Editorial: FATF greylisting: time to revisit the approach

The FATF's non-compliant country and territory "naming and shaming" process of 2000–2006 (FATF, 2007), coupled with its mutual evaluation scheme and methodology introduced in 2002 (Kyriakos-Saad, 2005), provided a firm framework for ensuring near-global implementation of its anti-money laundering and combating of financing of terrorism and proliferation (AML/CFT/CPF) standards. These processes morphed into the current FATF International Co-operation Review Group (ICRG) processes, with a blacklist of countries that refuse to implement the FATF standards appropriately (or in practice continue to fail to commit themselves politically to progress improvements) and a grey list of countries with so-called strategic deficiencies in their compliance framework.

Prior to 2016, the grey list included countries that are not politically committed to addressing the identified deficiencies (the dark grey list) and countries that adopted and were working on an action plan to address the problems (the light-grey list). Since 2016, only countries that are working on solving the problems are listed, i.e. those previously labelled as "light-grey".

Since 2016, the formal language of the FATF has softened in its public greylisting statements (De Koker, Howell and Morris, 2023, p. 6). The February 2024 version of the statement entitled *Jurisdictions under Increased Monitoring* reads as follows (FATF, 2024a, 2024b):

> Jurisdictions under increased monitoring are actively working with the FATF to address strategic deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation financing. When the FATF places a jurisdiction under increased monitoring, it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes and is subject to increased monitoring. This list is often externally referred to as the grey list.

Being greylisted should therefore send a positive signal that the country is implementing an action plan to address the identified deficiencies. Yet, the FATF presents these positive developments as a risk information that other countries should take into account in their risk analysis. To confuse matters further, however, the FATF also states in the introductory statement in relation to the listed countries (FATF, 2024a, 2024b):

> The FATF welcomes their commitment and will closely monitor their progress. The FATF does not call for the application of enhanced due diligence measures to be applied to these jurisdictions. The FATF Standards do not envisage de-risking, or cutting-off entire classes of customers, but call for the application of a risk-based approach.

As a result, evidence points to continuing negative economic impact on countries that are greylisted (De Koker, Howell and Morris, 2023). It means that countries that commit to solving the identified problems and implement an action plan to do so are punished when doing so. That approach, it is submitted, makes little sense. It is, however, currently particularly relevant to the Sub-Saharan Africa region, as 12 of the 21 greylisted countries after the February 2024 plenary meeting of the FATF are from that one single region (FATF, 2024a, 2024b). Greylisting impacts on the listed country but also indirectly on its trade partners. These impacts would tend to be amplified where a number of trade partners are concurrently greylisted. Such impact poses significant risks to the development of that region and to its stability.

Adding to the negative impact of the FATF's greylisting is the use of that list as a trigger for other lists of higher-risk third countries, especially the EU and the UK lists that trigger

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enhanced due diligence measures by their institutions in relation to listed countries and persons connected to them (De Koker, Howell and Morris, 2023 par 2.3; EU Fourth AML Directive, 2015; Money Laundering, Terrorist Financing and Transfer of Funds (Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (UK). Unger B, 2023)

Two arguments are often advanced to justify the need for the current grey list and its design:

FATF needs a big stick to ensure compliance: The FATF does need an enforcement mechanism, but it has the blacklist that will still serve as a threat for countries that fail to progress to higher compliance levels if greylisting is abolished or amended. In addition to the FATF, the market also puts pressure on non-compliant jurisdictions. Non-compliant countries risk losing correspondent banking relationships and business opportunities if international institutions have concerns about their money laundering and financing of terrorism of proliferation risks. The risk information is disclosed in mutual evaluation processes and will influence risk decisions of institutions globally, even in the absence of a grey list.

The grey list and the lists of the EU and UK are not to punish countries but to protect their systems against risk posed by those jurisdictions (European Commission, 2023). This argument is often heard, but it is unconvincing (De Koker, Howell and Morris, 2023, par 7; De Koker and Goldbarsht, 2024). Greylisting follows some time after the public identification of a country's deficiencies by publication of their mutual evaluation report. If there were concerns about the risk posed by the country, the mutual evaluation report itself would have triggered the higher risk third country listing. That does not happen in relation to the EU or the UK list.

