

AML/CTF Supervision

Consultation Draft



**10 Key Enablers & 40 Key Takeaways to Improve
Supervisory Effectiveness**

October 2024

AML/CTF Supervision - 10 Key Enablers and 40 Key Takeaways to Improve Supervisory Effectiveness - Consultation Draft

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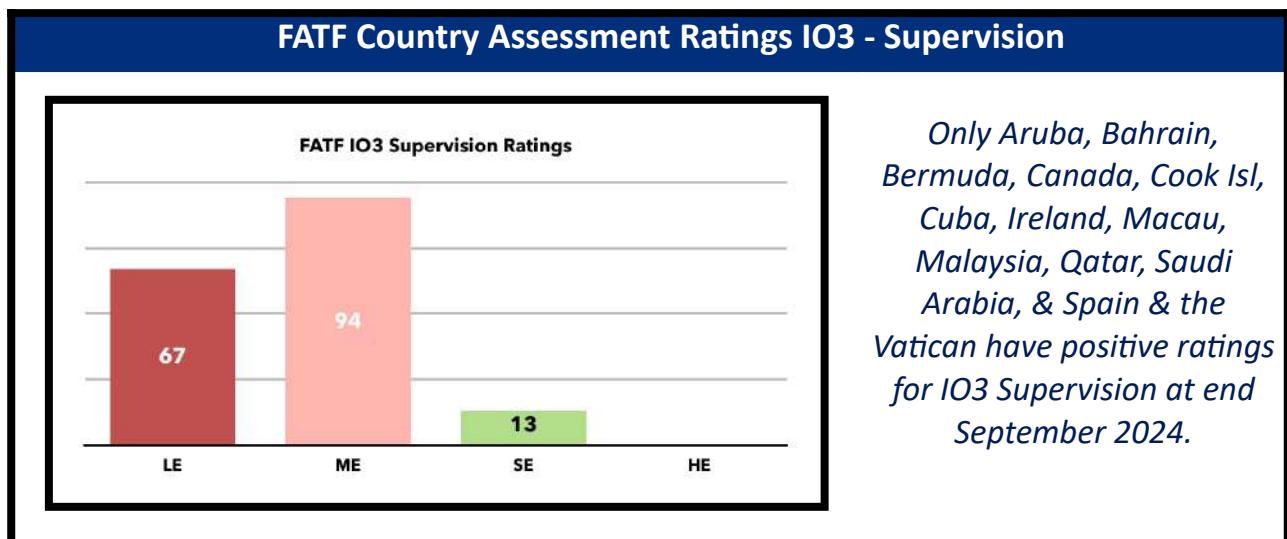
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1. Introduction

Effective supervision is not an exact science & cannot be strictly defined, or considered as something that can be taken “off the shelf” and is expected to work and operate effectively, repeatedly and without many years & cycles of operation. It is for most countries a journey, which starts with legacy regulators & regulations, updated to reflect AML/CTF global standards, new rules & regulations, or even with newly installed regulators and coverage of sectors new to regulation. In time, regulation & regulators can evolve from a relatively basic coverage & limited capabilities for licensing and authorisations, supervision & sanctions, to more effective approaches where experience & confidence is gained, & a focus on technical compliance via an audit style approach can evolve into a more risk based understanding of the ML/TF threats & how these are being addressed & where the regulator has a positive influence/impact on the regulated sector, & even on other AML/CTF stakeholders.

1.1 FATF Assessment & Commentary on Supervisory Effectiveness

According to the FATF Country Assessments of Immediate Outcome 3 Supervision, the need for most countries to continue on their journey towards improving effectiveness in supervision is clear - (see chart below).



According to the FATF Methodology in 2023, a country’s supervisory regime is based on a number of success factors which include licensing, ML/TF risk understanding, use of sanctions and communication etc but its much more than compliance with AML/CTF requirements. According to FATF, compliance is not enough, as compliance also needs to mitigate the ML/ TF risks. For example one of 6 main factors states:

- “with a view to mitigating the risks, how well do supervisors, on a risk sensitive basis, supervise or monitor the extent to which FI’s are complying with their AML/CFT requirements?”

It’s also not enough that for example FI’s are effective as described above, but are effective not least due in part because of the impact from supervisors. For example another factor states:

- “to what extent are supervisors able to demonstrate that their actions have an effect on compliance by financial institutions?”

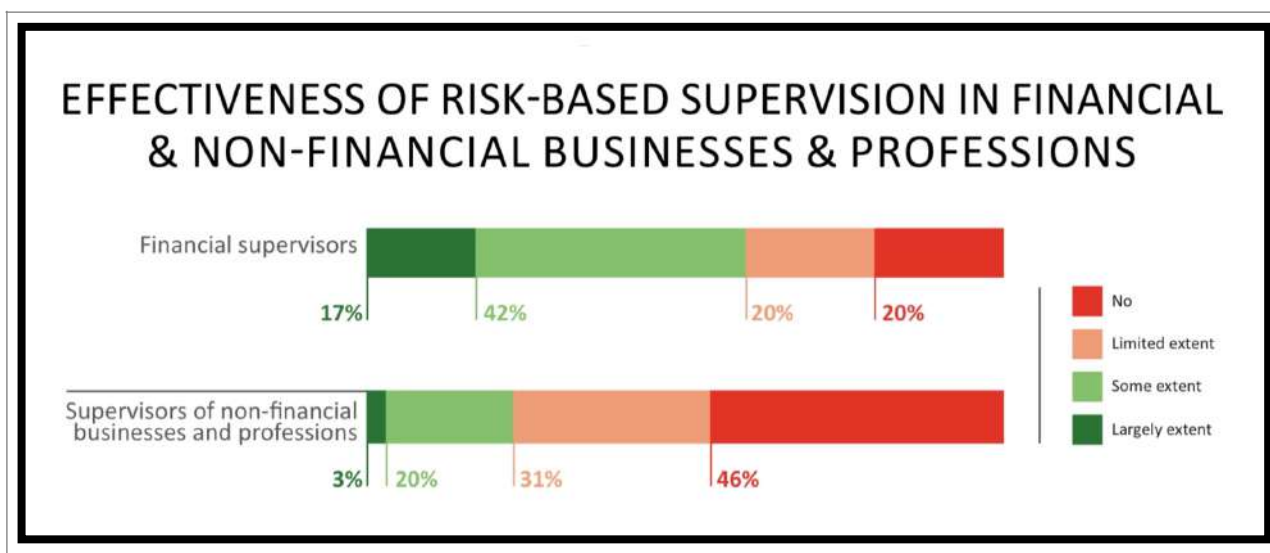
In FATF’s own Risk Based Approach to Supervision 2021¹ Report, it states that:

“AML/CFT Supervisors play an essential role in protecting the financial system and other sectors from misuse by criminals and terrorists by

- *increased FI's awareness and understanding of the ML/TF risks and setting regulatory obligations and facilitating and encouraging good practices*
- *enforcing and monitoring compliance with AML/CTF obligations and*
- *taking appropriate measures where deficiencies are identified"*

Also that *"In order to perform this function effectively and efficiently, supervisors must implement a risk based approach. An RBA involves tailoring the supervisory response to the assessed risks. Tailoring supervision to address the relevant ML/TF risks will reduce the opportunities for criminals to launder their illicit proceeds and terrorists to finance their operations and improve the quality of information available to law-enforcement authorities. It will also ensure that supervisory activities do not place an unwarranted burden on lower risk sectors, entities, and activities. This is crucial for maintaining or increasing financial inclusion which could reduce overall ML/TF risks by increasing transparency".*

In FATF's Report on the State of Effectiveness and Technical Compliance 2022², one of the 5 main improvements countries could do *"to improve supervision"*, was to, *"adjust the nature and focus of supervisory activity to the identified ML/TF risks and national context. This may include longer, more in depth and frequent supervisory activity, as well as more nuanced supervisory plans for different sectors, depending on ML/ TF risks"*. Another was to *"transition from a rule-based to a risk-based approach"*. The 2022 effectiveness report assessed progress being made by supervisors to move to this risk based approach.



The FATF also stated in this 2022 effectiveness report (based on a sample of 59 countries³), that:

- *"Across both financial and non-financial sectors, supervisors are overall struggling to effectively implement a risk-based approach. In the analysed sample, as the graph above highlights, just 17% of financial institutions' supervisors and 3% of designated non-financial business and practise (DNFBP) supervisors had been able to do so to a large extent" - see chart above.*

The 2022 report also stated that a *"transition from a rule-based to a risk-based approach takes time" AND, "it also requires a change in the supervisory culture, & investment in capacity building & training of staff"*

In FATF's 2022 report, countries that performed well in respect to "Supervision" demonstrated many of the below traits, that:

- *"Supervisors have a good/very good understanding of risks, with regularly updated sectoral risk assessments;*

- Supervisors use a combination of tools to identify and understand risk, including offsite and onsite actions;
- Regulations cover most or all designated DNFBP's (with supervisors monitoring their implementation);
- Supervisors co-operate on a domestic and international basis;
- Supervisors apply the risk-based approach to a large extent for Financial Institutions, and for designated non-financial businesses and professions;
- Supervisors have access to a range of sanctions, or which many are considered effective; and
- Supervisors are conducting outreach activities to the private sector on a regular basis to support understanding and implementation of obligations"

1.2 BCBS/EBA - Other Supervisory Expectations

FATF reviews are the only publicly available independent information source that assesses the performance of supervisors, albeit against ML/TF expectations, but they are not the only standard setter that is interested in supervision. FATF has relied to a large extent on the formative work of the Basel Committee on Banking Supervision (BCBS) which published "Guidelines - Sound management of risks related to ML/TF 2020"⁴, updating previous work that dates back decades, and the EBA's Risk Based Supervision Guidelines most recently updated in November 2023⁵, which provides rich content particularly on what risk based AML/CTF supervision looks like.

1.3 GCFFC Supervisory Experts propose 10 key enablers and 40 key takeaways

In response to the challenges countries are facing in converting progress in largely achieving positive technical compliance results, into positive supervisory effectiveness ratings in FATF assessments, GCFFC Experts have identified a number of important success factors or key enablers and from these key takeaways, which, if adopted, could make a real difference and help to improve effectiveness in ratings for supervisors. Having considered reports from the FATF, BCBS and supranational institutions like the EU as regards AML/CTF supervision, and based on personal knowledge and expedience, the GCFFC Experts stress the importance of these key enablers and key takeaways which if considered and implemented, where still needed, could help significantly improve supervisory effectiveness. These Key Enablers and Key Takeaways are also supported by Explanatory Notes set out in the Appendix.

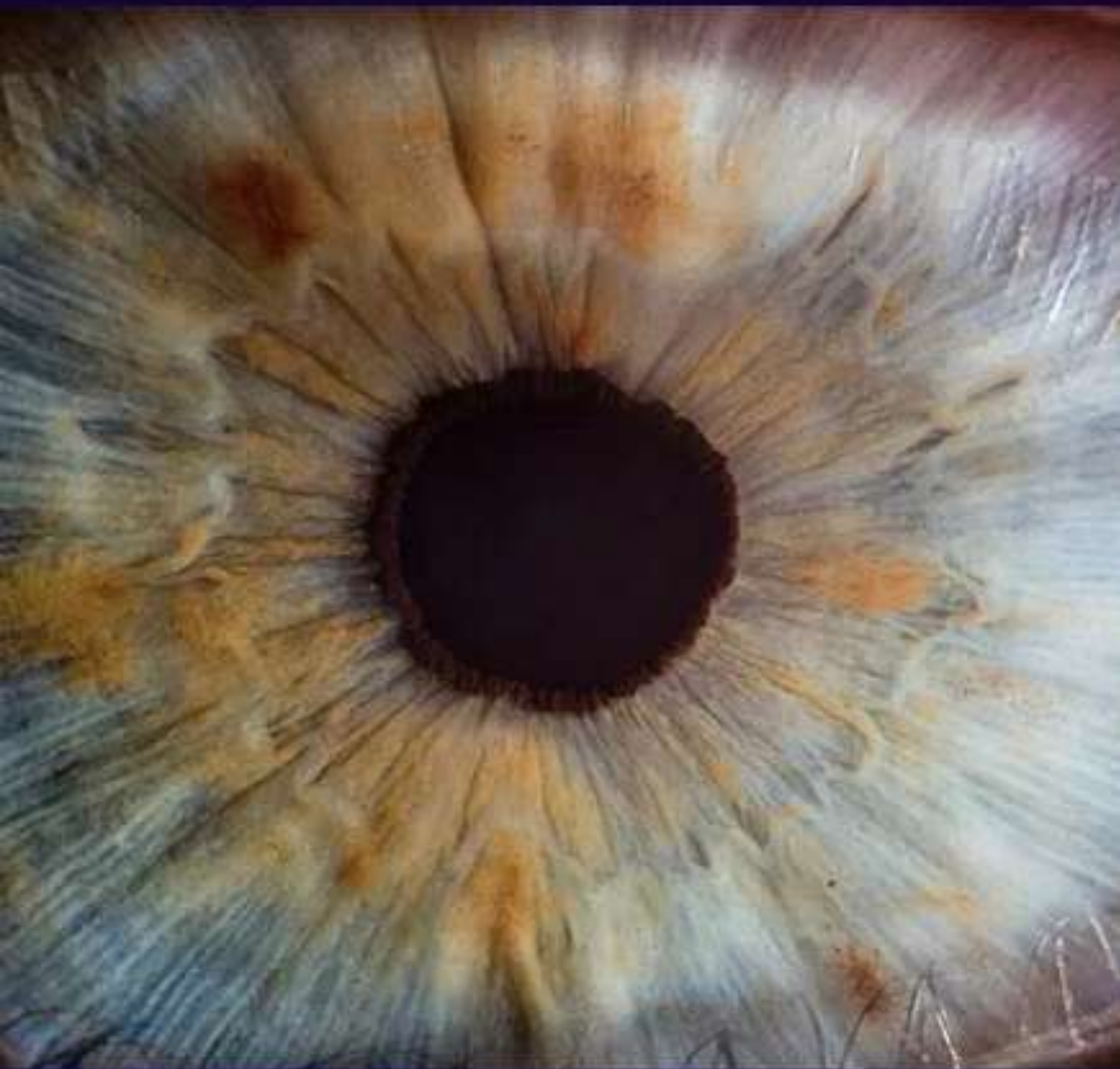
1.4 Consultation

The GCFFC and its Experts are publishing this paper, as a consultation draft, and intend to engage and discuss with all interested stakeholders these key enablers, key takeaways and explanatory notes in order to better improve supervisory effectiveness.

