A ‘Risky’ Risk Approach: Proportionality in ML/TF Regulation

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Introduction: Risk, protection and proportionality

Looking back over the past half century, industrialised countries have gone through an interesting transition: from welfare state to a risk control society. One form of risky conduct most worrying to the authorities was the recreational use of psycho-active substances, a concern with long historical roots.[1] Correlated with this development was the stark increase of crime or, at least, deviant and risk-seeking conduct. To manage these risks requires action by the State, however, such intervention should be proportionate to the risks it aims to control.

Proportionality matters in the relationship between the government and the public. Though it is not operationalised it evolves alongside political and legislative developments. However, in the field of money laundering it is questionable whether this principle is met. A review of the Regulatory Impact Assessments for UK Money Laundering Regulations in 1993 and 2001 showed costs to be significantly understated and benefits unquantified, merely promising sweeping protections for society.[2] This way of dealing with proportionality to justify enhanced measures reduces it to an empty formula. We are of the opinion that the proportionality principle is too important to be ignored, especially in the (global) anti-money laundering (AML) policy which since 2001 additionally encompasses the financing of terrorism. This regime has now been made more targeted by the new risk-based approach. The question is whether this approach has achieved the right proportionality.

The risk approach/concept of the FATF

The anti-laundering policy has to address the risks connected with laundering in a commensurate way as formulated by the AML standard-setter, the Financial Action

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1 P.C. van Duyne and M. Levi, *Drugs and money. Managing the drug trade and crime-money in Europe* (London: Routledge, 2005) ch.2.4; W. Laqueur, *Europe since Hitler* (Middlesex: Harmondsworth, 1970) part 2; B. Whitaker, *The global connection: the crisis of drug addiction* (London:, Jonathan Cape, 1987).

2 J. Harvey, ‘Compliance and reporting issues arising for financial institutions from money laundering regulations: a preliminary cost benefit study’. (2004) 7(4) *Journal of Money Laundering Control* 333-346.

Task Force (FATF), in its guidance of 2007.[3] Earlier, the Third EU Money Laundering Directive of 2005 had introduced the concept of the 'risk-based approach' for the first time in EU criminal law.[4]

Risk management has long been associated with the insurance industry,[5] where it was relatively straightforward to assess the probability of events within a defined period, then to calculate the loss in the event that such incident took place. Apart from its tempting elegance, there were other reasons to adopt a risk-based approach in the AML world. One of the main complaints with the compliance regime was the costs that compliance placed on those subject to the rules. Compliance was carried out as 'rule based' and did not differentiate between levels of risks which was little cost-effective. It was understandable that banks were more receptive to a 'risk-based approach' as this was familiar language,[6] and they formed part of the group developing guidance to foster a common understanding of what the term actually meant. However, the FATF has opted for a 'soft' intuitive formulation of the risk-based approach that ". . . encompasses recognising the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks".[7]

Within normal banking business, 'risk taking' is the pursuit of profitable opportunity whereby the business risk being taken is assessed, measured and managed. By way of example, based on their prior experience, banks are able to calculate with a high degree of accuracy their loan-default ratio. Extending this approach, banks should be able to assess the probable number of transactions associated with criminal activity. However, two problems immediately present themselves. First, criminal related transactions will not necessarily be loss making; so will not be observable from any historical loss database. For this reason, indicators and red flags have to be built up in more interpretative ways. Hence the criticism that banks can only truly observe what is *unusual*.[8] Secondly, when 'suspicions' are reported,

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3 FATF, Guidance on the Risk-Based Approach to combating money laundering and terrorist financing (FATF, 2007).

4 E. Herlin-Karnell, The constitutional dimension of European criminal law (Bloomsbury Publishing plc, 2012).

5 G. Dionne, Risk Management: History, Definition, and Critique, HEC Montreal - Department of Finance (2013) 16(2) *Risk Management and Insurance Review* 147-166.

6 This quantitative assessment to risk is familiar territory for the banking sector under the Basel Accords: https://www.bis.org/bcbs/basel3.htm (last accessed August 11, 2016).

7 FATF (n.3) p. 2

8 G. Favarel-Garrigues, T. Godefroy, and P. Lascoumes, 'Sentinels in the banking industry: Private actors and the fight against money laundering in France' (2008) 48(1) *British Journal of Criminology* 1-19; M. Levi, and P. Reuter, 'Money Laundering' (2006) 34(1) *Crime and Justice* 289-375; M. Gill, and G. Taylor, 'Can Information Technology Help in the Search for Money Laundering? The Views of Financial Companies' (2003) 5(2) *Crime Prevention and Community Safety: An International Journal* 39 – 48.

banks express “dissatisfaction with feedback on actions resulting from SARs”.[9] Such feedback information is essential for building a database and to accumulate knowledge.

What is evident is that despite a common vocabulary, the interpretation of ‘risk’ within AML is fundamentally different. Within this context the phrase ‘being at risk’ points at some external and indeterminate threats.[10] The ‘threat’ justification lingers as heavy *ex post* justification for the AML policy. That general threat is now refined to the extent that “... resources should be directed in accordance with priorities so that the greatest risks receive the highest attention”[11] (op. cit. 5, p.2). A risk-based attempt to operationalise proportionality would mean that a high-risk threat would require greater resources, and lower risk less resources. This is more than obvious, but unfortunately we are lacking any objective rod of measurement. The problem of the indeterminable delineation of low or high risk was soon recognised.[12] Naturally this makes the implementation of this approach more complicated[13] or arbitrary. Without proper yardsticks, institutions must attempt to second guess whether their perception of risk will match that of the regulator,[14] resulting in what we might more accurately term *‘interpretation risk’*.

This problem is aggravated by the way in which the two policy subjects are formulated, namely as “ML/TF” or “money laundering and financing of terrorism”, as two concatenated sentence parts worded in a kind of repeated incantation. That formulation is repeated in follow-up or related policy papers making the expert community talk and write about “ML/TF” as a kind of inseparable twin-phenomenon. But in every respect they are not co-joined: money launderers do not blow themselves up and if they do their job correctly, their activity goes unnoticed. Terrorists operate differently and do not need sophisticated financial constructions for the, often, small sums of money they consume. A US government report on the

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9 J. Harvey, ‘Just How Effective is Money Laundering Legislation?’ (2008) 21(3) *Security Journal* 189-211, 211.

10 D. Demetis, and L. Angell, ‘The risk-based approach to AML: representation, paradox, and the 3rd directive’ (2007) 10(4) *Journal of Money Laundering Control* 412-428.

11 FATF (n.3) p. 2

12 Amongst others, by M. Killick, and D. Parody, ‘Implementing AML/CFT measures that address the risks and not tick boxes’ (2007) 15(2) *Journal of Financial Regulation and Compliance* 210-216; L. de Koker, ‘Identifying and managing low money laundering risk’ (2009) 16(4) *Journal of Financial Crime* 334-352; S. Ross, and M. Hannan, ‘Money laundering regulation and risk-based decision-making’ (2007) 10(1) *Journal of Money Laundering Control* 106-115.

13 L, Ai, J. Broome, and H. Yan, ‘Carrying out a risk-based approach to AML in China: partial or full implementation?’ (2016) 13(4) *Journal of Money Laundering Control* 394-404; M. Bergström, K. Helgesson, U. Morth, U. Uppsala, V. Humanistisk-samhällsvetenskapliga, F. Juridiska, and I. Juridiska, ‘A New Role for For-Profit Actors?: The Case of Anti-Money Laundering and Risk Management’ (2011) 49(5) *Journal of Common Market Studies* 1043-1064.