South Africa provides a good case in point. South Africa's mutual evaluation report was adopted by the FATF at its June 2021 plenary meeting. The report identified 67 actions that South Africa had to complete to align its AML/CFT/CPF framework with the FATF standards. South Africa began to take action and by February 2023, when it was greylisted by the FATF, only eight strategic deficiencies remained. When it greylisted South Africa, FATF even acknowledged the improvements made since 2021 (FATF, 2023):

> Since the adoption of its MER in June 2021, South Africa has made significant progress on many of the MER's recommended actions to improve its system including by developing national AML/CTF policies to address higher risks and newly amending the legal framework for TF and TFS, among others.

By the time it was greylisted, the risks posed by its system to the financial sectors of other countries were therefore far lower than in June 2021. Only on 17 May 2023, the European Commission responded to the FATF greylisting of South Africa by adding South Africa to the EU list of "high risk third countries". (European Commission, 2023). In October 2023, the FATF formally re-rated 18 of South Africa's 20 deficiencies based on the progress made by the South African authorities in the two-year period following the 2021 mutual evaluation. This further reflected the significance of the strides made since the publication of the report. On 4 December 2023, HM Treasury advised that South Africa was added to their schedule of "high-risk third countries" under the UK Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations, 2017.

The timelines and processes are not reflective of genuine concern about actual risks posed by these jurisdictions with strategic deficiencies.

Further developments regarding these lists raise additional questions. In January 2024, the UK changed their regulations to automatically label FATF black- and greylisted countries as higher-risk third countries and to have that label automatically removed when they are delisted by the FATF. In February 2024, the FATF delisted the United Arab Emirates (UAE) from its

grey list. In April 2024, however, the European Parliament voted to keep the UAE on the EU's list of higher-risk third countries. This places the EU out of step with the FATF and with the UK following the latter. The FATF operates by consensus, and it is not clear why the EU members agreed to the delisting of the UAE if they doubted that it qualifies for delisting. From a global crime risk management perspective, these actions and tensions are unhelpful.

How can the FATF improve its current processes? There are a number of actions that the FATF can take to improve the current approach:

- There is a clear need to carefully consider the objectives of the process as a whole as well as the broader development implications of the current design. The FATF should review the process and consider the unintended consequences of the current listing approach, including the use by the EU and countries such as the UK as well as the application by the private sector to inform a clear objective and appropriate approach;
- We are nearing the point where half of the world's jurisdictions have been listed and some listed repeatedly. There is a need to review the countries that have been – and are in danger of being – greylisted. Generally, these are not the countries that hold the greatest share of proceeds of crime globally. Despite the potential under the current principles to prioritise the review of those countries with more significant financial sectors – e.g. US$5bn or more in financial sector assets (FATF, 2024a, 2024b) - many countries with smaller economies and limited linkages with the international financial system have been listed. A more sensible focus is required. That focus should also be reflected in the listing criteria and action plans. If a small jurisdiction is included primarily because its off-shore financial sector poses a risk to the international financial system, the focus should be primarily on appropriate improvement in relation to that off-shore sector rather than following a cookie-cutter approach that also brings other less relevant strategic deficiencies in its national AML/CFT/CPF system into play. Often, these deficiencies can only be remedied by diverting limited national resources from other development goals to increase compliance with FATF standards where that may deliver limited benefit to the country and to the international community;
- Consider the use of the listing process to enforce improvements in effectiveness. Currently, a country can be listed if it has a low or moderate level of effectiveness for 9 or more of the 11 immediate outcomes, with a minimum of two lows, or if it has a low level of effectiveness for 6 or more of the 11 Immediate Outcomes (FATF, 2024a). Effectiveness is often closely associated with the wealth of the country. Unless sustainable resourcing of effective AML/CFT/CPF structures is addressed, most probably through continuing development aid, many smaller economies may find themselves repeatedly greylisted. Consider also the increasing use of "sustained improvement" language in country action plan goals, e.g. to show a sustained increase in AML investigations and prosecutions. The need to show evidence of sustained improvement locks the country into the grey list for at least three years, and often longer, before it can prove that the improvements are indeed "sustained". The longer a country spends on the grey list, the greater the risk of significant negative economic impact; and
- Once a jurisdiction enters the ICRG review process as a result of its mutual evaluation results, it has a one-year observation period to make the necessary changes before it is greylisted (FATF 2024a). Only a few countries have managed to make the changes within that very short period. By lengthening the observation period by 6 or 12 months, or, ideally, by tailoring a fair period for each jurisdiction, many countries will be under pressure to meet the standards without being unfairly exposed to the negative economic impacts of greylisting.

Pressure is required to ensure appropriate action globally, but that pressure must also be applied sensibly to avoid unintended negative consequences.

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