1.5 GCFFC Experts

GCFFC Experts formed a working group led by Chair, Jamal El-Hindi⁶ and Vice Chairs, Mariano Federici⁷ & Bryan Stirewalt⁸, with support and contributions from subject matter experts with special thanks to Hans Peter Bauer⁹, Maud Bokkerink¹⁰, Nicolas Choules Bourbidge¹¹, Sharon Campbell¹², Alison Clew¹³, John Cusack¹⁴, Himamauli Das¹⁵, Sylvie Matherat¹⁶, Hiroshi Ozaki¹⁷, David Parody¹⁸, Gabriel Romo¹⁹, Maija Treija²⁰ & Daniel Zuberbühler²¹. This work has been supported by the GCFFC Effectiveness Secretariat Team without which this paper could not have been produced, and many thanks go to Lotte Ludekens²² and Karel de Zoete²³.

Improving Supervisory Effectiveness



10 Key Enablers and 40 Key Takeaways

2. Ten (10) Key Enablers (KE) and 40 Key Takeaways (KT)

The 10 key enablers & 40 key takeaways focus on key areas where improvements in supervisory effectiveness could result in the biggest gains, in many countries. As policy makers and supervisors consider where improvements are still needed, this consultation paper is intended to form the basis for a constructive discussion. The 10 key enablers & 40 key takeaways are supplemented by Explanatory Notes, recognising these may evolve through further discussions and engagements.



Key Enablers 1 & 9 are pre conditions & continuing conditions for supervisory effectiveness; Key enabler 3 is related to coverage and systems; Key enablers 4, 5 & 6 relate to “risk based supervision” - Key enablers 7, 8 & 9 relate to influencing and impacting behaviours, co operation and essential capabilities & Key Enabler 10 for supervisory maturity.

1. Political Support and Operational Independence

- 1.1 (KT1). Genuine Political leadership on tackling ML/TF is essential with appropriate governance, inviting supervisors to actively contribute to the wider AML/CTF effort and support for supervision, in terms of political support and ensuring operational independence. Political support can be demonstrated also in practice in terms of budgets and resources, promoting co operation between agencies and information sharing, including also internationally, where appropriate.
- 1.2 (KT2). If the Supervisory system is combined with other agencies, including AML/CTF country leadership and or FIU activities, supervisors should still work and co operate with prudential and or conduct supervisors and ensure all supervisors enjoy operational independence.
- 1.3 (KT3). With political support and operational independence must also come transparency responsibility and accountability of supervisors.

2. Supervisory Coverage & System

- 2.1 (KT4). Sectors mandated by FATF, such as FI's, DNFBP's and VASP's should be fully included without exception, so as to comply fully with FATF R15 & R22. Once included, supervisory coverage & effective supervision as required by R26 & R28 should be carried out. Supervisors should be guided by the "same activity, same risks, same rules" principle, recognising that whilst innovation and Reg tech has brought significant benefits, it is also providing similar services to highly regulated and supervised financial services and entities, representing less controlled products and services and in many cases evading effective equivalent oversight. Whilst traditional supervisors may be loathe to extend their remit to new entrants, where regulatory jurisdiction is unclear, and/or coverage nascent, this thorn has to be grasped. It should be expected that money launderers and terrorist financiers will exploit these situations. Supporting innovation and new entrants and competition and financial inclusion should not come at the expense of increased ML/TF risks. In terms of NPO's, they should only be subject to AML/CTF type supervision or oversight to the extent they fit the more limited definition in R8 being the relatively small segment of the NPO population that represents genuine ML/TF risk. Supervisors, should show leadership here to help balance to focus on the true ML/TF risks without imposing unnecessary burdensome conditions on the entire sector, and to promote productive engagement including PPP's as further described in 6 below.
- 2.2 (KT5). Additional sectors beyond those mandated by FATF should also be considered, if included in Country NRA's or Sector ML/TF Risk Assessments, though coverage from supervisors can be risk based.
- 2.3 (KT6). Whatever supervisory system is in place, & there is no ideal one system fits all, the system should be such where clear roles and responsibilities are allocated, with adequate coverage from one or more agencies, and where more than one agency has responsibility for any sector, system effectiveness is likely enhanced through relevant AML/CTF and Sector knowledge and expertise in place and a spirit of co operation, collaboration and information sharing being demonstrated. It should be noted that countries are expected to apply the Basel Core Principles of Supervision (CP) to AML supervisory requirements, so to the extent that these are not followed, good reasons should be available.

3. ML/TF Risk Assessments

- 3.1 (KT7). Supervisory ML/TF Risk Assessments are the result of the combination of two risk assessments, the Sector and the Entity Risk Assessment.
- 3.2 (KT8). The Sector Risk Assessment is usually carried out periodically as part of a Country's National AML/CTF Risk Assessment. Supervisors should be fully involved in this process. In most countries, Banks, particularly the largest are often considered as presenting the highest risks within the finance sector, with other financial service providers often risk rated on the basis of inherent risk and vulnerabilities. Other regulated sectors such as Casinos, DNFBP's and VASP's are also usually included in the National AML/CTF Risk Assessment. As mentioned in 2.1 (KT4) above supervisors should be aware of sectors where ML/TF risks are present but where supervisory coverage is nascent and or where the application of the principle, "same activities, same risks, same rules" doesn't apply or where in effect supervisory knowledge and coverage is limited. It should be expected that money launderers and terrorist financiers will exploit these situations.
- 3.3 (KT9). The Entity Based Risk Assessments (for the purposes of classifying entities as higher, medium or lower risk), should be based on a methodology that establishes the inherent ML/TF risks of the entity, including by applying the appropriate sector risk rating (from the Sector Risk Assessment).
- 3.4 (KT10). Supervisors may wish to consider the following:
 - 3.4.1 whether their entity risk ratings should be informed by the results from the entities own ML/TF risk assessment. Whilst an entities own risk assessment is required to be completed by the entity based on supervisory guidance and so should be consistent with the supervisors view on what data should be collected by the entity and what areas should be measured for the entity to determine its own inherent

and residual ML/TF risks, no two entity risk assessments will be calibrated to a common basis and will present real reliance challenges for supervisors, without such a common standard being applied.

- 3.4.2 whether to include an impact or size factor as a “dominant” or “determinative” risk factor, as this may distort the final results, producing ratings useful to prudential supervisors rather than to pure AML/CTF supervisors.
- 3.4.3 whether to use additional information sought from entities and for example also from agencies such as the FIU where available, on the quality of reporting and co operation from reporting entities, which could be taken into consideration to assess the entities overall ML/TF risk rating.
- 3.4.4 If there are material differences in risk ratings from the entity’s own risk assessment and from the supervisory risk assessment, these should be understood and resolved.
- 3.4.5 Other risk factors, which may come for example, from unintended consequences from innovation and new technology, new products and services and new entrants. For example, whilst faster payments are largely welcome they also support faster frauds, especially cross border, and whilst open banking supports new entrants to provide improved services to customers of incumbent FI’s they also often provide less mature ML/TF controls and or are often subject to minimal supervisory oversight.
- 3.5 (KT11). The focus in supervisory methodologies on inherent ML/TF risks, over residual risks, (which could in theory also be used), would though require supervisors either to have their own robust and up to date assessment on sector and entity controls, or be able to rely on information from those they supervise, which presents real challenges In practice. As a result, supervisors usually take a more cautious approach, and history and experience suggests their is merit to this.
- 3.6 (KT12). Supervisors should ideally update entity risk assessment annually, (entity risk profiles) or at least in case of major changes and or events, except for lower risk entities. Sector risk assessments will usually be carried out periodically as part of a Country’s National AML/CTF Risk Assessment.

4. Supervisory Plans

- 4.1 (KT13). Supervisory plans should be risk based and supervisory activities should be intensified based on the risk ratings determined under the supervisory risk assessment.
- 4.2 (KT14). Applying resources to supervisory tasks including the supervisory inspection plan should be based on ML/TF risks and not on available resources, though resources will always be limited to some degree and risk based decisions will need to be made.
- 4.3 (KT15). Where populations of high risk are very large, these should be further segmented so as to prioritise the very highest risks. The highest risk segments should not receive all the supervisory attention but a balance made across all risk categories, using risk based approaches.
- 4.4 (KT16). Whilst the traditional supervisory approach of onsite inspections and testing has been a mainstay of supervisory plans, particularly for higher risk rated entities, and whilst their is merit in one to one meetings and face to face interviews, in particular with key position holders, AML/CFT risk and control design and effectiveness can also be assessed using data requests and technology by supervisors to assess entity risks and responses and to compare entities to identify Red flags, outliers and other results from data analytics.
- 4.5 (KT17). Using data, data analytics, technology and advanced reporting including Artificial Intelligence (AI) can improve both supervisory coverage and help target resources where risks are identified. For example, individual examinations can be improved through gaining better insights to address during examinations and trends and outliers can be identified over time which could trigger areas of focus on issues and or specify entities, and permit supervisors to be more flexible in scheduling and carrying out examinations. See also 8.3 (KT33) below.

- 4.6 (KT18). Supervisory responsibility for effective supervision should not be delegated to external audits, though their work can be relied upon, in circumstances where genuine reliance is reasonable.
- 4.7 (KT19). Supervisory plans should consider broader levels of engagement with those where high intensity of supervision has been determined, to further increase co operation, feedback and capacity building, including for example, a supervisory college, including representatives from all appropriate supervisory agencies, the FIU, foreign supervisors with branches in their jurisdictions etc.
- 4.8 (KT20). Supervision should also apply and appropriate intensity applied to newly regulated entities and to entities being liquidated.
- 4.9 (KT21). Supervisors should consider providing annual reports, including objectives, metrics and results of their activity, and the impact of supervision on their supervised sectors.

5. ML/TF Risk Tolerance

- 5.1 (KT22). Supervisors should understand it is not possible to expect a zero tolerance approach to either ML/TF risks for supervised sectors and or entities. Applying a zero tolerance requires there to be no business activity. Even supervisory risk assessments do not envisage a zero residual risk result even for low risk entities with strong controls. As such supervisors should seek to understand an entities tolerance for ML/TF risk, assess it's reasonableness and that it's AML/CTF programme is managed so as to stay within a reasonable risk tolerance, bearing in mind its own risk assessment of the entity. Being outside tolerance at any given time should be identified by the entity itself, for example in the case of a control failure or weakness but fixed and the entity brought back into tolerance within a reasonable period, once the remediation is completed. Supervisors should always be informed of these cases, and should assess levels of reporting and remediation in its overall assessment of the entity, whether positive or negative.

6. Co Operation & Collaboration

- 6.1 (KT23). Whatever supervisory system is in place, co-operation, collaboration, co ordination, knowledge and information sharing is essential amongst all key stakeholders, which applies domestically but also has relevance internationally. Some systems will require or expect more formality than others to document collaboration, knowledge and information sharing which may be necessary but should not be an excuse not to do this, or used to hinder it. Supervisors that recognise an effective AML/CTF programme will include the reporting of SAR's to the FIU and co operation with the FIU and LEA and will want to actively engage with relevant FIU/LEA personnel to gain insights into the quality of the reporting and co operation in order to factor this information into their overall assessment of the entity.
- 6.2 (KT24). Supervisors should engage in regular outreach to the supervised sectors to explain supervisory expectations and encourage feedback through engagement and consultation with the supervised sector, and in particular with private sessions with MLRO's.
- 6.3 (KT25). Supervisors can play an important role in promoting so called public private partnerships, including by convening and leading and/or contributing and/or supporting financial information sharing partnerships to improve overall ML/TF effectiveness. Ideally supervisors should be present in public and private sector PPP's recognising they provide support by their presence and can add legitimacy. Supervisors can also play an important role in supporting appropriate private to private (P2P) information sharing initiatives which may need legal and regulatory support, where the case for this is made and necessary privacy safeguards are included.
- 6.4 (KT26). Supervisors will need to play a leading role in PPP and P2P initiatives and proactively engage with financial privacy and data protection supervisors and or agencies to ensure PPP and P2P arrangements have advocates and support from these agencies, with appropriate privacy safeguards.
- 6.5 (KT27). Supervisors can also play an important role supporting innovation and the use of new technology and/or supporting industry platforms to improve the effectiveness/or efficiency in combating

ML/TF, without promoting particular platforms which still require the implementation of adequate systems and controls, with no dilution of regulatory responsibility and accountability for those supervised using any such platforms or services.

7. Impacting & Influencing Behaviour

- 7.1 (KT28). Supervisors should consider implementing senior manager type regimes or making senior individuals responsible and accountable. Supervisory action could also be taken, in addition to those against the entity but also individuals, where powers permit, where evidence of culpable active or passive behaviour exists which meets a requisite threshold of carelessness, negligence, recklessness, intent or wilful neglect as appropriate with appropriate proportionate sanctions applied as a result. Whilst these may fall short of action that would fall into the domain of the criminal law and be a matter for prosecuting authorities, where evidence exists of potential criminality, this should be fully investigated and evidence provided to and the criminal authorities supported in any proposed action taken.
- 7.2 (KT29). Supervisors could also consider alternatives which incentivise entities, for example adjusting capital buffers to reward those FI's that exceed & to penalise those that fall materially short of the requisite minimum standard for an AML/CTF programmes. Using capital buffers to impose additional costs on entities & imposing fines & penalties should be avoided if leading to doubling the penalty.
- 7.3 (KT30). Whilst some supervisors and or supervisory regimes favour imposing large fines and penalties on entities, in relevant cases, others take a different view, with arguments from supervisors both in favour and against. Where administrative fines and penalties are available to supervisors these should be the preferred route if considered appropriate and necessary with transparency and due process, in preference to other entity sanctions, particularly avoiding using the threat of criminal sanctions to persuade entities to agree to voluntary settlements. Where criminal violations exist those individuals responsible should be prosecuted. In some countries, the ability to consider levying meaningful fines and penalties is limited due to particular environmental factors, including political and business factors and or limited resources and expertise.
- 7.4 (KT31). The use of best practice practice guides, establishing standards and training for senior officers holders, can raise their performance and support them to succeed and to avoid failure through not knowing what good enough looks like.

8. Building & Retaining Essential Capabilities

- 8.1 (KT32). Supervisors need to ensure knowledge capital is acquired and retained, as well as human, financial, social and other resources. A challenge relating to remuneration, pay scales and comparisons for AML/CTF supervisors, versus other comparable public sector professionals and private sector professionals should be acknowledged and addressed.
- 8.2 (KT33). Supervisors should explore the opportunities available to them from technology, data, & data analytics, including AI to modernise the supervisory approach. See above at 4.5 (KT17) for more details.
- 8.3 (KT34). Supervisors would benefit from **establishing an informal contact group** and perhaps from a professional standards body able to train & certify supervisors. Resources are available to supervisors including for example from FATF training Centres. Innovative hiring models including temporary secondment models or exchange programmes could be considered & ethical considerations addressed.

