Research reveals serious issues with Bhutan's AML/CFT ratings

Bhutan's anti-money laundering regime has been upgraded on 'technical compliance' ratings. But the country's reputation remains tarnished by unchanged 'effectiveness' ratings with 'major flaws' according to independent research.

The latest re-rating of Bhutan's AML/CFT regime, released on 20 September, updated 14 of 40 'technical compliance' ratings. Asia-Pacific money laundering watchdog APG "welcomed" the steps Bhutan took to improve its "technical compliance", but didn't upgrade any of the 11 'effectiveness' measures which the Paris-based Financial Action Task Force regards the "main component" of anti-money laundering evaluations.

This means that the Kingdom's reputation and access to financial markets continues to be affected by its 'effectiveness' ratings from 2016, which the latest research published in the *Journal of Money Laundering Control* finds doesn't properly evaluate effectiveness. (Bhutan was awarded lowly 'moderate' scores in two areas assessed for 'effectiveness', and the lowest possible ratings in the remaining 9 of 11 so-called 'outcome' measures).

New criteria seek to assess effectiveness

FATF introduced a new 'effectiveness' methodology in 2013 because compliance with its "40 recommendations" (previously the sole focus of evaluations since 1990) gave no assurance that money laundering regulations were effective.

An extensive process demanding significant resources and preparation by authorities, evaluations now assess anti-money laundering regimes based on two sets of rules: technical compliance with FATF's 40 recommendations, and 'effectiveness' based on 11 'outcome' measures. But the new study reveals major flaws with the effectiveness criteria.

Measuring effort, not outcomes

According to the study's author, Dr Ron Pol from international consultancy AMLassurance.com, "misapplication of *outcome* labels for what are, in truth, simplistic *output* and *activity* measures miss an opportunity to evaluate the real impact of anti-money laundering rules."

He says that FATF's new methodology doesn't evaluate outcomes in the sense generally understood as the *effect or impact* of regulations.

"More meaningful outcome measures, for example, might include the extent to which the system better allows authorities to reduce and prevent crime, and to cut the social and economic harms caused by serious crime like drugs-trafficking, corruption, fraud and tax evasion."

"Some of those measures are difficult to evaluate" says Pol, "but assessing anti-money laundering regimes by superficial 'easy-to-measure' metrics suggests that the intensive rating exercise conveys value more as a rhetorical device than any real measure of effectiveness."

"That's because the current measures largely reflect the efforts of regulatory and enforcement authorities, not whether those efforts have any meaningful impact on serious crime."

'Tick-box' compliance extended

"Moreover", adds Pol, "assessors often use the same evidence to assess both the old and new criteria. But, compressing FATF's 40 recommendations into an abbreviated yet broadly equivalent list of so-called 'outcomes' adds little new evaluative capability beyond 11 more boxes to tick."

"The nature of any tick-box system means that it's possible for jurisdictions to get high ratings without much impact on crime, and vice versa" says Pol. "To their credit, authorities appear often to have focused more on crime prevention than better ratings, although close examination of more than 50 evaluations to date reveal ways to achieve both. Nonetheless, although the new ratings system arguably lacks much meaning, low scores have a very real impact on any jurisdiction's access to financial markets."

Effectiveness gap evidence mounting

Another academic paper also notes "enormous" frustration that, despite nearly 30 years of money laundering obligations (now imposed on millions of firms in nearly 200 countries) the "huge and growing cost of compliance has been accompanied by little observable effect". Professors Levi, Reuter and Halliday say that the modern anti-money laundering system is "highly cost-inefficient" and has failed "to produce credible evidence of [its] effectiveness."

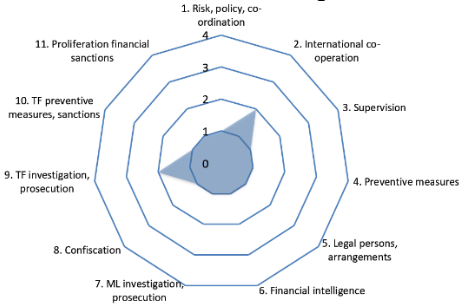
The new study's detailed analysis makes similar findings. It concludes that FATF's new methodology offers few reliable indicators about the effectiveness of money laundering controls.