14 Demetis and Angell (n.10); L. Gelemerova, ‘On the frontline against money-laundering: the regulatory minefield’ (2009) 52(1) *Crime, Law and Social Change* 33-56.

profile of the 11 September hijackers stresses that while terrorists can use proceeds from crime (such as fraud) and funds raised through charities, they can also use legitimately earned funds.[15] This lack of differentiation between two very different activities means that talking of 'being at risk from ML/TF' is meaningless.

Despite these caveats, the FATF made an attempt to clarify the concept of risk. For the purpose of ML/TF risk, the FATF proposes the following key concepts and formula: "Risk is a function of … threat, vulnerability and consequences".[16] At first sight this looks reasonably clear. However, the details of these three functions are not specified. *Threat* is all about actors or activities "with the *potential* to cause harm" with "past, present and future ML or TF activities".[17] The concept of *vulnerability* "comprises those things that can be exploited by the threat . . ."[18] which may be any kind of weakness in the defensive system irrespective of the likelihood of its use. Then comes the component, *consequence*, comprising any "impact or harm of ML/TF", including "the underlying criminal and terrorist activity on financial systems and institutions, as well as the economy and society more generally [. . .] short term or long term".[19] Recognising that specifying the consequences of "past, present and future threats, short or long term", requires sophistication, the report truncates the approach by allowing "that countries may instead opt to focus primarily on achieving a comprehensive understanding of their threats and vulnerabilities".[20] But what is the risk where threat is low and vulnerability is high, or vice versa? Despite this ambiguity, the risk-based approach is expected to ensure proportionality: effort commensurate to risk. This must prevent what is called in the next section the 'nut-sledgehammer effect'.

Save the nut, restrain the sledgehammer

Proportionality is a commonplace concept and often applies without being noticed. We realise its absence when the opposite prevails: "to take a sledgehammer to

[15] D.M. Lormel, Chief Financial Crimes Section, FBI Federal Bureau of Investigation before the House Committee on Financial Services, Subcommittee on Oversight and Investigations, Washington, DC, 12 February 2002, www.fbi.gov/news/testimony/financing-patterns-associated-with-al-qaeda-and-global-terrorist-networks(last accessed, August 11, 2016); also FATF, Terrorist Financing. Typologies Report. (FATF, 2008).

[16] FATF, Guidance: National Money Laundering and Terrorist Financing Risk Assessment February (FATF, 2013) p.7.

[17] FATF, Guidance: National Money Laundering and Terrorist Financing Risk Assessment February (FATF, 2013) p.7.

[18] FATF, Guidance: National Money Laundering and Terrorist Financing Risk Assessment February (FATF, 2013) p.7.

[19] FATF, Guidance: National Money Laundering and Terrorist Financing Risk Assessment February (FATF, 2013) p.7.

[20] FATF, Guidance: National Money Laundering and Terrorist Financing Risk Assessment February (FATF, 2013) p.8.

crack a nut". So, how much of the present regulatory and law enforcement 'artillery' is justified by the facts and figures? This question is important as much criminal law policy development and enforcement is rather faith than fact driven: the fear of crime phenomenon in a time of decreasing crime figures, fanned by recycled statements and citations.

The crime-money risk: faith, facts and recycling

Obviously, the basis of all AML efforts is the supposed threat of crime-monies to the financial system and as a "critical enabler of serious and organised crime, grand corruption and terrorism".[21] The magnitude of the threat of crime-money is the first term of the equation of proportionality to which the measures of intervention must be proportionate. The evidence loaded onto the threat side of the scale was said to be "2.7% of global GDP or $1.6 trillion in 2009"[22] – this is discussed further below. The destabilising influence of crime-money is part of the ideology of the FATF, World Bank, IMF and the UN. According to this ideology, being obtained from crime, these proceeds cannot be accounted for. Without commercial rationale, they may be put into banks or be withdrawn, making the financial market volatile. Lack of rationality implies transactions to be capricious and, therefore, difficult to predict or control.[23] Warnings in no uncertain terms abound: enshrined in the supra-national regulations we read that money laundering (and terrorist financing) "shakes the very foundations of our society".[24] It should be noted that this 'earthquake warning' was issued well before the credit crisis of 2008, which was unrelated to the presence of crime-money.[25] Have these 'earthquake warnings' been substantiated by solid empirical evidence? Attempts to put 'empirical building blocks' on the scale of the threat are anything but convincing: the methodology used is questionable, while the 'outcomes' from various assessments obtain their weight rather by the social mechanism of quoting and re-quoting until assumptions became facts. In this way, 'truth' is established by what is widely believed and not as

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21 UK Government Home Office and HM Treasury Action Plan for anti-money laundering and counter-terrorist finance (April 2016) p.7.

22 UNODC, Estimating illicit financial flows resulting from drug trafficking and other transnational organized crime. Research report, October, Vienna, 2011, p.7.

23 V. Tanzi, Money Laundering and the International Financial System. International Monetary Fund, Washington, DC, 1996; P. Quirk, 'Macroeconomic implications of money laundering' IMF Working Paper, WP/96/66, Monetary and Exchange Affairs Department, IMF, Washington, DC. 1996.

24 Directive 2005/60/EC 26th October 2005 on 'the prevention of the use of the financial system for the purpose of money laundering and terrorist financing', p.1. See also UK Government Home Office/HM Treasury, 2016 (footnote 25) where ML/ TF jointly "undermine the integrity of our financial institutions and markets" (p.7).

25 N. Ryder, The financial crisis and white Collar Crime, (Cheltenham: Edward Elgar, 2014).

a result of empirical evidence. For example, the first such 'estimate' was launched by the FATF in 1990. It was based on more or less hypothetical data of the UN Office of Drugs and Crime (UNDCP), to which the FATF attached an equally hypothetical clause that 50 – 70 % could be "available for laundering".[26] The semantic implication of the term 'available' has never been properly analysed and has always been taken as what *is* being laundered even if it is not the same. 'Available' is rather a synonym for 'in reserve' where nobody knows what will be actualised. Still, this formulation is frequently used to denote the volume of the threat of money laundering. In the UNODC 2011[27] report on illicit financial flows, we find the 'availability' phrase 168 times and sometimes refined as "potentially available" or "actually available" though without further clarification of this differentiation. Whatever their meaning, they do not contribute to a precision of the threat scale. Apparently the 'empirical building blocks' to measure the threat in order to attune a proportionate response are malleable from the start. That does not mean that a threat approach would be wrong *per se*, as long as one is sufficiently specific of what that threat implies. One can refer to 'harm' as a measurable effect of laundering and then look at the way the insurance industry solves the insurance against harm.[28] Twenty years ago, the IMF determined the crime-money flood was "2 to 5 percent of global GDP ... probably [as] a consensus range".[29] With that, two 'truths' were born: the 'consensus' and the '2-5% of GDP' range. Consensus between whom? There is no documentary evidence of it, but nevertheless until the present the alleged 'consensus', sometimes referred to as 'IMF consensus'[30], remains. For the crime-money flood the IMF produced its own evidence: Tanzi[31] and Quirke [32], both from the IMF, hastened to provide some substantiation in the form of assumptions, flexible concepts, data from Interpol and many regression analyses all leading to the inevitable 'consensus range'. No assessment of the data reliability or the all-encompassing laundering definition, which notably includes legal but undeclared (non-taxed) work.[33]

Despite its *deus ex machina* origin, the 'IMF consensus' has led a tenacious life. Even consensus followers, such as Walker and Unger, call the figure a guess and

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26 FATF, Financial Action Task Force on Laundering, Report (Paris: FATF, 1990) p.5.