9. Environmental Factors

- 9.1 (KT35). Supervisors and supervision does not operate in a vacuum. They operates within a broader public/private space within countries which have diverse challenges and opportunities impacted by domestic environmental factors, which can have a material impact on their work and how effective they can be.

- 9.2 (KT36). Environmental factors will impact the effectiveness of supervision as well as of other agencies and so these should be identified and born in mind when evaluating a country's overall ML/TF effectiveness. The FATF Methodology currently requires assessors to consider a number of these structural elements, and other contextual factors, to reach a general understanding of the context in which the country's AML/CFT system operates, though these issues are seldom assessed in practice, and/or fail to be reflected in terms of outcomes, and/or even where reports make reference to these structural elements assessors often omit analysing how these types of shortcomings impact on the assessment of each individual immediate outcome. Given the relevance these structural elements and contextual factors may play in explaining why levels of effectiveness may be higher or lower than expected, for assessing immediate outcomes 3 and 4, the FATF's methodology ought to require assessors to weigh their impact.
- 9.3 (KT37). The fight against ML/TF should ideally be a policy of State, bringing together all political forces irrespective of which one may be exercising power at a particular time and so the most important environmental factor is likely to be genuine political support and political will to achieve success. Nevertheless, additional important "environmental factors", also play a significant role in overall effectiveness in combatting money laundering and terrorism finance whether that be for supervisors or for any of the agencies involved.
- 9.4 (KT38). These "Environmental Factors" include:
 - Corruption and criminality including ML/TF
 - Institutional weakness, instability & the rule of law
 - A capable, independent, and efficient judiciary
 - Exclusion and informality including authoritarian abuses

10. Supervisory Maturity

- 10.1 (KT39). Supervisory responses, will reflect country factors, in terms of political, economic and social development, as well as ML/TF risk and due consideration should be given to the the relative supervisory response as well as the absolute response.
- 10.2 (KT40). Supervisory progress can be assessed not simply against a common checklist, but against these country factors and as against progress over time. An example of a Supervisory Maturity Model is set out in the Key Enabler 10 Explanatory Note.

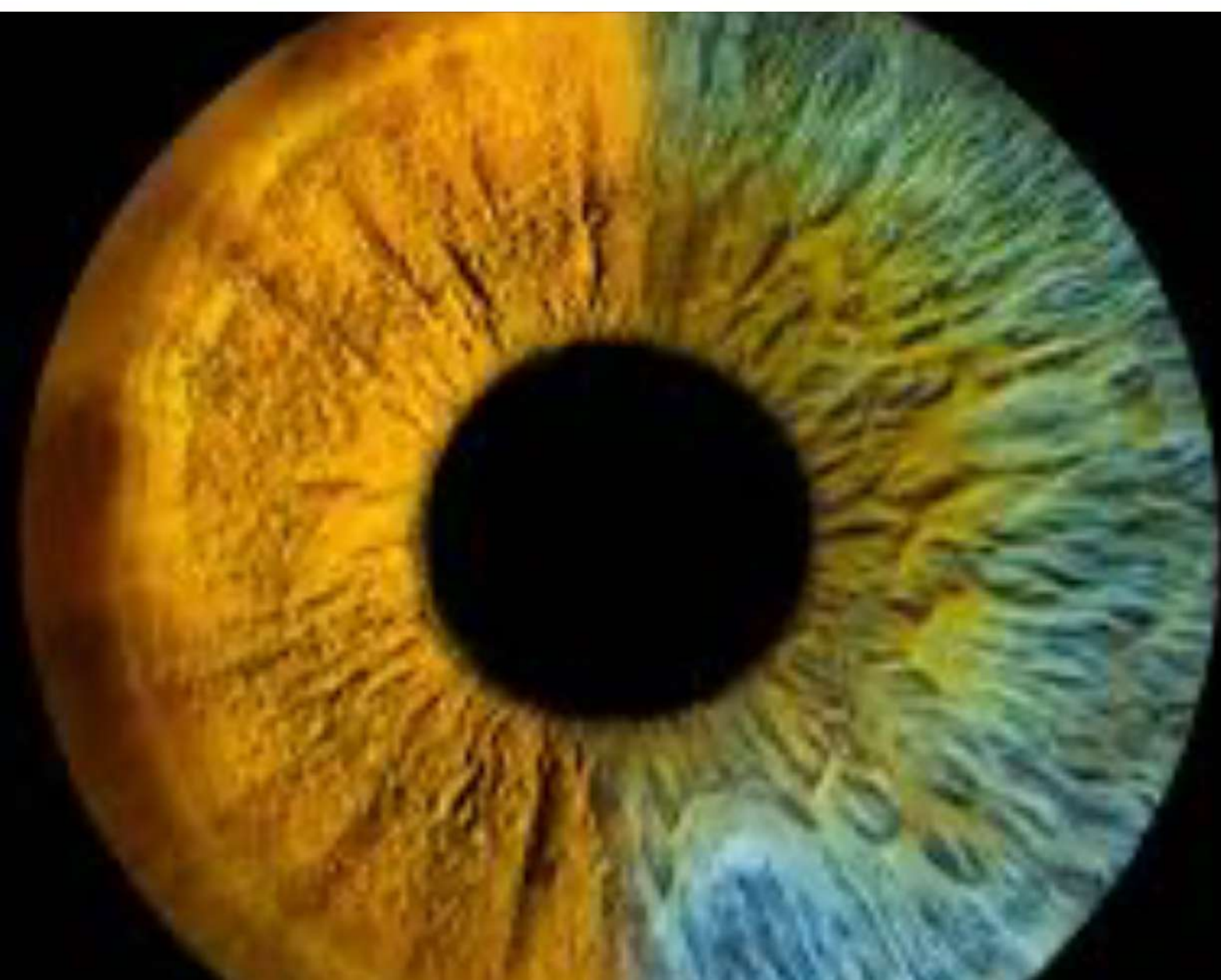
3. Conclusion

Achieving effective levels for supervision is not easy, & takes time. So called "pre conditions", "environmental factors" & "supervisory arrangements" play a significant role. No country has yet achieved 'High Effectiveness' ratings for supervision from FATF (for IO 3 Supervision) but with just over a dozen receiving positive effectiveness ratings, there is much to be done, but best practices to improve supervision are now available. Whilst there is no one size fits all approach to improving supervisory effectiveness, the GCFEC Experts believe that improvements can be achieved by focussing on areas which can enable improvements to materialise. At their heart, they involve supervisors willing to adopt truly risk based supervisory processes, which also means supporting risk based processes for those they supervise. This requires knowledgeable, skilled, experienced, cooperative, collaborative & committed supervisors, & may require in some cases cultural change. The gains to be had for success in supervision are not only to be found in achieving positive FATF IO3 results, but will help facilitate better results for FATF IO4 (Preventative Measures) as well as FATF IO6 (Financial Intelligence) & for other Immediate Outcomes (IO's). Expectations for supervision should remain realistic & no one expects "Super Vision", but superior levels of effectiveness, insights & actions can be achieved using the key enablers & key takeaways promoted by the Experts.

Improving Supervisory Effectiveness

Appendix

Explanatory Notes



Appendix - Explanatory Notes

Key Enablers & Key Takeaways to Improve Supervisory Effectiveness

1. Political Support and Operational Supervisory Independence

Irrespective of the supervisory system in a country, and no one system has yet been recommended as necessarily optimal, strong political support for AML/CTF actions is necessary and at the same time minimising political interference into agencies which need to have operational independence, such as law enforcement, Financial Intelligence Units and Supervisors.

1.1 Political Support

The fight against ML/TF should ideally be a policy of the state in addition to government policy, bringing together all political forces irrespective of which one may be exercising power at a particular given time. Nevertheless, it will be the government of the day that leads on this issue and a senior member or members of the government should be mandated as responsible for oversight and direction of the overall policy. Traditionally, tackling money laundering has been seen as the responsibility of finance ministers, as has the tackling of terrorism finance. That said, action targeting the underlying predicate crimes themselves, is seen as the responsibility of interior ministries, involving the criminal justice system, including law enforcement, intelligence agencies and other agencies such as customs and border controls, whereas tax crimes remain within finance. Supervisors will normally come under the responsibility and accountability of finance ministers. This may be different for DNFBP sectors and may be one of the reasons why professional supervision is often lacking or less effective. These sectors operate outside the financial sphere, and there is rarely a natural government agency that is willing to take responsibility, albeit the Tax authorities have been delegated to act as supervisors in some countries and in others especially for so called professions, the self regulatory authorities.

Political support can take many forms, but can be demonstrated in practice in terms of budgets and resources, promoting co operation between agencies and information sharing, including also internationally, where appropriate.

1.2 Operational Independence

According to R26 FI Supervision Interpretative Note , *“supervisors should have sufficient operational independence and autonomy to ensure freedom from undue influence or interference”*. Political interference into the activities of public sector agencies in particular law enforcement, Financial Intelligence Units and or supervisors can seriously undermine these key activities. Political interference can come in a number of ways, including through inappropriate public commentary, or private threats or intimidation, through requesting information on cases or investigations that should not be shared or encouraging selective action, that may be inappropriate. Interference can also come with threats around promotion and or job security. Interference from other stakeholders can also affect autonomy and independence, even if well intentioned and so whilst information sharing and collaboration and co operation is necessary, appropriate ways of working and MOU’s ensuring professional working should be followed. At the same time as operational independence should be defended, supervisors should be wary not to overstate perceived advantages of the country to some or to over promote the countries attributes over others, based on the level and or nature of regulation and or supervision, unless credible evidence is also used to justify any such promotion. To do so otherwise would suggest an obvious lack of independence.

Nevertheless, with political support and operational independence must also come transparency responsibility and accountability, with supervisors expected to deliver on their mandates, to be effective and to improve the overall effectiveness of those they regulate.

2. Full Supervisory Coverage & Systems

2.1 Supervisory Coverage

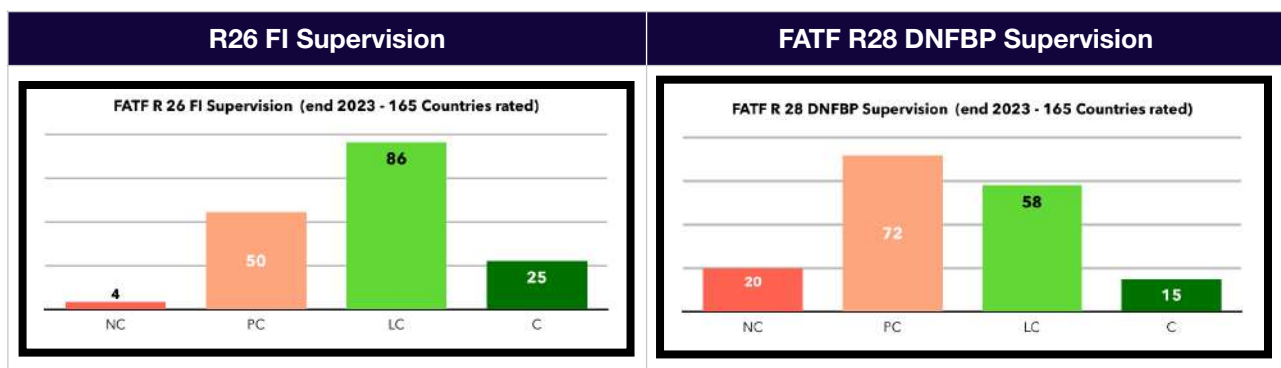
The original FATF 40 Recommendations developed in 1990 included Banks and non bank financial institutions, but these have since been revised and expanded and now include DNFBPs (including “Casinos”, “Real Estate Agents”, “Dealers in precious metals and dealers in precious stones”, certain types of “Lawyers, notaries, other independent legal professionals and accountants”, & certain “Trust and company service providers”. And more recently Virtual Asset Service Providers (VASPs). Those sectors covered by FATF as being required to adopt AML/CFT measures & to be monitored or supervised, have different levels of supervisory expectations, though whilst there are minimum requirements additional supervisory attention should be applied by countries after carrying out their own sectoral risk assessment to determine relative ML/TF risks, & then applying consequential monitoring or supervision as appropriate.

FATF Minimum Standards for Supervision for Selected Sectors				
	Financial Institutions	DNFBP Casinos	DNFBP Others*	VASPs
Licensing / Registering	✓	✓	✓	✓
Monitoring Option		✓	✓	✓
Supervision Option			✓	✓
SRB Option			✓	
Supervision Mandated	✓	✓		

* “Real Estate Agents”, “Dealers in precious metals and dealers in precious stones”, certain types of “Lawyers, notaries, other independent legal professionals and accountants”, & certain “Trust and company service providers”.

In FATF’s Report on the State of Effectiveness and Technical Compliance 2022²⁴, one of the 5 main improvements countries could do “to improve supervision”, was to, “continue to broaden regulatory frameworks to include non-financial sectors, ensuring adequate supervision and implementation of adequate, proportionate and dissuasive sanctions when needed”.

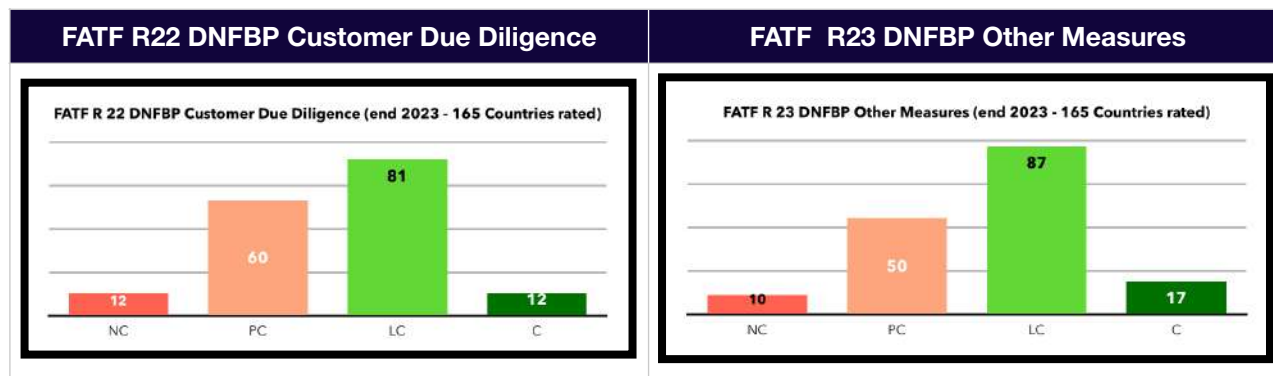
This report also highlighted that 32% of countries rated had not reached a positive rating for supervision of FI’s and that the equivalent rate for supervision of DNFBPs was 68%. As at the end of 2023, the rate for FI supervision not reaching positive ratings had slightly worsened to 33%, but for DNFBPs it had improved to 56%. It is likely that supervision of VASPs is significantly lower than that of DNFBPs, recognising the relatively recent requirement and changes to Recommendation 15. See chart on page 4 above.



