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2005]

COMBATING THE FINANCING OF TERRORISM:
THE ROLES OF THE IMF

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RESPONSES to the rise in international crime touch on many of the compelling legal problems we face today as policymakers, both nationally and internationally. One of the biggest challenges in combating international crime we face is the very nature of its global reach. Crimes can be committed in one country, the proceeds sent to another and the perpetrators disappear to yet another country. In the 1980s, with the war on drugs, delinking the proceeds of crime from the crime itself was seen as a way to combat drug trafficking. In 1989, at the G-7 Summit in Paris, the Financial Action Task Force (FATF) was formed for the purpose of “the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing.”¹ The FATF is a policy making body comprised of officials from twenty-eight countries who meet three times a year. They set the standards for anti-money laundering and combating the financing of terrorism (AML/CFT), and evaluate each other’s progress in this area by conducting on-site visits to member countries.

The FATF has extended the concept of delinking proceeds of crime from the crime itself to other crimes. Today, the FATF has agreed to a minimum list of crimes that all countries globally should make “predicate crimes” for money laundering so that the proceeds of such crimes can be seized, restrained, forfeited and confiscated. In 2003, the FATF issued a revised standard encapsulated in the FATF Forty Recommendations. The Eight Special Recommendations on Terrorist Financing remain in effect from 2001, and a ninth was recently added. In 2004, the FATF, the International Monetary Fund (IMF) and the World Bank worked together to draft the Methodology for Assessing Compliance with the FATF Forty Recommendations and the FATF Eight Special Recommendations (“2004 Methodology”), which lists a number of criteria under each recommendation which must be met.² Therefore, I would like to focus on the legal and institutional requirements for compliance with the FATF requirements on

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1. Financial Action Task Force on Money Laundering (FATF), *More About the FATF and Its Works: What Is the FATF*, [hereinafter *More About the FATF*], at http://www.oecd.org/fatf/AboutFATF_en.htm (last modified May 14, 2004) (discussing history and purpose of intergovernmental FATF regulating body).

2. See generally FATF, *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 8 Special Recommendations* (Feb. 27, 2004) [hereinafter *2004 Methodology*], available at http://www.oecd.org/fatf/pdf/Meth-2004_en.PDF

confiscation in AML/CFT areas. Specifically, I will focus on FATF Recommendation Three and then on FATF Special Recommendation III and the relevant criteria in each Recommendation.³ First, however, I would like to give an overview of the history of the IMF's involvement in this area.

I. OVERVIEW OF THE IMF INVOLVEMENT IN THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

Historically, there have been many successful initiatives by the world community after global efforts to combat AML/CFT began in the early 1990s with the FATF. Money laundering is now criminalized in almost all countries, and banks and financial institutions are much better protected today against penetration by criminal organizations than they were ten years ago. Additionally, a network of financial intelligence units (FIUs) is now in place to provide a rapid response to criminal money transfers, and confiscation of large sums of money is now routine in some countries.

National and global efforts, however, had plateaued because of the difficulty of ensuring universal and consistent application of international standards and also because of a lack of resources to address the problem in a number of countries. Only twenty-eight countries were members of the FATF⁴ and the FATF realized that if it was to broaden its sphere of influence, it must ask the international institutions of the IMF and the World Bank to join the FATF in the fight against money laundering and the financing of terrorism.

Consequently, three years ago, the international community asked the IMF and World Bank to contribute to anti-money laundering efforts, and, in the aftermath of September 11, 2001, to help counter the financing of terrorism. This contribution takes the form of an assessment program and technical assistance services across the wide membership of the 184 IMF member countries. The assessment program, using a methodology common to the IMF, the World Bank and the FATF, allows us to identify deficiencies in country frameworks, whether in the legal framework on criminalization, confiscation, mutual legal assistance, extradition or financial sector robustness.

Under the 2003 Revised FATF Forty, assessments will also extend to cover aspects of designated non-financial businesses and professions

(addressing 2004 Methodology's background, use in assessment and evaluations, interpretation and compliance).