27 UNODC (n.26).

28 For elaboration see P.C. van Duyne, J. Harvey, and L. Gelemerova,'The Monty Python Flying Circus of Money Laundering and the Question of Proportionality' in G.A. Antonopolous (ed.) *Illegal Entrepreneurship, Organized Crime and Social Control: Essays in Honour of Professor Dick Hobbs* (Springer, 2016).

29 M. Camdessus, ML – the importance of international countermeasures' February 10, 1998. Available at: http://www.imf.org/external/np/speeches/1998/021098.htm (last accessed August 11, 2016).

30 UNODC (n.26)

31 Tanzi (n.27)

32 Quirk (n.27)

33 L. Gelemerova, The anti-money laundering system in the context of globalisation: a Panopticon built on quicksand? (Nijmegen: Wolf legal Publishers, 2011).

point at the fact that it has not been replicated “even by academics doing intensive studies within the Fund”. [34] Nevertheless, they also accept the IMF approach and most of its underlying assumptions. Other authors[35] are more critical and point at the inaccurate or flawed data, without much effect.

The available meagre evidence is insufficient as a basis for finding a proportional risk-based counter strategy: proportional to what?

Laundered and unlaundered money: more than semantics

As previously discussed, the phrase, ‘available for laundering’, appears central notwithstanding its lack of operationalisation. We now look at its further implication: the existence of *un*laundered monies because not every opportunity is actualised. What does that mean and what is its risk or threat? Here we have several problems to solve going beyond semantics.

In the first place, we face an unsolved problem of delineation or defining where mere possessing of proceeds stops and laundering begins. When we look at the practice of law enforcement, we can observe that there is a pressure from the prosecution to stretch the coverage of the verbs ‘possess’ and ‘hide’ such that laundering begins from the moment of ‘criminal ownership’.[36] Consequently, every profitmaking crime is laundering which negates the concept of ‘available for laundering’. Some crimes by their nature contain laundering, and therefore the concept of availability would not apply.

This conclusion has implications for the elements of risk assessment: threat; vulnerabilities; and consequences. Even if we condemn the activity morally, is there a threat to the financial system when the money is laundered, given that it is included in the GDP, taxed and spent on licit VAT-taxed commodities?

Thus far, the threat scale of the balance appears filled with (often recycled) assumptions, unclear concepts and unreliable data.

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[34] J. Walker, and B. Unger, ‘Measuring global money laundering: “the Walker gravity model”’(2009) 5(2) Review of Law and Economics 820 – 853, 823.

[35] R. Barone, and D. Masciandaro, ‘Organized crime, money laundering and legal economy: Theory and simulations’ (2011) 32(1) European Journal of Law and Economics 115-142; F. Schneider, and U. Windischbauer,‘Money laundering: some facts’ (2008) 26(4) European Journal of Law and Economics 387-404; T. Blickman, ‘Countering illicit and unregulated money flows money laundering, tax evasion and financial regulation’ (2010) Crime & Globalisation Debate Papers TNI Briefing Series.

[36] P.C. van Duyne, M.S. Groenhuijsen and A.A.P. Schudelaro,‘Balancing financial threats and legal interests in money-laundering policy’ (2005) 43(2-3) Crime, Law and Social Change 117-147; L. Gelemerova, The anti-money laundering system in the context of globalisation: a Panopticon built on quicksand? (Nijmegen: Wolf legal Publishers, 2011).

The rumbling pot of empirical research

Despite the high political priority of criminal finances, empirical studies in this field are few and far between.[37] We have economic studies usually from the angle of econometric modelling and "IMF-consensus" following to a varying degree.[38] Next to that, we have behavioural research primarily carried out at the micro level using data from criminal files, law enforcement databases or fieldwork, some of them testing the mainstream assumptions.[39]

By way of illustration of the problems faced, we discuss the studies carried out by Walker because these appear to have gained considerable attention. Beginning in 1995, they are based on a broad definition of laundering, a basic aspect of the methodology. "Money laundering is the process by which illicit source moneys are introduced into an economy and used for legitimate purposes".[40] This definition has an enormous range, encompassing also the 'percolation' of crime money by means of mere spending. That is a choice one can debate or respect if it were not for the restrictive clause of 'used for legitimate purposes'. There are many definitions of money laundering,[41] Yet in many studies the definition is unclear, and mentioning a definition at the beginning does not guarantee that the authors adhere to it during the rest of their exposé. Back to Walker's definition, spending money on legitimate objects for criminal purposes remains outside the circumference of

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37 The authors draw on an earlier elaboration of the empirical evidence in Van Duyne *et al*. (n.32)

38 See for example Schneider and Windischbauer, (n.40); Barone and Masciandaro (n.40) and B. Unger, H. Addink, J. Walker, J. Ferwerda, M. Van den Broek, and I. Delaenu, *Project ECOLEF The Economic and Legal Effectiveness of Anti-money Laundering and Combatting Terrorist Financing Policy*, Project funded by the European Commission DG Home Affairs, JLS/2009/SEC/AG/087, February 2013.

39 P.C. van Duyne, 'Money laundering policy. Fears and facts' in P.C. van Duyne, K. Von Lampe and J.L. Newell (eds.), Criminal finances and organising crime in Europe (Nijmegen: Wolf Legal Publishers, 2003);~~ J. Meloen, R. Landman, H. De Miranda, J. Van Eekelen, S. Van Soest, , Buit en besteding. Zoetermeer, (Elsevier Overheid, 2003)~~; P.C. van Duyne, and H. Miranda, 'The emperor's cloths of disclosure: hot money and suspect disclosures' (1999) 3 Crime, Law and Social Change 245-271; P.C. van Duyne, M. van, Soudijn, and T. Kint, 'Bricks don't talk. Searching for crime money in real estate' in P.C. van Duyne, S. Donati, J. Harvey, A. Maljevic and K. von Lampe (eds.), Crime, money and criminal mobility in Europe (Nijmegen: Wolf Legal Publishers, 2009); P.C. van Duyne, and M.R.J. Soudijn, 'Crime-money in the financial system: what we fear and what we know' in M. Herzog-Evans (ed.), Transnational Criminology Manual, Volume 2 (Nijmegen: Wolf Legal Publishers, 2010).

40 J. Walker, Estimates of the Extent of Money Laundering in and through Australia (John Walker Consulting Services, 1995) p.1.

41 Summarised by E. Busuioc, 'Defining money laundering. Predicate offences – The Archilles' heel of anti-money laundering legislation' in B. Unger (ed), The scale and impacts of money laundering (Cheltenham: Edward Elgar Publishing, 2007) and B. Unger, and G. Rawlings The amounts and effects of money laundering. Report for the Ministry of Finance. (Utrecht: Utrecht School of Economics, 2006).

laundering: *e.g.* buying a smuggling boat or paying illegal migrant workers.[42] A serious flaw is, however, the extremely low response rate to the questionnaire on which Walker based his study: 28 responding agencies of which only eight mentioned a "total laundered value" ("proceeded against") of which four could mention a conviction. There was no proper account of the competence of the respondents for making more than just hunches. According to Walker, his respondents estimated the percentage laundered per type of crime at mostly 80%, which is empirically unrealistic.[43] Nevertheless, it attained a high following from, amongst others, the FATF, World Bank and IMF, and that figure found its way into the economic model used in the project for the Dutch Ministry of Justice,[44] repeated in research by Walker and Unger[45] and in the ECOLEF project for the European Commission.[46] The model and findings were finally re-used in the UNODC 2011[47] report on criminal finances prepared by Pietschmann (STAS) and John Walker (consultant).[48] Thus methodologically questionable research that supports the previously mentioned 'consensus' becomes recycled and, in the absence of the researchers' original caveats, politically accepted.