FATF member countries, Australia, China and the USA are rated Non-Compliant for both R22 (DNFBP Customer Due Diligence) and R23 (DNFBP Other Measures), and so are also unsurprisingly also rated Non-Compliant for R28 (DNFBP Supervision). Canada is rated Partially Compliant for R22 (DNFBP Customer Due

Diligence) and Non-Compliant for R23 (DNFBP Other Measures), and rated Non-Compliant for R28 (DNFBP Supervision).

The FATF ratings for countries for R22 and R23 suggests more needs to be done on preventative measures by DNFBPs themselves in many countries, which correspondingly means more effective supervision of DNFBPs is certainly required.



Countries that have failed to implement existing FATF requirements, covering in particular all DNFBP categories as well as VASP's, should do so immediately, and apply the minimum expected measures. These sectors should be included in Country Sector Risk Assessments, so that relative ML/TF risks can be identified and appropriate supervisory arrangements applied to each sector.

For example whilst a number of DNFBP's are subject to monitoring or supervision often by SRB's, this is not permitted for FI's, Casino's & VASPs. For higher risk DNFBP's (excluding Casinos) countries could consider supervision for example by a professional independent supervisor, in such cases representing an upgrade on SRB supervision.

2.2 Supervisory Systems

In 2009 the World Bank in its "A Practical Guide to Bank Supervisors on Preventing ML/TF" in 2009²⁵, reported that, "Each jurisdiction devises and establishes its own organisational framework for AML/CFT supervision. Decisions to adopt a particular model or supervisory arrangement flow from individual natural criteria, and these might be features of the domestic banking system, or the powers and resources of existing agencies, and or priorities in the fight against ML/TF in general terms, however, based on a review of many supervisory frameworks, 3 models exist:

- supervision by the bank supervisory body,
- supervision by the FIU, &
- shared supervision".

According to the FATF Effective Supervision and Enforcement By AML/CFT Supervisors Financial Sector and Law Enforcement 2015²⁶ (Guidance on a Risk Based Approach), it was reported that "there are many different supervisory approaches, and while the FATF does not prescribe a particular supervisory model, whichever supervisory system is chosen, it should effectively address and mitigate the ML/TF risk". This position was reiterated in FATF's paper described as non-binding guidance on "Risk Based Supervision" in 2021²⁷, stating that, "the FATF focuses on outcomes rather than process", i.e. "it does not prescribe a particular supervisory framework as long as the supervisory outcomes effectively address ML/TF risks".

Nevertheless it did describe "examples of common AML CFT supervisory frameworks":

- A single AML/CFT supervisor responsible for AML/CFT supervision of all relevant entities (this task is usually exercised by the same authority which fulfils the task of FIU or the Prudential supervisor).

- *The integration of some aspects of supervision, for example, integrated AML/CFT, and Prudential supervision of the financial sector and/or the FIU or tax or other authority is responsible for AML/CFT, supervision of all or some non-financial sectors.*
- *A decentralised model for AML/CFT supervision with multiple agencies and/or SRBs responsible for AML/CFT supervision across and within different sectors. The FIU or another authority may also play a role in overseeing or coordinating supervision of all or some DNFBP²⁸ sectors”.*

Jurisdictions will have to weigh up, whether necessary changes in supervisory arrangements, which address supervisory challenges to address ML/TF risks by those they are required to supervise, can be achieved without introducing additional risks or losing benefits from existing or other supervisory arrangements. The following identified challenges are likely to inform how supervisory arrangements are likely to evolve:

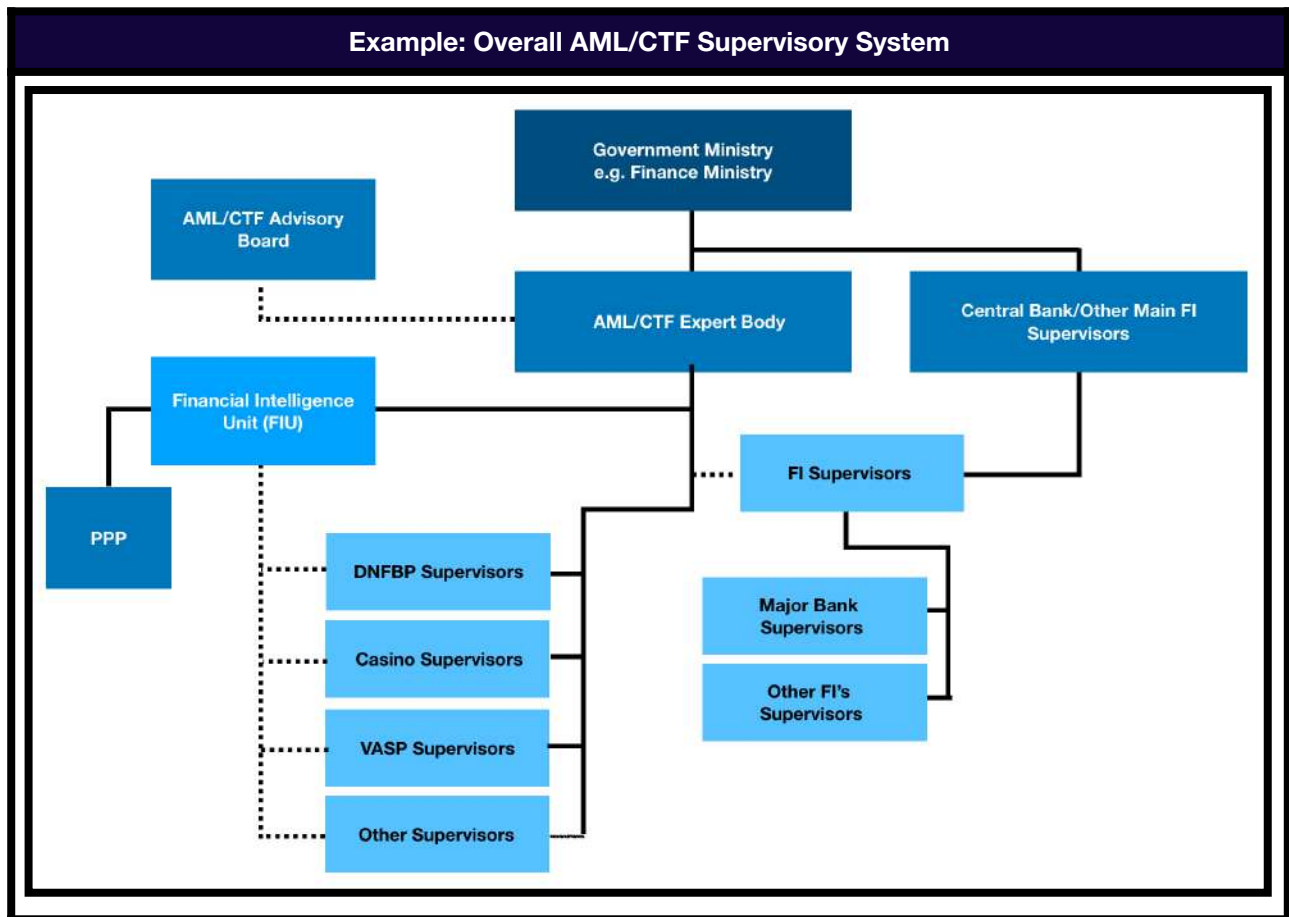
- The expansion in sectors to be regulated, for example to the virtual assets sector;
- The expansion within sectors of new entrants, for example in financial services, innovation and a transition to digital is disrupting traditional operations leading to a much more fragmented financial system;
- The sustainability of current AML/CTF programmes, if technical compliance overshadows effectiveness and efficiency;
- The changing nature of ML/TF risks, as described in country national risk assessments (NRAs), but not always tailored to specific sectors, and/or updated regularly;
- The FATF findings about supervisory weaknesses and/or recommended actions, including:
 - Acting to accelerate the transition from a rules based to a risk based approach to supervision including ensuring levels of supervisory intensity have an impact on addressing ML/TF risk
 - Increasing coverage of DNFBPs & VASPs & the quality of risk based supervision in these sectors;
 - Promoting innovation to improve effectiveness in mitigating ML/TF risks; and
 - Supporting information sharing including public private partnerships, and engaging with data protection supervisors to enable private to private data sharing with privacy safeguards.

There are many opinions on the benefits and trade offs for each system, and a successful system choice may depend more on the size and scale of the sectors to be supervised and the approach and history of supervision in the jurisdiction and the maturity and capabilities of various agencies. For example, whilst the focus on mitigating ML/TF risks may suggest the main areas of risk are from financial institutions, the banking or financial services supervisors may be best placed to lead AML/CFT supervision. Still prudential supervisors may have a different approach to conduct supervisors, with the former focusing more on the integrity and reputation of the financial system and the latter compliance with applicable laws and regulations. These supervisors may be very reluctant to supervise other sectors where they have little or no expertise, for example DNFBP's where often professional standards bodies, especially for lawyers notaries and accountants have often been co opted though here their may exist a lack of independence and so specialist supervisors may be appropriate for these roles.

Alternatively, the FIU could be chosen, as it should have the expertise to both understand ML/TF risks and to be able to assess the effectiveness of the regulated sector in terms of SAR reporting and FIU co-operation. This could have an accelerating impact on the transition from a rules-based traditional tick-the-box approach to more risk-based and outcomes-based supervisory results. FIUs though may not be best placed to understand the sectors themselves, nor how to carry out examinations and testing. Also the FIU

may not be right, if the FIU itself is not able to perform its existing tasks adequately, or would be insufficiently resourced to successfully carry out this additional mandate.

An example of a supervisory system is set out in the chart below, which favours in this example, the Banking/FI supervisors regulating the financial services sector and specialist third supervisors regulating other sectors, with a role for the FIU optional. Whatever system is used, co operation is required for all involved to make any system effective.



2.3 Level Playing Field

Supervisors should be guided by the principle²⁹ “same activity, same risks, same rules” recognising that whilst innovation and Reg tech has brought significant benefits, it is also providing similar services to those provided by highly regulated and supervised financial services and entities, but by different means which may escape licensing and or effective supervision, and so may represent less controlled products and services. Whilst traditional supervisors may be loathe to extend their remit to new entrants, where regulatory jurisdiction is unclear, and/or coverage nascent, this thorn has to be grasped, otherwise gaping holes will exist for ML/TF to exploit. Where necessary supervisors should look to move from an entity to an activity-based approach to regulation, which would mean imposing similar requirements upon all active players in a particular market segment, regardless of the legal nature of those entities.

It should be expected that money launderers and terrorist financiers will exploit these situations. Supporting innovation and new entrants and competition and financial inclusion should not come at the expense of increased ML/TF risks.

3. ML/TF Risk Assessments

The FATF, BCBS, the EU & many leading countries recognise that regulated sectors & individual obliged entities have unique ML/TF risk's & AML/CTF obligations & therefore a rules based approach to supervision is no longer appropriate. Supervisors need to transition from rules based to risk based supervisory plans which require supervisors to have their own view on sector & entity risk from a ML/TF perspective and design a "risk based" supervisory strategy. Sector risk assessments, (for regulated sectors), should be a focal point of a countries National AML/CTF Risk Assessment, & supervisors will be key contributors to this element of the NRA. In many countries, comprehensive AML/CTF NRA's are produced infrequently, so supervisors will likely have to update their own sector AML/CTF risk assessments annually alongside entity risk assessments.

The FATF, BCBS, the EU and many leading countries, including Spain & Ireland, that received positive ratings for IO 3 Supervision, have suggested & or use similar risk based methodologies, as do France, Germany, Switzerland, Hong Kong, Singapore and many more, to plan and develop an effective supervisory risk based strategy, at least for Banks & other regulated FI's. This leads to determining the level of supervisory intensity applied to segments and entities based on ML/TF risk. The US takes a somewhat different approach, with supervisory intensity mandated particularly across all Banks & none Bank FI's but the extent of scrutiny is based on ML/TF risk.

The FATF, BCBS, EU risk based supervisory model, has matured for Banks and other FI's. It involves assessing the risk of the sectors that are regulated by FI supervisors and also separately assessing the ML/TF risks from individual regulated entities and then combining both ratings, to generate final ratings. These ratings are then used to determine the level of supervisory scrutiny to be applied, including resources, which represents the supervisory plan. Crucially the plan is risk based and for example it is the level of ML/TF risk in a sector and applied to individual entities that should determine the outcome as far as scrutiny is concerned. Some jurisdictions, do include factors to weight the size or importance of a sector and or entity considering the idea of "impact" as being relevant also, for example, Hong Kong & Singapore, and it appears the EU's new AML Authority may adopt this method for determining its directly to be supervised FI's.

Classifying entities as higher, medium or lower risk, should be based on a methodology that establishes the inherent ML/TF risks of the entity, including by applying the appropriate sector risk rating (from the Sector Risk Assessment). The focus in supervisory methodologies on residual ML/TF risks, over inherent risks, (which could in theory also be used), would though require supervisors either to have their own robust and up to date assessment on sector and entity controls, or be able to rely on information from those they supervise, which presents real challenges In practice. As a result, supervisors usually take the cautious approach, and focus on inherent risks and history and experience suggests their is merit to this.

Nevertheless, supervisors should consider their entity ratings and compare these to the own ratings of those they supervise. If there are material differences in risk ratings from the entity's own risk assessment and from the supervisory risk assessment, these should be understood and resolved. Supervised entities must carry out an own risk assessment to be completed by the entity based on supervisory guidance and so it should be consistent with the supervisors view on what data should be collected by the entity and what areas should be measured for the entity to determine its own inherent and residual ML/TF risks. No two entity risk assessments will be calibrated to a common basis and will present real reliance challenges for supervisors, without such a common standard being applied, hence why data may be used but a supervisory methodology is needed. Supervisors may want to use additional information sought from entities and for example also from agencies such as the FIU where available, on the quality of reporting and co operation from reporting entities, which could be taken into consideration to assess the entities overall ML/TF risk rating.