3. See generally FATF, *Interpretative Note to Special Recommendation III: Freezing and Confiscating Terrorist Assets* (Oct. 3, 2003) [hereinafter *Interpretative Note*], available at http://www.oecd.org/fatf/pdf/INSR3_en.pdf (interpreting proper freezing and confiscating compliance procedures in relation to terrorist activities).

4. See FATF, *More About the FATF*, *supra* note 1 (providing history of FATF and documenting expansion of membership over time); see also FATF, *Members and Observers*, at http://www.oecd.org/fatf/Members_en.htm#Members (last modified Jan. 31, 2005) (providing complete list of current FATF members as well as groups with observer status).

(DNFBPs) such as lawyers, accountants and precious metal dealers. Assessments cover both the legal framework and the implementation of the country's AML/CFT framework. The experience of the pilot program highlighted that among the main deficiencies were: inadequate measures to confiscate terrorist assets, a lack of requirements to obtain information on customer identity, a lack of international cooperation and inadequate systems to report suspicious transactions linked to terrorism. Through the provision of an ambitious program of technical assistance, the IMF offers help in addressing those deficiencies—some sixty-three countries have been directly assisted by the IMF in the last year, with 130 countries benefiting from thirty-two regional programs.⁵ In March 2004, this work was made a permanent part of the work of the IMF.

Although progress has been made, let us be clear on one point: crime still pays. The history of the fight against money laundering and the financing of terrorism is that the bad guys are quick to engage in a kind of criminal arbitrage. Money launderers will exploit any weakness in legislative and institutional frameworks, both domestic and international. They will take advantage of any failure of international cooperation, particularly in informal, unregulated and unsupervised sectors. They will find loopholes wherever they exist.⁶ The international community, therefore, would like to ensure that all countries have the appropriate systems in place to deter money laundering and combat terrorist financing. This requires that proceeds of criminal offenses are removed from the financial system and removed from the control of criminals.

In this process, many considerations must be balanced against each other between government powers and individual freedoms. In the area of AML/CFT, there has been a significant move towards government powers. The IMF Legal Department has been asked to advise a number of countries on these issues.

II. THE RATIONALE OF AML/CFT REQUIREMENTS REGARDING CONFISCATION UNDER FATF RECOMMENDATION THREE

The underlying rationale of 2003 FATF Recommendation Three (provisional measures and confiscation) and FATF Special Recommendation III (freezing and confiscating terrorist assets) is that countries must have the ability to confiscate proceeds and instrumentalities of money laundering, terrorist financing or other predicate offenses in order to remove them from the financial system, and thereby weaken the position of criminals globally. In the previous FATF Forty from 1996, only money laundering crimes were required to be covered. The new 2003 standard

5. See IMF, *The IMF and the Fight Against Money Laundering and the Financing of Terrorism* (Sept. 2004), at <http://www.imf.org/external/np/exr/facts/aml.htm> (explaining IMF's role in fighting money laundering and initiatives taken to combat it).

6. Augustine Carstens, Deputy Managing Director of IMF, Address at the IMF Legal Department's Semi-Annual Central Banking Seminar (June 2004).

under FATF Recommendation Three is much broader-reaching and covers, at a minimum, money laundering and terrorist financing offenses, as well as the predicate crimes listed in the designated categories of offenses located in the glossary of the 2004 Methodology. This minimum list was agreed to by the delegations of the FATF after much debate. This means that all countries must be able to seize, restrain and confiscate proceeds from offenses such as drug offences, human trafficking, fraud and corruption.⁷ Essentially, this means that authorities should have powers to identify property, seize and freeze property and confiscate property in an effective manner.

