



The impact of the Financial Action Task Force's  
greylisting on financial systems and trade of emerging  
economies

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## **Abstract**

The Financial Action Task Force (FATF) has become the lead driving force in the combat of Money Laundering and Terror Financing (AML/TF) through their 40 recommendations that member states have to comply with. This compliance is sought through the development of effective Anti-Money Laundering and Counter Terror Financing (AML/CTF) frameworks that must be implemented by the member states and all states with which they conduct trade, despite the inequality of the financial impact such implementation may have on each state when failure results in greylisting. Greylisting alerts the other states to the ineffectiveness of the AML/CRF frameworks of the state in question, and this affects the manner in which the greylisted state trades.

The grey list was developed by the FATF in order to assess the states in accordance to their compliance with the 40 recommendations and to publicly list them in the event of failure to implement effective AML/CTF frameworks which, in an increasingly global financial market, would mean the possible compromise of said global financial market.

The FATF is able to enforce the 40 recommendations and coerce states to be compliant due to the fact that they are backed by international institutions such as the International Monetary Fund (IMF) as well as the World Bank (WB), in addition financial institutions of states such as the United States of America, United Kingdom and the European Union require adherence to the 40 recommendations in order to interact with the states applying for a loan or aid.<sup>1</sup>

Greylisted states in the global south are disproportionately represented on the grey list and most are in need of the foreign aid, investment, loans and trade from the abovementioned states. The additional scrutiny which must be applied when conducting trade with the greylisted states raises a deterrent to those wishing to trade with the greylisted state and has been shown to affect the cash inflow and GDP of the grey listed state.

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<sup>1</sup> FATF March 2022 <https://www.fatf-gafi.org/en/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-march-2022.html>.

Due to the disproportionate representation of states with emerging economies on the greylist, 60% of which states are located in Africa, a continent plagued by its own historical inequities, raises the question whether the 40 recommendations warrants a blanket approach and whether the penalty, being greylisted, considering the investment required to formulate and establish AML/CTF frameworks, is justified.

The discussion examines states considered successful and those who have repeatedly failed to comply – as evidenced by their repeated appearance on the grey list – furthermore, how they can develop the AML/CTF frameworks with assistance from the FATF and others considered less vulnerable to the abuse of ML/TF by the FATF.

## List of abbreviations

|               |   |
|---------------|---|
| AML           | Anti-money laundering                                   |
| BSA           | Ban Secrecy Act, 1970                                   |
| CDD           | Customer due diligence                                  |
| CFT           | combating the financing of terrorism                    |
| CIP           | Customer Identification Programme                       |
| CL & SC       | Crime, Law and Social Change                            |
| CTF           | Counter-terrorism financing                             |
| DFNBPs        | Designated Non-Financial Business and Professions       |
| ESAAMLG       | Eastern and Southern Africa Anti-Money Laundering Group |
| EU            | European Union  |
| FATF          | Financial Action Task Force                             |
| FCA           | Financial Conduct Authority                             |
| FDI           | Foreign Direct Investment                               |
| FIA           | Financial Intelligence Authority                        |
| FinCEN        | Financial Crimes Enforcement Network                    |
| FIU           | Financial Intelligence Units                            |
| FSAP          | Financial Sector Assessment Programme                   |
| FSI           | Financial Secrecy Index                                 |
| FSRBs         | FATF-style regional bodies                              |
| G7            | Group of Seven  |
| GC            | Gambling Commission                                     |
| GDP           | Gross Domestic Product                                  |
| HMRC          | His Majesty's Revenue and Customs                       |
| HM's Treasury | His Majesty's Treasury                                  |
| HM's          | His Majesty's   |
| HSBC          | HSBC Holdings Private Limited Company                   |
| ICCT          | International Centre for Counter-Terrorism              |
| IFFs          | Illicit Financial Flows                                 |

|                     |   |
|---------------------|---|
| IMF                 | International Monetary Fund   |
| IMFFA               | International Monetary Fund Financial Analytics   |
| J Finance Crime     | Journal of Financial Crime  |
| J Invest Compliance | Journal of Investment Compliance  |
| JFRC                | Journal of Financial Regulation and Compliance  |
| JGSS                | Journal of Global South Studies   |
| JMLC                | Journal of Money Laundering Control   |
| KYC                 | Know Your Client/Customer   |
| KYC                 | Know Your Client/Customer   |
| LEU                 | Law Enforcement Unit  |
| MENAFATF            | Middle East and North Africa Financial Action Task Force  |
| ML/TF               | Money Laundering/Terror Financing   |
| MLR                 | Money Laundering, Terrorist Financing, and Transfer of Funds (information on the payer) Regulations of 2007 |
| NDNFBPs             | Non-designated non-financial business and professions   |
| NYLSLR              | New York Law School Law Review  |
| OCC                 | Office of the Controller of the Currency  |
| OECD                | Organisation for Economic Co-operation and Development  |
| PBSs                | Professional Body Supervisors   |
| POCA                | Proceeds of Crime Act, 2002   |
| RIPE                | Review of International Political Economy   |
| SA Merc LJ          | South African Mercantile Law Journal  |
| SAR                 | Suspicious Activity Report  |
| SRA                 | Solicitors Regulatory Authority   |
| TF                  | Terror Financing  |
| TFS                 | Targeted financial sanctions  |
| UAE                 | United Arab Emirates  |
| UBO                 | Ultimate Beneficial Owner   |
| UK                  | United Kingdom  |
| UN                  | United Nations  |

|                 |   |
|-----------------|---|
| UNECA           | United Nations Economic Commission for Africa |
| UNODC           | United Nations Office on Drugs and Crime      |
| USA Patriot Act | United States of America Patriot Act, 2001    |
| USA             | United States of America                      |
| USD             | United States Dollars                         |
| WB              | World Bank                                    |

## Chapter 1: Introduction

### 1.1 Background

The Financial Action Task Force (FATF) has placed South Africa and other emerging economies such as Turkey and Nigeria on a grey list.<sup>2</sup> In the context of organisations like the FATF and international finance, a grey list refers to a list of countries or jurisdictions that are not fully compliant with international standards or recommendations related to anti-money laundering (AML) and counter-terrorism financing (CTF).<sup>3</sup> Countries are greylisted due to certain deficiencies in their legal and regulatory frameworks, which places them at risk of being used for illicit financial activities, such as money laundering and terrorist financing. This listing may result in the trade of companies, financial firms and other industries undertaking to conduct additional verification in order to be compliant with set regulations.<sup>4</sup> An additional layer of scrutiny of the listed states' transactions is expected of member and non-member states, as well as the institutions within their borders, whether in trade or ownership, to promote vigilance through increased verification, for the activities of terrorist factions and money laundering schemes.<sup>5</sup> It further acts as a signal to would-be investors to apply increased caution when conducting business with these states; the greylisting moreover raises a red flag that engenders strict adherence to the recommendations of the FATF.<sup>6</sup>

In the context of greylisting by organisations like the FATF, hyper-vigilance<sup>7</sup> may be necessary to prevent individuals or entities from inadvertently engaging in financial transactions with countries on the grey list. It reflects the need for individuals,

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<sup>2</sup> Fabricius 2023 <https://issafrica.org/iss-today/shades-of-grey-fatf-lists-south-africa-and-nigeria>.

<sup>3</sup> Yarovy A [The FATF Grey List and Blacklist: Complete Guide](#)

<sup>4</sup> De Koker, Howell and Morris 2023 *Risks* 10

<sup>5</sup> Fabricius 2023 <https://issafrica.org/iss-today/shades-of-grey-fatf-lists-south-africa-and-nigeria>.

<sup>6</sup> Sharman 2009 *RIPE* 581.

<sup>7</sup> Hyper-vigilance, which refers to a state of heightened or excessive vigilance, alertness, or attentiveness to potential risks, threats, or dangers in connection with transactions originating from the greylisted state, a reaction which is deemed necessary in order to prevent the possibility of being tainted by doing business with the greylisted state.

businesses, and financial institutions to exercise extreme caution and due diligence to avoid potential legal or reputational risks associated with such transactions.

This study critically assesses the interaction between the recommendations issued by the FATF and the established guidelines and standards within international payment systems, organisations and trade. The primary focus is to determine whether a level of redundancy or overlap exists in these recommendations.

The FATF was established in response to an economic declaration made in Paris on 16 July 1989 at the Group of Seven (G7) summit, in which the G7 states – the United States of America, Canada, France, Germany, Italy, Japan and the United Kingdom – expressed concerns over the growing threat of money laundering and terrorist financing.<sup>8</sup> The organisation was initially meant to include only the G7 states, but they saw the wisdom of greater inclusivity and extended their membership to include 39 member states located in the Americas, Europe, Middle East, and Oceania.<sup>9</sup>

The FATF was established by the Ministers of its Member jurisdictions.<sup>10</sup> The mandate of the FATF is to set standards and promote effective implementation of legal, regulatory and operational measures to combat money laundering, terrorist financing, and the financing of proliferation.<sup>11</sup> Like terrorism, the financing of proliferation includes nuclear, chemical, and biological weapons, and entails illicit financial flows that threaten the integrity of the international financial system.<sup>12</sup> The foregoing is done in collaboration with international stakeholders; the FATF works to identify national-level vulnerabilities, again with the goal of protecting the international financial system from misuse.<sup>13</sup>

Greylisting by the FATF is utilised to restrict the use of financial systems by alerting its member jurisdictions of the risks that may arise from transactions originating

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<sup>8</sup> <https://www.fatf-gafi.org/en/the-fatf/history-of-the-fatf.html>

<sup>9</sup> Mekpor, Aboagye and Welbeck 2018 *JFRC* 444.

<sup>10</sup> FATF 2023 <https://www.fatf-gafi.org/en/the-fatf/history-of-the-fatf.html>.

<sup>11</sup> FATF April 2019 <https://www.fatf-gafi.org/en/the-fatf/mandate-of-the-fatf.html>.

<sup>12</sup> FATF April 2019 <https://www.fatf-gafi.org/en/the-fatf/mandate-of-the-fatf.html>.

<sup>13</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html> 8.

from the states identified.<sup>14</sup> On 23 February 2023, South Africa and Nigeria were added to the grey list. The Rand decreased by 1.3%, putting further strain on an already struggling currency.<sup>15</sup> The placement was caused by the country's failure to erect proper controls and legislation to guard against money laundering and terrorism funding within the period set out by the FATF. It affected the cash flow and income of South African traders wishing to export their goods. In turn, this had a negative effect on their contributions to the economy of a country that was already suffering from high inflation rates, job losses and a lack of job creation.<sup>16</sup>

A study conducted by the International Monetary Fund (IMF) found a correlation between the greylisting of a country and lower cash flow, which effects the growth rate of the economy.<sup>17</sup> States that have undergone greylisting may face difficulties when they seek to interact with international financial institutions such as the IMF and the World Bank, and government institutions that form part of the United States of America, United Kingdom and the European Union.<sup>18</sup>

In light of this mandate of the FATF, to monitor money laundering (a pandemic first addressed by members of the United Nations at the *Vienna Convention*),<sup>19</sup> terrorist financing, and the financing of weapons of mass destruction, which remain an enduring risk to the integrity of the financial system, it was the decision of the states represented at the Vienna convention to move forward with the mandate as the foregoing threats required a sustained political commitment by each state to continuously combat ML/TF.<sup>20</sup>

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<sup>14</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html>.

<sup>15</sup> Hummel, Acharya and Winning 2023 <https://www.reuters.com/world/africa/financial-crime-watchdog-adds-south-africa-nigeria-grey-list-2023-02-24/>.

<sup>16</sup> FATF 2023 <https://blog.docfox.co.za/the-fatf-greylists-south-africa-and-what-that-means-for-you?>.

<sup>17</sup> Kida and Paetzold 2021 *The Impact of Gray-Listing on Capital Flows*.

<sup>18</sup> FATF March 2022 <https://www.fatf-gafi.org/en/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-march-2022.html>.

<sup>19</sup> *UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988) (hereinafter the *Vienna Convention*).

<sup>20</sup> FATF April 2019 <https://www.fatf-gafi.org/en/the-fatf/mandate-of-the-fatf.html>.

The FATF was granted an extended mandate in 2019, which highlights the organisation's commitment to addressing the threats posed by the abuse of the financial system by criminals and terrorists. This extended mandate emphasises the importance of the FATF's role in leading coordinated global efforts to combat the threats posed by ML/TF. Its mandate is aligned with the focus of the study, which is to examine the impact of the FATF's recommendations and greylisting on international trade and financial institutions. From 1987 to the date of issuance of the new mandate in 2019, the FATF operated within a time-bound mandate that focused on combating money laundering and therefore, restricted the FATF's effectiveness.<sup>21</sup> The extended mandate as passed in April of 2019, recognises the need for the FATF to continue to lead decisive, co-ordinated and effective global action to counter the threats of the abuse of the financial system by criminals and terrorists, as indicated, while strengthening its capacity to respond to these threats, which are faced by all states.<sup>22</sup>

This study explores the manner in which financial institutions and/or states are affected by greylisting of the FATF in international trade. This study investigated how these measures affect the participation of emerging economies' in international trade by analysing specific economic trends before and after greylisting. Additionally, the research closely scrutinised how greylisting influences the established principles governing international trade transactions by financial institutions. This study aims to contribute to the existing body of knowledge by providing insights into the specific recommendations issued by the FATF, which, in turn, lead to the formulation of laws influencing how financial institutions in various jurisdictions uphold international trade agreements.

## **1.2 Motivation**

The IMF has demonstrated that greylisting is detrimental to the cash flow of various states.<sup>23</sup> Their study refers to research conducted by Morse on a group of 39 states,

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<sup>21</sup> FATF April 2019 <https://www.fatf-gafi.org/en/the-fatf/mandate-of-the-fatf.html>.

