcome' measures intended to assess the effectiveness of AML/CFT regimes.

It shows, for example, that "international co-operation [facilitating] action against criminals and their assets" is the most highly rated of the so-called 'effectiveness' measures. Fifty-four percent of assessed countries' AML/CFT systems were judged at the requisite standard to a large or very large extent (with 'substantial' or 'high' ratings).

AML/CFT 'effectiveness' compliance: October 2018, 59 jurisdictions



Source: [Visualising all AML/CFT evaluations]()

Initial responses to the newfound ability to visualise FATF ratings were interesting, particularly in the context of recent events.

Ad-hoc responses to anecdotal 'evidence'

A senior compliance manager in a leading global financial services firm confided that "to be honest this is quite a surprising discovery". Closely following the Danske Bank scandal, he had been swept up in the 'consensus' that it was exacerbated by lack of efficient international cooperation, now driving urgent policy responses to 'fix' the problem. But, he said, "your charts suggest that international cooperation IO2 is the strongest element of the FATF framework."

A senior official in a major global 'acronym' agency also observed apparent "perverse internal inconsistency issues, for example, on average, supervision has better effectiveness than implementation in the private sector, and international cooperation is rated very well; but many reports indicate that pursuing foreign predicates is a challenge under IO7, etc!"

Yet any inconsistency was not the result of my opinion. It arose directly from the perverse opacity of the official metrics themselves. I'd simply

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wrestled the data into some coherent format. Absent which, unsurprisingly, anecdotal 'evidence' filled the gaps between the official measurement system and the narrative promoted by industry participants.

(Ironically, just a few months earlier, FATF itself identified "a clear need to improve information sharing and international cooperation", despite its own metrics hailing international co-operation the leading indicator of the effectiveness of anti-money laundering controls).

From a political science perspective this sort of occurrence is, of course, commonplace. Ad hoc responses to anecdotal evidence from a few masthead events which by curious happenstance align with industry narratives ('shroud waving' enabling extended regulatory powers, and a more expansive compliance burden favouring 'solutions providers') is hardly news. Nor, politicians' perennial need to be seen to 'be doing something'.

The ability more readily to access the industry's own metrics might help.

Likewise, drawing from some of the new 'points generating' techniques developed in response to the 'effectiveness' methodology.

Many ways to boost FATF ratings

One of the practical lessons from reviewing many of the published evaluations to date is the remarkable number of points "left on the table".

In Australia's case, for example, alternative scenarios ranged from several fewer points to perhaps half a dozen higher ratings that authorities might have achieved, without any material change to core law enforcement objectives.

Ironically, one of the primary reasons many countries appear to have received fewer points (and in a few cases considerably lower ratings) than they might have achieved appears often due to a focus on law enforcement effectiveness, presumably on the assumption that law enforcement effectiveness bears some resemblance to FATF effectiveness.

The result is that some evaluations present apparent naivety, with authorities inadvertently relegating their countries to years of financial restrictions despite relatively little money laundering risk.

Most countries, however, appeared to oscillate between 'real' effectiveness and FATF 'effectiveness'; not gaining as many points as they might, but not losing too many either.

I look forward to the opportunity to analyse the UK report. Early indications suggest that I might add it to a 'masterclass collection' where savvy officials played FATF's tick-box system for what it is.

In the meantime, the latest 'effectiveness' research study ends optimistically. Mostly.

Positive signs? Maybe.

There is no sign that FATF's 'effectiveness' standards might be updated for, well, effectiveness. The stoic indifference to the United Nations in 2011, Europol in 2016 and independent scientific evidence and analysis since 1994 remains, apparently, firm.

But, FATF's frank acknowledgement that evaluating for effectiveness was missing, and important, is a positive step. Likewise, that outcomes matter. FATF also frequently adjusts its standards and guidance as circumstances change. If it accepts that some principles and practices underpinning its effectiveness framework might be improved, that tradition might continue. But FATF is a membership organisation. So, it would be wrong to blame FATF. If its members seek crime prevention effectiveness, or prefer stylised tick-boxes, the choice is theirs.

In the meantime, although FATF's new 'effectiveness' ratings system arguably lacks much meaning (at least in terms of recognised evaluative principles and policy effectiveness), low scores have a very real impact on any jurisdiction's access to financial markets. But not, it seems, the UK.

FATF's endorsement enables the United Kingdom's legitimate financial flows, and criminal flows, to continue unimpeded by the ignominy of poor ratings.

A former management consultant and lawyer in the United Kingdom and New Zealand, Dr Ronald F Pol is a political scientist specialising in policy effectiveness and outcomes. His PhD thesis focused on new ways to resolve the super-wicked problem posed by modern anti-money laundering measures, arguably the least effective anti-crime prevention measure, anywhere, ever (as he was quoted in US Senate testimony). Pol's thesis also empirically identified how professional facilitators (lawyers, accountants and real estate agents) are used to launder proceeds of crime in real estate, beyond the theory and assumptions of the contemporary artificial construct of rules based on manufactured standards. He developed innovative practical new ways to unearth evidence, establish culpability and open fresh investigative leads into 'hidden' transactions that might never trigger suspicious activity reports which currently constrain law enforcement results to "sweating the one percent" impact on serious profit-motivated crime they already do well. His current work focuses on new ways to operate sustainably and demonstrably in the 99% zone, for practical realisation beyond political rhetoric about 'making crime not pay'.