Positive signs

But the new study ends optimistically. "FATF's frank acknowledgement that evaluating for effectiveness was missing, and important, is a positive step", says Pol. "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 reasonably be expected to continue."

Additional notes

FATF effectiveness ratings: Bhutan



This chart (and other countries assessed) is available in PPTX and PDF formats.

Data: Mutual Evaluation Report: Bhutan (Oct 2016, p12). Second Follow-up Report (Sep 2018)

About the Financial Action Task Force

- About FATF & APG
- About mutual evaluations: here
- About FATF 'effectiveness': here
- About FATF's 'effectiveness' methodology: here ('immediate outcomes' on p16 & ratings on p21)

Supplementary material: Bhutan

The new study used 'immediate outcome 7' (money laundering investigations and prosecutions) to illustrate differences between *outputs* and *outcomes*, and why it matters.

Assessors noted that authorities prioritise predicate crimes, such as corruption, rather than laundering. There was also a lack of policy direction, capacity, resources and specialist expertise, and limited co-ordination between law enforcement agencies (FIU, anti-corruption commission and police). Successful money laundering prosecutions also received concurrent sentences with predicate offences, which assessors rued as "another disincentive to pursue money laundering investigations."

Bhutan targets predicate crime to address its key money laundering threats, with "the five major proceeds generating predicate crimes generally investigated, prosecuted and convicted". But it was given the lowest possible rating for this factor, due to the tiny number of money laundering cases and Bhutan's inability to prove that its focus on predicate crime mitigated money laundering risks.

"That may be true", says Pol, "and Bhutan clearly has serious capacity constraints, but more money laundering prosecutions (an *activity* or *output* measure) might, or might not, help achieve the (crime prevention) *outcomes* authorities seek."

He gave a hypothetical example where enforcement agencies detect and prosecute twice as much serious crime but, with prosecutors overwhelmed, and consistent with Bhutan's focus on the underlying crime, no money laundering charges are laid.

Authorities would of course promote their doubling of crime detection to positively influence ratings, but with no money laundering cases, Bhutan's FATF 'effectiveness' score on this measure might conceivably remain low.

"Bizarrely", says Pol "the prospect of the lowest possible rating if authorities disrupt significantly *more* serious crime is an unintended consequence of focusing on simple output measures rather than crime prevention outcomes. Presumably, that's not the Kingdom's intention, or FATF's."

1. **The full study**: Pol, R, F., *Anti-money laundering effectiveness: Assessing outcomes or ticking boxes?* Journal of Money Laundering Control (2018), Vol 21 No 2: http://dx.doi.org/10.1108/JMLC-07-2017-0029. About *Journal of Money Laundering Control*: here
2. **Companion study**: Pol, R. F., *Uncomfortable truths? ML=BS and AML=BS²*, Journal of Financial Crime (2018), Vol 25 No 2: http://doi.org/10.1108/JFC-08-2017-0071. About *the Journal of Financial Crime* here.
3. **Other study referenced**. Levi, M., Reuter, P., Halliday, T., *Can the AML system be evaluated without better data?* Crime, Law and Social Change (2017), available here
4. **Acknowledgements**. An earlier version of the analysis which formed this article (in the author's PhD thesis) was reviewed by supervising Professors Jason Sharman (now at Cambridge) and AJ Brown and Duncan McDonnell (Griffith), and examined by Professors Michael Levi (Cardiff) and Louis de Koker (La Trobe), before the *Journal of Money Laundering Control's* own peer-review process. The author is grateful for their invaluable assistance. Any errors are the author's alone.

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The study's author is a political scientist linking public policy with effectiveness. This involves examining not only whether rules exist, or meet recognised standards, or countries adopt them, or even if firms comply with them, but whether they work. Do they produce intended outcomes? Also: 1-page outcome effectiveness & AML/CFT effectiveness profiles.	Tel: +64 (4) 566 5144 Mobile: +64 (27) 241 1163 Email: Ronald.Pol@TeamFactors.com, or Ronald.Pol@AMLassurance.com