<sup>22</sup> FATF April 2019 <https://www.fatf-gafi.org/en/the-fatf/mandate-of-the-fatf.html>.

<sup>23</sup> Kida and Paetzold 2021 *The Impact of Gray-Listing on Capital Flows*.

ten of which were greylisted, which showed that greylisting negatively affects bank inflows by 15-16%.<sup>24</sup> The study conducted by Morse was the first to include all components of capital flow: foreign direct investment, portfolio, banking and others. It was based on a sample of 89 states considered to be emerging economies, or states that are transitioning to becoming developed countries.<sup>25</sup>

Kida and Paetzold employed the International Monetary Fund Financial Analytics (IMFFA) database in the period between 2000 and 2017 and found that 78 states that had been greylisted at least once showed a capital flow incline of 7.6% of their GDP during the period of greylisting.<sup>26</sup>

The FATF is an international policy making body which does not take part in the enforcement of legislation, investigation or the prosecution of crimes. Despite the foregoing, the FATF is able to compel states to comply with its rules in two ways:

- a. Reactive compliance, which is when decision-makers in targeted jurisdictions observe and then react to material economic losses resulting from the reputational damage caused by greylisting; and
- b. Pre-emptive compliance, when material economic losses due to greylisting are anticipated and compliance is an attempt to pre-empt the damage.<sup>27</sup>

The argument about the effectiveness of greylisting can be applied to the larger states of Austria and Switzerland – two countries with similar populations and Gross Domestic Products (GDPs).<sup>28</sup> An assessment by the FATF in 2015 found the Austria had failed to properly implement anti-money laundering measures in exchanging tax information with other countries. Austria was forced to reform when they were placed under the FATF's enhanced follow-up process. The country was subsequently removed from the grey list when their transparency in the financial sector was upgraded and they were once again FATF-compliant.<sup>29</sup> In contrast, Switzerland –

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<sup>24</sup> Morse 2019 *International Organization* 537.

<sup>25</sup> Morse 2019 *International Organization* 537.

<sup>26</sup> Kida and Paetzold 2021 *The Impact of Gray-Listing on Capital Flows*.

<sup>27</sup> Sharman 2009 *RIPE* 576.

<sup>28</sup> Sharman 2009 *RIPE* 576.

<sup>29</sup> Sharman 2009 *RIPE* 575.

who maintains the very same standards and do not conform to internationally accepted practices in either the exchange of tax information or anti-money laundering – has maintained its financial secrecy.<sup>30</sup>

This requires a probe into the manner in which international trade of certain states is affected by FATF greylisting, further exploration of the reasons why two similar countries can be treated differently, and the trends that appear in legislation and in the pursuit of reform of financial institutions and the legislation passed when emerging economies, such as South Africa, are greylisted by the FATF and effectively hobbled in terms of international trade.

### ***1.3 Research question***

The question posed in this study was, "What is the impact of the FATF's greylisting on international financial systems and trade of emerging economies?"

### ***1.4 Research aims and objectives***

Accordingly, the aim of the proposed research was to explore the impact that FATF greylisting has on international trade.

In order to achieve this, the following objectives were important:

- a) Analysing the role and purpose of the FATF;
- b) Explaining the role of the FATF in shaping legislation to reform financial systems, which affects emerging economies' ability to participate fully in international trade, how they trade in the international market, the policies around initiating greylisting, and the purpose of these policies;
- c) Determining the procedures that financial institutions and states must follow to be removed from the grey list; and
- d) Examining the FATF recommendations to avoid greylisting and the influence it may have on international trade.

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<sup>30</sup> Sharman 2009 *RIPE* 577.

## **1.5 Research methodology**

As a research method, this study made use of a literature review. The research sought to question the impact of the FATF on emerging economies and financial institutions when a state is placed on the grey/black lists. This was undertaken through referral to various primary sources, including FATF reports, legislation, policies, international law, and relevant case law as well as secondary sources, including law journals and books. The primary and secondary sources utilised to substantiate the research were obtained via accredited search engines such as LexisNexis and the Ferdinand Postma Library at the North-West University, South Africa, to ensure that accurate information and arguments were discussed.

The study was limited to investigating how international trade conducted by existing greylisted states or financial institutions has been affected due to FATF greylisting and the policies and legislation that were implemented in response to the impact. This was explored in tandem with what are considered best practices, the states at the forefront of such good practices, and how better states considered to be emerging economies can adapt those best practices in order to better combat ML/TF.

## **1.6 Framework**

The first chapter sets out the background and context of the study, the motivation, research question, aim and objectives, and the research method.

The second chapter examines the role and purpose of the FATF, the nature of their recommendations, the implementation of these through initiating greylisting, and its effectiveness.

The third chapter focuses primarily on the rationale behind greylisting, along with the policies and legislation that have been formulated or amended in response to greylisting in emerging economies. It also looks at how this affects the manner in which these states conduct trade in the international market.

The fourth chapter zooms in on the steps and procedures to be taken by greylisted states and financial institutions to no longer be in contravention of the policies of the FATF and to be removed from the grey list. This includes an unpacking of best practices in this regard.

The fifth chapter examines FATF policies that centre on the avoidance of greylisting by states and financial institutions. This involves pre-empting actions by the FATF by implementing policies and enacting legislation. The ways in which such pre-emption may influence international trade are discussed.

The sixth chapter concludes the study and highlights the conclusion as based on the findings of the preceding chapters. It answers the research question by integrating the findings and arriving at a concise conclusion with recommendations for institutions who want to avoid FATF greylisting or be delisted. Recommendations include possible future research into the effect of greylisting on financial systems and their impact on international trade of emerging economies.

## **Chapter 2: Analysing the role and purpose of the Financial Action Task Force and initiating greylisting**

### **2.1 Mandate of the FATF**

To understand the role and purpose of the FATF, it is important to know the context of its establishment. This background knowledge illuminates any recommendations by the task force and their implementation of greylisting.

Due to the rise in illicit drug trafficking in the 1980s, the topic was high on the list of discussion points in Vienna, France when the United Nations held a conference for the adoption of a *Convention against Illicit Traffic in Drugs and Psychotropic Substances* (the *Vienna Convention*) in 1988.<sup>31</sup> The *Vienna Convention* defined money laundering as the money laundering has been addressed in the 1988 UN *Vienna Convention*. Article 3.1 describes money laundering as "the conversion or transfer of property, knowing that such property is derived from any offense(s), for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in such offense(s) to evade the legal consequences of his actions".<sup>32</sup>

#### *2.1.1 Initial mandate: money laundering*

Money laundering allowed the circulation of illegal funds through legitimate businesses. Originally, laundromats were used for this purpose because most of their transactions were done in cash. Unlawfully obtained cash was mixed in with the legitimate earnings, which made it almost impossible for law enforcement to accurately monitor and identify questionable practices. This made it possible for the money to be claimed as legitimate money made through legal trade, and it was difficult for law enforcement to prove that it was not.

In essence, the *Vienna Convention* birthed the idea of an anti-money laundering (AML) function, but most United Nations (UN) members considered the process of

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<sup>31</sup> 1988 *Vienna Convention*.

<sup>32</sup> Nance 2017 *CL & SC* 114.

regulating such an adaptable financial system too complex a function for the UN. This resulted in a member of the UN proposing the establishment of a fact-finding task force to catalogue AML statutes around the world.<sup>33</sup>

On 16 July 1989, the seven foremost industry leaders in the world met in Paris as the G7. The G7 were united in their concern over the rise of income from the illicit drug trade and the associated laundering that served to hide it.<sup>34</sup> The formation of the FATF was the result of an international coordinated effort to combat these crimes.

### *2.1.2 Expansion of the mandate*

Upon its establishment, the FATF had a one-year mandate to stop funds flowing from the trade of illicit narcotics and to estimate the value of the narcotics market through the estimated amount of money laundered.<sup>35</sup>

In consideration of the initial mandate by the FATF, it is the opinion of Pavlidis that had the FATF limited their study to its initial mandate, which focused on the phenomenon of money laundering, its trends and techniques and to further propose measures to combat said phenomenon, the FATF would have wound up in its first year. The evolution of the FATF from a temporary body to a sustainable public as well as political commitment to combat money laundering and the various illicit financing, that has become prevalent over the years, is owed to the expansion of its mandate as discussed hereunder.<sup>36</sup>

The initial 11-member task force with its sole mandate has since expanded to 37 full members, consisting of nine regional groupings as associate members and 28 observer bodies.<sup>37</sup> Since its inception, the FATF's primary goals have evolved to:

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<sup>33</sup> Nance 2017 *CL & SC* 114.

<sup>34</sup> Turner 2015 *NYLSLR* 547–559.

<sup>35</sup> Nance 2017 *CL & SC* 115.

<sup>36</sup> Pavlidis 2021 *J Finance Crime* 766.

<sup>37</sup> Mekpor, Aboagye and Welbeck 2018 *JFRC* 433.

- a. Combating the laundering of money, the financing of terrorists, as well as other threats to the integrity of the international financial system through the development and promotion of policies;
- b. Promoting the effective implementation of regulatory, legal, and operational measures for the combating of financial crime;
- c. Setting international standards for the above;
- d. A thorough and rigorous review of the compliance of states through monitoring and evaluation.<sup>38</sup>

In 2001, following the terrorist attacks of September 11, the FATF incorporated terrorist financing. In 2019, the FATF then adopted an open mandate which in turn introduced minor adjustments to the FATF and its governance. This was evidenced through the Ministers meeting every two years and selecting a president of the FATF, in effect ensuring a term is two years in duration and finally, the addition of a stronger funding model to enable expansion of the workload that would be necessitated by the adjustments.

The FATF is an intergovernmental body with a large membership. The body itself lends itself to the design and supervision of the international AML and combating the financing of terrorism (CFT). The inclusion of, e.g., the People's Republic of China as member has allowed the FATF to shed its image of serving the interests of the United States of America.

## ***2.2 FATF monitoring***

The FATF maintains its legitimacy and impartiality by ensuring inclusivity, inviting and incorporating feedback, and making use of expertise of private stakeholders in banking, finance, and law. Additional processes are incorporated, which provides a broader interaction of processes and governance practices; hence, member states do not become the sole institutional source of political authority and innovation. All of this translates into a specialised institution that sets the bar internationally.<sup>39</sup>

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<sup>38</sup> Mekpor, Aboagye and Welbeck 2018 *JFRC* 433

<sup>39</sup> Al-Emadi 2021 *JMLC* 754.

The FATF upholds its standards through a recommendation framework that aims to encourage states to effectively monitor, develop and implement key tools to curb corruption. The goal is to protect the integrity of both the private and public sectors by virtue of promoting transparency, which inadvertently leads to the prompt detection, investigation and prosecution of corrupt activities.<sup>40</sup>

### *2.2.1 FATF recommendations*

The recommendations are the minimum expectation from FATF in terms of implementation with due consideration of the state of the nation and its legal framework, which may be a hindrance in implementing the recommendations, the most demanding of which is monitoring.

According to Nance, at international level, the FATF monitoring system has the furthest reach and monitoring is carried out through two means:

- a. Mutual evaluation; and
- b. Typology exercise<sup>41</sup>

#### **a. Mutual evaluation**

This entails an on-site visit by a team of experts from other FATF member states or representatives of other international institutions. This team is charged with conducting interviews with stakeholders and fills out a detailed and extensive "common methodology", which constitutes a comparison of the state's AML regime against the 40 recommendations. The results are discussed in the plenary meeting, which is a review by the peers of the state. If found to be unsatisfactory, the state is subjected to close monitoring and the requirement to present the strides taken to breach or close the gap between identified risk and compliance.<sup>42</sup>

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<sup>40</sup> Al-Emadi 2021 *JMLC* 754.

<sup>41</sup> Nance 2018 *CL & SC* 138.

<sup>42</sup> Nance 2017 *CL & SC* 116.

## **b. Typology exercise**

This entails a group of experts coming together in order to understand and identify the characteristics and behaviours of customer transactions that may be considered high risk and developing actions to mitigate and manage the risk. The premise of the exercise is that the activities associated with money laundering and the funding of terrorism follow certain identifiable patterns, which financial institutions and other regulatory bodies can detect and use to prevent suspicious transactions.<sup>43</sup>

This typology exercise employed by the FATF is a dynamic process that is regularly updated to keep up with ever-evolving money laundering and terrorist financing trends. In the finance and other regulated industries, it is an important tool for identifying unusual or suspicious patterns to prevent abuse of the financial sector.<sup>44</sup>

### *2.2.2 Enforcement of FATF policy*

Despite its expensive monitoring process, the FATF had no formalised policy for enforcing the standards established for a full decade post inception. The singular note that could be found on enforcement was in the current Recommendation 19, which calls for members to practice extreme caution when dealing with the financial bodies of states with deficient AML systems. This included keeping on record a written explanation of the reason for engaging with the financial institutions of such states.<sup>45</sup>

The initial process for enforcement was on a needs basis, and only when the Austrians and Turkish flouted non-compliance; Turkey failed to criminalise money laundering and Austria issued anonymous bank accounts.<sup>46</sup>

The FATF developed what can be loosely described as a three-step process:

1. Reporting to plenaries to ensure continued compliance;

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<sup>43</sup> Al-Emadi 2021 *JMLC* 755.

<sup>44</sup> Nance 2017 *CL & SC* 116.

<sup>45</sup> Nance 2018 *CL & SC* 139.

<sup>46</sup> Nance 2018 *CL & SC* 140.

2. Letter(s) from FATF President expressing concern and a visit from the FATF delegation; and
3. Expulsion from FATF and invoking caution in all transactions with the particular state.<sup>47</sup>

### **2.3 The Lists**

The FATF is an intergovernmental body that aims to establish a framework and encourage effective implementation of recommendations to efficiently combat AML/CFT. However, this means that they do not have as much authority to enforce penalties, and this is where the FATF adopts a name-and-shame tactic.

