Risk Assessment: divergence in theory and practice

Expert Hub, Den Haag, 23-35 January 2018

Ben Evans, Co-founder and Director
Our Learning Objectives

• Learn what FATF says about risk assessments and linked requirements

• Understand how this is being interpreted in practice

• Identify different approaches to country-level implementation

• Consider their advantages and disadvantages

• Identify factors which may influence civil society’s engagement strategy

• Brainstorm relevant engagement strategies

• Identify which strategy would work best in you country
The Theory:
What R8 and IO.10 require.
“Not all NPOs are high risk, and some may represent little or no risk at all.”

The *International Best Practices: Combating the Abuse of Non-Profit Organisations* (FATF (2015))
The Detail
Methodology

FOR ASSESSING TECHNICAL COMPLIANCE WITH THE FATF RECOMMENDATIONS AND THE EFFECTIVENESS OF AML/CFT SYSTEMS

February 2013

FATF Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems

(FATF 2013)

Updated June 2016
The R8 Compliance Steps

- National Risk Assessment (R1.1)
- NPO Sector Risk Assessment (R8.1(a)(b))
- Review of Measures (R8.1(c))

All references are to paragraphs in the *Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems* (FATF (Updated 2017))
1. Assessing risks and applying a risk-based approach

Countries should identify, assess, and understand the money laundering and terrorist financing risks for the country, and should take action... aimed at ensuring the risks are mitigated effectively.
8. Non-profit organisations
Countries should review the adequacy of laws and regulations that relate to non-profit organisations which the country has identified as being vulnerable to terrorist financing abuse. Countries should apply focused and proportionate measures, in line with the risk-based approach, to such non-profit organisations to protect them from terrorist financing abuse, including:

(a) by terrorist organisations posing as legitimate entities;

(b) by exploiting legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset-freezing measures; and

(c) by concealing or obscuring the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.
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Without prejudice to the requirements of Recommendation 1, since not all NPOs are inherently high risk (and some may represent little or no risk at all), identify which subset of organizations fall within the FATF definition of NPO, and use all relevant sources of information, in order to identify the features and types of NPOs which by virtue of their activities or characteristics, are likely to be at risk of terrorist financing abuse.
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Methodology: 8.1.(b)

Countries should...(b) identify the nature of threats posed by terrorist entities to the NPOs which are at risk as well as how terrorist actors abuse those NPOs;
Methodology: 8.1.(c)

Countries should...(c) review the adequacy of measures, including laws and regulations, that relate to the subset of the NPO sector that may be abused for terrorism financing support in order to be able to take proportionate and effective actions to address the risks identified.
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Countries should...(d) periodically reassess the sector by reviewing new information on the sector’s potential vulnerabilities to terrorist activities to ensure effective implementation of measures.
Terrorists, terrorist organisations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the NPO sector.

10.2. To what extent, without disrupting legitimate NPO activities, has the country implemented a targeted approach, conducted outreach, and exercised oversight in dealing with NPOs that are at risk from the threat of terrorist abuse?
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10.2. To what extent, without disrupting legitimate NPO activities, has the country implemented a targeted approach, conducted outreach, and exercised oversight in dealing with NPOs that are at risk from the threat of terrorist abuse?
10.(a).4. Examples of Information that could support the conclusions on Core Issues:

4. Information on sustained outreach and targeted risk-based supervision and monitoring of NPOs that the country has identified as being at risk of terrorist financing abuse (e.g. frequency of review and monitoring of such NPOs (including risk assessments);...
The R8 Compliance Steps

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NPO Sector Risk Assessment (R8.1(a)(b))

Review of Measures (R8.1(c))

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Applying it in Theory
1. Assessing risks and applying a risk-based approach

...countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified.

This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk-based measures throughout the FATF Recommendations.

Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions.
The National Risk Assessment

(see also the World Bank and IMF methodologies)
NPO Sector Risk Assessments and Reviews

**FATF says almost nothing about how they should be done...**

C(5). *These exercises could take a variety of forms and may or may not be a written product.*

*(Interpretive Note to Recommendation 8)*

15. *Elements of a country’s domestic sector review could include: the size, type, and scope of NPOs, their activities, their donor base, cross-border activity and financing, movement of funds, means of payments, type and location of activities engaged in, services provided, and the level of risk associated with these elements.*

*(Best Practices Paper)*
What is Risk?

Figure 1. Threat + Vulnerability = Risk

- **Threat**
  - Organisational
  - Sectoral

- **Vulnerability**
  - Organisational
  - Sectoral

- **Risk**
  - Legitimate NPO is exploited
  - Sham NPO enters the sector

*International Best Practices: Combating the Abuse of Non-Profit Organisations (FATF (2004))*
Risk Factors in the NGO Sector

NPO Sector Strength / Vulnerability Matrix

VULNERABILITY/ HIGH RISK

INFREQUENT

High Public Trust

Humanitarian disaster

Decentralized

Mission Focused

STRENGTH/ LOW RISK

FREQUENT

Rich

Self-regulation

Proximity to low Governance

Proximity to high risk area or communities

Low Governance

Service Provision

Unregulated
Helpfully, it does emphasise consultation.

See:

• Introduction to *Methodology*
• 8.2 (c) of *Methodology*
• Immediate Outcome 1:
  – 1.6, 1(a)3, 1(b)6
• And your handouts.
Assessments (in Theory):
What FATF says about assessing R8, IO.10 and the RBA
## Technical Compliance Rating System

<table>
<thead>
<tr>
<th>Rating</th>
<th>Code</th>
<th>Description</th>
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<tbody>
<tr>
<td>Compliant</td>
<td>C</td>
<td>There are no shortcomings.</td>
</tr>
<tr>
<td>Largely compliant</td>
<td>LC</td>
<td>There are only minor shortcomings.</td>
</tr>
<tr>
<td>Partially compliant</td>
<td>PC</td>
<td>There are moderate shortcomings.</td>
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<tr>
<td>Non-compliant</td>
<td>NC</td>
<td>There are major shortcomings.</td>
</tr>
<tr>
<td>Not applicable</td>
<td>NA</td>
<td>A requirement does not apply, due to the structural, legal or institutional features of a country.</td>
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FATF Private Sector Consultative Meeting (PCSF)
  - Vienna, March 22nd 2017.

- 1 Day Side Meeting on the revised R8 and IO.10

- Attended by:
  - FATF Staff and FSRBs
  - Government and inter-governmental officials
  - NPOs
  - Invited experts

- Chatham House rules
7 Key Takeaways on Risk Assessments

• Different forms of RA are possible, and there is no preferred methodology. The key point is that the country can show that it understands the risks

• Countries should update the RA periodically as the risk changes

• Risks differ from countries but also within countries, depending on areas/regions

• Consultation and inclusiveness enriches all RA, evaluations and follow ups.

• Many misconceptions still exist: that NPOs are particularly vulnerable; that more regulation is the key to a good assessment; that MEs will focus on laws and regulations as opposed to ‘other measures’ (policy, outreach and self-regulation)

• Govs need to do lot more engagement with smaller NPOs: not just engage with usual counterparts

• Government should Coordinated outreach to NPOs at the national level, so as not to overburden NPOs
7. Assessors should use the country’s own assessment(s) of its risks as an initial basis for understanding the risks, but should not uncritically accept a country’s risk assessment as correct, and need not follow all its conclusions. ...There may be cases where assessors cannot conclude that the country’s assessment is reasonable, or where the country’s assessment is insufficient or non-existent.

Introduction to Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems
Quality and Consistency

The Mutual Evaluation Process

Getting started
Selection of the experts who will form the assessment team.

Technical review
The country provides all relevant laws and regulations to prevent criminal abuse of the financial system.

Assessors analyse the laws and regulations, primarily looking at the technical requirements of the FATF Standards.