In the next round of assessments of countries to be undertaken by the IMF, World Bank, FATF and the FATF Style Regional Bodies (FSRBs), such as MoneyVal and the Caribbean Financial Action Task Force (CFATF), assessors will have to examine the extent to which countries are seizing, confiscating or otherwise restraining *all* property that is the proceeds of crime and not just some of such property, and whether they are doing so effectively. For example, in some jurisdictions, proceeds of terrorist financing and instrumentalities of money laundering may be subject to seizure, restraint or confiscation by law, but in practice no such action is taken by the authorities for various reasons, such as lack of understanding of the standard, lack of understanding of the concept of instrumentalities or legal impediments to such seizures.

Assessors must also look at mutual legal assistance with respect to confiscation to ensure that countries can assist other countries in restraining and confiscating international proceeds of crime. This is the next phase of implementation to be worked on by countries in order to fully comply with the revised FATF Recommendations. In summary, provisional measures and confiscation must cover laundered funds (including any commissions made by the money launderers) or proceeds of predicate offenses or their equivalent value—instrumentalities used or intended for use in money laundering, financing terrorism or predicate offenses and property of corresponding value (i.e., money judgments and substitute assets) as per criterion 3.1 of the 2004 Methodology.

Seizure and confiscation of property in the hands of third parties is also a current issue, and one that, if not dealt with adequately, can seriously undermine the effectiveness of a confiscation regime. Confiscation procedures usually recognize that confiscation of property will require the freezing or confiscation of property from third parties in order to prevent any dealing, transfer or disposal of property subject to confiscation.⁸ In assessing the adequacy and effectiveness of a particular regime, assessors will need to review when this can occur and in what circumstances (i.e.,

7. See *2004 Methodology*, *supra* note 2, at 72 (defining “designated categories of offences”).

8. See *id.* ¶ 3.2, at 10 (explaining what is required under Recommendation III through “Essential criteria” clarification 3.2 that includes laws and other provisions to preserve property subject to confiscation).

how are spouses, nominees or corporate owners treated). In particular, assessors will need to review the burdens and presumptions that are part of the legal system in this area. In some jurisdictions, there is a reverse onus of proof so that the defendant must prove that he or she came into possession of the proceeds in question by legal means. In other jurisdictions, the state may have to prove at a civil standard only that the proceeds were proceeds of crime obtained by a connected party and therefore should be subject to seizure or freezing provisions.

Another area of review and potential difficulty is gifts. Assessors must review how gifts are treated in the relevant legislation. What is considered to be a bona fide transaction in each particular country? Bona fide third parties should be able to defeat confiscation and forfeiture of their property. Assessors must review this principle in the area of voiding contracts as well as in the area of confiscation. Is an innocent-owner defense to confiscation and forfeiture available?⁹

Other areas to be reviewed in countries in order to assess the effectiveness of their particular regimes include the number and value of confiscations, restraints and seizures in that particular jurisdiction and reasons for lack of any of the above. For example, assessors will look to evidentiary problems, restrictive judicial interpretations or judicial discretion in non-mandatory confiscation jurisdictions, and compare this with available data on the underlying proceeds generating offenses. In order to further assess the effectiveness of the particular regime, assessors will need to review the number of investigations, prosecutions and convictions.¹⁰ It is also important to assess the resources and capacity as well as the background and training of the relevant authorities.¹¹ Moreover, assessors will look for specialized units of prosecutors who can effectively prosecute cases and forfeit property. These units tend to have better success than a generalized approach to prosecution, given the complex nature of cases in this area.

Also relevant is the question of the different types of confiscation that are available in a particular jurisdiction. What is the standard of proof required in confiscation matters? Are judges imposing a higher standard than is required by law? Assessors will also look to procedural law. Restrictive procedural guarantees for defendants in either the provisional measures regime or the confiscation regime can circumvent the intent of confiscation law. For example, in one jurisdiction, the Criminal Procedure Code allowed freezing for only a short time before the proceeds had

9. *See id.* ¶ 3.5, at 10 (positing idea that under Criterion 3.5 law should provide protection for rights of bona fide third parties).

10. *See id.* ¶ 32.2, at 45 (explaining that authorities should maintain statistics on matters relating to combating money laundering and terrorist financing as suggested in Criterion 32.2 of 2004 Methodology, including transaction reports, statistics on prosecutions and data on legal assistance).