States that are rated "partially compliant" and "non-compliant" have to increase their level of compliance. Accordingly, the three-step procedure mentioned above is partially employed in that:

- (i) The non-compliant state must prepare a follow-up report after two years, elaborating on measures taken to address the non-compliance. In cases of serious deficiency or failure to address observed weakness, the evaluation plenary requires more frequent reports; and
- (ii) serious cases are publicised by the FATF in two lists:
  - a. The grey list: this is for countries with serious anti-money laundering weaknesses, but with the commitment to address them; and
  - b. The blacklist: this list includes countries that do not take sufficient precautions to address money laundering and are unable to implement measures to address this gap.<sup>48</sup>

#### *2.3.1 A coercive institution*

The above mechanisms rely heavily on the private sector to carry out the strictures and limitations required to limit the financial transactions of a state, and, according to Nance, this is what has earned the FATF the reputation of a coercive institution. Although it has no powers to enforce its regulations, the community and the power of association are vital; the risk of exclusion from major markets raise the cost of non-compliance, and that constitutes the incentive to comply.<sup>49</sup>

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<sup>47</sup> Nance 2018 *CL & SC* 141.

<sup>48</sup> Al-Emadi 2021 *JMLC* 754.

<sup>49</sup> Nance 2018 *CL & SC* 140.

These lists result in restrictions or "penalties" which are not carried out by the FATF but, rather, through the network established in the private sectors, financial institutions, rating houses, and other such institutions that affect the viability of international transactions of origin from the affected state.<sup>50</sup> The two lists are explained below:

**a. Grey list**

This category or set of states were previously labelled, "Improving Global AML/CFT Compliance: On-going process"; more recently, this has changed to "Jurisdictions under Increased Monitoring" or, more briefly, the grey list.<sup>51</sup>

Greylisting as method was introduced to assess the AML/CTF concerns identified by the FATF. The listed state then makes a commitment to actively address these deficiencies via the AML and CFT mechanisms already in their financial systems within a timeframe of between 12 and 18 months. During this time, the state in question is placed under increased FATF scrutiny to ensure that the state adheres to their commitment to strengthening their AML and CFT detection measures.<sup>52</sup>

Once the period has come to an end, the state is assessed according to the commitments made. Depending on whether the outcome is positive or negative, the state is either removed from the grey list or blacklisted.

**b. Blacklisting**

This list consists of countries with an escalated risk level alert, or the "high risk jurisdictions" that failed to address the significant shortcomings of their economies to combat AML and CFT. As a result of this failure, the FATF alerts the other jurisdictions or states to the blacklisted status of the particular economy, prompting countermeasures.<sup>53</sup>

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<sup>50</sup> Nance 2018 *CL & SC* 140.

<sup>51</sup> De Koker, Howell and Morris 2023 *Risks* 3.

<sup>52</sup> De Koker, Howell and Morris 2023 *Risks* 3.

<sup>53</sup> De Koker, Howell and Morris 2023 *Risks* 3.

The countermeasures mentioned above are intended to mitigate the risk posed by the noncompliant state. With these in place, the economy of the affected state is slowed, which prevents economic engagements; this reinforces the economic sanctions listed.<sup>54</sup>

## **2.4 The Grey List**

Greylisting serves as a mechanism encouraging states to act and improve their AML/CFT measures within the timeframe provided. By subjecting greylisted countries to increased monitoring and scrutiny, the FATF aims to ensure that they make the necessary reforms to strengthen their systems and comply with international standards. This process helps to enhance global efforts to combat money laundering and terrorist financing by holding countries accountable for their commitments to combat financial crimes.<sup>55</sup>

Though the FATF has stated that the mechanisms used above in no way call for enhanced due diligence in terms of transactions related to the greylisted or blacklisted states, this is often the result of the risk mitigation triggered by the listings. In addition, it has been observed that the blacklisting of non-members undermines the state's sovereignty and contradicts the international conventions. This results in diplomatic tension as the FATF rules are not legally binding for non-members.<sup>56</sup>

Though FATF rules are not legally binding for non-members, this fact has not precluded states such as North Korea, Iran, and Myanmar from being blacklisted or, in the instance due to the allowance of states to use their discretion in the economic transactions, "dark-greylisted" a term utilised to refer to jurisdictions that may face more severe consequences than those on the standard grey list, potentially

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<sup>54</sup> De Koker, Howell and Morris 2023 *Risks* 3.

<sup>55</sup> The Financial Action Task Force <https://www.fatf-gafi.org/en/the-fatf/what-we-do.html#:~:text=The%20Financial%20Action%20Task%20Force,countries%20are%20taking%20effective%20action.>

<sup>56</sup> The Financial Action Task Force <https://www.fatf-gafi.org/en/the-fatf/what-we-do.html#:~:text=The%20Financial%20Action%20Task%20Force,countries%20are%20taking%20effective%20action.>

indicating a further level of scrutiny, which would in turn negatively impact their financial market.

According to the International Monetary Fund's report on offshore centres, the most likely competitive factor in the current international environment is the established reputation of the state.<sup>57</sup> Sharman opines that the reputational effects of the grey list reverberate on two levels:

- a. Reputational; and
- b. Financial<sup>58</sup>

**a. Reputational**

Although FATF does not have control of how the member and other states react to the publicised listing, the loss of reputation suffered once the list is publicised is a beacon that adds to the reputational cost of the listing. The list is like a warning that announces the failure of the affected state to implement policies to support the AML and CFT frameworks.<sup>59</sup>

An example of the way reputational damage influences the affected state is seen in the near instant reaction triggered by the issuance of the list. In 2002, St Kitts and Nevis, the Cayman Islands, the Cook Islands and Liechtenstein were listed on the FATF's blacklist. A month after the announcement, the United States Financial Crimes Enforcement Network issued advisories regarding these states; these advisories were only withdrawn once the states were de-listed.<sup>60</sup>

This "peer effect" is not the only way the reputation of the states is affected; being perceived as the "lowest common denominator" and being judged the worst of the group is even more detrimental, Morse opines that the failure of a government to implement policies which will increase their chances of not being included on an FATF list signals to the global market that the government is either unable or

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<sup>57</sup> International Monetary Fund (2002) 18.

<sup>58</sup> Sharman 2009 *RIPE* 581.

<sup>59</sup> Morse 2019 *International Organization* 522.

<sup>60</sup> Sharman 2009 *RIPE* 581.

unwilling to enforce policies that will prevent money laundering and terror financing which, signal leads to being ostracized but, being subjected to further scrutiny as an untrusted market.<sup>61</sup>

## **b. Financial**

The second level on which the listings impact a state is on a financial level. The lists are a powerful catalyst for policy change as the financial market utilises the list to redirect the resources of states that are not compliant.<sup>62</sup>

In one of their recommendations, the FATF states that the private sector must maintain "customer due diligence procedures" and that measures should be taken to better assess the risk of money laundering and terrorist financing in the listed jurisdictions.<sup>63</sup> Hence, financial resources are redirected from noncompliant states.

Financial institutions or banks strictly follow the guidelines set out for due diligence as their reputation also hangs in the balance. In countries such as the United States of America, financial houses not only suffer reputational damage, but also incur a monetary penalty for "failing to maintain an effective anti-money laundering and terror financing programme".<sup>64</sup> The most recent and largest fine issued in 2023 was levied against a Danish bank in the form of a settlement of 2 billion USD. Danske Bank allowed suspicious transactions of approximately 200 billion USD through its branch in Estonia.<sup>65</sup> In 2012, HSBC bank was handed a fine of over 1 billion USD for "failing to maintain an effective anti-money laundering programme".<sup>66</sup>

The above illustrates that banks, like states, also require information on money laundering and terrorist financing risk; this will protect them from significant reputational damage if ever they are involved in a financial integrity scandal. As was said by a compliance executive from one of the biggest banks in the United States

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<sup>61</sup> Morse 2019 *International Organization* 523.

<sup>62</sup> Morse 2019 *International Organization* 525

<sup>63</sup> Morse 2019 *International Organization* 522.

<sup>64</sup> Morse 2019 *International Organization* 520.

<sup>65</sup> Bjerregaard and Kirchmaier 2019 *The Danske Bank Money Laundering Scandal* 39.

<sup>66</sup> Morse 2019 *International Organization* 519.

of America in an interview conducted by Morse for her paper titled "Blacklists, Market Enforcement, and the Global Regime to Combat Terrorist Financing": "[N]o firm wants the reputational damage of having been used as a vehicle for criminal activity, or worse, as a channel for financing terrorism."<sup>67</sup>

The risk of reputational damage or "naming and shaming" that the FATF has developed so effectively is one of the paramount reasons for increased vigilance against high-risk transactions from states the FATF has flagged via non-complier lists, these lists point banks to the states with the highest risks as opposed to what was the practice before the establishment of the non-complier list which was to refer to 200-page report. This mutual evaluation report would be outdated and had no cumulative ratings or include any comparable summary judgment of the policies of the state.<sup>68</sup>

The risk-based approach has become widely practised, and countries such as the United Kingdom (UK) and the United States of America (USA) have already adopted due diligence regulations independent of the FATF. The FATF has encouraged the worldwide adoption of this type of risk mitigating measures in all transactions.

The practical implication of the grey list is the effect it has on a state's economy and financial system such as, limiting foreign investment, the restriction of cross-border transactions, and problems encountered when attempting to obtaining credit. Countries that have been placed on the blacklist – Iran, Myanmar, the Democratic People's Republic of Korea and, more recently, Russia – are subject to international sanctions packages, determined by the way financial institutions and regulators react to states that have been grey or blacklisted by increasing the due diligence required to trade or invest. Hence, the FATF effectively utilises grey and blacklisting to influence the economic and social standing of such countries.

It must then be concluded that the role of the FATF is to effectively pressure the non-compliant states through the additional measures applied by different

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<sup>67</sup> Morse 2019 *International Organization* 521.

<sup>68</sup> Morse 2019 *International Organization* 520.

international financial institutions in the lending of funds to the greylisted states and the reputational damage which is suffered by these states through, in part, the coverage from the media that ignores the nuances of listing. The media coverage, to an extent, compounds the reputational damage, along with the enforcement that follows the coverage from the market actors which intensifies the reputational effects of the FATF list. The former US Assistant Secretary for Terrorist Financing and Financial Crimes noted that the power of the FATF, in part, lies in that “it creates dynamics that you don’t fully control, where small actions have systemic resonance. Once FATF lists a country, FATF does not control how the market responds.”<sup>69</sup>

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<sup>69</sup> Morse 2019 *International Organization* 521.

## **Chapter 3: The role of greylisting by the Financial Action Task Force in shaping international financial systems, trade, and policies of emerging economies**

### ***3.1 Role of Greylisting***

As mentioned in Chapter 2, the Financial Action Task Force (FATF) has moulded into the pivotal institution in a powerful financial governance regime.<sup>70</sup> The states of the globe have come to rely on the tools of the FATF to counter a variety of crimes, which includes but, are not exclusive to, transnational organised crime, terrorism, and weapon proliferation. With global leaders such as the United Kingdom (UK) and the United States of America (USA) leading the charge in terms of policy implementation, transformation, and prosecution of such crimes. The forementioned commitment has led to most states committing to meet the standards set by the FATF.

The FATF essentially sets the standard for anti-money laundering, counter terrorism, and proliferation (AML/CFT/CPF), and with these standards aim to set frameworks that guard against the manipulation of economies for purposes of AML/CFT and CPF. According to De Koker, Howell and Morris, there have been studies on the impact of a state being greylisted, or a "jurisdiction under increased monitoring", that may result in the state being negatively influenced both socially and financially.<sup>71</sup>

#### **a. Financially**

The financial aspect is the impact on the foreign capital, which flows into a state as a result of being placed on the grey list; this includes foreign direct investment (FDI), portfolio and other flows, which include interest-bearing bank lending, trade credit and other. Although the FATF does not have any powers to sanction countries, their creation of soft laws and the grey list has the effect of alerting other countries and financial institutions to possible risks of being associated with a non-compliant

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<sup>70</sup> Nance 2018 *CL & SC* pg nr.

<sup>71</sup> De Koker, Howell and Morris 2023 *Risks* 1–32.

country, and this leads to increased scrutiny, stricter Know Your Client/Customer (KYC) measures, and other compliance-related policies.<sup>72</sup>

The financial implication, in essence, is a product of the cooperation of the international community. Because the FATF has no ability to enforce its findings, it relies heavily on collaborative efforts of the states forming that international community through the ongoing effort to harmonise AML/CFT regimes.<sup>73</sup>

These collaborative efforts translate into additional precautionary measures taken during the appearance on the greylist, which prevents such countries from unencumbered participation in the international economy.<sup>74</sup>

## **b. Socially**

One of the most valuable currencies on the globe is the reputation of a state. When a country is greylisted, their reputation for being able to combat corruption, money laundering, and terror financing is brought under suspicion.<sup>75</sup>

As stated before, the FATF has no control over the manner in which member and other states react to the listing of one of their peers; however, appearing on the list does seem to highlight to other states the dysfunctional AML and CFT processes of a particular country.<sup>76</sup>

The effects of reputational damage have already been cited in the losses suffered by St Kitts and Nevis, the Cayman Islands, the Cook Islands and Liechtenstein, when they were included on the FATF's black list in 2002. A month after the announcement, the United States Financial Crimes Enforcement Network issued advisories regarding their stance in opposition to reopening their trade and

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<sup>72</sup> Nanyun and Nasiri 2021 *JMLC* 242.

<sup>73</sup> Nanyun and Nasiri 2021 *JMLC* 237.