The UNODC report did recognise the problem of definition, but did not solve it. Instead we find the earlier mentioned variations of 'availability' ('actual' and 'potential'). Notable is the phenomenon of 'fact framing' by means of what Van Duyne *et al*[49] have called the 'indicative bias': sliding from the subjunctive modus of 'may', 'might' and 'could' (but also 'available') to the indicative modus of '*it is*'.[50] Once the suggestions have transited to the indicative modus they have become 'facts'. And having been endorsed by authoritative bodies, they are unassailable.

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42 Furthering the commission of crime is one of the clauses of the US Anti-Laundering Act of 1986.

43 Walker (n.48) P. Reuter, 'Are the estimates of the volume of money laundering either feasible or useful?' in B. Unger and D. van der Linde (eds.), Research hand-book on money laundering (Cheltenham: Edward Elgar, 2013) p.227.

44 B. Unger, The scale and impacts of money laundering (Cheltenham: Edward Elgar Publishing, 2007); B. Unger, and G. Rawlings The amounts and effects of money laundering. Report for the Ministry of Finance. (Utrecht: Utrecht School of Economics, 2006)

45 J. Walker and B. Unger, 'Measuring global money laundering: "the Walker gravity model", (2009), Review of Law and Economics, 5.2, 820 – 853

46 Unger et al (n.43). A copy of the final report for this project is available at: http://www2.econ.uu.nl/users/unger/ecolef_files/Final%20ECOLEF%20report%20(digital%20version).pdf (accessed 8th December, 2016).,

47 UNODC (n.26)

48 The methodology employed by the UN project was reviewed by an 'external reference group' that included Prof. Dr. Friedrich Schneider from Johannes Kepler University of Linz and Prof. Dr. Brigitte Unger from Utrecht University (UNODC, 2011, p. 2 (n.43)

49 Van Duyne et al (n.32)

50 That indicative bias has been present from the first FATF report of 1990 onwards, as observed by P.C. van Duyne, 'Money-laundering: estimates in fog' (1994) 19 The Journal of Asset Protection and Financial Crime 103–142.

The last attempt to assess the money laundering threat was funded by the European Commission and carried out by Utrecht University.(Unger et al.)[51] The study is plagued by a lack of comparable international data which forces the researchers to resort to 'proxy' variables with many unproven assumptions which generate hypothetical statements. Unsurprisingly, the 'availability' phrase slips into the conclusions this time in the form of 'launderable money as % of the GDP' for the EU and a selection of other countries. The foggy basis is again the unvalidated Australian estimation model with the indicative bias of 'may' slipping to 'is'.

Economic models may impress the unobservant, but only 'data on the ground' can clear the fog. That was at last achieved by Ferwerda, who (. went through the list of laundering's alleged negative effects on the financial system and looked for matching empirical evidence.[52] He found that evidence was lacking. He shared this experience with Reuter[53] who undertook a similar analysis. Worse, Ferwerda noticed that claims about the existence of evidence were untrue. For example, Barlett claimed that it is "clear from the evidence" laundering distorts a long list of economic aspects (mentioning 12 in total).[54] Ferwerda checked this list and found no supporting evidence.

Connecting criminal statistics to reality remains difficult. Ferwerda[55] points at the double-counting problem that arises from counting money laundering in addition to the predicate offence in cases of self-laundering. This is confirmed by the authors' own research as well as by researchers coming to similar conclusions.[56] Schneider and Windischbauer criticise the over-reliance on "scientifically doubtful" data[57] (regretfully with little learning effect in terms of valid data).[58]:

Should we thus conclude that the whole crime-money scare was just a political mainstream hoax? Despite lacking evidence, there is still a danger of dismissing all

51 Unger et al (n.43)

52 J. Ferwerda, 'The effects of money laundering' in B. Unger and D. van der Linde (eds.), Research handbook on money laundering (Cheltenham: Edward Elgar, 2013).

53 P. Reuter, Are the estimates of the volume of money laundering either feasible or useful? In: B. Unger and D. van der Linde (eds.), *Research handbook on money laundering.* Cheltenham, Edward Elgar.(2013)

54 B. Barlett, The negative effects of money laundering on economic development, Countering Money Laundering in the Asian and Pacific Region. For the Asian Development Bank, Regional Technical Assistance Project No. 5967. (2002) p.33.

55 Ferwerda (n.65), p.43.

56 P. Reuter, and V. Greenfield, 'Measuring global drug markets: How good are the numbers and why should we care about them?' (2001) 4 World Economics 159-173.

57 Schneider and Windischbauer (n.40) p. 117

58 see also PC Van Duyne, and H Miranda, H., (1999), The emperor's cloths of disclosure: hot money and suspect disclosures. (1999) Crime, Law and Social Change, no. 3, 245-271; P. Reuter, P. and E. M. Truman, 'Anti-money laundering overkill?: It's time to ask how well the system is working'(2005) *The International Economy,* Winter, 56-60; and Reuter and Greenfield (n.69)

warnings as 'crying wolf' while there are stray-wolves around. There are historical indications that investment in the real estate sector has resulted in local inflation.[59] Journalistic investigations indicate that much 'shady money' swarms in the London property market – 'findings' that are included in government response documents.[60] However, for singling out money laundering as an endemic phenomenon with an indiscriminately devastating effect on the stability of the financial system, there is insufficient empirical evidence. 'Available' crime-money has to be compared with the effects of other money flows, *e.g*. originating from migrant labour savings or financial windfalls from the oil or minerals extraction industry.[61] Macro-economically, these monies may have similar effects: Russia or Venezuela would be a good example in this regard.

Consequently, we are back to the AML regime as wielding a sledgehammer without knowing what nuts to crack. Obviously, if such an essential term is missing that does not contribute to answering the proportionality question.

The Risk-Based Approach and proportionality

We may have to resign ourselves to the fact that the evidence of the crime-money threat is meagre and the deducted conclusions debatable. While the enforcement efforts are genuinely sizeable, the seriousness of the money laundering threat remains a matter of belief. How big? The total of all laundering has thus far only caused ripples in the water? Nevertheless, the FATF's approach has been like an old-fashioned broadside firing indiscriminately at all that resembles money laundering. Unsurprisingly, such broadsides always hit something, so that the FATF could always claim success, even if efficiency was far away.

As mentioned earlier, in 2006, the FATF established an advisory group (including banking and securities sectors' representatives) to investigate the risk-based approach to money laundering.[62] This group's '*RBA-report*' was adopted at FATF's June 2007 Plenary. The report detailed the principles for public authorities as well as financial institutions. The *RBA-report* recognises that each country and respective authorities should tailor its anti-laundering/ TF regime according to its individual risks. Hence, no single risk based model for all. The *RBA-report* recognises the need for flexibility, adapting over time and space and the undesirability of a "tick box" approach just to be safe and to meet regulatory needs. The *RBA-report*

[59] In Morocco and Colombia see, respectively, De Mas, P., De poreuze noordkust van Marokko. (2001), nr. 5 Justitiële Verkenningen, , 72-86 and D.I. Keh, Drug money in a changing world: economic reform and criminal finance (Vienna: UNDCP, 1996).