11. *See id.* ¶ 27.5, at 40 (elaborating further techniques that should be used as instructed by elements in Criterion 27.5 of 2004 Methodology).

to be returned to the defendant.¹² This effectively nullified the seizure and confiscation provisions laid out by the jurisdiction in the substantive law.

These are the types of issues that assessors from the IMF, World Bank, FATF and the FSRBs must look at in assessing how effective countries around the world are at combating the financing of international crime. The IMF Legal Department also looks at such issues when assisting countries in this area when it gives technical assistance. These are the same issues that all countries must look at when drafting their legal frameworks in order to create robust and effective confiscation regimes that can decouple proceeds of crime from the crimes themselves.

III. UNIQUE CONSIDERATIONS FOR SPECIAL RECOMMENDATION III: FREEZING AND CONFISCATING TERRORIST ASSETS

Requirements to comply with FATF Special Recommendation III (“SR III”) have been amplified under the 2004 Methodology. SR III requirements should now also be read in conjunction with the Interpretive Note to SR III and the relevant United Nations Security Council Resolutions (UNSCRs) 1267 and its successor resolution, 1373, and any prospective resolutions relating to the freezing and, if appropriate, seizure of terrorist assets. SR III consists of two obligations.

The first obligation “requires jurisdictions to implement measures that will freeze or, if appropriate, seize terrorist-related funds or other assets without delay in accordance with relevant United Nations resolutions.”¹³ The second obligation of SR III is “to have measures in place that permit a jurisdiction to seize or confiscate terrorist funds or other assets on the basis of an order or mechanism issued by a competent authority or a court.”¹⁴ Essentially, in order to comply with SR III, a jurisdiction must have effective laws and procedures (i.e., authority to designate persons and entities) to freeze terrorist funds or other assets of persons designated under UNSCRs 1267 and 1373 and subsequent related UNSCRs. For more details, see specifically the requirements under SR III.1 and SR III.2 of the 2004 Methodology, which include the requirement that a country “have effective laws and procedures to freeze terrorist funds or other assets of persons designated” in the context of UNSCR 1373.¹⁵ According to SR III, “[s]uch freezing should take place without delay and without prior notice to the designated persons involved.”¹⁶ In practical terms, countries must verify that the action taken is “without delay” by confirming the pro-

12. The proceeds had to be turned over to the defendant before trial.

13. See *Interpretative Note*, *supra* note 3, ¶¶ 1-2, at 1 (listing obligations and objectives of Special Recommendation III).

14. See *id.* (same).

15. See *2004 Methodology*, *supra* note 2, ¶ III.1, at 61 (requiring countries to enact appropriate freezing and seizure laws to comply with regulations).

16. *Id.* ¶ III.2.

cedures that it has in place to freeze funds in order to comply with UNSCR 1267 and successor resolutions when it receives an updated UN list of targeted terrorists. More interestingly, SR III also requires that countries have laws and procedures to examine and give effect to freezing requests received from other jurisdictions under UNSCR 1373. In practical terms this means that countries must be able to designate terrorists quickly. Designation is a necessary initial step in order to identify terrorist-related assets to be frozen.¹⁷

Designating terrorists under UNSCR 1373 is a completely different process than designating them under UNSCR 1267.¹⁸ Under 1267, the UN Security Council designates persons or entities as terrorists or terrorist organizations. These designations are taken from member nations, who using the UN process, send their requested designations to the UN Security Council. If no other country objects, the name is then added to the list on a lapse-of-time basis. The lists are then circulated to countries and disseminated within countries using whatever national system has been set up.