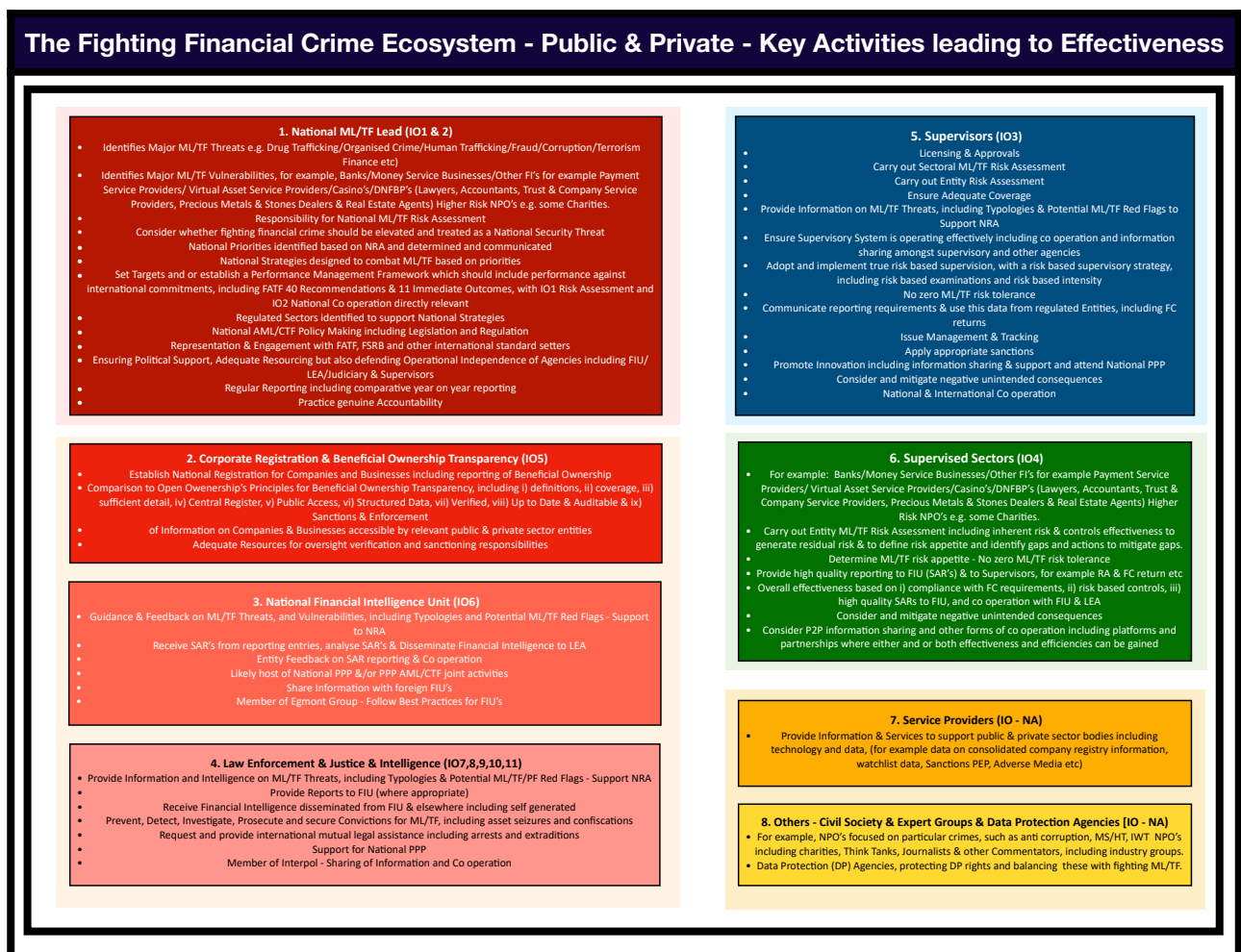
Supervisors should ideally update entity risk assessment annually, (entity risk profiles) or at least in case of major changes and or events, except for lower risk entities. Sector risk assessments will usually be carried out periodically as part of a Country's National AML/CTF Risk Assessment.

Whilst risk based supervisory methodologies are increasingly more common, there are many countries, which are starting out on this journey and should accelerate their transition from “rules based” to “risk based” supervision. The risk based methodologies used for sectors where Banks and FI’s operate should also be useable with appropriate modifications for other sectors, such as DNFBP’s and VASP’s.

As mentioned in 2.3 above supervisors should be aware of sectors where ML/TF risks are present but where supervisory coverage is nascent and or where the application of the principle, “*same activities, same risks, same rules*” doesn’t apply or where in effect supervisory knowledge and coverage is limited. It should be expected that money launderers and terrorist financiers will exploit these situations.

Effective AML/CFT supervision also requires strong key AML/CFT stakeholder relationships, that join up key AML/CFT activities, including in particular the work of the many public and private sector agencies so that system wide effectiveness can be achieved. Key Activities from all stakeholders include the various risk assessments, for example, the National ML/TF Risk Assessment, the Sector ML/TF Risk Assessments, Bank & non Bank FI Risk Assessments and Supervisory Risk Assessments and Supervisory Plans, and information from all parties designed to inform risk and response. This is not an easy task, but countries that have done well and are rated positively by FATF for both IO3 Supervision and R26 FI Supervision and to a lesser extent for R28 DNFBP Supervision, (as these are still for many work in progress), operate strong risk based methodologies that generate genuine ML/TF risk ratings that help classify them into categories in order then to build a supervisory plan and to apply differentiated levels of intensity.

For more on the various stakeholders, and their key activities, including for these purposes for a high level summary including for supervisors, see the chart below.



4. Supervisory Plans

The risk based approach to supervision as described in Section 3 above is strongly encouraged and endorsed by the FATF, the BCBS and the EU. Approaches to identify high, medium & low risk Banks & FI's & other entities in other sectors in many countries are mostly similar, but when it comes to the frequency and deployment of supervisory tools in response, there appears to be a significant variation. Whilst inspections or examinations have traditionally been the most obvious supervisory tool, the range of supervisory tools actually is much broader & includes data collection, reporting, monitoring, interviews, meetings, audits, as well as offsite and on-site inspections or examinations. Inspections or examinations can be thematic across sectors, comprehensive for entities or targeted, and involve a limited engagement with Bank or FI staff or can be more extensive, covering all 3 lines of defence as well as with directors & auditors.

Whilst the FATF, BCB & EU provide clarity on what is expected in terms of increasing supervisory intensity on higher risk rated entities, no minimum expectations in terms of application of tools or frequency is provided. As a result there is a significant variation in country approaches, ranging from high risk entities being assessed via onsite inspections every year to on-sites for some being undertaken only every 3-5 years, with corresponding medium risk and low risk entities receiving proportionately less intense scrutiny.

Traditionally on-site inspections have generally been accepted as representing the most intense scrutiny to date, but they are resource heavy & may not provide value for money, or the most effective and efficient way to scrutinise entities. For example, some on-sites can last a few weeks & involve a few staff with limited testing. Others, can last many months, with experiences in some countries, for example in the USA, where annual on-site inspections can be essentially perpetual in nature & roll on from 1 year to the next.

Whilst the frequency of on-site inspections in some places (for example in Qatar) for higher risk entities is even under 1 year³⁰, this is unlikely to be possible to replicate in countries with much larger numbers of supervised entities & more limited resources. A number of countries add an additional "ultra high risk rating", for example in France and Ireland³¹, on top of their risk assessment classifications, so that a small number of Banks & FI's will always receive at least annual on-site inspections, where otherwise being rated as high risk in a larger pool, would reduce this likelihood significantly. These are often included by adding an additional "impact" criteria to the risk assessment which usually means national champion Banks and FI's including globally, regionally or nationally significant as the case may be, are included in this highest category of risk. This is also a feature of the approaches in Hong Kong³² and Singapore³³. Some countries including Bahrain, Germany and Switzerland rely also on annual external audits³⁴. The BCBS, could help by setting minimum standards for frequency & or scrutiny and or alternatively guidance on the use of supervisory tools to reflect the results of supervisory ML/TF risk assessments. This would require a consensus or common ground from members, but the resource issue may be an important factor in practice. Whilst the FATF makes clear intensity levels for supervision should be based on levels of ML/TF risks and not on available supervisory resources, the practical realities are that available resources are a factor in many countries. Countries with large ML/TF risks including larger financial centres should have available larger supervisory resources, which are also skilled and experienced to fulfil their duties. Countries with lesser ML/TF risks, and whose domestic ML/TF risks do not have as an international or regional impact, should be assessed at least as far as supervision under IO3 is concerned with this in mind, and not judged unfairly to a rules based standard. Reconciling different approaches would help promote consistency and clarity for those still on the journey from rules based to risk based supervision. Whilst Banks & other FI's are the most intensely supervised, this is usually a result of their inherent vulnerabilities to ML/TF. Other sectors will be rated differently & supervisory intensity considered differently as a result.

Using data, data analytics, technology (including Artificial Intelligence) & advanced reporting can improve both supervisory coverage & help target resources where risks are identified. For example, individual examinations can be improved through gaining better insights to address during examinations & trends & outliers can be identified over time which could trigger areas of focus on issues & or specify entities, & permit supervisors to be more flexible in scheduling & carrying out examinations. Supervisors can also use tools³⁵ to scan for trends, including regulatory developments in other jurisdictions for outside information to stay abreast of best practices.

5. ML/TF Risk Tolerance

Whilst risk based supervision to many supervisors means assessing ML/TF risks and applying a risk based supervisory plan, it should mean more. It should also include the impact of supervision on those they regulate, and expectations around ML/TF risk in the regulated sector. For example, some supervisors still communicate and or operate to a zero tolerance approach to ML/TF risk in regulated sectors. Further some focus just on technical compliance as opposed to effectively addressing ML/TF risks and more on prevention than on detecting and reporting suspicions of financial crime from those they regulate. Such an approach can have counterproductive outcomes, including impacting financial inclusion.

Others have recognised this is unrealistic as experience has shown this approach to be flawed. For example of one of the worlds leading AML/CTF Supervisors, the HKMA has stated since 2015³⁶, that, *“We will continue to use a risk-based approach in our supervision. This is not a ‘zero failure’ or ‘zero tolerance’ approach, no amount of action by the HKMA or AI’s [FI’s] will prevent ML/TF completely. Our objective is that AI’s [FI’s] take a risk-based approach to implement AML/CFT measures: Implementation by AI’s [FI’s] should be aimed at managing risks; We see some AI’s [FI’s] that successfully implement such an approach; To implement such an approach effectively and successfully, sufficient consideration and resources must be given to execution and customer facing issues”.*

Just as supervisors are expected to allocate resources to higher ML/TF risk, so should those they regulate. For example, their could be justification and a higher tolerance for less frequent or intense controls in lower risk areas and/or applied to lower risk customers, as opposed to higher risk ones. No amount of controls deployed, no matter how strong or comprehensive will prevent ML/TF, or detect all ML/TF. Naturally ML/TF is unwanted but controls are not going to be 100% effective, especially as those involved in ML/TF are highly motivated and well resourced to try to avoid and/or get around these controls. Supervised entities will operate many controls, designed to mitigate ML/TF risks, and for these to operate at high levels of effectiveness with testing and assurance applied. Nevertheless even with well designed and assurance and testing applied, many controls are calibrated to operate at effectiveness levels reaching 95-98%. The 2-5% delta is often a reasonable compromise made regarding the deployment of resources to achieve acceptable levels of effectiveness as well as reflecting challenges that complex processes, including those involving human judgement in particular will not generate 100% consistent outcomes. Any such delta, for example a 2-5% control failure rate is unlikely to represent a major ML/TF risk, because the control weakness would have to coincide with the particular transaction and or customer involved presenting actual ML/TF risk, which is very unlikely. The risk nevertheless exists and is by extension within acceptable risk tolerance.

With this in mind, supervisors should be comfortable with FI’s taking this approach. This is essentially an expression of ML/TF risk appetite and/or tolerance which if reasonable should be accepted, and is certainly neither reckless nor complacent. Nevertheless it does mean that compliance with applicable AML/CTF regulations are unlikely to be fully complied with if full compliance is defined as having all controls operating at 100% accuracy levels.

Achieving 100% levels is often described as “full technical compliance”. Experience shows that setting 100% performance targets for even key controls is unrealistic, even in the best of controls environments. Accurately testing and reporting on well designed and operating controls and responding to identified weaknesses is consistent with sound risk management and control practices. It is contrary to a zero tolerance approach for ML/TF. Expecting and examining to full technical compliance, and finding violations where controls are operating effectively with a reasonable ML/TF tolerance, is incompatible with reasonable risk based supervision which should recognise that a high level of operating effectiveness which addresses ML/TF risks, can be achieved without achieving fully so called “technical compliance”.

6. Co-Operation and Collaboration

As can be seen above, in Section 2 Full Supervisory Coverage and Systems and in Section 3 ML/TF Risk Assessments, co operation between supervisors and with other key stakeholders, is essential in order to achieve effective supervision. Without being prescriptive as effective co operation and collaboration can take many forms, Supervisory agencies may find it useful to identify a list of key strategic partners among competent authorities at the national level and ensure arrangements are made so as to work closely in enhancing coordination and cooperation, as well as with other partners, with whom they must work in order to achieve common goals. How this is achieved may well depend on the particular supervisory system in place, and how supervision, (prudential, conduct and sector specific) and the leading AML/CTF Expert body and the FIU are constituted and operate. Supervisors should also actively facilitate and participate in international regulatory colleges, and in regular dialogue in fora such as the BIS (BCBS) and at the EU (EBA - AML Authority) as well as within the relevant FATF (including regional) working groups. Supervisors should also recognise the need for co operation beyond those in official capacities in the public sector. In many cases supervisors have led so called Public Private Partnerships of Financial Information Sharing Partnerships, for example in Singapore and are leading an initiative in Japan, and in other countries they are an important member, providing active support and encouragement to private sector members. With co operation and collaboration such an important element in bringing together many agencies and parties involved in combating ML/TF, the challenges of doing so, and ensuring for example prudential and conduct supervision, FIU activities and other agency priorities are supported including respecting data protection and data privacy regulations and data protection agencies is essential.

6.1 Key Strategic partners

The supervisory agencies could identify a list of key strategic partners among competent authorities at the national level with which to work closely in enhancing coordination and cooperation. This will also depend on the particular supervisory system in place. To determine the list of key strategic partners the following objective criteria could be considered:

- Relevance of the competent authority for risk assessment and risk mitigation purposes;
- Relevance of the competent authority for ensuring consistency/coherence in regulatory and supervisory approaches;
- Relevance of the competent authority as a source of information for the regulator and/or for information sharing/exchange purposes;
- Relevance of the competent authority in the use of supervisory outputs, including for national risk assessment and/or policy development purposes.