Scoping note
The assessors identify areas of focus specific to the country’s context for the on-site visit.

The country can comment on the scoping note.

Draft mutual evaluation report
Which covers both technical compliance and effectiveness.

Assessors draft their findings on how well the country has implemented the FATF Standards, and whether their efforts deliver the right results.

On-site visit
The assessors travel to the country. During two weeks they meet with public and private sector to see how the laws work in practice and look for evidence that they are effective.

The draft report goes through various cycles of discussion and review by the assessed country and independent reviewers.

FATF Plenary adoption
The FATF Plenary discusses the findings, including the ratings and recommended actions, and adopts the final report for publication.

The members of the FATF Global Network, representing 198 countries, review the report for technical quality and consistency.

Publication
The final report: in-depth analysis & recommendations for the country to strengthen its measures to prevent criminal abuse of the financial system.

A mutual evaluation report is not the end of the process. It is a starting point for the country to further strengthen its measures to tackle money laundering and the financing of terrorism and proliferation.

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Assessments (in Practice): What MERs are telling us
### Evaluation Case Study: Norway v Ethiopia

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- Norway: ✔️
- Ethiopia: ✗

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[Greenacre Group Logo]
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**R8 Compliance Rating**
ECNL Analysis of Mutual Evaluations

• **Risk** is the core of FATF standard - increasingly in the latest MERs published in 2016

• If the government **did not** carry out risk assessment or risk-based approach, the country would likely **not be compliant with R8**
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<td><em>should conduct a formal review of the entire NPO sector in order to identify those NPOs falling within the relevant FATF definition, and identify NPOs that could potentially pose a higher FT risk</em></td>
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<td>Austria</td>
<td>PC</td>
<td><em>does not have a targeted, interagency coordinated approach to TF risks.... has not reviewed the adequacy of laws and regulations that relate to entities that could be abused for TF... No domestic sector review of its NPO sector, or periodic reassessments.</em></td>
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The Reality:
How R8 and IO.10 are being implemented
Case Studies: Discussion Points

1. Any general comments or observations?

2. what are the pros and cons, opportunities and risks?

3. How practical is this as a potential means of engagement?

4. Do you have any relevant experiences to share?
Methodological issues

• The RBA approach of FATF is fundamentally unproven

• The false dichotomy implied by the ‘At Risk’ concept. *Might a spectrum or venn be better?*

• The tests are not sensitive or specific.

• (rare events) x (big population) x (insensitive tests) = false positives

• The difference between ‘risk’ and ‘consequence.’ *Risk may or may not crystallize.*
Data issues

- Little or no hard data
- Confidentiality
- Circular categorisation
- Discrepancies between organisational and functional categories
- Is the evidence that supported the assessment strong enough to support its publication, bearing in mind the potential results?
Problems with Outcomes

• Lack of data defaults to high risk perception. *Strong incentives for governments to take a low risk-approach.*

• It is difficult to envisage how some types of sub-categories may be effectively targeted for new or enhanced regulation.

• Singling out. *Stigmatization of those identified as ‘at risk’ – by regulators, by funders, by the public and by bankers.*
Case Study 1: Australia (NRA)

Key features of the Australian terrorism financing environment

A risk to Australia’s national security

Terrorism financing is a risk to Australia’s national security, financial system, commercial organisations and not-for-profit organisations (NPOs). Primarily, terrorism financing is a national security risk as it can directly enable terrorist acts both in Australia and overseas. In Australia, individual have been convicted of terrorism offenses and funds have been raised to support domestic activity and overseas terrorist groups.

In addition to funding individual terrorist attacks and operations, terrorism financing helps establish and maintain terrorist groups in Australia and foreign countries and sustains the networks that connect them. Terrorism financing supports the least visible aspects of a group’s operations by paying for daily living expenses, travel, training, propaganda activities, organisational costs, and compensation for wounded fighters or the families and dependents of terrorists who have died.