<sup>74</sup> Nanyun and Nasiri 2021 *JMLC* 237

<sup>75</sup> Morse 2019 International Organization 522.

<sup>76</sup> Morse 2019 International Organization 522.

removing these states from their internal greylist. These advisories were only withdrawn once the states had been delisted.<sup>77</sup>

This "peer effect" is not the only means of reputational damage to a state; When a greylisted state is identified as the "lowest common denominator" the effect thereof means that said state can suffer from a reputation that attracts negative attention, limiting economic growth and attracting sanctions. This identification can discourage investment and trust from international partners.<sup>78</sup>

To offset the effects of being greylisted, a state must commit to actively combat the deficiencies that lead to their listing and improve AML/TF measures through continuous development of the integrity of the financial systems and the employment of regulations passed by the state.<sup>79</sup>

### **3.2 Application of the Grey List**

Since the inception of the FATF grey list in 2000, when the initial 13 states were listed, the FATF has submitted 125 states for mutual review, 98 of which were listed for their weak or inefficient AML/TF measures.<sup>80</sup> Of those 98 states, a total of 89 were emerging or developing economies. Between 2000 and 2017, some of the developing nations were greylisted with varying levels of success; states such as Ghana, Nigeria and Kenya – to name a few – were removed only to return.<sup>81</sup> At the time this paper was written, there were 22 states on the list: Bulgaria, Burkina Faso, Cameroon, Croatia, Democratic Republic of Congo, Haiti, Jamaica, Kenya, Mali, Malta, Mozambique, Namibia, Nigeria, Philippines, Senegal, South Africa, South Sudan, Syria, Tanzania, Turkey, Vietnam and Yemen.<sup>82</sup>

Of the 22 countries on the list, two have a stable or developed economy, and the remaining 20 are emerging economies of which 12 are on the continent of Africa.

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<sup>77</sup> Sharman 2009 *RIPE* 581.

<sup>78</sup> Morse 2019 International Organization 522.

<sup>79</sup> Maslen (2023) *The impact of grey listing by the Financial Action Task Force*.

<sup>80</sup> Maslen (2023) *The impact of grey listing by the Financial Action Task Force*.

<sup>81</sup> Guchu (2023) *The FATF grey list: An explainer*.

<sup>82</sup> FATF 2024 <https://www.fatf-gafi.org/en/topics/high-risk-and-other-monitored-jurisdictions.html>.

Emerging states are more susceptible to money laundering and terror financing and though there is a trail that can be followed the complex nature of the financial systems used by perpetrators which are inclusive but, not exclusive to the use of shell companies and non-profit organisations and further aided by the high costs of compliance training and implementation of compliance systems within banks and other financial institutions aid in shielding the illicit financial flows (IFFs).<sup>83</sup> In 2018, the IMF reported that the developing world was losing up to 5% of their GDP and that Africa was a leader in terms of illicit outflow, which was estimated at 7.7%.<sup>84</sup> The task of these emerging states is therefore more complicated in that, the financial systems are not as developed or well regulated. When these challenges are further coupled with the escalating cost of compliance to financial institutions such as banks, it becomes a tough task for states with limited resources to combat money laundering and terror financing. Many of these countries are battling diseases, poor infrastructure and poverty; inevitably regulating the fight against money laundering and illicit financial flows (IFFs) to a secondary concern.<sup>85</sup> Mugarura remarks that, when the operations of a financial institution are placed in a lawless business environment, it extends beyond its domestic borders to become an international security concern.<sup>86</sup>

### ***3.3 Combating AML/CTF***

In order to limit these concerns and avoid greylisting, emerging economies have made concerted efforts to amend their AML/CFT policies and legislation to address deficiencies and comply with recommendations of the FATF. The most noticeable trends implemented by states successfully removed from the grey list includes the following:

#### **a. Legislative reforms**

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<sup>83</sup> Mugarura 2020 *JMLC* 901.

<sup>84</sup> Mugarura 2020 *JMLC* 901.

<sup>85</sup> Marxen 2019 *SA Merc LJ* 274.

<sup>86</sup> Umar, Abu and Mohammed 2020 *JMLC* 604.

As a point of departure, all financial institutions are subject to the international AML requirements as determined by the UN. Several states in emerging economies have laws in place, have enacted new legislation, or amended existing legislation to align with FATF recommendations. These enactments or amendments result in improved transparency in the financial transactions conducted, successful criminalisation of money laundering, and the implementation of mechanisms resulting in the forfeiture of assets of those implicated.<sup>87</sup>

#### **b. Regulatory framework enhancement**

Financial and special intelligence teams are established with the aim of reinforcing regulatory frameworks, improving customer due diligence procedures, and enhancing reporting requirements for financial institutions to detect suspicious activities.

#### **c. Institutional capacity building**

These emerging economies have prioritised increasing the capacity of law enforcement agencies, financial regulators, and other relevant institutions to effectively implement AML/CFT measures. This increased capacity includes training programmes, technical assistance, and developing expertise in investigating financial crimes.

#### **d. Risk assessment**

Countries who were successfully delisted facilitated risk assessments nationally to identify and grow their understanding of the money laundering and terrorist financing risks specific to their jurisdictions. This also helps to develop the targeted strategies set by the states and the efficient allocation of resources for purposes of mitigating these risks.

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<sup>87</sup><https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Fatf-recommendations.html#:~:text=As%20amended%20November%202023.,applicable%20definitions%20in%20the%20Glossary.>

## **e. International cooperation**

Increased cooperation with international institutions and partnerships with other states, regional organisations and the FATF are essential for effective exchange of information and coordination of efforts to address cross-border financial crimes.

## **f) Public-private collaboration**

Better collaboration with the private sector, i.e., financial institutions such as banks, is fundamental to stronger AML/CFT controls, shared best practices, and improved compliance with regulations.<sup>88</sup>

### ***3.4 Journey off the greylist: Uganda and UAE***

The actions set out above have enabled some emerging and developing economies to demonstrate their continuous commitment to improving the integrity of their financial systems and standards.<sup>89</sup> The two states most recently delisted (February 2024) are Uganda – a developing or emerging economy, and the United Arab Emirates (UAE) – a state that could be termed a stable economy.<sup>90</sup>

Below follows a short look into the reasons the two countries were greylisted, and the measures taken to improve their respective standings and facilitate their removal from the FATF's grey list.

#### ***3.4.1 Uganda***

In 2020, Uganda was greylisted by the FATF due to concerns raised about its lack of progress in addressing shortcomings in their AML/CT framework. The issues listed included the following:<sup>91</sup>

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<sup>88</sup> International Monetary Fund 2023 *Anti-Money Laundering and Combating the financing of terrorism (AML/CFT)*.

<sup>89</sup> FATF 2024 <https://www.fatf-gafi.org/en/topics/high-risk-and-other-monitored-jurisdictions.html>.

<sup>90</sup> FATF 2024 <https://www.fatf-gafi.org/en/topics/high-risk-and-other-monitored-jurisdictions.html>.

<sup>91</sup> FATF 2024 <https://www.fatf-gafi.org/en/topics/high-risk-and-other-monitored-jurisdictions.html>.

- **Lack of effective AML/CFT measures**

The FATF found that there were strategic deficiencies in the overall AML/CFT framework in Uganda. To be more specific, it was found that there was a lack of effective measures to investigate, prosecute and convict individuals involved in money laundering and terrorist financing activities.

- **Weak legal and institutional framework**

The FATF found that the legal and institutional framework for AML/CFT in Uganda was inadequate for the identification, evaluation and mitigation of AML/CFT risks. There were also concerns about the independence and effectiveness of the financial intelligence unit and other institutions responsible for AML/CFT.

- **Inadequate supervision and regulation**

The FATF noted that Uganda's supervision and regulation of the financial sector – especially banks and other financial institutions – was not adequate to ensure compliance with AML/CFT requirements.

There were gaps in the oversight and enforcement mechanisms to prevent the misuse of the financial system for illicit activities.

- **Lack of international cooperation**

The FATF found that Uganda was not effectively cooperating and sharing financial intelligence with other countries and international organisations in the fight against money laundering and terrorist financing.

This limited Uganda's ability to track cross-border illicit financial flows and take coordinated action against such activities.

- **Failure to implement FATF Action Plan**

When the FATF first identified strategic deficiencies in Uganda's AML/CFT system, the country was given an action plan to address these issues. However, the FATF

determined that Uganda had not made sufficient progress in implementing the necessary reforms within the agreed timelines.

The combination of structural weaknesses in Uganda's AML/CFT framework, the lack of effective implementation, and inadequate international cooperation all contributed to the FATF's finding that the country's system was vulnerable to risks. The country was greylisted in 2020.

In an effort to be delisted, Uganda embarked on a four-year action plan to address the shortcomings identified by the FATF:<sup>92</sup>

- a. The country introduced legal and regulatory reforms through the amendment of their Anti-Money Laundering (Amendment) Bill, 2022, which aims to empower the Financial Intelligence Authority (FIA) and other supervisory authorities to levy administrative penalties for breach of the provisions of the Act and for related matters. They presented the Companies (Amendment) Bill now Act 16 of 2022, and Anti-Terrorism (Amendment) Bill No. 25 of 2022 along with other bills aimed at improving the transparency of beneficial ownership information. Customer due diligence requirements for financial institutions were enhanced and presented to parliament and passed in 2022.<sup>93</sup>
- b. Institutional strengthening through measures taken to improve the bandwidth and independence of its financial intelligence unit, the Financial Intelligence Authority (FIA), by providing additional resources, improving its analytical capabilities, and ensuring its operational autonomy.
- c. Supervisory enhancements made evident in the strengthened supervision and regulation of its financial sector, particularly in high-risk areas such as real estate, precious metals, and money service businesses. This was ensured through the implementation of a risk-based approach to supervision and an emphasis on conducting on-site inspections and enforcing compliance with AML/CFT requirements.
- d. Improving investigation and prosecution by training law enforcement agencies and the judiciary in investigating and prosecuting money laundering and terrorist financing cases, and to establish specialized units within the police and the Directorate of Public Prosecutions to focus on these types of cases.
- e. Enhancing international cooperation by entering into memoranda of understanding with several states and international organisations to enable the exchange of financial intelligence and the coordination of cross-border investigations. Uganda has also participated in regional AML/CFT initiatives by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), as

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<sup>92</sup> FATF 2024 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2024.html#Uganda>.

<sup>93</sup> Financial Intelligence Authority 2022 *The Six New Bills Passed By Parliament Addressing FATF Recommendations*.

well as those initiated globally as a way to strengthen its cooperation with other jurisdictions.<sup>94</sup>

- f. Monitoring and reporting were made evident by the regular progress reports provided to the FATF, which demonstrated the commitment to address the identified deficiencies. The country also worked closely with the FATF and other international bodies to receive technical guidance and assistance in the implementation of Uganda's action plan.<sup>95</sup>

Although Uganda has been removed from the grey list, the FATF will continue to monitor Uganda's progress in implementing the recommendations of the action plan, with the FATF ensuring that the state continues the efforts displayed so far and continues to address any remaining weakness in its AML/CFT framework.

### *3.4.2 United Arab Emirates (UAE)*

In March of 2022, the UAE was placed on the FATF's grey list due to the following shortcomings in their AML/CFT frameworks:

#### **a. Ineffective supervision and regulation**

The FATF found that the supervision and regulation of the UAE's financial sector, particularly in areas such as real estate, precious metals and other high-risk activities, was not effective to mitigate risks of money laundering and terrorist financing. There were concerns about the lack of robust oversight and enforcement mechanisms to ensure compliance with AML/CFT requirements.<sup>96</sup>

#### **b. Insufficient transparency of beneficial ownership**

The FATF identified deficiencies in the UAE's framework for ensuring the transparency of beneficial ownership information, which is crucial to preventing the misuse of legal persons and arrangements for illicit purposes.

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<sup>94</sup> FATF 2024 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2024.html#Uganda>.

<sup>95</sup> FATF 2024 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2024.html#Uganda>.

<sup>96</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html#UAE>.

There were concerns about the accuracy and availability of beneficial ownership data, as well as the effective implementation of related measures.

**c. Weak enforcement and prosecution**

The FATF noted that the UAE's efforts to investigate, prosecute, and convict individuals involved in money laundering and terrorist financing activities were not effective. There were concerns about the UAE's ability to identify, trace, and confiscate the proceeds of crime.

**d. Inadequate international cooperation**

The FATF found that the UAE's cooperation with other countries and international organisations in the area of AML/CFT, particularly in terms of exchange of financial information and facilitating extradition, was not satisfactory. This limited the UAE's ability to address cross-border money laundering and terrorist financing threats.

**e. Lack of progress on action plan**

When the FATF first identified the strategic deficiencies in the UAE's AML/CFT system, the country was given an action plan to address these issues. However, the FATF determined that the UAE had not made sufficient progress in implementing the necessary reforms within the agreed timelines.<sup>97</sup>

The combination of these factors, including the lack of effective supervision, insufficient transparency, weak enforcement, and inadequate international cooperation, led the FATF to conclude that the UAE's AML/CFT framework had strategic deficiencies, resulting in its inclusion on the grey list.

The FATF's decision to remove the UAE from the grey list follows the progress made by the UAE in improving its AML/CFT regime through meeting its obligations as stipulated in the action plan. In addition, the UAE has prioritised a review of its

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<sup>97</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html#UAE>.

compliance framework and, in addition, taken steps to ensure that it reinforces its regulatory framework through the following:<sup>98</sup>

**a. Strengthened supervision and regulation**

Targeted financial sanctions (TFS) are increased through sanctioning non-compliance among reporting entities and demonstrating a better understanding of UN sanctions evasion among the private sectors. The improvement of understanding as it relates to ML/TF risks of designated non-financial businesses and professions (DNFBP) supervisors in their application of effective and proportionate sanctions for AML/CFT non-compliance involving Financial Institutions and DNFBPs and increasing Suspicious Activity Report (SAR) filing in the abovementioned sectors.