The system under UNSCR 1373 and successor resolutions is different.¹⁹ There is no central repository for all lists. There is no common list. Rather, each country may have its own list which it can circulate on a bilateral or multilateral basis. Consequently, each country must have a designation person or committee who can review the names on a circulated list from another country and decide if those persons or entities should be designated in their particular country as terrorists. For example, in the United States, the Office of Foreign Assets Control (OFAC) has the responsibility for handling such requests. It is possible that a particular country may not agree with the designation, but that country must have a clear methodology or approach which is consistently used to come to that conclusion. Whatever decision is taken, this authority will also need to keep copies of all its decisions as well as a record of all the different country terrorist lists it has received and how it has disseminated them. If the country decides that it agrees with the designation, then it must freeze the accounts of any such persons or entities, and "such freezing should take place without delay and without prior notice to the designated persons

17. See *Interpretative Note*, *supra* note 3, ¶ 3, at 1, ¶ 6, at 2 (addressing issues of "designated persons" and freezing without delay to efficiently combat terrorist financing); see also *2004 Methodology*, *supra* note 2, ¶ III.8, at 62 (stating that in addition to freezing procedures "countries should have effective and publicly-known procedures for unfreezing").

18. See S.C. Res. 1267, U.N. SCOR, 53d Sess., 4051st mtg. at 2, U.N. Doc. S/RES/1267 (1999) (requiring all states to comply with freezing of funds of those designated by UN Security Council committee).

19. See S.C. Res. 1373, U.N. SCOR, 55th Sess., 4385th mtg., U.N. Doc. S/RES/1373 (2001) (requiring countries to undertake terrorism-prevention processes).

involved.”²⁰ The “no prior notice” requirement is similar to the “no tipping off” provisions under the anti-money laundering regime.

Countries must have readily identifiable contact authorities so that other countries know who to contact when looking to advise that country on a new terrorist designation. How will this be effected: on a government website, advertised to other countries, clearly accessible to a wide group of people? It is critical that countries set up a designation authority that has the mandate and the ability to convene and consider requests rapidly. For example, countries will not be in compliance with SR III if the designation body must refer the matter to a high level committee that only meets once a quarter.

Designation is a necessary initial step in the freezing mechanism in order to identify terrorist-related assets to be frozen. Once a designation is made, notification must be given to various parties, depending upon the nature of the located terrorist target. Each country must have procedures in place in order to notify any or all of the following:

- the UN Al-Qaida and Taliban Sanctions Committee (Criterion III.1) if an Al-Qaida person or entity is designated;
- other countries under UNSCR 1373 (Criterion III.2) where accounts for a designated terrorist from that other country’s list are located by the local financial institution or authority;
- the financial sector within the country pursuant to the “immediate” notification requirement in Criterion III.5; and
- the general public, given the expansive scope of funds or other assets as laid out in Criterion III.5 which may need to be frozen.

Further, “clear guidance” must be issued by a country to its financial institutions and the general public regarding freezing obligations.²¹

Should a financial institution find money or assets in an account in the name of a designated terrorist in its institution, the financial institution must be able to report to an identifiable central authority via an identifiable mechanism immediately. Does the country have a toll-free number to call, a website, a manned e-mail address? How will that country be available to assist its citizens with questions on this matter? One of the difficulties posed by SR III is the wide definition of funds or other assets which are defined as:

[F]inancial assets, property of every kind, whether tangible or intangible, movable or immovable, however acquired, and legal documents or instruments in any form, including electronic or

20. See 2004 Methodology, *supra* note 2, ¶ III.2, at 61 (elaborating on freezing procedures).

21. See *id.* ¶ III.6, at 62 (stating that, to be compliant with Criterion III.6, countries should provide guidance in relation to freezing mechanisms to anyone who may be holding targeted funds or assets).

digital, evidencing title to, or interest in, such funds or other assets, including, but not limited to, bank credits, travellers cheques, bank cheques, money orders, shares, securities, bonds, drafts, or letters of credit, and any interest, dividends or other income on or value accruing from or generated by such funds or other assets.²²

This effectively means that many companies may be caught by this recommendation, and so entities that have formerly not been exposed to the FATF Forty and the Nine Special Recommendations may now need to be aware of such requirements. This will be a particular challenge for many countries going forward, as most companies do not have a regulatory authority on which to rely for advice and assistance. How will countries reach such companies with the relevant information and assistance?