[60] UK Government Home Office and HM Treasury (n.25)

[61] van Duyne and Levi (n.1).

[62] FATF, Guidance on the Risk-Based Approach to combating money laundering and terrorist financing (FATF, 2007).

even recognises that “an over-zealous effort to counter the risks could be damaging and counter-productive, placing unreasonable burdens on industry and act against the interests of the public by limiting access to financial services for some segments of the population” [63]). In line with this observation, it admits that not all suspicious fishes can be caught.

The *RBA-report* is quite detailed in its indications of what kinds of risks are to be rated as low or high, in general as well as for various separate Recommendations. The *RBA-report* provides further separate elaborations for the public authorities as well as the financial institutions. It contains the specific elements for a national risk-based approach as well as for the financial sector. An important theme is the efficient allocation of resources proportionate to perceived risks, which goes through all the ranks, from governmental policy making to the individual account manager. The *RBA-report* does not suggest prohibiting institutions from getting involved in high-risk situations, as long as they have the right risk-mitigating strategies in place. Despite all the well-chosen advice and encouragement, it remains unclear what low- and high-risk factors are, and whether this is meant as a dichotomy: how many shades of grey are between low and high risk and how to determine what is a ‘commensurate’ action to mitigate risks? It remains an exercise in beating about the bush.

A year after the RBA-report the FATF issued another report on risk assessment strategies; this time with respect to Terrorism.[64] The ML/TF Assessment Strategies describes in general terms what risk assessment is and what it considers national threat assessments reports from 10 countries plus Interpol and Europol. They are too diverse to summarise by way of abstract. It is unclear whether they are intended as national threat assessments or tokens of annual stock taking for the usual annual report of the national FIU or another public authority. Full of truisms, they add little value to the 2006 *RBA-report*.

Though the literature reveals no opposition to the concept of a risk-based approach, it took four years for it to become official through its integration into the list of new Recommendations (2012) and connected methodology (2013). In addition, in 2013 the FATF issued another guidance document (*National money laundering and terrorist financing risk assessment*).[65] How do we interpret this new methodology from the risk and proportionality angles?

Again, we have the imaginary ‘scale’ of resources versus risk. While the above discussed FATF documents refer to the RBA as a tool of resource efficiency at executive level (the financial and designated non-financial sectors), it does not

[63] FATF (n.81) p.16

[64] FATF, Money Laundering & Terrorist Financing Assessment Strategies: Terrorist Financing. Typologies Report. (FATF, 2008).

[65] FATF, Guidance: National Money Laundering and Terrorist Financing Risk Assessment February (FATF, 2013).

consider the supervisory efforts. That is an omission: the risk-based approach must also be applied by supervisors. This is the implication of Recommendation 1: 'countries should identify, assess and understand risks and designate an authority or mechanism to coordinate actions to assess risks'. This means staff input at all levels of policy supervision and execution: national as well as sector-wise. To put it simply: the risk assessment requirement must be implemented at every step of the 'AML ladder', from government downwards to supervisors and further to the individual financial institutions and 'designated non-financial businesses or professions' in the form of notary or art dealer. One can in addition think of nominated coordinators or commissions at the level of ministries, Financial Intelligence Units (FIU) and recognised sector bodies and staff: the bureaucratic outgrowth accompanying every institutional innovation. That does not arise without expenses, all of which must be put on the 'effort scale'. The same applies to how FATF's effort is allocated.

The allocation of effort or resources must be guided by or weighed against risk assessment, which is the principle bringing greater efficiency by targeted actions[66] The same meaning is repeated in the Guidance notes on the RBA set out in the FATF 2013 methodology.[67] This provides a further elaboration that discretion is extended to the country authorities to determine appropriate measures 'Once ML/TF risks are properly understood'[68] However, the 2013 guidance remained silent on how to achieve that. Instead, reference is made to nine sectoral RBA guidance papers[69] which lack specificity.

This brings us naturally back to the concept of risk. The FATF provides the formula that risk is a "function of three factors: threat vulnerability and consequence".[70] We discussed this earlier and concluded that it is not a very helpful formula. The formula is not repeated in the Recommendations or in the Methodology. Neither do we find a statistical approach to ML/TF risks. The Methodology explicitly states a number of times that assessment is not a statistical exercise, pointing to required flexibility and hence subjectivity in approach. We only find mention of 'low(er) risk', 'high risk' and 'risk' in general. Low(er) risk is very restricted and concerns basically mainly transactions with FATF-compliant institutions and countries, or public bodies. If a country decides not to apply (partly) certain FATF Recommendations, it must demonstrate that "there is a proven low risk of ML/TF" or

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[66] FATF (n.81)

[67] FATF Methodology For Assessing Technical Compliance With The FATF Recommendations And The Effectiveness Of AML/CFT Systems, FATF/OECD Paris February, (FATF, 2013).

[68] FATF (n.88) p.4

[69] The FATF is in the process of reviewing its sectoral specific guidance and the full list of available reports can be accessed from: www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc(fatf_releasedate) (last accessed: January 29, 2016).

[70] FATF (n.88) p. 7

"a financial activity (other than the transferring of money or value) is carried out by a natural or legal person on an occasional or very limited basis, such that there is a low risk of ML/TF"[71]. All else is 'high risk' and does not need to be proven.

In conclusion, there is a new approach with 'risk' as a central concept which is not delineated, except when there is a proven 'low risk', that only occurs in FATF-compliant situations or with recognisable insignificant transactions. And upon this accumulation of indeterminable concepts every country must build a national risk approach.

The fourth round: evidence from 13 Mutual Evaluation Reports

There is no recent evidence of the functioning of the new methodology except what the FATF itself produces in the form of Mutual Evaluation Reports (MERS) in the fourth evaluation round. At the time of writing, only thirteen countries have been evaluated.[72] In addition, the MERs provide only the opinion of the assessors: they are the spectacles through which we look at how the requirement of national risk assessment (NRA) has been implemented. This is important as we found that many evaluation teams take it upon themselves to challenge rather than support the view of national authorities. It remains unclear how their knowledge of national risk would be more accurate than that of the national authorities.

Of the countries mentioned in Table 1 (below), the evaluations took place in 2014 and 2015 and the reports were accepted and endorsed by the FATF Plenary. We will elaborate on some of the findings which are relevant for our search of proportionality and the corresponding meaning of risk.

In the first place, there is the repeated FATF aim of 'allocating resources proportionate to the risks'. This applies to financial and economic sectors, to types of customers and countries such that most resources go to the highest risks. Does this also apply to the evaluation resources of the FATF: balancing its resources (staff and time) against the levels of risk posed by various countries to be evaluated? If that were the case, can we expect some ordering in the evaluation? For example, starting with the high risk countries and doing the lower risk countries later?

In the second place, it appears that we have an unresolved meaning issue as soon as such a rank ordering of 'high – low risk' countries is suggested. This is more than semantics. Attempting to apply the FATF's own formula – risk is a function of threat, vulnerability and consequences – it appears to be useless for any

71 FATF (n.88) p.23

72 This has increased to 23 at the time of final editing, December 2016, justifying a follow-up study.

ordering or other application. The FATF Guidance had already dropped the component ‘consequence’. With the two remaining components, we observe that they are used loosely and often interchangeably, which makes their country-wise application most uncertain. These components can be examined as applied to a selection of countries with a small or less developed economy: Armenia, Ethiopia, Samoa and Vanuatu.