Once identified new (or updating) MOU's can be agreed to formalise the expected collaboration, which can take the form of:

- Access to information and information exchange;
- Establishments of periodic coordination meetings;
- Points of contact;
- Liaison officers (if applicable);
- Enhanced operational coordination mechanisms;
- Strengthening of procedures;

- Feedback on quality and use of information shared and received;
- Capacity building and training.

Where the supervisor, is not the FIU (or even where it is but is acting as supervisor and not as the FIU), collaboration between the supervisor and the FIU as key strategic partners is essential. This should benefit both the supervisor and the FIU, for example:

- The FIU should provide meaningful input to the supervisor periodically on:
 - The nature and quality of reporting by reporting entities;
 - The level, nature and type of cooperation in responding to requests for further information by reporting entities to the FIU;
 - Provide the supervisor with outcome on trends, patterns, and risks resulting from strategic studies and reports to relevant competent authorities;
 - Feedback from other competent authorities, if relevant, received by the FIU, of use to the supervisor in connection with its strategic and operational activities, for example from law enforcement agencies.
 - The inclusion and involvement in FISP's (Financial Information Sharing Partnerships), or so called PPPs (Public Private Partnerships) where the FIU is involved;
- The supervisor should provide meaningful input to the FIU periodically on:
 - It's risk assessment of reporting entities, especially if there are material changes affecting particularly large contributors of financial intelligence to the FIU;
 - The outcomes of inspections of reporting entities;
 - The level, nature and type of cooperation in dealings with the supervisor by reporting entities;
 - Feedback from other competent authorities, if relevant, received by the supervisor, of use to the FIU in connection with its strategic and operational activities.

Additional areas of collaboration between the supervisor and the FIU could include establishing FISP's or PPP's, by joint participation in sectoral risk assessments, and/or coordinating joint training, and/or awareness activities.

6.2 Data Privacy Partners

A key partner for supervisors is increasingly data privacy agencies. According to the GCFCC Data Privacy Experts Working Group Paper on "Fighting Financial Crime & Protecting Responsible Data Sharing: A Path Forward"³⁷, published in October 2024, the relationship between fighting financial crime and safeguarding data privacy is an important one and should be encouraged. It is not a zero sum game with one party winning and the other losing in any AML/CTF regime and so finding the balance and a way forward which provides legal gateways to share necessary information is critical. FATF also considers information sharing "*crucial*" in AML/CTF³⁸, noting that since financial crime networks operate across lines of business and are often transnational, data sharing has the potential to assist FI's and authorities to reduce data collection and pinpoint suspicious activities with more accuracy, for better AML/CFT outcomes if proper DPP safeguards are in place. Ensuring there is a clear legal basis which supervised entities can rely on to share information – and clear guidance about the extent of permitted data sharing, is central to the success of data sharing regimes, as is understanding how to respect broader data privacy regime requirements.

7. Impacting and Influencing Behaviour

A key factor as set out in the FATF Methodology³⁹ for assessing IO3 (Supervision) is *“To what extent are remedial actions and/or effective proportionate & dissuasive sanctions applied in practice”*. FATF R35 also states that, *“Countries should ensure that there is a range of effective, proportionate & dissuasive sanctions, whether criminal, civil or administrative, available to deal with natural or legal persons covered by Recommendations 6, & 8 to 23, that fail to comply with AML/CFT requirements. Sanctions should be applicable not only to FI’s and DNFBPs, but also to their directors & senior management”*.

7.1 The use of large dissuasive Sanctions

Many Supervisors have extensive powers to investigate and to penalise regulated entities in many countries. Other countries still need to acquire or use these powers, which are essential and expected under FATF R35 Sanctions. In more countries than ever before, fines and penalties have been levied over the last few years, as the focus on supervision and the effectiveness on supervision becomes more important. Indeed the levels of published fines and penalties levied against regulated entities for ML/TF this century is similar in size with the amounts of funds recovered against ML/TF’s over the same period, with at least 50% levied by US agencies, though this is changing. To date less than a dozen countries can be described as having used dissuasive sanctions.

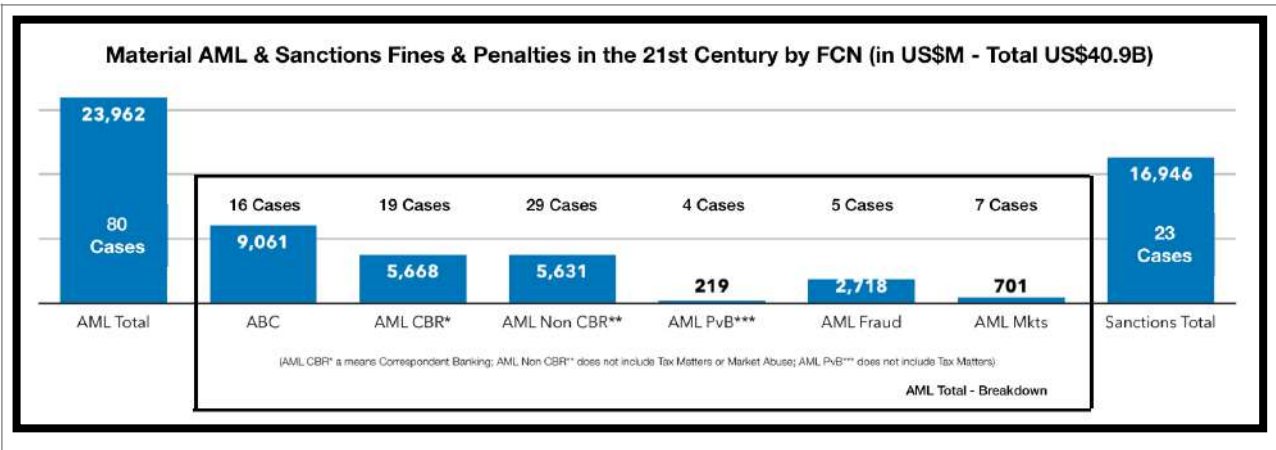
This suggests the private regulated sector needs to do more, but also that the public sector needs to do much more in recovering criminal assets, when SARs to FIUs from the private sector have increased from tens of thousands to tens of millions in the same century. Whilst the investigation and sanctioning of egregious behaviour in the regulated sector is largely seen as a positive, is necessary and appropriate and is encouraged by FATF, it generally produces negative country headlines and many traditional prudential supervisors have not been convinced this is the right approach.

Many traditional prudential type supervisors believe these sanctions are either unnecessary or unwise. Unnecessary because those responsible for any violations should & can be quickly replaced & consequences should be better applied to responsible and or accountable individuals and not to the institutions they mismanaged. Unwise because the overriding objective for prudential supervisors is to protect the safety and soundness of the financial system, which can be imperilled by action taken which could affect the systems wider reputation and in particular large FI’s where retaining trust and confidence remains an important element in retaining trust and confidence of its customers and its place in the system as a whole.

So called conduct and sector specific type regulators and AML/CTF supervisors are traditionally less concerned about these risks, and have shown an increasing desire in a number of countries to levy ever larger fines and penalties for AML/CTF programme weaknesses and for violations of AML/CTF laws and regulations. Conduct and sector specific type regulators whilst less concerned about wider considerations for many they regulate, may still defer to prudential supervisors when dealing with large systemically important Banks/FI’s.

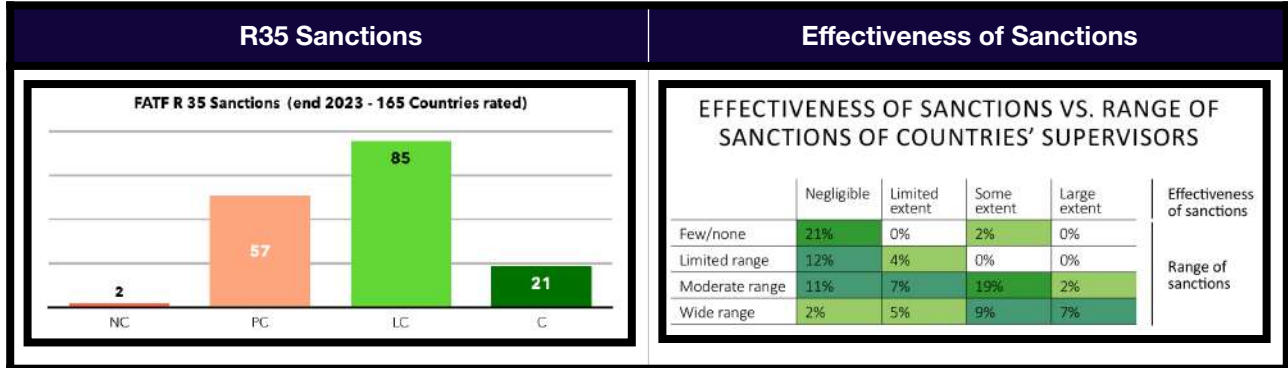
7.2 The imposition of large material AML/CFT Financial Penalties

A review⁴⁰ of all material AML fines (>US\$10 million) levied against FI’s globally in the 21st Century (to end of 2022), revealed 80 fines valued at US\$23.9 billion. The majority of these material AML fines, (50/80 or 63%) were levied in the USA representing 54% in value and 30 material AML fines were levied elsewhere (representing 46% in value), with 9 in the UK, 2 in each of Australia, Malaysia, the Netherlands and Sweden, and 1 in each of Chile, Denmark, Germany, Hong Kong, Mexico, Norway, Philippines, Singapore, South Africa and Switzerland. These material fines can be broken down into a number of categories, including 16 Anti-Bribery & Corruption cases at US\$9 billion, 19 AML Correspondent Banking cases at US\$5.6 billion, 29 AML Non-Correspondent Banking cases at US\$5.6 billion, 4 Private Banking cases at US\$219 million, 5 AML Fraud cases at US\$2.7 billion & 7 AML Markets cases at US\$701 million. So whilst material AML/CTF fines and penalties are on the increase, only 6 countries have imposed more than one material fine of over US\$10 million this century.



Large fines & penalties are not the only sanctions available of course, though they are the most noticed & reported upon. Other sanctions include: written warnings; orders to comply with specific instructions/ restrictions; ordering regular reports on the measures the FI is taking; barring individuals from employment within that sector; removing, replacing or restricting the powers of managers, directors, &/or controlling owners; imposing conservatorship or suspension or withdrawal of the license & even criminal penalties.

In FATF’s reporting on 165 countries assessed by the end of 2023, 64% received positive ratings for R35 Sanctions. See the chart below. In however, the FATF’s Report on the State of Effectiveness and Technical Compliance 2022⁴¹, based on a sample of 59 countries⁴², “looking towards sanctions⁴³ applied by supervisors to supervised entities, performance is low. Countries’ sanctions are not very effective (limited or not effective in 59% of cases)”. See again the chart below. This suggests that whilst those countries with a wider range of sanctions available to them, felt the impact of applying sanctions was more effective, the extent of such effectiveness was reported still as mostly negligible and or limited.



7.3 Personal Accountability

According to the former NY FED President in remarks to the BIS⁴⁴ in 2018, he stated that, “we need to recognise that an effective regulatory regime and comprehensive supervision are not sufficient. We also need to focus on the incentives facing banks and their employees”. He suggested one idea that a, “possible reform could involve putting a greater onus on senior management for the costs incurred from regulatory fines or other legal liabilities, rather than on shareholders alone. Greater personal liability may also be a powerful incentive to promote better behaviour. I suspect changes in these areas would lead senior managers to encourage their staff to speak up earlier about emerging risks, be more attentive when red flags were raised, and respond sooner and more forcefully”.

So called senior manager regimes support this idea and exist and operate in a number of countries including in the UK. In these regimes senior leadership roles are only taken up after a fit and proper test is completed and once in role, responsibilities and accountabilities are established, to make it clearer on those the supervisor expects to discharge responsibilities and where accountability later lies in case of problems.

Supervisors should consider implementing senior manager type regimes or making senior individuals responsible and accountable. Supervisory action could also be taken against the entity but also against individuals, where powers permit, where evidence of culpable active or passive behaviour exists which meets a requisite threshold of carelessness, negligence, recklessness, intent or wilful neglect as appropriate with appropriate proportionate sanctions applied as a result. Whilst these may fall short of action that would fall into the domain of the criminal law which is a matter for prosecuting authorities, where evidence exists of potential criminality, this should be fully investigated and evidence provided to criminal authorities and they should be supported in any proposed actions.

The use of best practice guides, establishing standards & training for senior officers holders, can raise their performance & support them to succeed & to avoid failure through not knowing what good enough looks like.

7.4 Capital Frameworks

In December 2017⁴⁵, the BIS issued revised standards that finalised its post financial crises reforms and Basel III framework. The revised standards included a new way to measure the amount of operational risk capital (ORC) that banks are required to hold. In practical terms, a bank's internal operational loss history will be taken and used (with other factors set by the regulator) to calculate the amount of capital that is required. Managing ML/TF risk well can translate into minimising an ORC charge, as performance on ML/TF is within the operational risk domain. Of course, poor management of ML/TF risk has the opposite effect. Making the ML/TF component of the ORC transparent to both the regulated entity and publicly, through disclosure in annual report and accounts would encourage the sector to improve their performance in managing ML/TF risks, and highlight Banks in particular that need to do more.

7.5 Black or Grey-listing

The listing of countries by FATF with significant ML/TF weaknesses, (grey listing) comes with it an obligation on the listed country to deliver an action plan to make improvements to be considered for later removal from these lists. This is a multi year effort. This usually then takes priority in country over all other ML/TF related actions, which can squeeze out other none FATF related important initiatives. The effects of these lists can have significant direct economic impacts on listed countries as well as indirect costs and penalties on countries, in particular costs and penalties of cross border financial activity, including on cross border payments and correspondent banking. Grey listing to some currently underweights threats and overweights responses and so is claimed by some to be unfair to many countries in the so called 'global south' where resources are more limited. It is understood FATF is looking at this issue and may make some positive changes as a result. Whilst listing has to date encouraged increased effort by countries and has lead to improved effectiveness, there are consequences which are both intended and unintended that are important to recognise. For example FATF listing requires third countries to respond, which includes raising the ML/TF risk of that country in third party ML/TF risk assessment models, and in third party customer risk assessment models. This translates into raising inherent ML/TF related risk which requires then a corresponding increase in controls be applied to compensate. This can lead to foreign correspondent bank accounts being restricted from the grey listed country and customers from this country also having increased control measures applied to their international payments. This applies, in the case of foreign correspondent banks even when, for example as is the case with the grey listing of South Africa, ratings for Bank related recommendations were all positive⁴⁶.

7.6 Published Findings and or Hearings

Supervisors can share important details of cases that should be of interest to and or are relevant to others in the regulated sector. This can include root cause disclosures and lessons learned which can be invaluable and a way to make the overall system more resilient, despite individual weaknesses identified. For the most important cases or issues, it could be useful to hold public hearings, for example public enquiries and or through parliamentary committees which provides the opportunity to call evidence, hear from witnesses and experts and assess options and make recommendations. A good example of this was the establishment of the Cullen Commission in British Columbia in Canada⁴⁷.