**b. Increased transparency of beneficial ownership**

An Ultimate Beneficial Owner (UBO) register is created for the registration of any individual within an organisation with an interest that exceeds 25%, or with significant influence or control over that organisation's operations. The Ministry of Economy and Intelligence Units (FIU) of the UAE requires a more detailed report on beneficial owners in order to create a centralised UBO register to be made accessible to regulatory authorities and law enforcement across the globe.

**c. Strengthened enforcement and prosecution**

Additional resources are provided to the FIU to increase their capacity to provide financial intelligence to Law Enforcement Units (LEU) and to use financial intelligence from local and international counterparts to a greater extent to pursue high-risk ML threats. A specialised court is added for increased investigation and prosecution of ML as well as other financial crimes.

**d. Adequate international cooperation**

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<sup>98</sup> <https://www.nortonrosefulbright.com/en/knowledge/publications/eb06aa7c/uae-removed-from-the-fatf-grey-list>

Outbound AML requests are increased to facilitate ML/TF investigations.

The FATF further recommended that the UAE should continue to work with the regional AML/CFT body and the Middle East and North Africa Financial Action Task Force (MENAFATF). It also recommended the UAE maintain improvements to its AML/CFT system and the abovementioned improvements. The UAE's compliance with these recommendations resulted in their removal from the grey list.

### **3.5 Conclusion**

The implementation of the FATF's recommendations and subsequent action plan are essential in order to curb money laundering, terror financing, corruption and other crimes perpetuated through the monetary system and financial institutions to mitigate the effects of such transactions. However, as seen in the case of Uganda, it takes an emerging economy twice as long to promulgate, enact and enforce AML/CFT legislation as that of a state with a stable economy.<sup>99</sup> The emerging economies of Barbados and Pakistan had a similar timeframe of 3 to 4 years on the grey list before they could successfully implement the action plan. Again, this testifies to the difficulties these emerging economies must overcome to implement the sophisticated systems required to comply with the standards of the FATF.<sup>100</sup> Implementing or adhering to regulations of the FATF is not necessarily cost effective for the majority of states deemed to be non-compliant and may even be considered a burden imposed on the firms in these states. The uniform scale on which states are measured, without the FATF's due consideration and failure to take account of the effect of the impositions as well as the changing conceptions of social acceptance in transactional networks of global order when a state is placed on the grey list and is viewed as the lowest common denominator.<sup>101</sup> It cannot be denied that there are severe implications for AML/TF and that cooperation is necessary but, support from the international organisations – such as the UN, the OECD/FATF, the World Bank, the IMF and the Basel Committee – that oversee the compliance of

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<sup>99</sup> Mugarura 2020 *JMLC* 908.

<sup>100</sup> Rahman and Rehman *Case Study: Pakistan's Journey off the FATF Grey List and the Role of the Institute of Chartered Accountants of Pakistan*.

<sup>101</sup> Mugarura 2020 *JMLC* 901.

these listed countries is indispensable. The facilitative role of international organisations is supplemented by different levels of national compliance initiatives worldwide, but the associated cost burden on national governments is undeniable. Despite massive efforts and apparent successes, the effectiveness of AML tools to combat corruption and other predicate offences is questionable.<sup>102</sup>

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<sup>102</sup> Mugarura 2020 *JMLC* 901.

## **Chapter 4: Determining the procedures that financial institutions and states must follow to be removed from the grey list**

### ***4.1 Introduction***

The Financial Action Task Force (FATF) can be termed a multilateral organisation by combating money laundering, terrorist financing and proliferation of weapons of mass destruction through its development and promotion of policies that protect the international financial system.<sup>103</sup> The FATF has gained its credibility through being an independent, unbiased and inter-governmental body that ensures a secure and stable international financial system.<sup>104</sup>

The manner in which the FATF achieves this is by setting standards (such as the 40 recommendations set in 1990) to help states build a robust international anti-money laundering regime. The 49 FATF recommendations provide a framework that sets the standard against which states are measured for their implementation, this framework then assists the states to institute necessary measures for purposes of combating money laundering and terrorist financing.<sup>105</sup>

The primary reason for the existence of the FATF recommendations is for implementation by member states, as this enables the financing sector to detect and deter money laundering and terrorist financing. Failure by a state to implement the recommendations leads to assessment by the region the state is in, a typology assessment, and – if the state in question falls short of FATF requirements – placement on the grey or black list.

### ***4.2 Lenders of consequence: International Monetary Fund and World Bank***

As previously stated, the FATF does not have the ability to enforce its mandate as it lacks the opinion of law required in international customary law to form obligations

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<sup>103</sup> Davis "Prevention of Terrorist Financing" 451.

<sup>104</sup> Pavlidis 2021 *J Finance Crime* 765.

<sup>105</sup> Nanyun and Nasiri 2021 *JMLC* 234.

that bind all parties.<sup>106</sup> However, this has not diminished the impact of the FATF, as the International Monetary Fund (IMF) and the World Bank (WB) are important partners of the FATF. The IMF and WB are important players in the movement of money, as the IMF promotes economic development and the WB is able to extend credit through loans with the condition that it enhances the rule of law, prudent governance, economic adjustment programmes, and the improvement of both public and private-sector accountability. An important condition of WB loans is the applicant state's adherence to FATF recommendations.<sup>107</sup>

It is the support of these two entities that have changed the status of the FATF recommendations from "soft law" a term defined as "laws that are legal norms, principles, codes of conduct and transactional rules of state practice, which are recognized in either informal or formal multilateral agreements recognize" to "hard law", a compulsory compliance in trade for access to IMF and WB loan facilities. This has earned the FATF the title of coercive institution, as it relies heavily on international monetary lenders such as the International Monetary Fund (IMF) and the World Bank (WB) to draw compliance.<sup>108</sup> If this initial deterrent is disregarded, the private sector is expected to carry out the strictures and limitations required to limit the financial transactions of a state. Threats of exclusion from major markets raise the cost of non-compliance, and therein lies the coercive power of the FATF.<sup>109</sup>

### ***4.3 FATF recommendations and state compliance***

The FATF has a far-reaching influence, and very few states have escaped inclusion on their lists. Countries such as Australia, Canada, France, Germany, Japan, New Zealand, Singapore, the United Kingdom and the United States of America have not been listed, thanks to their consistent maintenance of good AML/CFT practices.<sup>110</sup> The period of time spent on the grey list is determined by how quickly a country

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<sup>106</sup> Pavlidis 2021 *J Finance Crime* 765.

<sup>107</sup> Nanyun and Nasiri 2021 *JMLC* 237.

<sup>108</sup> De Oliveira 2018 *CL & SC* 154.

<sup>109</sup> Nance 2018 *CL & SC* 140.

<sup>110</sup> Gallant (2024) *Symposium on IFFs: Grey-listing, global anti-money laundering regulation and the classic divide*.

addresses weaknesses in their AML/CTF framework as identified by the FATF. The FATF meets quite frequently to ensure their records remain updated.

Emerging economies make up the majority of states with weak frameworks, and a total of 60% of greylisted countries are in the global south and, more specifically, on the continent of Africa.<sup>111</sup> States with emerging or developing economies struggle to comply with the requirements set by the FATF, as is evident from their repeat appearances on the dreaded lists in 24 years. These countries are most commonly found to fall short of the following FATF recommendations:

- a. Lack of legislative reforms in terms of AML/CFT;
- b. Weakened regulatory framework;
- c. Limited scope of ML/TF investigations, establishment or expansion of agencies or financial regulators to increase expertise and therefore expedite the prevention of ML/TF;
- d. Gaps in risk assessment capabilities for purposes of identifying and understanding trends within their jurisdictions;
- e. Failure to cooperate regionally and internationally with other institutions for purposes of coordinating efforts;
- f. Little to no collaboration between the public and private sector for purposes of strengthening AML/CFT controls.<sup>112</sup>

In October of 2022, the Basel Institute on Governance<sup>113</sup> released the components that were found to be similar points at which states located in sub-Saharan Africa were falling short in meeting in order to comply with the FATF recommendations for the implementations of AML/CTF frameworks.<sup>114</sup> These states were subject to their regional FATF bodies in terms of the Mutual Evaluation Report, and the action plans concentrated on the following imperatives:

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<sup>111</sup> Alsancak (2024) *The FATF gains momentum in breaking Africa's cycle of grey listing.*

<sup>112</sup> Guchu (2023) *The FATF grey list: An explainer.*

<sup>113</sup> Basel Institute on Governance (2022) *Special report: FATF grey-listing in Sub-Saharan Africa.*

<sup>114</sup> Basel Institute on Governance (2022) *Special report: FATF grey-listing in Sub-Saharan Africa.*

- Assess risks through a national risk assessment and remedy anti-money laundering (AML) and combating the financing of terrorism (CFT) deficiencies in line with identified risks;
- develop risk-based supervision for the financial sector and other designated non-financial businesses and professions (DNFBPs);
- establish accurate beneficial ownership information registers;
- enhance the capacity of financial intelligence units;
- enhance the capacity of law enforcement agencies; and
- implement effective targeted financial sanctions regimes related to terrorism financing and proliferation financing.

The above speaks to financial institutions as well as the state.

Jackson<sup>115</sup> defines the five main objectives of the FATF as the development of AML and CFT standards; the development of measures for level of compliance with those standards by member countries; the promotion of effective implementation of legal and operational measures to combat ML, TF and other threats related to the integrity of each country's financial system; the identification of vulnerabilities at national levels to ensure correction; and the rectification and protection of the global financial system from abuse.

#### **4.4 FATF and financial institutions**

The FATF glossary<sup>116</sup> defines financial institutions as:

“[A]ny person or entity who conducts as a business one or more of the following activities or operations on behalf of a customer:

1. Acceptance of deposits and other repayable funds from the public;
2. Lending;
3. Financial leasing;
4. The transfer of money or value;

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<sup>115</sup> Jackson (2012) *The financial action task force: an overview*.

<sup>116</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html>.

5. Issuing and managing means of payment (e.g. credit and debit cards, checks, traveller's checks, money orders and banker's drafts, electronic money);
6. Financial guarantees and commitments;
7. Trading in:
  - (a) Money market instruments (checks, bills, CDs derivatives, etc.)
  - (b) Foreign exchange
  - (c) Exchange, interest rate and index instruments
  - (d) Transferable securities
  - (e) Commodity futures trading.
8. Participation in securities issues and the provision of financial services related to such issues;
9. Individual and collective portfolio management;
10. Safekeeping and administration of cash or liquid securities on behalf of other persons;
11. Otherwise investing, administering or managing funds or money on behalf of other persons;
12. Underwriting and placement of life insurance and other investment related insurance;
13. Money and currency changing.<sup>117</sup>

The definitions also include non-financial institutions and distinguishes them by stating the two types of non-financial institutions:

- a. The designated non-financial business and professions (DFNBPs) such as casinos, real estate agents, lawyers, notaries or other legal professionals and accountants. These need to be licensed and have measures in place to prevent the casinos from being owned by criminals as well as supervision of their compliance to AML/CFT requirements; and
- b. The non-designated non-financial business and professions (NDFNBPs) which are businesses other than those under DFNBPs that pose a money laundering or terrorist financing risk such as sellers of high-value and luxury goods.<sup>118</sup>

Measures to prevent the abuse of financial institutions by criminals must be in place. This must be achieved through internal policies that should include ongoing training to keep employees alert and updated on current developments due to the risk of

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<sup>117</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html>.

<sup>118</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html>.

non-compliance and the consequences.<sup>119</sup> As mentioned previously, the FATF receives tremendous support from the International Monetary Fund (IMF) and the World Bank (WB), and this support enables the FATF to affect and shape international financial systems to comply with FATF recommendations.<sup>120</sup>

Financial institutions must establish adequate preventative measures to remain FATF-compliant. Screening during the hiring process is an important measure included under Recommendation 15 of the FATF:

Financial institutions should develop programs against money laundering and terrorist financing. These programs should include:

- a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.
- b) An ongoing employee training program.
- c) An audit function to test the system.

Lax control during the hiring process creates opportunities for criminals to infiltrate financial institutions through senior managerial positions. This impresses upon countries the importance of legislation and regulatory bodies to monitor the implementation and practice of existing legislation, which FATF recommendation 23 states as follows:

Countries should ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. Competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution.

In light of the above risks to financial institutions and the states they reside in, the key to remaining unlisted or becoming delisted depends entirely on a country's ability to implement FATF recommendations.

The FATF recommendations are a good point of departure for implementation in the form of legislation as opposed to recommendations of 15 and 23, as mentioned

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<sup>119</sup> Nanyun and Nasiri 2021 *JMLC* 239.

<sup>120</sup> Nanyun and Nasiri 2021 *JMLC* 239.

above, being made after an evaluation. Recommendation 5 to 25 of the FATF contains a list of actions to be taken to avoid inclusion on the list of countries under increased monitoring. Below follows some of the most important ones:

**a. Compliance with regulations for anti-money laundering (AML) and countering the financing of terrorism (CFT)**

Implementing or strengthening of robust AML/CFT measures to prevent money laundering and terrorist financing activities in the financial and non-financial sectors by complying with Article 3(1)(b) and (c) of the 1998 *Vienna Convention* which has the title of "offences and sanctions" and sets out that states should criminalise AML/CFT.<sup>121</sup> It reads as follows:

3. Each Party shall adopt such measures as may be necessary to establish as criminal offences under its domestic law, when committed intentionally:
  - (1)(b)(i) The conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph (a) of this paragraph, or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions;
  - (ii) The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in accordance with subparagraph a) of this paragraph or from an act of participation in such an offence or offences;<sup>122</sup>
- (c) Subject to its constitutional principles and the basic concepts of its legal system:
  - (i) The acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from an offence or offences established in accordance with subparagraph a) of this paragraph or from an act of participation in such offence or offences;
  - (ii) The possession of equipment or materials or substances listed in Table I and Table II, knowing that they are being or are to be used in or for the illicit cultivation, production or manufacturer of narcotic drugs or psychotropic substances;

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<sup>121</sup> Carrington and Shams "Elements of an Effective AML/CFT Framework" pg nr 403.