Table 1

Summary of Mutual Evaluation Reports

Country	Year of MER	pages	Number of evaluators	NRA in place	Application of NRA	'High risk' & vulnerabilities	'Low risk'
Armenia	2015	182	7	Yes	Not at executive level	Real estate & size of shadow economy	Terrorism
Australia	2015	198	10	Yes, but no national policy	Predicate offence priority	Non financial Sector; Drugs, fraud and tax evasion	Discussed, no specific areas. Review questioning of national assessment
Belgium	2015	213	7	Yes, but fragmented	Needs conversion into national policy	Diamond dealers Money transfer service	Consumer credit and finance leasing companies
Costa Rica	2015	169	8	In development	Priority predicate offence drugs.	Real estate, public corporations. Lack of casino supervision	Terrorism
Cuba	2015	186	9	All in place, but no STRs	Not clear	Drugs, embezzlement, bribery & fraud	*"not an attractive place for ML/TF."*
Ethiopia	2015	105	7	In progress	Not applied	Corruption, Tax evasion. Trafficking Humans & commodities vehicle dealers and real estate	Formal financial sector not attractive
Italy	2016	230	8	In place and general good understanding of ML risk	Applied but could be better!	Tax & excise, drugs & OC activities	Mainly process no sectors identified
Malaysia	2015	211	7	Integrated RA	FIs endorse RBA	Fraud, drugs and corruption	Counterfeiting & pira-

Country	Year of MER	pages	Number of evaluators	NRA in place	Application of NRA	'High risk' & vulnerabilities	'Low risk'
				into policies & priorities	LEA: minimal outcome		cy
Norway	2014	206	10	Present but incomplete. No overarching policy	Priority predicate offences, not ML	MVTS, shipping, fisheries and labour markets	Report questioning of approach to identified low risk
Samoa	2015	187	8	NRA reasonable understanding, insufficiently shared	Needs resource allocation. No ML investigations	Remittance sector; domestic banking & IBC. Cross border cash transfers & IFCs	No terrorism
Spain	2014	206	10	Good: identifying, assessing & understanding	In place but not always followed	ETA and terrorism; drugs, OC, real estate; MVTS	Operational – but lawyers criticised for self-perception as low risk
Sri Lanka	2015	170	8	NRA: reasonable understanding not followed by implementation	Sectors do not follow NRA. Predicate offences priority: 1 ML conviction	Drug trafficking Corruption and fraud	Negative – failure to prove low risk, report questioning of accountant's low risk designation
Vanuatu	2015	167	7	No proper understanding	Not yet completed & doesn't cover specific risks	International FIs; the remittance sector; TCSPs, currency exchange; casinos and gaming businesses	Failure to apply or identify and where they can do so, it is questioned

Source: Country Mutual Evaluation Reports can be found on the FATF website: http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate) (accessed 8th December, 2016)

What ML risk do countries such as these pose? The first two countries, Armenia and Ethiopia, are described as financially isolated. Samoa and Vanuatu have off-shore services, but on a modest scale. These countries are each for differing reasons, technically vulnerable, even if hardly anything happens. Should these countries be inspected by a platoon of seven to eight experts for about two weeks, producing reports of 105 to 182 pages? This is a relevant question if we want to understand the nature of the output: *e.g.*, the Ethiopian MER of 105 pages, drafted by seven evaluators and subsequently reviewed by six reviewers (three reviewers is more usual).[73] Questions like these cannot be answered from the FATF documents, whether from the methodology or the MERs themselves. For an efficient running of the mutual evaluations these questions are highly relevant. For example, in cases of the conjecture "vulnerable but no threat", a quick technical 'compliance scan' could be a sufficient evaluation.

The reverse can also apply: much threat of crime money ('available' for laundering) but low vulnerability because the 'gates are guarded and the bulwarks manned'. According to the MERs this seems to be the case with Italy and Spain, rated as enthusiastic appliers, a conclusion which required a 16 day on-site visit by respectively eight and ten evaluators. A virtually risk-free country is Cuba: no threat because of lack of economic freedom and a meticulous technical compliance in accordance with the general control intensity in the country. It took nine experts twelve days to reach that conclusion.

Looking at this first batch of MERs, it is difficult to identify any consideration of resource allocation, let alone a proportionality of applied resources set off against risk. The number of evaluators is higher than in the 3rd evaluation round, the reports are about the same length and it is hardly possible to determine any ordering according to the seriousness of ML or TF risk. In short, this collection of evaluated countries looks rather a 'random sample', revisited because it is once again their turn, rather than as a result of assessment of 'risk'.

In the following sections we shall focus on what evidence of risk and proportionality the MERs bring forward.

Country-wise evidence of risks and proportionality

As remarked earlier, the proportionality principle applies at every level of the national ML/TF regime: from the highest policy making body through to the notary, real estate agent or the dealer of high valued goods such as car dealers or antique shops. That means that, on all levels, allocated resources, mainly staff, must be

[73] We have previously commented on the cost involved in the 3rd round MER process (Van Duyne *et al.*, (n.32); the 4th round comprises: Incorporation of self assessment; desk review of technical compliance and visit to assess outcome effectiveness. This is followed up by an assessment for consistency carried out by an independent team.

commensurate to the risks they have to mitigate (Recommendations 1 and 2 and their interpretive notes). What do we learn from the 13 MERs?

In the first place, the evaluators must assess whether and to what degree a national authority and the obliged institutions "identify, assess and understand the risks", whether this is expressed in a national risk-based assessment that is adopted by the authorities, the sector supervisors and obliged entities. This is not a costless undertaking. It requires broad institutional participation to put it in place and a bureaucracy to maintain it. This has to be justified by the "identified, understood and assessed risks". But what are the measuring rods? The answer is: there are none. Even if the formula put forward by the FATF was valid, it is decisively crippled by leaving the 'consequence' component out: a third of the gauge is missing and the remainder is badly formulated. Lacking criteria, the evaluators resort to an enumeration of the usual profitable crimes.

A second serious flaw concerns the underlying statistics. The FATF thus has failed to create the statistical instruments for identifying and analysing (part of) the threat. In light of the poor quality of statistics actually accepted (by the Plenary, but delivered by the evaluators and reviewers), we observe that the FATF itself is and has been consistently deficient on this essential point, thereby contravening its Recommendation 33. Consequently, there is no national unified database from which to learn quantified aspects of the assumed laundering threat. In the absence of sufficient data, a truly 'risk-based' approach is impossible.

In light of this observation, we can only look at the fragments of evidence of what is presented as 'threat' – acting like forensic archaeologists. But which fragments? We have: Suspicious Transaction Reports (STRs) and sometimes Suspicious Activity Reports (SARs), containing a number of transactions, then we may have investigations, prosecutions and convictions, possibly accompanied by asset recovery. Deducing any level of threat from these 'evidence fragments' is as speculative as deducing the colour of hair of a Neanderthal from an excavated little toe. Of the STRs we do not know the number of false alarms; of the prosecutions we do not know whether and how many cases were halted or dismissed or added to the main charge without registration. Some numbers concern cases, other prosecuted or convicted persons. So what do such statistical fragments of the studied MERs tell us? Looking across all of the reports contained in Table 1 we draw attention to the following as examples.

- The prosecution or conviction rates in nine countries were negligible or not available. Only Austria, Belgium, Italy and Spain have prosecution rates exceeding 100 for the latest available year (2013 or 2014[74]).

[74] Data reported is for the latest year included within each of the MERs and is frequently two to three years earlier that the date of evaluation.