8. Building and Retaining Essential Capabilities

According to R26 FI Supervision Interpretative Note⁴⁸, “Countries should ensure that financial supervisors have adequate financial, human & technical resources. These supervisors should have sufficient operational independence and autonomy to ensure freedom from undue influence or interference. Countries should have in place processes to ensure that the staff of these authorities maintain high professional standards, including standards concerning confidentiality, and should be of high integrity and be appropriately skilled”.

Supervisors have a difficult role, not just 1) to understand the business models & main activities of those they regulate, which should take years of building knowledge & experience, but also 2) to learn & excel in the role of a supervisor, which also requires an extensive knowledge of the relevant laws & regulations, the ability to carry out the supervisory tasks that are required to be undertaken, for example a) interviews of senior leaders (who are often business & AML/CTF experts) in the regulated sector, b) data collection, analysis & assessment, c) effective scrutiny including through planning & carrying out inspections which will include rigorous testing, analysis & assessment to generate results, & d) the behavioural skills to collaborate & co operate, to utilise available incentives and sanctions, & e) to do all of this when usually under resourced & with environmental factors impacting the effort.

8.1 Human Capital and Resources

Individual supervisors with all of these multidisciplinary skills are rare, though administrative agencies should be equipped with all these knowledge bases & seek to ensure sufficient relationships & interactions to benefit from this collective knowledge base to generate supervisory excellence. For more on collaboration & developing a framework for enhancing co operation & collaboration see Key Enabler 6. Supervisory excellence likely comes with experience for most supervisors, with experience in different sectors, different agencies & even in both public & private sectors, likely to benefit supervisors in time. Supervisory excellence can also be achieved by continuing a supervisory role even in a single agency but learning & acquiring experiences & competences which can be supplemented by working with other sectors & agencies. Each agency has its own objectives, but overall it makes sense to work together towards common goals addressing ML/TF risks. A challenge relating to nurturing & retaining talented supervisors is remuneration, where pay scales & comparisons for AML/CTF supervisors, versus other comparable public sector professionals & private sector professionals can be an issues and should be acknowledged & addressed.

8.2 Knowledge

Whatever supervisory system is selected and arrangements put in place the supervisor must encompass (i.e. not merely have access to but rather actively utilise and integrate) diverse sets of knowledge in order to effectively leverage their authority in a way that helps address ML/TF risks. The key knowledge bases to which a supervisor must have access include:

- Knowledge of state (and/or government) AML/CFT priorities;
- Functional knowledge of AML/CFT rules and their uses, and the gaps in those rules and regulations, as well as whether material execution gaps exist.
- Technical knowledge of regulated industries, above and beyond that which is inherent to "natural" regulators, many of whom may have limited experience within the private sector;
- Knowledge of the functions and limitations of law enforcement as it fights illicit activity, and how it uses the information it receives from AML/CFT reporting; and
- Knowledge of the way financial institutions and other sectors such as DNFBP's, as appropriate, are uniquely susceptible to facilitating illicit activity.

The AML/CTF supervisor needs the above knowledge precisely because the constituent components that make up the national AML/CFT system (prevention, detection and criminal justice) are interconnected in such a way that a vulnerability or gap in knowledge of one area affects all of them. Each one of the components is interconnected.

Practical examples of the way these overlapping areas of knowledge intersect include:

- Detection systems which are directly influenced by the amount and quality of information supplied to Financial Intelligence Units (FIUs) by the reporting entities, and feedback received.
- The effectiveness of the criminal justice apparatus depends to a large extent on the added value that financial intelligence provides to the information already contributed by reporting entities. The higher the quality of suspicious activity reports, the greater the ability of FIU's to produce value added financial intelligence for use by criminal justice operators (i.e. law enforcement, prosecutors, and judges).
- Reporting entities, in turn, are influenced by the quality of the regulatory framework and supervision, given supervisors ability to identify weaknesses in one reporting entity, ensure deficiencies are corrected and lessons learned passed on to other reporting entities.
- Finally, preventive measures to deter ML and TF can only be effective if the criminals and terrorists perceive that the information that is requested by the system and reported is effectively used to detect their transactions, obtain convictions, divest them of their property and disrupt their goals.

Overall system effectiveness is therefore enhanced when all the component parts of the system work to support not only their own immediate needs, but also those of others also contributing, to generate a virtuous circle. This is what ultimately contributes to achieving the higher-level objective of *“providing a decisive contribution to the fight against financial crime & improving the soundness of the financial system”*.

8.3 Technology

Supervisors are often responsible for many hundreds and in some cases thousands of regulated entities, are reliant on technology to support their supervisory activities. Supervisors should explore the opportunities available to them from technology (including Artificial Intelligence), data, and data analytics to modernise the supervisory approach (“SupTech”). The main technology needs are:

- to support data collection, aggregation, assessment and analysis, in particular in relation to supervisory AML/CTF sector and entity risk assessments.
- to support market surveillance activities, in particular to monitor for suspicious or unusual insider dealing and/or market abuse activity amongst the regulated sector and or their customers.
- to support testing of the effectiveness of IT deployed by supervised entities, particularly as regards tools for e.g., that are configured to perform name & or transaction screening, to measure hit rates.
- to support inspection activities, for example French supervisors have tested artificial intelligence, to help select risk based customer files to review from the millions potentially available.
- to support internal compliance requirements.

According to the OECD Business and Finance Outlook 2021: AI in Business and Finance⁴⁹, *“Digital 24 technologies and data – including Artificial Intelligence (AI) -- hold the potential to automate and thus improve the efficiency and effectiveness of regulatory, supervisory and enforcement activities”*. Supervisors may delegate and or utilise the skills of professional third parties in support of these technology needs.

Whether developing in house or insourcing technologies, supervisors need to avoid behaviour that they would criticise in a supervised firm, such as buying an off-the-shelf IT tool without configuring it and using it

appropriately or being able to sensibly interpret what it is telling them. Whilst supervisors have their own technology needs, they also need to have an understanding of the technology needs of those they regulate, and to be able to assess, test and conclude whether those they regulate are operating and using technology to satisfy their AML/CTF obligations adequately.

This is much more than recording the name of the vendors selected, even for popular technology vendors commonly used by many in the regulated sectors, and involves assessing how the regulated entity has selected, understands, explains, configures, operates, reports and tests the effectiveness of the technology as it is used to support the relevant AML/CTF process.

8.4 Resources

The system must also have adequate resources to be able to achieve its purpose. Adequately resourcing to achieve effective supervision in terms of staff, technology & access & use of data is costly. There are more regulated sectors & entities than ever before, which creates challenges over resource allocation, though risk based supervision dictates allocating resources should be based on ML/TF risk assessments. In many countries, supervisory funding comes out of the public purse and/or from licensing fees or other levies on the financial sector. Still, most supervisors nevertheless complain of underfunding which limits coverage, scope of their work, intensity and scrutiny and ultimately affects overall effectiveness. Whilst this is for governments to address, the old adage that compliance is expensive but non compliance is more expensive should be born in mind, when setting budgets. It's also governments from FATF member states that have set international standards and effectiveness expectations including of supervisors, and so it is incumbent on them, as they promote these as core specialist activities that adequate resources are made available in these countries and they support third countries with capacity challenges. Whilst resources should always be adequate, they can go and be used further, to the extent that efficiencies can also be achieved. Resources may be available to supervisors including for example from FATF training centres, and other resources for training and education purposes. Innovative hiring models including temporary secondment models or exchange programmes should be considered and traditional ethical considerations addressed.

8.5 Efficiencies

Supervisors can benefit from and can look to make efficiencies, as inefficient activities are costly, usually take longer and create friction. They can also leverage others including the FIU, those they regulate, and those that audit and or can independently monitor the activities of those the supervise. They can also look to benefit from better international supervisory engagement focussed on practical internal supervisory needs and not just on AML/CTF standards at fora like the BCBS.

8.5.1 Duplicate or Semi Duplicate Processes

Supervisory agencies often duplicate similar activities, Countries duplicate similar activities with other countries, and of course globally when aggregated similar activities carried out independently are very inefficient. Some of these activities can and should be standardised and models provided to all, like for national risk assessments, sector risk assessments, entity risk assessments which would significantly increase overall efficiency. What is then different and needs to be assessed is the data and judgement applied. When it comes to entity risk assessments their is a parallel exercise being undertaken by regulated entities, based on regulatory expectations which in some cases are leveraged for risk based supervisory purposes but not in most cases. These are hugely data heavy and expensive regulatory requirements and must be used and or modified so that sector and entity risk assessments can be leveraged to both benefit the supervisory and the regulated sectors.

8.5.2 Data for Supervision

Data requests by supervisors should also be consolidated & purpose oriented which supports overall effectiveness and where it can be demonstrated it is highly useful. For example, questionnaires, financial crime returns, AML annual reports, annual Risk Assessments, are all important & interesting artefacts for supervisors but data that is essential for example, to feed the supervisors essential systems should be the

highest priority and be subject to the highest clarity in terms of data specificity & time series that is reasonable & can be provided, for example on customer & transaction types, with product & service & geography data. Data requests from the FIU, from sectors & entities should be similarly considered & highest priority data should be data that is used & necessary to support the risk based approach.

8.5.3 Use of Third Parties e.g. Auditors, Independent Consultants and Monitors

Supervisory intensity, in terms of frequency and scrutiny is limited by resourcing in many countries and the use of third parties to perform tasks and or report on for example controls effectiveness by external auditors makes sense in these circumstances. For example, in Germany, the BaFin and in Switzerland the FINMA requires external auditors of regulated entities to certify FI operations comply with AML/CTF obligations as well as being able to direct them into focussing in particular areas. In the UK, the financial services supervisor can appoint a so called “skilled person” to work with a regulated entity, often to report on AML/CFT remediation and/or enhancement work. In the USA, so called “independent consultants” and/ or “monitors” have been appointed by supervisory (and law enforcement) agencies to “monitor” and report on remediation and enhancement work. Using third party resources, such as external auditors, independent consultants and/or monitors provides an alternative “free resource” as the regulated entity pays the bill, to direct additional hands to supervision and can be attractive for supervisors, but these should be well chosen and supervised. Supervisors should select & rely only on professional third parties, and watch for:

- over use & or over reliance on these resources as they may hollow out the essential capabilities of the supervisor.
- where external auditors may not deploy sufficient AML/CTF expertise to their testing, or to their assessment and analysis of the results or have access to data which allows comparative AML/CTF analysis which compares to that available to a supervisor.
- where Independent consultants &/or monitors are running businesses for profit, some may succumb to mission creep, in order to expand the scope of their activities, to promote so called best in class standards as the requirement & or to present opinions without an evidence base which may theoretically reduce ML/TF risk but is far from existing applicable legal and regulatory requirements, and or even risk based.
- Independent consultants and/or monitors benefiting from information on one mandate to gain another, which potentially raises questions about confidentiality and use of proprietary information.

8.6 International Co Operation and Collaboration

Whilst the BCBS, brings together leading international supervisors, including AML/CFT supervisors, their focus is on high level matters such as standards for AML/CFT programmes for Banks and for guidance for supervisors. The work of the BCBS is important & highly respected, but supervisors would benefit either from more & broader engagement by the BCBS and or by alternative structures. Whilst FIUs have the Egmont Group, supervisors may find establishing their own more informal contact group, can be achieved without the formality, responsibility and legal challenges faced by FIU’s.

8.7 Certification and Recognition

Supervisors are considered by most societies as highly professional and are well respected, and for good reason. Nevertheless, they hold many authorities and powers akin to those of the police, law enforcement and/or prosecutorial agencies, yet unlike those operating in these professions in the public sector, their is not the same minimum education, training, or experience, and/or qualification standards that provide supervisors with qualifications and or certifications to support the work they do and to provide evidence of competence and capabilities for the roles they perform. It is somewhat an irony, that those that are supervised; bankers, lawyers and accountants, and even real estate agents and those running casinos, must be qualified and/or certified and/or licensed, but those that supervise them need not. Supervisors would benefit either from a professional standards body able to train and certify supervisors, as well as a contact group for regulators (see 8.6 above).

9. Environmental Factors

The AML/CFT system does not operate in a vacuum. It operates within a broader public/private space within countries which have diverse challenges & opportunities impacted by domestic factors. These factors will impact the effectiveness of supervision as well as of other agencies and so these should be identified and born in mind when evaluating a country's overall ML/TF effectiveness. The FATF Methodology currently requires assessors to consider a number of these structural elements, and other contextual factors, to reach a general understanding of the context in which the country's AML/CFT system operates, though these issues are seldom assessed in practice, and/or fail to be reflected in terms of outcomes, and/or even where reports make reference to these structural elements assessors often omit analysing how these types of shortcomings impact on the assessment of each individual immediate outcome. Given the relevance these structural elements and contextual factors may play in explaining why levels of effectiveness may be higher or lower than expected, for assessing immediate outcomes 3 and 4, the FATF's methodology ought to require assessors to weigh their impact.

The fight against ML/TF should ideally be a policy of State, bringing together all political forces irrespective of which one may be exercising power at a particular time and so the most important environmental factor is likely to be genuine political support and political will to achieve success. Nevertheless, additional important "environmental factors", also play a significant role in overall effectiveness in combatting money laundering and terrorism finance whether that be for supervisors or for any of the agencies involved.

9.1 Corruption and Criminality including ML/TF

Corruption is a structural weakness that can affect the effective implementation of a country's AML/CFT regime. An effective system requires respect for the principles of transparency and good governance and the existence of appropriate measures to prevent and combat corruption. Corruption facilitates ML/TF and affects systemic effectiveness in combating these crimes, as it makes detection more difficult and hinders the effective implementation of investigative and judicial processes. For its part, ML facilitates corruption by allowing the concealment and use of assets obtained illegally. ML/TF also undermines the supremacy of state government, promotes corruption which corrodes legitimacy and challenges the collective threat of the use of overwhelming force administered by legitimate states to defend their societies and communities. In most countries, governments have been able to resist "state capture" but in some countries States have been overwhelmed by criminal forces, or have succumbed and been out manoeuvred by corrupted or criminal adversaries. Russia, Myanmar and North Korea are but 3 obvious prime examples.