Terrorism financing also poses significant risks to any organisation involved in the activity, even if their involvement is unwitting. It can severely damage the reputation of financial institutions involved as part of the process, the integrity and work of non-government organisations such as charities and humanitarian groups can be seriously undermined if they are misconstrued as a cover for terrorism financing activity.

Commingling legitimate funds with funds collected for terrorist groups. This is especially the case for donations collected through charities and NPOs. Commingling can disguise funds raised for terrorism financing among legitimate donations. It can also add to the total pool of funds directed towards a terrorist group.
Case Study 1: Australia (NRA)

Current and emerging terrorism financing channels

In the short to medium term a number of channels are likely to pose an increased risk of being misused for terrorism financing.

- **Self-funding** from legitimate sources being used to pay travel and living expenses for Australians to fight alongside terrorist groups overseas. Family and associates in Australia have also knowingly or unwittingly transferred their own legitimately obtained funds to persons engaged in conflict. This is also a significant risk that will continue to fund the activities of any lone wolf extremists within Australia. Lone wolf extremists act alone to plan or carry out violent acts in support of a group or ideology, without support or assistance from any group.

- **Charities and NPOs** may be used to raise funds for groups engaged in foreign conflict and as a cover to transfer funds offshore. Funds for legitimate humanitarian aid may also be diverted in Australia, or at their destination, and used to support terrorist groups.

Online payment systems may be used to collect donations and transfer funds to extremists in Australia and overseas. The use of online payment systems may correspond with the use of social media by terrorist groups and extremists to radicalise, recruit and communicate with sympathisers.

- **Stored value cards** and **cred/debit cards** may be used by Australians linked to foreign terrorist groups to access funds overseas.

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Case Study 1: Australia (NRA)

The risks associated with the misuse of charities and NPOs are high as these organisations offer the capacity for groups to raise relatively large amounts of money over time.

Charities and not-for-profit organisations

Some Australia-based charities and NPOs have been exploited by terrorist groups to raise relatively large amounts of money over time. These organisations can be exploited in a number of ways:

- Charities and NPOs can be used to disguise international funds transfers to high-risk regions.
- Funds raised for overseas humanitarian aid can be earmarked with funds raised specifically to finance terrorism.
- Funds sent overseas for charities with legitimate intentions can also be intercepted when they reach their destination country and tightened off for use by terrorist groups.
- The risks associated with the misuse of charities and NPOs are high as these organisations offer the capacity for groups to raise relatively large amounts of money over time. However, this risk should be considered in the context of the relatively low incidence of terrorism financing in Australia, and the low value of funds suspected to have been raised in Australia to date, while charities and NPOs are one of the more significant Australian terrorism financing channels. They have not featured in a large number of Australian terrorism financing cases. Rather than representing a sector-wide risk, terrorism financing in Australia has been limited to a handful of charities and NPOs.

Self-funding from legitimate sources

Domestic charities and NPOs are at risk of being misused by overseas terrorist groups which have a supporter base among communities in Australia. Some donors may willingly provide donations to support the groups, while others donate, and the charities themselves, may be coerced, extortion or misled about the purpose of funding.

Charities and NPOs which operate in cities and war zones overseas are at risk of being infiltrated and exploited by terrorist groups in these areas. Funds sent to Syria and neighbouring countries for humanitarian aid are at increased risk of being used for financing terrorism if they are sent through less established or start-up charities and NPOs.

Those wanting to send funds to Syria for family and humanitarian purposes are advised to do so by donating to a United Nations humanitarian agency or to an Australian humanitarian organisation, the Australian Council for International Development website www.aidinternational.org.au is a number of Australian humanitarian organisations accepting donations for humanitarian aid in Syria. Further information on providing financial support to family, friends or humanitarian efforts in Syria is available at www.livingguitgether.org.au.
“No comprehensive reviews were undertaken in order to identify the features and types of NPOs that are particularly at risk of being misused for TF or other forms of terror support.”