
Editorial: Regulatory impact assessment: towards a better approach for the FATF

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The Financial Action Task Force (FATF) was not planned to develop into the global standard-setting body for anti-money laundering and counter financing of terrorism and proliferation (AML/CFT/PT). Its initial 1990 Recommendations – later known as the Forty Recommendations – were simply recommendations for countries on measures to be adopted to prevent money laundering in their financial systems. These initial recommendations were not the result of exhaustive research but was simply informed by the experience and wish lists of a small group of experts (De Koker and Turkington, 2016). Neither did the FATF give a lot of thought to their actual impact on the relevant offences or to any potential negative consequences that may flow from the implementation of the recommendations.

Timing; the strategic alignment with international objectives relating to terrorism, anti-corruption and proliferation; its peer review mechanism; and its leverage of economic penalties against non-compliant jurisdictions helped to position the FATF as a global financial standard-setter whose non-binding standards are hard “soft law” that countries ignore at their peril. Little has however changed in the way in which the FATF sets its standards. Primary reliance is still placed on expertise of the FATF member delegations rather than research and objective analysis. This increases the chances that standards may fail to deliver on policy objectives and may have unintended negative consequences. I, therefore, believe that FATF should embrace regulatory impact assessment (RIA) and should do so as part of a more evidence-based standard-setting process.

Since the publication of the 1990 FATF Recommendations, RIA has emerged as an important element of an evidence-based approach to policymaking. RIA is defined by the OECD as “a systemic approach to critically assessing the positive and negative effects of proposed and existing regulations and non-regulatory alternatives” (OECD, 2022). RIA approaches are not novel. The OECD has, for example, formulated RIA best practices as far back as 1997 (OECD, 1997), and today some form of RIA has been adopted by all OECD members (OECD, 2022). The OECD-housed FATF, therefore, does not have reach far to access expertise on RIA.

The absence of such assessments when FATF standards are formulated limit regulatory options when countries undertake their national RIAs: Negative consequences that are baked into the FATF standards cannot be easily avoided, and countries are faced with the option to either fail to comply with a FATF standard or to comply while attempting to limit the negative consequences within the limited space allowed by the standard. While such tensions cannot be avoided entirely, they can be limited if the FATF ensured that its standard-setting processes are informed by RIA.

RIA is not a silver bullet. The assessments are often complex, especially where data is absent. RIA will certainly be challenging for the FATF as the assessments will have to be performed at a global level. RIA will, however, identify potential impacts and will inform the design of appropriate standards that can effectively and efficiently impact money laundering and the financing of terrorism and proliferation. Importantly, it can help the FATF to identify potential unintended consequences, allowing them to avoid these.



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The FATF is clearly concerned about such unintended consequences. In February 2021, the FATF Plenary launched a project to analyse the unintended consequences of the implementation of the FATF standards (FATF, 2021). The project focused on four broad themes: de-risking, financial exclusion, undue targeting of nonprofit organisations and impacts on human rights (with a focus on due process and procedural rights). The selection of these themes was informed by FATF interest and what it viewed as one of the greatest concerns. Regrettably, the FATF published only a high-level summary of the project reports (FATF, 2021), depriving researchers of the opportunity to study and engage the FATF's analysis of these important issues.

The project did not amount to a structured impact assessment and the project team did not attempt an exhaustive academic analysis of the relevant issues (FATF, 2021). It does, however, reflect the FATF's concern about the unintended negative consequences of the implementation of its standards. The FATF's concern about the effectiveness of the implementation of its standards has also been increasing over the past decade. The limited evidence of the positive impact of AML/CFT measures on money laundering and terrorist financing calls for further interrogation and a consideration of the strategic direction of the FATF (Pol, 2018). It is furthermore not clear that the strategies of the past are ideal strategies to mitigate the risks posed by new technologies and virtual assets (De Koker and Goldbarsht, 2022). RIA can assist in identifying relevant issues, interrogating policy options and providing some answers to inform effective and efficient FATF standards.

The absence of an impact assessment was evident in the FATF's 2020 adoption of new risk assessment standards relating to proliferation financing linked to targeted financial sanctions of the United Nations Security Council. In the past, regulated institutions simply scanned names of sanctioned entities against the names of customers and parties to transactions to identify potential breaches. The new standards require countries and all AML/CFT-regulated institutions to assess their risk of proliferation financing abuse in relation to Iran and North Korea, and enhance their risk mitigation measures, where appropriate.

While the risk of proliferation of weapons of mass destruction certainly justifies standards that require risk assessment and risk mitigation by jurisdictions, it is less evident that proliferation financing risk assessment by all regulated institutions is warranted or will be effective. Effective proliferation financing risk assessments are complex and require a level of technical expert and some geopolitical insights that are not readily available to most small, regulated institutions. Furthermore, the assessment requires them to differentiate between general proliferation and proliferation financing breaches – that fall outside FATF's scope – and proliferation financing breaches in relation to Iran and North Korea, which are within the FATF's cope. Many of these are not likely to be abused for sanctions breaches relating to Iran or North Korea. The new standards, therefore, give rise to a real risk of low levels of compliance and an even lower quality of compliance where institutions undertake such assessments. The standards impose expensive compliance obligations may add little to mitigating proliferation risks.

In addition, the measures may be accompanied by unintended negative consequences, such as de-banking of smaller institutions that are less likely to perform appropriate risk assessments and may therefore be deemed by global banks to pose an unacceptable risk. There is also the likelihood that higher compliance expenses may create cost barriers that increase financial exclusion levels, thereby undermining the United Nations' Sustainable Development Goals.

These consequences apparently did not receive significant attention while the draft amendments were discussed among FATF members. The draft amendments were released

for public comment, and it was only during this phase that a small group of academics and civil society representatives raised these concerns (De Koker, 2020). The public consultation phase was, however, at a late stage in the standard-setting process and FATF members were reluctant to re-open drafting negotiations. As a result, the FATF acknowledged the concerns and responded with minor amendments, including inserting a potential exemption of relevant regulated institutions where national regulators assess the level of proliferation financing risk as low. While these amendments are welcomed, they are unlikely to address the concerns that were raised. An impact assessment earlier in the process, on the other hand, could have informed drafting that lessened the risk of unintended consequences while increasing the effectiveness of the new changes.

RIA is not a technical or bureaucratic hurdle. Though often flawed, these assessments remain valuable mechanisms that inform sensible regulatory policy. The FATF will benefit from that support and the FATF's global stakeholder community will reap the fruits of a more evidence-based approach to integrity standard-setting.

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