<sup>122</sup> Article 3(1)(b) of the 1998 *Vienna Convention*.

- (iii) Publicly inciting or inducing others, by any means, to commit any of the offences established in accordance with this article or to use narcotic drugs or psychotropic substances illicitly;
- (iv) Participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences established in accordance with this article.<sup>123</sup>

States around the world have not only criminalised money laundering and the financing of terrorism but have also established specialised anti-corruption courts. This requirement to criminalise Terrorism Financing is found under Article 7 of the *Convention against Financing of Terrorism* of 1999, which focuses on three (3) important factors, namely:

- (a) Compliance with AML-CFT preventative measures, which include –
  - Acting against offenders, and
  - International cooperation in this critical law enforcement functions.<sup>124</sup>
- (b) Criminalising the financing of terrorism; and
- (c) Ensuring that such offences are designated as predicate offences for money laundering.

## **b. Customer due diligence (CDD)**

Customer due diligence comprises a set of preventive measures employed in order to restrict the abuse of financial institutions by criminals. It entails the implementation of internal policies that may vary according to the institution's size, nature, and its scope of operation. These procedures should include implementing policies and ongoing training in order to keep employees well informed.

In Recommendations 15 and 33, the FATF sets out the following in terms of natural persons:

- 15. Countries and financial institutions should identify and assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of new products and new business practices, including new delivery mechanisms, and (b) the use of new or developing technologies for both new and pre-existing products. In the case of financial institutions, such a risk assessment should take place prior to the launch of the new products,

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<sup>123</sup> Article 3(1)(c) of the 1998 *Vienna Convention*.

<sup>124</sup> Article 7 of the 1999 *Convention against Financing of Terrorism*.

business practices or the use of new or developing technologies. They should take appropriate measures to manage and mitigate those risks. To manage and mitigate the risks emerging from virtual assets, countries should ensure that virtual asset service providers are regulated for AML/CFT purposes, and licensed or registered and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF Recommendations.<sup>125</sup>

33. Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

FATF Recommendations 5 to 25 encourage states to prioritise and promote preventative measures over the seizure, confiscation, and forfeiture of assets. Along with Customer Due Diligence (CDD) the preventative measures include, know your customer, a process through which each customer must disclose and submit identification of their ultimate beneficial owner, more often the individual owner who has an interest exceeding 5% (five percent) and thereby facilitating the promotion of high ethical standards.<sup>126</sup>

### **c. Record keeping**

Maintain detailed records of customer identification data obtained during the CDD process to ensure transparency and traceability of financial transactions for a period of no less than five (5) years following the termination of the customer's account.<sup>127</sup> In complying with this requirement, financial institutions and other obliged entities under AML/CFT regulations must display diligent record keeping to demonstrate compliance and assist the authorities with investigations.

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<sup>125</sup> FATF February 2023 <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2023.html>.

<sup>126</sup> Basel Committee on Banking Supervision (2006) *Core Principles for Effective Banking Supervision* 25–26.

<sup>127</sup> Carrington and Shams "Elements of an effective AML/CFT framework" 391.

Thoroughness record keeping is more strictly applied to non-residents, as recommendations 23 states that no person or their agent should be enabled to open an account under a fictitious name and the account must only be opened where the customer has been verified. The framework of information to be collected from a customer is the following:

1. Name and legal form of customer's organisations
2. Address
3. Names of the directors
4. Principal owners or beneficiaries
5. Provisions regulating the power to bind the organisation
6. Agent(s) acting on behalf of the organisation, and
7. Account number (if applicable).

#### **d. Cooperation with regulatory authorities**

This cooperation refers to a state's collaborative efforts with the regulatory bodies and their participation in joint inspections to demonstrate their commitment to comply with international standards through the employment of a variety of formal and informal mechanisms. The four main formal mechanisms through which states attempt to encourage interagency cooperation and information flows are:

- i. **Legal obligations:** Formulation of legal frameworks to mandate cooperation and information sharing among law enforcement agencies, e.g., competencies for investigation and prosecution are commonly split across several independent agencies; no anti-corruption body is able to fulfil its functions in a vacuum. The vehicle to allow this is inclusive of the enactment of statutes, granting of executive orders, or conclusion of memoranda of understanding that outline specific requirements and procedures for interagency collaboration.<sup>128</sup>
- ii. **Interagency councils and committees:** The objective of Recommendation 31 is to achieve effective cooperation.<sup>129</sup> In other

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<sup>128</sup> Jenkins (2019) *Interagency coordination mechanisms* 3.

<sup>129</sup> Jenkins (2019) *Interagency coordination mechanisms* 3.

words, the recommendation does not tell countries what to do; it only guides them to implement effective mechanisms to achieve this objective through the formation of councils or committees that are dedicated to the facilitation of regular communication, coordination, and joint decision-making. These bodies provide a platform for discussing shared challenges, identifying opportunities for collaboration, and developing coordinated strategies. Although Recommendation 31 does not set out a strict framework for cooperation, it does suggest that states enter into cooperative arrangements with the relevant FIU, law makers, law enforcement and other competent authorities. The collaborative efforts also require that states take cognisance of Recommendation 26, which states that FIUs should receive timely access to information required, whether administrative, financial or regarding law enforcement.<sup>130</sup>

- iii. **Information-sharing platforms:** Creating centralised platforms or systems that enable agencies to seamlessly share data, intelligence, and best practices. These platforms can range from simple data repositories to sophisticated collaboration tools that facilitate real-time information exchange and analysis.
- iv. **Joint training and exercises:** Conducting joint training exercises and simulations that bring together personnel from different agencies to enhance interoperability, coordination, and communication skills. These exercises can simulate real-world scenarios, allowing agencies to test and refine their collaborative response capabilities.<sup>131</sup>

#### e. Legislative stipulation

The United Nations Office on Drugs and Crime (UNODC) and the International Monetary Fund (IMF) jointly developed the model law on money laundering and the financing of terrorism in December 2005. Article 3.1.4.4<sup>132</sup> of this law provides that:

The financial intelligence unit may request in relation to any report it has received, any additional information it deems useful for the accomplishment of its functions from:

- Police departments;
- Authorities responsible for the supervision of the entities and persons subject to this law;
- Other administrative agencies of the State.

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<sup>130</sup> Carrington and Shams "Elements of an Effective AML/CFT Framework" 403.

<sup>131</sup> Carrington and Shams :Elements of an Effective AML/CFT Framework" 403

<sup>132</sup> UNODC/IMF (2005) *Model Legislation on Money Laundering and Financing Terrorism* 3.1.4.4.

The information requested shall be provided within the time limits set by the Financial Intelligence Unit.

There are other provisions under article 3.1.5 of the model law that require the FIU to apprise the relevant supervisory authority of the non-compliance of financial institutions or designated non-financial businesses and professions.<sup>133</sup>

The relevant state is allowed, through the above, to further facilitate the interagency cooperation by establishing other legislative and formal mechanisms such as ministerial orders, which would require the supervisory authorities to inform the FIU of any weakness identified in the suspected reporting systems of any institution through:

- (a) Formal multi-agency committees required by the FIU
- (b) Interagency memorandum of understanding
- (c) Staff exchange arrangements.

#### **4.5 Conclusion**

In order for the different states and financial institutions to comply with AML/CFT measures instituted by FATF-style regional bodies (FSRBs), they have to pass the assessments conducted through a process of mutual evaluation among the members of the assessor bodies. The IMF and WB assess financial institutions through the Financial Sector Assessment Programme (FSAP), which programme conducts comprehensive, an in-depth analysis into the resilience of a state's financial sector. The FSAP more frequently conducts reviews of 29 states with systemically important financial sectors to reflect their significance to the global financial system, the states include but are not exclusive to, the United States of America, United Kingdom, Japan, France, Germany, Italy, Switzerland, China, Saudi Arabia, Ireland and South Africa.<sup>134</sup>

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<sup>133</sup> UNODC/IMF (2005) *Model Legislation on Money Laundering and Financing Terrorism* 3.1.15.

<sup>134</sup> Revenue Capacity Development <https://www.imf.org/en/Publications/fssa/mandatory-financial-stability-assessments-under-the-fsap> - accessed 4 October 2024

The implementation of FATF recommendations is necessary in the combat of ML/TF which includes the harmonise legislation and enforcement efforts through the provision of coordination points, flexible responses to new threats, and the adoption of mutual evaluation processes. This produces the leverage required to exert peer pressure on non-compliant members, which enhances the international financial space and legitimises the FATF's processes.<sup>135</sup> However, the often indiscriminate application of FATF recommendations places emerging economies at a higher risk of falling foul of the FATF recommendations due to non-compliance.<sup>136</sup> A further obstacle is that developed states and tax havens do not have the means to determine which funds stem from illicit financial flows (IFFs), due to the complex manner in which they are laundered and transferred, i.e. through shell companies and states that allow financial secrecy.<sup>137</sup> Without the measures and flagging mechanisms for incoming funds from emerging economies, i.e. the registering or recording of ultimate beneficial owners (UBO) and sources of funds, this shortfall in the AML/CTF frameworks of states with developed economies and those with emerging economies alike, enables IFFs to leave the economy from states with emerging economies to that of developed economies without being checked for possible ML/TF and for same to flourish.<sup>138</sup>

The abovementioned gap between enlisting the assistance of financial institutions as well as states where financial secrecy is permitted, to drive the enforcement of AML/CFT through existing legislation enacted by the developed states in their AML/CFT framework to increase vigilance on funds received, through proper enquiry into UBO and source of funds or wealth, ML/TF it will continue to flourish. Having AML/CTF frameworks in place without the follow up action leaves states vulnerable as was seen with the release of the Panama Papers, where financial documents and attorney-client information was leaked revealing that close to 60% of those offshore

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<sup>135</sup> Nanyun and Nasiri 2021 *JMLC* 242.

<sup>136</sup> Sultan *et al* 2024 *JMLC* 86.

<sup>137</sup> African Union (2021) *Illicit Financial Flow Report of the High Level Panel on Illicit Financial Flows from Africa* 74.

<sup>138</sup> Al-Emadi 2021 *JMLC* 759.

accounts were from commercial institutions incorporated in the UK and its territories.<sup>139</sup>

The UK therefore faces serious risks in relation to laundering the proceeds of crimes, and this indicates that technical compliance with FATF rules is not sufficient to effectively curb money laundering. This lends credibility to assertions by Nanyun<sup>140</sup> about Pakistan and confirms admissions that FATF rules and recommendations are not guaranteed to prevent ML due to the deeply rooted risks and vulnerabilities in the financial system along with the rapid changes in ML trends. Besides this, some of the developed economies, such as the USA, Singapore and Switzerland, which appear under the top five of the Financial Secrecy Index (FSI), a global mechanism that ranks jurisdictions on their provision of financial secrecy which takes into the norms that contribute to secrecy as well as the amount of financial secrecy that a jurisdiction supplies to the states the ranking system of the FSI accounts for domestic laws and the degree to which the jurisdiction activity supplies secrecy and though secrecy is central to ML, the secrecy of the current top ranked secrecy suppliers, Singapore, Hong Kong, Luxembourg and Japan are yet to earmarked for any AML contraventions or failure to meet the FATF recommendation standards.<sup>141</sup>

Although it is not a foolproof system, financial institutions and states that adhere to the recommendations of the FATF and demonstrate a strong commitment to combatting financial crimes reduce their risk of being black or greylisted.

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<sup>139</sup> De Oliveira 2018 *CL & SC* 159.

<sup>140</sup> Nanyun and Nasiri 2021 *JMLC* 242.

<sup>141</sup> Gallant (2024) *Symposium on IFFs: Grey-listing, global anti-money laundering regulation and the classic divide*.

## **Chapter 5: Avoiding greylisting by the Financial Action Task Force: best practices for states and financial institutions**

### ***5.1 Introduction***

The Financial Action Task Force (FATF) was the result of growing concerns of G7 member states about drug trafficking at the time. Its mandate was to curb the rise in illicit trade and the concomitant circulation of funds thus accumulated.

Since its inception, the FATF has shaped itself into a powerful financial governance regime. Countries around the globe rely on their tools to counter a variety of crimes such as transnational organised crime, terrorism, and weapon proliferation. With global leaders such as the United Kingdom and America leading the charge in terms of policy implementation, transformation, and prosecution of such crimes, most states have committed to meeting the standards set by the FATF. This has led to the formulation and implementation of legislation pertaining to ML/TF, and to the prosecution, sanctioning and fining of states and financial institutions found to be in contravention of FATF recommendations.

This chapter explores the legislation implemented in the USA and UK that has pushed these countries to the forefront in terms of shaping AML frameworks across the globe. In their continuous efforts to combat financial crime, these countries have helped formulate problems and craft solutions for all new members of the FATF to adhere to and hence, are remaking the globe in their image.<sup>142</sup>

### ***5.2 United Kingdom***

The UK is one of the foremost economies and early identifiers of the need to formally combat financial crimes such as AML/CTF through maintenance of rigorous regulatory frameworks.<sup>143</sup> The UK recognised from the onset that its commitment to combatting AML/CTF was essential to ensure financial stability and protect their

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<sup>142</sup> De Oliveira 2018 *CL & SC* 159.