- Australia had from 2010 to 2013 on average 3,658 convictions each year, of which 1,444 for *receiving* offences only.
- Italy had 3,189 convictions in 2013 of which 2,472 (78%) concerned "*not the more serious crime*"; additionally, convictions for tax crime (1,641) and corruption (91) not mentioned under the denominator of money laundering.
- Belgium has 268 laundering convictions for the year 2013, but "a large number of cases are secured in domestic cases for *self-laundering*".
- Spain, "with a high level of understanding of its ML/TF risks", mentions that only 111 persons were convicted for money laundering, of whom 33 were for *self-laundering*.

We cannot deduce from these figures any valid interpretation of a ML or TF threat because the database reliability cannot be determined.

What remains of the fundamental requirement of connecting specific resources to identified 'high risks'? When we look at these 'high risks' as mentioned in the MERs, we see mainly the 'usual suspect' crimes: drugs, fraud, tax evasion and corruption for which we do not need highly qualified evaluators. For Belgium, one specific high-risk sector is mentioned by name - the diamond industry - not because a flow of related STRs reached the Belgian FIU but rather because not a single STR has been submitted, while the evaluators clearly thought there *should* be more![75] That looks like a strange working thesis: the less there is found, the more there should be.

National risk assessment & strategy evaluated

As mentioned before, developing and maintaining a risk-based national strategy in addition to a national risk assessment is not a complete solution. Nevertheless, the idea of an all-encompassing national strategy may be over-ambitious or detached from the work floor: the prosecution service, the police and the obliged entities and their supervisors. It may also be the case that a national strategy is difficult to convert into the plans and actions tailored to the details of that work floors. Then a gap may develop between the overall, country-wide risk assessment and deducted strategy on the one hand, and what at the executive level is perceived as the 'real' threat on the other hand. Given the fact that strategy designing is demanding, is there valid evidence to justify such an undertaking for ML/TF?

[75] There are persistent rumours of fraud in the Antwerp diamond sector operating through off-shore firms. One international diamond trader sued the Antwerp Diamantbank for deceit, laundering and abuse of trust. However, no STR was issued. (see www.politics.be (Accessed 2-6-2016). Also the typology report about the diamond sector suggested more cases, apparently not connected to STR statistics.

It appears that most evaluation teams are strict about this first Recommendation which reads like a mantra: countries "should identify, assess and understand" ML/TF risks and develop a risk-based approach or strategy. A mere summing-up of risks is, in the eyes of the evaluators, not enough as Norway learned. That country ordered its economic and environmental crime on a 'probability plus impact' scale but the evaluators thought this insufficient for a risk-based approach.

So who did fulfil this requirement and who did not? Below we give a short outline of the evaluators' judgement, to which should be added that the MERs do not contain a short abstract or summary of the evaluated NRA or strategy: regarding this recommendation, the evaluators' judgement is far from transparent.

Fully compliant

Spain was the only country rated as fully compliant. It showed a "high level of understanding"[76] and used material from several sources, but yet it was not flawless: it had not brought these components into a single national risk assessment. Nevertheless, it has a "sound" AML/CTF strategy. Measured by output (for the year 2012), it mentioned: 204 individuals prosecuted and 111 convicted (33 self-laundering), which looks modest for such a high rating with so much effort.

Largely compliant

Three countries were rated as largely compliant: Belgium, Cuba and Italy.

In the case of Belgium, a deficiency was observed concerning a requirement not found in other MERs: pro-active spotting of trends and emerging phenomena. Otherwise the approach was judged as fragmented; there was no adequate ranking (also not mentioned in other MERs) of risks; and there are shortcomings at supervisory level. Still, the law enforcement output was considered high for the country: 268 convictions, but with many 'easy' self-laundering cases.

The MER of Cuba contained little comment on the NRA, except unclear prioritisation.[77]

At the time of reporting, Italy had not yet developed a national strategy. But that has no consequence: even without that important requirement Italy operated well and displayed a "high understanding" (on most other points perfect ratings). Given this positive judgement what added value would a national strategy impart?

Partly compliant

The rating of partial compliance was attributed to Armenia, Australia, Costa Rica, Norway, Samoa and Sri Lanka.

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[76] FATF Anti-money laundering and counter-terrorist financing measures, Spain, Mutual Evaluation Report, December, 2014

[77] Cuba has remained outside of the FATF procedures and was not part of any prior evaluation round. In 2011 it was added to the 'public statement' (24th June) as 'not having committed…nor constructively engaged', although by June 2014 the authorities had apparently achieved a sufficient amount to be removed from the October 2014 list and subject to inspection.

Armenia has made progress according to the evaluators, but it does not understand its risks sufficiently: for its NRA it uses convictions, which is not a proper basis ('dark' or missing numbers). Prosecution targets mainly domestic self-laundering cases, with no third party ML involved. With 15 prosecutions in the last five years and ten convictions, the 'turnover' of cases is low, dampening knowledge building: even a doubling would not be encouraging of extra investment in strategy building.

Australia has a "good understanding" of ML/TF risks, but is inconsistent with FATF Standards as it focuses more on predicate crime than on ML. Australia has no policy setting out what is to be achieved and how to make clear what results from its efforts. Nor is it clear how the National Threat Assessment is used for further decision making, again, an apparent evaluation team-specific requirement not mentioned elsewhere. Average annual convictions for 2010-2013 were 3,658 of which 1,444 were for 'receiving'.[78]

Costa Rica has carried out a "national risk diagnosis" and is in the process of developing a national strategy, also for commensurate resource allocation. It displayed an "appropriate level of understanding"[79]. However, the authorities have a clear preference for fighting drug trafficking with scant resources left for ML investigation in other profit generating crimes: 12 prosecutions and 9 convictions (3 acquittals).

Norway was another matter: according to the FATF it lacked "a proper understanding of risk".[80] Its National Risk Assessment (February 2014) shows "significant shortcomings . . . and gaps in input and areas covered".[81] Also, the priorities are not according to the FATF Standard as "prosecutor and investigators view ML as an ancillary to the predicate offence"[82], which explains the low prosecution and conviction output, respectively 7 and 4 for 2013, mainly for self-laundering.[83]

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[78] See Table 3.5, p. 59 of the Australian MER: "Convictions equivalent to Vienna/Palermo conventions ('knowledge', recklessness")". Queensland mentioned only 'receiving'. Queensland and Victoria accounted for 92% of the convictions. For further discussion of Australia, see ch.13 in this collection.

[79] Mutual Evaluation of Costa Rica, 2015, GAFILAT (2015) p. 7 available at: http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/MER-Costa-Rica-2015-ENG.pdf (accessed 8th December, 2015)

[80] Mutual Evaluation of Norway, 2014, FATF (2014) p. 7, available at http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Norway-2014.pdf (accessed, 8th December, 2016)

[81] FATF (n.104) p. 7

[82] FATF (n.104) p. 16

[83] FATF (n.104) p. 60

Samoa displays a "reasonable overall understanding"[84] for its domestic risks, but has not sufficiently understood the international (off-shore) threat. It also has not shared its National Risk Assessment, undertaken in 2012, with the private sector, nor has it implemented a comprehensive risk based approach for allocating resources, which are devoted to predicate offences. Consequently, there have been no ML investigations, prosecutions or convictions.

Sri Lanka has "a reasonable understanding of its ML risks",[85] which is not manifested in its national strategy, however. While its FIU gets sufficient STRs (718 in 2014), the prosecution thinks it easier and more cost-effective to prosecute the predicate offences. As a result, there are insufficient resources for ML investigations, and convictions are mainly obtained for predicate offences: three against one for ML from 2010 to 2014.