Under SR III, a country must also have the legal and operational authority as well as the capacity to monitor compliance by all affected entities.²³ Again, how are countries going to monitor compliance by a number of entities previously unaffected by either anti-money laundering or combating the financing of terrorist regimes? Finally, countries are required to have a full range of sanctions available for noncompliance—criminal, civil or administrative.²⁴ The United States, through the OFAC, is leading the way in this area. The United States authorities will be offering technical assistance to countries in implementing SR III by setting up and upgrading their own authorities. Likewise, the IMF will also offer such technical assistance, and efforts are underway to ensure that efforts will be coordinated in this area.

IV. SOME FINAL THOUGHTS

Compliance with SR III will be a challenge for many countries and will be the subject of many technical assistance requests in the upcoming years. There is no clear assessment of the amount of funds which may likely be frozen from terrorist financing. There are, however, some figures available on the money laundering side of things. To put the money laundering issue into perspective, the cost and risk of money laundering and organized crime were assessed in the United Kingdom in the full regulatory impact assessment for the Money Laundering Regulations 2003.²⁵ The report stated:

22. *Interpretative Note, supra* note 3, ¶ 7d, at 3.

23. *See 2004 Methodology, supra* note 2, ¶ III.13, at 63 (explaining that countries should have appropriate monitoring and sanctioning capabilities).

24. *See id.* (stating that countries should have sanctions available); *Interpretative Note, supra* note 3, ¶ 8h, at 6 (stating that “[f]ailure to comply . . . should be subject to civil, administrative or criminal sanctions”).

25. *See generally* Anti-Money Laundering Branch, Her Majesty’s Treasury, *Full Regulatory Impact Assessment Money Laundering Regulations 2003* (Nov. 26, 2003), at http://www.hm-treasury.gov.uk/media/4B7/B5/fullriamlr03_80.pdf (reporting on implementation, regulation and risk assessment of money laundering issues).

The risk posed by money laundering is twofold: its facilitation of underlying criminal activities, and the threat to economic and financial activity when high flows of laundered money distort normal market incentives. Most crimes are committed for financial gain, and the volume of criminal assets laundered through the UK is undeniably large. Recent estimates indicate that the value of illegal drugs transactions in the UK could be up to £8.5 billion per annum, with direct losses from fraud totaling some £10.3 billion per annum. . . . Moreover, comparatively small flows of money can facilitate serious offences: efforts to disrupt the funding arrangements of terrorist organisations have led governments around the world to strengthen their anti-money laundering regimes.²⁶

Clearly this is a challenging area for financial institutions as well as the international community. The numbers listed above are extremely high and show the degree to which proceeds of crime are still flowing through the international financial systems despite all that has been done so far to combat this problem. Training is the key, both in terms of general anti-money laundering measures as well as specific training on spotting suspicious transactions and distinguishing them from those that are legitimate.

While a solid legal framework is critical, implementation on a day-to-day basis is the key. This is particularly the case regarding the role of the FIU. The more knowledge the national FIU gains about financial transactions, both legitimate and suspicious ones, the more quickly it will be able to assist financial institutions in making speedy decisions about specific cases reported to the FIU by the financial institutions. From there, cases can be developed, assets can be frozen, seized or otherwise restrained; and, over time, prosecutions can be taken against money launderers and terrorist financiers resulting in the eventual confiscation of the proceeds of crime from the criminals. Furthermore, typologies of money laundering schemes can be circulated nationally so as to alert other financial institutions and DNFBPs to “red flags” to watch out for when embarking on financial transactions with or for clients.

The work at the IMF will continue in the areas of assessment and providing technical assistance to IMF membership with the goal that all participants in the international financial system will take up the fight against money laundering and terrorist financing. Hopefully, this work will result in the amount of seizures, restraints and eventual confiscations increasing dramatically, so that criminals will no longer feel that crime pays.

26. *Id.* ¶ 8, at 2-3.