<sup>143</sup> Srivastava, Simpson and Powell *International Guide to Money Laundering Law and Practice* 56.

national history. To that end, the UK has earned its place as a leader in the enactment and maintenance of the regulatory frameworks listed below:

- a. The money laundering, terrorist financing, and transfer of funds (information on the payer) regulations of 2017, which have become the cornerstone of the UK's AML efforts.
- b. Terrorism Act of 2000 as amended; and
- c. The Proceeds of Crime Act 2002 (POCA) as amended, a piece of legislation with far-reaching consequences in the form of seizures for those who contravene it.

These regulatory frameworks are the basis of the UK's prevention of AML/CFT and are discussed hereunder:

- a. The Money Laundering, Terrorist Financing, and Transfer of Funds (information on the payer) Regulations of 2007 (the MLR)

The initial Money Laundering Directive was initiated by the European Union (EU) in 1993. This was followed by the UK's implementation of the first MLR, which was promulgated in 1994 and has since undergone a few amendments. The MLR was formulated in order to ensure compliance with the POCA as it addresses the implication of AML/CFT accomplices.<sup>144</sup> The MLR scrutinises offenders as well as facilitators, i.e., those who are aware of the offense, but hides it or neglects it.<sup>145</sup>

The MLR impresses on professional bodies in finance and law the importance of knowing your customer (KYC). This requires that the professional body obtains information from corporates as well as individuals before entering into an agreement to render a service.

Knowing your customer entails obtaining the details of the counterparty and the subjects (person companies and their addresses). The effectiveness of this reporting system extends the duties of the business quarter. According to the money laundering regime of 2003, the principle of KYC is important for maintaining customer records and training staff, and failure to implement it may result in a

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<sup>144</sup> Van Jaarsveld 2004 *SA Merc LJ* 317.

<sup>145</sup> Wronka 2022 *JMLC* 663.

criminal conviction and a two-year sentence and fine under section 32(a).<sup>146</sup> The MLR sets out the requirements for supervisory bodies (there are currently 25) and their formation, and how they should conduct their activities.<sup>147</sup>

Three of the bodies as indicated in the requirements for supervisory bodies contained in the MLR are statutory and the remainder, a total of 22, are professional body supervisors (PBSs).<sup>148</sup> His Majesty's Treasury (HM's Treasury) is responsible for ensuring the effectiveness of the supervisory regime and engages regularly with the supervisors. HM's Treasury publishes an annual report on the performance of all supervisors, with the latest edition released in December 2023. "Statutory supervisors" is the term often used – including by the FATF in the UK's last assessment – to refer to the three public sector supervisors. The three statutory supervisors are:

- i. **The Financial Conduct Authority (FCA)**, which is the independent conduct regulator of financial services firms and financial markets in the UK. It supervises approximately 21 500 firms for compliance with the various MLRs as of December 2022. These are all financial services firms that include banks, electronic money institutions, and crypto-asset exchanges and custodian wallet providers. The FCA is responsible for supervising firms in its remit who also provide money service business or trust and company services.<sup>149</sup>
- ii. **The Gambling Commission (GC)** is the statutory AML/CTF supervisory authority for all online (remote) and land-based (non-remote) casinos operating in Great Britain or providing casino facilities to British customers, as well as money service business activities offered by these firms. The GC supervised 265 firms for compliance with MLRs in December 2022.<sup>150</sup>
- iii. **His Majesty's Revenue and Customs (HMRC)** is the statutory AML/CTF supervisor of several activities regulated under the MLRs.<sup>151</sup>

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<sup>146</sup> Section 7 of the *Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations, 2017*.

<sup>147</sup> HM's Treasury (2022) *Anti-money laundering and countering the financing of terrorism: Supervision Report 2020–22*.

<sup>148</sup> HM's Treasury (2022) *Anti-money laundering and countering the financing of terrorism: Supervision Report 2020–22*.

<sup>149</sup> HM's Treasury (2023) *Reform of the Anti-Money Laundering and Counter-Terrorism Financing Supervisory Regime*.

<sup>150</sup> HM's Treasury (2023) *Reform of the Anti-Money Laundering and Counter-Terrorism Financing Supervisory Regime*.

<sup>151</sup> HM's Treasury (2023) *Reform of the Anti-Money Laundering and Counter-Terrorism Financing Supervisory Regime*.

These three statutory supervisors sit alongside 22 PBSs, who supervise the implementation of AML/CTF laws and regulations. Regulations in the MLR have been noted to include conditions "significantly beyond the requirements set out in the European Union's Fifth Anti-Money Laundering Directive", while other countries may be less on the alert.", an observation that placed the UK at the forefront of the legal reform since the introduction of the MLR in 1993.<sup>152</sup>

b. *Terrorism Act* of 2000 as amended

The MLR regulations called for further legislation, and in 2000, the *Terrorism Act* was enacted. Part 3 of this piece of legislation sought to widen the definition of terrorist activities; this imposed further duties, which were related to disclosing information relating to terrorist financing.

The terror attacks that took place at the World Trade Centre in New York on 11 September 2001 served as a catalyst for the replacement and expansion of the duties mentioned above. These amendments are contained in the first three parts of the *Anti-Terrorism, Crime and Security Act* of 2001:

i. Part 1 – Terrorist property

- Part 1 and the first two Schedules guarantee that, if it is suspected that the funds available may be utilised for purposes of financing terrorism, the authorities may call upon investigative and freezing powers available for such purposes;
- Account monitoring orders were introduced to enable the police to demand that financial institutions produce account information of up to 90 days.
- The existing instruction to report knowledge or suspicion of terrorist financing was changed so that failure to report such knowledge or suspicion on 'reasonable grounds' was an offence.
- Law enforcement agencies were granted the power to seize terrorist cash anywhere in the UK; previously, law enforcement could only freeze assets once the suspect had been charged. Now, accounts can be frozen from the beginning of the investigation.<sup>153</sup>

ii. Part 2 – Freezing orders

This addition created the authority of HM Treasury to freeze the assets of overseas governments or residents who have taken, or are likely to take,

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<sup>152</sup> Pavlidis 2020 *J Invest Compliance* 2.

<sup>153</sup> Edmonds *Money Laundering Law* 7.

action to the detriment of the UK's economy, or action constituting a threat to the life or property of a national or resident of the UK and repealed the provision in the 1964 Act which allowed HM Treasury to freeze assets.

iii. Disclosure of information

The expansion of this subject under Part 3 emphasises the MLR provisions as far as the disclosure of information by statutory bodies such as HM Treasury, as well as those companies incorporated in the UK and restriction on the Secretary of state in sharing of information across the border when disclosure of information is required.

The *Proceeds of Crime Act 2002 (POCA)*

The POCA contains three main principles under sections 327, 328 and 329, which are considered offences:

- Section 327 – An offence is committed if a person conceals, disguises, converts, transfers or removes from the jurisdiction property which is, or represents, the proceeds of crime which the person knows or suspects represents the proceeds of crime.
- Section 328 – An offence is committed when a person enters into or becomes concerned in an arrangement which he knows or suspects will facilitate another person to acquire, retain, use or control criminal property and the person knows or suspects that the property is criminal property.
- Section 329 – An offence is committed when a person acquires, uses or has possession of property which he knows or suspects represents the proceeds of crime.<sup>154</sup>

The above codification and subsequent criminalisation of money laundering carries a possible 14-year imprisonment sentence if found guilty by either the Crown or Magistrate Court in addition to a fine.<sup>155</sup>

There have been various changes to these laws as per the directive of the EU. However, since 1997, the UK has remained at the forefront of legislative implementation of the directives and the legislation enacted, such as the POCA, has often been a more stringent and thorough legislation than the proffered recommendation, the MLR and POCA have furthermore become a blueprint for what is acceptable and deemed to be in compliance with the FATF recommendations.<sup>156</sup>

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<sup>154</sup> Edmonds *Money Laundering Law* 7.

<sup>155</sup> Wronka 2022 *JMLC* 664.

<sup>156</sup> Ryder *Money laundering an endless cycle?* 78.

### **5.3 United States of America**

As mentioned above, the USA has played a leading role in the global combat against money laundering and terrorism with its adoption of the National Anti-Money Laundering and Anti-Terrorism Strategy in the late 1970s. This strategy became the bedrock for the development of legal frameworks aimed at detection and prevention of financial crimes.<sup>157</sup> Initially, the USA promulgated the *Bank Secrecy Act* of 1970, which required that financial institutions collect customer information. This was followed by the *Financial Crimes Enforcement Network*, the *Money Laundering Control Act*, the *International Money Laundering Act* and, finally, the *Finance Intelligence, Analysis and Reporting Act*. We will take a look at what each of the above strategies, regulations and acts encompass in order to comply with the FATF regulations and which has led to the USA becoming a model for other states.<sup>158</sup> They are as follows:

a. The *Ban Secrecy Act* (BSA) of 1970

The BSA forms the basis of USA AML laws and was enacted in 1970. The objective of the BSA is to strengthen the measures taken by the USA to detect, prevent and prosecute money laundering and the financing of terrorism.

To carry out its objective, the BSA sets out the duties of financial institutions to collect, record, and report customer information. The BSA further sets out the reporting requirements for these reports containing currency transaction and suspicious activity reports.

In the year 2001, the *Patriot Act* was enacted to amend the BSA.

b. United State of America *Patriot Act* of 2001(*Patriot Act*)

The *Patriot Act* was enacted after the terrorist attacks of 11 September 2001 and amended the BSA.

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<sup>157</sup> Edmonds *Money Laundering Law* 7.

<sup>158</sup> Sanction Scanner (2024) *Anti-Money Laundering (AML) in United States of America*.

One of the amendments was section 326, which required financial institutions to establish a customer identification programme (CIP) to be incorporated into their AML compliance programmes as set out in the BSA. The CIP's main purpose was to serve as a vehicle to enable the financial institution to discover or establish the true identity of their customer or client.<sup>159</sup>

A further amendment was that financial institutions must obtain the information pertaining to the beneficial ownership of private bank accounts and any of their corresponding accounts in regard to certain foreign financial institutions.<sup>160</sup>

### c. Regulations

The USA has a singular AML regulator – the United States Department of Treasury's Financial Crimes Enforcement Network (FinCEN). As central reporting authority, FinCEN oversees the implementation of the BSA while collaborating with other agencies in preventing and investigating financial crimes.

The Office of the Controller of the Currency (OCC) regulates the national banks and federal savings and loan associations. It further plays a role in the BSA implementation and enforcement and oversees AML/CFT practices within financial institutions.

The USA AML framework took centre stage and has remained there since the War on Drugs began in the 1970s, which naturally lead to the adoption of "Follow the money" as a means of unearthing ML in the 1990s, "Follow the money" has therefore become a blueprint of sorts, states around the world have modelled their AML frameworks on same.<sup>161</sup>

## **5.4 Prosecution in money laundering contraventions**

As indicated previously, regulators are established to oversee professional bodies and assist with their reporting to the relevant statutory bodies. Historically, ML relied

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<sup>159</sup> *Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) (2014) Examination Manual 1.*

<sup>160</sup> Section 312 of the USA *Patriot Act*, 2001.

<sup>161</sup> Bernussi, Villela and Debatin 2023 *Journal of Global South* 30.

heavily on the services of non-financial operations as well as professions in the finance and legal sectors, i.e. accountants, realtors, lawyers, notaries, trust and company service providers, real estate agents and providers of gambling services and gaming, dealers of precious stones and metal, etc. These are sectors in which confidentiality is prized and the privileged client-attorney relationship can be relied on.<sup>162</sup>

Due to the above, financial institutions have been vulnerable and – whether wittingly or unwittingly – have been complicit in ML schemes due to the variety of services offered and their global reach in terms of expansion to different markets.<sup>163</sup>

#### **a. United States of America**

In the 1980s cash-reliant businesses such as laundromats were used to "clean" dirty money, acting as points of re-entry into the market as legitimate money. A similar method that made waves in the 70s and 80s was the Pizza Connection, where members of the Sicilian and American mafias used small pizzerias to distribute drugs and launder the illicit "pizza money" through.<sup>164</sup>

More recently in 2020, the FinCEN Files were leaked. These consisted of documents that contained suspicious transactions that had taken place between 1999 and 2017. More than USD \$2 trillion had been moved in alleged suspicious payments and 170 clients across the globe were flagged for their potential involvement in illicit transactions.<sup>165</sup>

The Files fingered five international financial institutions: JP Morgan Chase, HSBC, Standard Chartered Bank, Deutsche Bank and The Bank of New York Mellon Corporation who, according to the files, were complicit in the movement of cash for shadowy figures and criminal networks. The involvement of the HSBC came on the back of previous fines of USD 1.9bn for failures to stem Illicit Financial Flows (IFFs)

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<sup>162</sup> UNECA (2020) *United Nations Economic Development in Africa Report* 92.

<sup>163</sup> UNECA (2020) *United Nations Economic Development in Africa Report* 92.

<sup>164</sup> Arshinoff, Tassé and Humphreys *Global Finance and the Enablers of Corruption* 25.