Non-compliant

Vanuatu and Ethiopia were rated as *non-compliant*.

Ethiopia[86] has only recently (2009) adopted a comprehensive law against ML and is still in the process of drafting its NRA and strategy. The emphasis within AML enforcement is on the flow of capital, in particular the out-bound flow which is more of a concern than proceeds from other crimes, according to the evaluators' apparent amazement: 98 % of the STRs concerned Hawala banking which resulted in 32 convictions (March 2013 – March 2014).[87] In Vanuatu, the preconditions for an effective AML/CFT system were not present: lack of understanding of risks; no political commitments, resources or skills in law enforcement and regulatory authorities. It has no ML/TF investigations, prosecutions and convictions. The drafting of an NRA is in progress. The country has been placed on the serious warning list.

As mentioned before, these thirteen MERs are not considered as a representative sample for the MERs still to come. However, they are sufficient to raise questions.

While analysing these evaluations, the authors wondered how these could be interpreted against the FATF's own requirement of proportionality. Does compli-

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84 Mutual evaluation of Samoa (APG, 2015) September available at http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Mutual-Evaluation-Report-Samoa-2015.pdf (assessed, 24th February, 2017)

85 Mutual Evaluation of Sri Lanka (APG, 2015) http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/APG-Mutual-Evaluation-Report-Sri-Lanka-2015.pdf

86 Mutual Evaluation of Federal Republic of Ethiopia, (ESAAMLG, 2015), available at http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/WB-ESAAMLG-Mutual-Evaluation-Report-Ethiopia-2015.pdf (accessed, 8th December, 2016)

87 MER, FATF (n.110) p.33

ance with the risk-based strategy result in more results, *e.g.* more STR reports or "mitigation" of ML risks? This question is not raised and even if it had been, none of the MERs are able to answer it. The fuzzy concept formulation of risk, its inconsistent and often ritualistic use in the texts, and the lack of budget data does not provide much that is concrete. Measurement by law enforcement output is methodologically not possible – not even by the best evaluated country for Recommendation 33 (statistics): a 'fully met – C' for Malaysia, illustrating rather the lack of statistical knowledge of the evaluators. The many frequency tables Malaysia produced cannot be taken as an integrated database for a systematic and detailed analysis.

Conclusion and discussion

In the introduction, we raised the question whether and to what extent the (global) AML regime based on the new risk assessment approach is proportionate to the threat it intends to fight: is the balance between target and resources appropriate? This question, (besides concerns about FATF accountability), is difficult to answer, in the first place because of concept inconsistency. The FATF truncated its own risk definition by cutting out the essential component 'consequences' without explaining how this changed the whole risk concept. But why should we deal with risks if we are told: "Don't bother about the consequences if such events happen"? It takes the rationality out of the risk approach: to our knowledge there is no insurance company which would operate on this risk basis.

Despite this fundamental flaw, the FATF has persevered with its risk-based approach, which can be considered as politically consistent, but not as a token of coherence. The FATF failed to address essential questions. Since 2006/7, it has demanded National Risk Assessments ("NRA"). But is there evidence of its added value? Is it too early to raise this question? That depends on the countries. Most of the industrialised countries have maintained for many years a mature AML system, underpinned by considerable experience. In our sample, these are: Australia, Belgium, Italy and Spain. For these countries the question should be raised: what will the NRA approach add to the way money laundering has been tackled in the years before and in case of proven added value, will it be proportionate to the additional efforts? For each country this question should have been raised.

Addressing this question exposes a fundamental flaw: there is no valid baseline or zero measurement for 'extra' risk-based performance. Rather, this requirement has not even been mentioned. True, it is no easy task and requires a database building and a subsequent step-by-step cross-breakdown of data. Rather than be considered as some outlandish undertaking, it will create transparency: the evaluators did mention the relevant variables for such an analysis, but without realising their importance. Naturally, all this presupposes data discipline: reliability and a *clean* database. Clean governmental databases are the exception rather than the rule. In this field, there is one variable for which reliability really matters: the *seriousness* rating. If we want to give meaning to the use of the words commensurate or proportionality, we must know the seriousness of the individual laundering case for further aggregation[88], not the general phenomenon which is more or less an ideological issue. This precision is not what we found. The MERs mention for various countries that most of their laundering prosecutions concern 'easy' or small cases, mainly of self-laundering. These are interesting observations, but no more than rough indications. In this unspecified wording they further decrease the explanatory value of the 'seriousness variable' which for measurement purposes can be considered as 'polluted'.

As remarked before and by way of conclusion, we agree that knowing risks and outlining a strategy are valuable features in all policies, but we also observe that there is no evidence that the NRA yields an added value proportionate to all the efforts.

The MERs brought another issue to the fore, which looks like another dimension, but is nevertheless connected: the national sovereignty in designing a national strategy in which priorities are determined according to a rational weighing of national interests. This came to the open with three criminal law policy aspects: the prioritisation of predicate offences, confiscation prospects and self-laundering. Most of the evaluated countries addressed money laundering as an ancillary to the profit making predicate offence that is more often the source of real public concern than laundering itself. Given the sovereignty of criminal law, should countries be criticised for a policy of predicate crime prioritisation? This question has consequences for further priority setting, for example the preference for cases with 'easy confiscation' with sufficient proceeds, as was expressed by the Belgian public prosecution office. Otherwise, with scarce resources it may be rational to process easy cases first, such as self-laundering. (At least it 'feeds statistics'.) This leads to an ironic outcome: the FATF has consistently blamed countries for not criminalising self-laundering (explicitly mentioned in the MER of Italy[89]). Now that most countries have criminalised this built-in form of money-laundering, the FATF notices with irritation that police and prosecution have developed quite a taste for these 'easy' cases. On the other hand, the FATF (or its evaluators) would have reason for reproach if the criminalised self-laundering did not lead to more prosecution.

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[88] Gelemerova (n.37)

[89] Italy has now addressed this apparent deficiency.

Does this self-laundering and easy cases issue distract us from the NRA and proportionality discussion? No it is an inherent part of it, because the risk approach should contribute to a 'proportionate allocation of resources': low risks to be addressed with a lighter touch, 'high risks' with the 'heavy artillery'. Given the mentioned FATF pressure for criminalisation with all political force, it cannot be but 'high risk'. Hence, it is inappropriate for the evaluators to complain about the high prevalence of self-laundering unless the FATF repudiated its historical stand on this point.

Directly connected is the point of tax evasion and self-laundering. Tax crime is now a predicate offence for laundering with a 'built-in' self-laundering because of *disguising* (with the tax form) and *possession* (of the results). Proof of the former is at the same time proof of the latter: 'canned laundering' according to Van Duyne *et al*.[90]. These are the easy cases preferred by the prosecution while according to the FATF they form a 'high-risk' category. Therefore, applying the FATF rules, there is no ground for criticism. Or should this category rather be reduced to 'low risk' because the system may become clogged by a too enthusiastic prosecution service 'feeding its ML-statistics'? So, what indeed is high and low risk?

Returning to the relationship between risk and proportionality, it looks so simple and it is so easily written down in the FATF guidelines, recommendations and other policy papers. However, as soon as one has to spell out all implications and ramification, it proves to be more complex. The FATF has failed to unravel this complexity, saddling the global AML community with a defectively elaborated and immature approach.

[90] Van Duyne et al (n.41)