9.2 Institutional Weakness, Instability & the Rule of Law & Weaponising the FATF Standards

Countries with weak institutions or institutional instability, where the rule of law is selective, where the investigative or prosecutorial agencies act selectively, and where the independence of the judiciary is arbitrary, are unlikely to present conditions for supervisors to excell, more likely to seriously underperform. According to the U.K. based think tank, RUSI, in a report published in 2024⁵⁰, *"the FATF standards have been weaponised by authorities worldwide as part of holistic campaigns to crack down on targets who threaten their interests, most often civil society actors such as watchdog organisations, journalists, opposition figures, and other critics who threaten regime interests or stability"*. RUSI describe this phenomenon as "Authoritarian Abuse" to distinguish it from "over implementation". RUSI provide evidence of cases where "Authoritarian Abuse", *"may be perpetrated by all regime types. Cases have been observed in autocracies and hybrid regimes, but in addition, a handful of robust democracies have also been found to misapply anti financial crime measure to meet ulterior objectives"*.

9.3 Institutional Stability

Institutions contribute to stability, especially in times of uncertainty, & help anchor expectations. In times of political gridlock, effective institutions are vital since they can deliver their mandates decisively & outside of the push-and-pull of the political process. However, institutions can be threatened by those seeking to elude, or assist others to elude accountability. When the autonomy & operational independence of a

supervisor, or an FIU, is attacked by the undue interference of government or politics into their operations, the stability and the effectiveness of the institutions are undermined. Institutional stability demands a commitment not only from those leading key institutions in the AML/CFT system, who must guarantee that their activities remain within the reach of the law, but also demands stable governance. Governments must avoid elite capture, or benefiting only the political class. It also requires a deep commitment by public officials to accountability (i.e. responsibility for their own actions), integrity, & transparency.

9.4 The Rule of Law

One of the main structural elements that needs to be in place for an AML/CFT regime to be effective is the respect for the “Rule of Law”. Upholding this fundamental value is a necessary precondition for the effectiveness of a preventive regime, and particularly to the work of regulators. A regulatory framework can only operate effectively under the principle that every regulated person, every regulatory agency, and every public official leading those agencies and adopting regulatory actions be held accountable to the law. The most important application of the Rule of Law is the principle that governmental authority is legitimately exercised only in accordance with written & publicly disclosed laws. But the Rule of Law also means that rulers & the ruled (regulators & the regulated) are equal before the law, regardless of their authority and position of power. It also implies that breaches of the law will incur strictly laid down sanctions, following a clearly outlined process for the detection of breaches. The Rule of Law has a direct incidence on regulatory practices. Regulations must be issued in accordance with the law. This means that the quality of regulatory frameworks will also be determined by the quality of legal frameworks and the extent to which they enable certain regulatory practices (i.e. the implementation of a risk-based approach).

9.5 A Capable, Independent and Efficient Judiciary

Jurisdictions must have capable, independent, & efficient judicial systems. This is of fundamental importance to uphold the Rule of Law & to ensure that effective, proportionate, & dissuasive sanctions may be implemented against ML/TF, thereby creating the necessary deterrents that protect financial integrity, peace & security. This is equally important for the effectiveness of a regulatory framework, as regulators & regulated persons must have a capable, independent & efficient judicial system to review the application of regulatory actions, including sanctions. The lack of such structural elements, or significant weaknesses & shortcomings in the general framework, may significantly hinder the implementation of an effective AML/CFT framework. Missing structural elements may explain any lack of compliance or effectiveness.

9.6 Exclusion and Informality

Countries where levels of informality exist and or where they restrict access to supervised services also present risks, with activity transacted outside the formal financial sector, with little or no effective scrutiny. Ensuring like minded products & services that operate or have the same effect as those that are regulated for AML/CTF purposes should be similarly regulated & supervised. Some jurisdictions are characterised by very high levels of informality. The problem of informality presents significant challenges to the implementation of AML/CFT policies, which are usually designed to prevent & detect the occurrence of events of ML/FT through the formal sector. Unless the problem of informality is taken into consideration during the implementation of AML/CFT policies that demand closer scrutiny of the formal system, such scrutiny could discourage further formalisation in a vicious cycle. Therefore, in certain economies it is imperative to have a degree of understanding of the interrelationship between the problem of informality and ML/FT. In general, the prevalence of informality allows criminals to live off their income from crime more easily (a form of ML) by purchasing goods in the informal sector without much risk of detection. Informality creates numerous opportunities for the offender to introduce proceeds of crime into the economy, since most of the informal market transactions are made in cash and therefore can be carried out anonymously. These opportunities allow criminals to take a further step towards the concealment of the illicit origin of their assets. Finally, in a climate of cultural tolerance toward informality, criminals prosper and money launderers find it easier to operate in the financial system without being reported.

10. Supervisory Maturity

Supervisory responses will differ & reflect the maturity of supervision in country & by supervisory sector, also reflecting political, economic and environmental factors at play, as well as ML/TF risk. Progress to improve effectiveness in supervision can be assessed by benchmarking supervision against the 10 Key enablers & 40 Key Takeaways. An example of a Supervisory Maturity Model is set out below.

GCFFC - Key Enablers to further improve Supervisory Effectiveness - Maturity Model						
No	Maturity Levels	Level 1 - Basic	Level 2- Technical	Level 3 - Programme	Level 4 - Influencing	Level 5 - Effective
Pre Conditions / Continuing Conditions for Supervisory Effectiveness						
1	Political Support & Operational Independence	Little/No genuine Political Support/Operational Interference/Political Appointees of leaders	----->			High Political Support - Cross Party/Operational Independence/Merit Based Leaders appointed
2	Environmental Factors	Lower levels for Rule of Law, Independent Judiciary, Higher levels of Corruption, Institutional Instability, Exclusion & Informality	----->			Higher levels for Rule of Law, Independent Judiciary, lower levels of Corruption, Institutional Instability, Exclusion & Informality
Coverage and Systems						
3.1	Coverage	Supervision focus on main Banks & other main FI types; Mainly Prudential; Focus on Safety & Soundness	----->			Supervision of Banks, FI's, Casinos, VASPs & DNFBPs; Prudential & Conduct; Focus on addressing ML/TF risks.
3.2	Systems	Legacy supervisory system/ arrangements, with little co operation with other supervisors and/or FIU	----->			Bespoke supervisory system, with co operation and collaboration with other supervisors and FIU embedded
Risk Based Supervision						
4	ML/TF Risk Assessments	Irregular Sector Risk Assessments and/or Entity/ Group Assessments do not generate accurate Supervisory Plans	----->			Regular Sector Risk Assessments and Entity/Group Assessments generate accurate Supervisory Plans
5	Supervisory Plans	Levels of Supervisory Intensity insufficiently inadequate based on factors other than ML/TF risk (inherent)	----->			Levels of Supervisory Intensity sufficiently adequate based on ML/TF risk (residual) factors
6	ML/TF Risk Appetite	Zero Tolerance for AML/CTF Compliance Risk, auditing controls against strict interpretation of regs & apply best practices as standards	----->			Reasonable Risk Appetite for ML/TF risks, includes looking beyond technical compliance to what an effective AML/CTF programme means
Influencing and Impacting Behaviours / Co operation / Essential Capabilities						
7	Impacting and Influencing Behaviour	Little/No Accountability for AML/CTF breaches - No material impact on supervised sectors - More interested in protecting the reputation / image of the country	----->			Supervised Sectors are accountable for material AML/CTF breaches (TIC - Actual ML/TF & Overall programme effectiveness) - Material Impact on supervised sectors
8	Co Operation & Collaboration	Supervisors are siloed and rarely engage with other regulators (national or international), or FIUs, not engaged in PPPs, ignore innovation and new IT, and fail to address information sharing & privacy challenges	----->			Supervisors proactively engage with other regulators (national and international), FIUs, PPPs, supporting innovation and new IT, addressing information sharing & privacy whilst retaining safeguards
9	Essential Capabilities	Human capital, resources, knowledge, technology support, data collection and usage, & professional career pathways are limited and a recurring challenge	----->			Human capital, resources, knowledge, technology support, data collection & usage, & professional career pathways have been strategically considered and support overall effectiveness

Whilst maturity models differ and completing a comprehensive template is beyond the scope of this consultation paper, the principle is that at the lowest end of the scale, regardless of so called “technical compliance” achievements, there is little or no evidence of effectiveness or consideration given to effectiveness, and at the other end of the scale “highly effective” ratings will evidence a high level of supervisory focus on outcomes and strong collaboration with other AML/CFT regime stakeholders so that the system is able to identify and adapt to emerging challenges.

Endnotes:

- ¹ See: <https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Guidance-Risk-Based-Supervision.pdf>
- ² See: <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Report-on-the-State-of-Effectiveness-Compliance-with-FATF-Standards.pdf.coredownload.pdf>
- ³ In-text review of 59 country mutual evaluation reports, consisting of 29 FATF and 30 FSRB Members.
- ⁴ See: <https://www.bis.org/bcbs/publ/d505.pdf>
- ⁵ See: [https://www.eba.europa.eu/sites/default/files/2023-11/c0a72a30-19c6-4fbb-96cd-e2486ff0c8ec/Final report on guidelines amending the Risk Based Supervision Guidelines.pdf](https://www.eba.europa.eu/sites/default/files/2023-11/c0a72a30-19c6-4fbb-96cd-e2486ff0c8ec/Final%20report%20on%20guidelines%20amending%20the%20Risk%20Based%20Supervision%20Guidelines.pdf)
- ⁶ See: <http://linkedin.com/in/jamal-el-hindi-9b40889>
- ⁷ See: <http://linkedin.com/in/mariano-federici-05234037>
- ⁸ See: <http://linkedin.com/in/bryan-stirewalt-770996217>
- ⁹ See: <http://linkedin.com/in/hans-peter-bauer-8b730b20>
- ¹⁰ See: <http://linkedin.com/in/maudbokkerink>
- ¹¹ See: <http://linkedin.com/in/nicolas-choules-burbidge-38252479>
- ¹² See: <http://linkedin.com/in/sharon-c-4b63b72>
- ¹³ See: <http://linkedin.com/in/alison-clew>
- ¹⁴ See: <http://linkedin.com/in/john-cusack-48107a7b>
- ¹⁵ See: <http://linkedin.com/in/himamauli-das-98526375>
- ¹⁶ See: <http://linkedin.com/in/sylvie-matherat>
- ¹⁷ See: <http://linkedin.com/in/hiroshi-ozaki-133618a8>
- ¹⁸ See: <http://linkedin.com/in/dparody>
- ¹⁹ See: <http://linkedin.com/in/jamal-el-hindi-9b40889>
- ²⁰ See: <http://linkedin.com/in/maiija-treija-b394a290>
- ²¹ See: <http://linkedin.com/in/jamal-el-hindi-9b40889>
- ²² See: <http://linkedin.com/in/lotte-ludekens>
- ²³ See: <http://linkedin.com/in/kareldezoete>
- ²⁴ See: <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Report-on-the-State-of-Effectiveness-Compliance-with-FATF-Standards.pdf.coredownload.pdf>
- ²⁵ See: <https://openknowledge.worldbank.org/server/api/core/bitstreams/b7990e4d-c301-5fe9-81d4-69f2321e9c64/content>
- ²⁶ See: <https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/RBA-Effective-supervision-and-enforcement.pdf.coredownload.pdf>
- ²⁷ See: <https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Guidance-Risk-Based-Supervision.pdf.coredownload.inline.pdf>
- ²⁸ DNFBP's means: a) Casinos; b) Real estate agents; c) Dealers in precious metals; d) Dealers in precious stones; e) Lawyers, notaries, other independent legal professionals and accountants; and f) Trust and Company Service Providers
- ²⁹ A number of standard setters, including FATF have enunciated the principle that the "FATF Standards remain technology-neutral and follow the principle of 'same activity, same risk, same rules'. See: <https://www.fatf-gafi.org/en/publications/Fatfrecommendations/R16-public-consultation-Feb24.html>
- ³⁰ See: FATF Report of Qatar
- ³¹ See: FATF Reports
- ³² See: FATF Report of Hong Kong
- ³³ See: FATF Report of Singapore
- ³⁴ See: FATF Reports

³⁵ See: Supervisors can also use tools to scan for trends, including regulatory developments in other jurisdictions for outside information to stay abreast of best practices. For example, new AML/ CTF laws and regulations, particularly from leading countries and/or international financial centres may be informative as well as best practice guides or other form of published information. Tools are commercially available and used by those supervised already and often are expected to be used by those supervised, so supervisors should be aware of their capabilities, availability and usefulness.

³⁶ See: <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2015/20151007e1a1.pdf>

³⁷ See: TBC once Data Paper is published.

³⁸ <https://www.fatf-gafi.org/content/dam/fatf/documents/Partnering-int-the-fight-against-financial-crime.pdf> and <https://www.fatf-gafi.org/content/dam/fatf/documents/recommendations/Private-Sector-Information-Sharing.pdf>

³⁹ FATF Methodology. See: FATF Methodology. See: [https://www.fatf-gafi.org/content/dam/fatf-gafi/methodology/FATF Methodology 22 Feb 2013.pdf.coredownload.pdf](https://www.fatf-gafi.org/content/dam/fatf-gafi/methodology/FATF%20Methodology%2022%20Feb%202013.pdf.coredownload.pdf)

⁴⁰ See: <https://thefinancialcrimenews.com/financial-crime-bank-fines-in-the-21st-century-by-fcn/>

⁴¹ See: <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Report-on-the-State-of-Effectiveness-Compliance-with-FATF-Standards.pdf.coredownload.pdf>

⁴² In-text review of 59 country mutual evaluation reports, consisting of 29 FATF and 30 FSRB Members.

⁴³ "Examples of ranges and types of sanctions include: written warnings; orders to comply with specific instructions (possibly accompanied with daily fines for non-compliance); ordering regular reports from the institution on the measures it is taking; fines for non-compliance; barring individuals from employment within that sector; removing, replacing or restricting the powers of managers, directors, and controlling owners; imposing conservatorship or suspension or withdrawal of the license; or criminal penalties where permitted".

⁴⁴ The importance of incentives in ensuring a resilient and robust financial system by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the US Chamber of Commerce, Washington DC, 26 March 2018. See: <https://www.bis.org/review/r180420c.htm>

⁴⁵ See: <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2018/02/basel-4-the-way-ahead.pdf>

⁴⁶ See: FATF Report for South Africa

⁴⁷ See: <https://cullencommission.ca/files/reports/CullenCommission-FinalReport-Full.pdf>

⁴⁸ See: [https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF Recommendations 2012.pdf.coredownload.inline.pdf](https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf)

⁴⁹ See: https://www.oecd.org/en/publications/2021/09/oecd-business-and-finance-outlook-2021_377c2c18.html

⁵⁰ See: <https://static.rusi.org/weaponisation-of-fatf-standards-a-guide.pdf>

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By GCFFC Experts

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