<sup>165</sup> ICIJ (2021) *FinCEN Files*.

in 2012.<sup>166</sup> In their discussion of the case, Arshinoff, Tassé and Humphreys explained that the authorities recognised that the operation had exposed the American financial system to terrorists and corrupt regimes. However, the country opted for a fine over criminal prosecution, as the latter would result in the revocation of HSBC's banking license. This, in turn, would have dire consequences for the economy as employment would be affected.<sup>167</sup>

## **b. United Kingdom**

The UK has not experienced significant progress since 2008, when it was reported that the country was home to around 400 organised crime bosses with an amassed criminal wealth of approximately £400 million, which represented approximately 2% of the UK's GDP.<sup>168</sup> According to the UK's Economic Crime Plan for 2019-2022, the National Crime Agency had estimated in its 2019 assessment that the cost of organised crime in the UK was £37billion and that 4542 known organised crime groups were operating in the UK.<sup>169</sup> The forementioned indicates that though there are AML/CTF frameworks in place in states as developed as the UK, there are still gaps in the legislation and enforcement thereof. These gaps are made evident in that, despite the UKs' strict framework for AML/CTF, the codification and criminalisation thereof, along with the establishing of bodies which regulate and oversee professional bodies that have been historically found to be susceptible to unscrupulous parties seeking to utilise these professionals in those sectors for purposes of ML/TF, reports of AML/CTF due to organised crime can still be of the value of £37billion.<sup>170</sup>

In two recent matters, one of the PBSs, namely, the Solicitors Regulatory Authority (SRA) appeared before the Supreme Court to appeal the findings of the High Court in two matters:<sup>171</sup>

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<sup>166</sup> Arshinoff, Tassé and Humphreys *Global Finance and the Enablers of Corruption* 25.

<sup>167</sup> Arshinoff, Tassé and Humphreys *Global Finance and the Enablers of Corruption* 25.

<sup>168</sup> Sproat 2024 *JMLC* 134.

<sup>169</sup> Arshinoff, Tassé and Humphreys *Global Finance and the Enablers of Corruption* 25.

<sup>170</sup> HM's Treasury (2023) *Reform of the Anti-Money Laundering and Counter-Terrorism Financing Supervisory Regime*.

<sup>171</sup> Taylor 2024 *Spotlight on Corruption*.

- i. In 2014, Dentons UK and its Middle East subsidiary sought to conclude a property transaction through a holding company for their client, the chairman of a state-owned bank in a former Soviet Union territory. The transaction was valued at £7.9 million and partly funded by a donation of £800,000 from a company owned by an associate of Dentons' client.
- ii. A sole practitioner, who was found by the tribunal to have committed professional misconduct, had purchased a London hotel valued at £27 million in 2017 on behalf of their Iraqi client. The hotel would be partially funded through a company in Dubai owned by the Iraqi minister's brother. In 2018, the sole practitioner was instructed to purchase a home in London by using proceeds to be made from the expected sale of land in Iraq that belonged to a business associate.

Both cases illustrate the importance of a solid legal framework and regulators to oversee the enforcement of the legislation passed in order to remain abreast of the dangers of AML/TF. In two varying instances where Denton's may have a large number of staff and perhaps that translates to resources and the actions of a sole practitioner, both parties fell short when there was a requirement to initiate proper source of wealth and funds checks in relation to individuals from high-risk states seeking to purchase multi-million-pound properties in the UK.

## **5.5 Conclusion**

The G7 initiated the formation of the FATF with the UK and USA at the helm and in the formative years of the FATF, the USA lead the legal questions working group for AML efforts, these working groups were responsible for indicating a set of recommendations for the improvement of the legal systems of the global community.<sup>172</sup> In addition to the influence exercised above, the USA lead the 9/11 Commission when it came to being due to the attacks of 11 September 2001 on the World Trade Centre.<sup>173</sup> A further indication of the influence the USA and UK have had in shaping AML frameworks across the globe is in the process new members joining the FATF. New members of the FATF must commit to the adoption of a set of norms previously agreed to by existing members. by virtue of being the states that have the most influence over the FATFs' policies and regulations as same was drafted and approved by the UK, EU and USA, to be a vehicle through which the

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<sup>172</sup> Ekwueme 2022 *JMLC* 476.

<sup>173</sup> Ekwueme 2022 *JMLC* 470.

forementioned states project their principles, laws, rules and regulations on the rest of the globe.<sup>174</sup>

Through their initial involvement in the FATF and the policy-writing of the FATF, the USA and the UK have cemented their positions as global leaders in terms of their national adoption of AML criminal laws and law enforcement agencies. This includes a rigorous assessment of national police and judicial systems, surveillance and data retention systems, regulations to the financial services industry, and the establishment of international police cooperation agreements.<sup>175</sup> This expectation is set despite the fact that the global majority does not have the resources nor the influence of the UK and the USA to continuously develop the abovementioned aspects without significant investment from developed states and institutions such as the IMF and WB.

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<sup>174</sup> De Oliveira 2018 *CL & SC* 159.

<sup>175</sup> Bernussi, Villela and Debatin 2023 *Journal of Global South* 35.

## Chapter 6: Conclusion and Recommendations

### 6.1 Introduction

The premise of this research was to explore the impact that greylisting by the FATF has had on international trade by utilising the FATF's recommendation as a benchmark for compliance. From the time of its inception, the FATF's fight against IFF has been shaped by a small group of states, mainly situated in the global west. The USA, UK and EU have shaped AML frameworks across the globe by formulating the problems and their solutions into regulations that prospective new members must adhere to. Through this, these states – often named the "Great Powers" – have remade the globe in their image.<sup>176</sup>

The formulation of regulations and policies by the Great Powers and the institutions that lend credence to the grey list, such as the WB and IMF, have made the FATF a force of reform when it comes to combating AML/TF. However, for countries in the Global South, their dependency on the WB and the IMF raises obstacles once they are greylisted. A study conducted by the IMF found that, once listed, a state may experience lower cash flow, which affects the growth rate of the economy.<sup>177</sup> In addition, these states may face difficulties when seeking to interact with the WB and IMF.<sup>178</sup>

The fight against AML/TF has seen a disproportionate number of states in the Global South included on the FATF's grey list. These states very often have great mineral resources, but little to no financial resources due to their history of colonisation. It has been reported that the continent of Africa suffers a loss of 25% GDP, the equivalent of USD148 billion, per annum due to ML and corruption whereas, globally the estimate is set at USD 1 trillion.<sup>179</sup>

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<sup>176</sup> De Oliveira 2018 *CL & SC* 159.

<sup>177</sup> Kida and Paetzold 2021 *The Impact of Gray-Listing on Capital Flows*.

<sup>178</sup> FATF March 2022 <https://www.fatf-gafi.org/en/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-march-2022.html>.

<sup>179</sup> Ekwueme 2022 *JMLC* 468.

This is further compounded by the globalisation of financial institutions and the need to keep up with modern banking practices. States in the Global South are always attempting to catch up with such practices and with the legislation put forth by the Great Powers to improve compliance with FATF recommendations. The Great Powers are in the global west and have access to resources not readily available in the Global South, which is further compounded by financial institutions that have their main branches in the Global West with a purview of the funds moving in and out of states in the Global South to other banks outside of their borders and, more often than not, in the Global West.<sup>180</sup>

To illustrate the above, when the Panama papers from a Panamanian law firm were leaked in 2016, it revealed that close to 50% of the institutions named had been incorporated in the UK and its offshore territories, indicating that the UK played a significant role as a safe haven for IFFs.<sup>181</sup> An even stronger argument can be made for a tiered approach to evaluation and being placed on the grey list when it comes to developing economies as they do not have the resources or funds of the Global West and yet, the UK – an active, compliant member of the FATF with effective money laundering frameworks – could still be proven susceptible.<sup>182</sup>

It is important to remember that, for developing economies, increasing revenue and economic viability requires opening up their markets to allow foreign investment and trade. Estimates by Global Financial Integrity showed that about 3% to 5% of the IFFs in the African continent consist of corrupt activities such as bribery and embezzlement; criminal activities such as drug trafficking and smuggling constitute about 30% to 35%; and a whopping 60% to 65% of all IFFs are commercial transactions by multinational companies.<sup>183</sup> The most common IFFs conduit is multinationals in developing economies who utilise financial institutions familiar to

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<sup>180</sup> African Union (2021) *Illicit Financial Flow Report of the High Level Panel on Illicit Financial Flows from Africa 24*.

<sup>181</sup> Al-Emadi 2021 *JMLC* 758.

<sup>182</sup> Al-Emadi 2021 *JMLC* 758.

<sup>183</sup> African Union (2021) *Illicit Financial Flow Report of the High Level Panel on Illicit Financial Flows from Africa 24*.

their respective western states to facilitate their business undertakings. Hence, illicit money is most often moved via international trade.<sup>184</sup>

## **6.2 Recommendations**

In Chapters 1 to 5, we looked at the inception of the FATF, their aims and objectives, their recommendations for the prevention of AML/CTF, the repeated failings of certain regions to comply with FATF recommendations, and what may be considered successful interpretations of FATF recommendations.

The failings of emerging economies to comply with FATF recommendations must be attributed to more than a lack of interest from its leaders; the countries who established and maintain the FATF order are also at fault. Institutions in the developed states fail to raise alarms when IFFs appear in their records. Developing or emerging economies do not have the resources to invest in full implementation of FATF frameworks, and the FATF has full knowledge of the impact of such failure on the international trade of a non-compliant state. Morse<sup>185</sup> conducted a study on the reduction of bank inflows and growth in cross-border liabilities in a group of 39 countries over a period of five years. The study found that there was a decrease of up to 16% in bank inflows. A similar study by Kida<sup>186</sup> discovered a capital inflows decline of 7.6% in the average GDP of a greylisted state, which has negative consequences for the citizens of the greylisted state as well as stunted growth in their GDP as a result of corruption and IFFs through ML/TF.

In light of the impact of greylisting on emerging economies and their ability to take part in global trade, the relevant FATF regional bodies must be proactive and request data from financial institutions. They should also establish a body dedicated to overseeing regulatory bodies in the region that will track the progress of emerging economies and determine the need for a more stringent AML/CTF framework, and relevant regulatory bodies to implement said framework.

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<sup>184</sup> African Union (2021) *Illicit Financial Flow Report of the High Level Panel on Illicit Financial Flows from Africa* 66

<sup>185</sup> Morse 2019 *International Organization* 537.

<sup>186</sup> Kida and Paetzold 2021 *The Impact of Gray-Listing on Capital Flows* 5.

Furthermore, the PBSs that have memberships of multinationals – as would be the case with financial institutions, legal firms and even estate agents with headquarters within the jurisdictions of developed economies and with good AML/CTF frameworks in place (i.e. UK, USA, Austria, Germany, Belgium, France, Switzerland, etc.) – must have proper regulatory bodies in place that enforce the legislative framework and can account for the commercial relationships established within emerging economies. This would facilitate cooperation to expedite the flagging of irregular patterns or possible suspects and – in the event of asset seizure – how the funds may be expatriated to the developing economy for reinvestment. The regulatory bodies must require reports of suspicious conduct to flag possible concerns, submit the associated reports, and engage in continuous evaluation by the regulator, as PBSs remain vulnerable. The FATF, financial institutions and other PBSs must – in addition to equipping emerging economies with knowledge through shared information, best practices, etc. – the IMF and WB must generate a fund to aid these efforts so that states can build their capacity and strengthen their legal frameworks, further assisted by cross-country learning.

### **6.3 Conclusion**

The practice of greylisting has alienated emerging economies. Various studies have shown that greylisting has notable economic implications, including:

- a) A reduction of approximately 2% in the ratio of foreign direct investment into GDP, which increases with blacklisting, (e.g. North Korea and Myanmar);
- b) A loss of up to 10% in payments to the listed country from countries not listed;
- c) Up to 16% decrease in cross-border liabilities; and
- d) A decline in average capital inflows of close to 8% of GDP if a state is greylisted, declines of 3% in direct investment inflows, 2.9% in portfolio inflows, and close to 4% in other investments.<sup>187</sup>

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<sup>187</sup> Al-Emadi 2021 *JMLC* 759.

The financial consequences set out above are the stark reality of the penalties meted out to greylisted states. None of the 98 states that appeared on the grey list since its inception was countries with developed economies. Due to infrastructural needs, emerging economies are perpetually at the mercy of international monetary institutions such as the IMF and WB, who support and provide monetary assistance to the FATF, which is partially based on a country's compliance with FATF recommendations. Developed economies seem to go unpenalised.

The Financial Secrecy Index issued by Tax Justice Network in 2022, placed Switzerland and the USA in the top two positions in terms of financial secrecy.<sup>188</sup> This secrecy policy does not align with the AML/CFT framework required by the FATF; the FATF highlights the need for information sharing, gathering of data in the KYC process, and identifying the UBO of organisations. The latter is important for establishing sources of wealth and where it goes to demystify the penchant for complex financial structures routed through multiple corporate vehicles or trusts.<sup>189</sup>

It is an established fact that that secrecy allows ML/TF and other IFFs to flourish. Yet, as mentioned before, the majority of countries in the top 10 of the Financial Secrecy Index are in the West and developed economies. With the UK's appearance in the Panama papers, it was made obvious that an effective AML/CFT framework does not prevent the occurrence of money laundering and other commercial crimes through professional bodies, in real estate, finance and law. However, these revelations were not enough to place these developed economies (also founders of the FATF, IMF and WB) under scrutiny for potential greylisting, which raises the question of the impartiality of the FATF in its standardised application of its own recommendations. Those worst affected by the consequences of greylisting are, unfortunately, the poorest developing economies, and the process creates an endless polarity of states with power and those without.

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<sup>188</sup> Tax Justice Network 2022 *Financial Secrecy Index*.

<sup>189</sup> Gallant 2024 *Symposium on IFFs: Grey-listing, global anti-money laundering regulation and the classic Divide 3*.

The FATF is necessary to curtail the rampant criminality of ML/TF and related crimes with a view to building a sustainable, equitable global economy. However, with the stark inequalities between the countries of the world, this inevitably requires a level of sharing of resources and knowledge. The FATF greylisting process must be more transparent, as much of the IFF laundering ascribed to developing economies on the grey list can be traced back – at least partially – to developed economies in the West and, more recently, Middle Eastern and Asian states. This must change, and parading poor countries on and off the grey list will not achieve this. What would change the status quo is if secrecy havens in some of the richest nations in the world were made to answer to an equally enforceable set of standards or risk similar damage to their international trade and reputations.

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