The Anti-Money Laundering Policies and its Global Convergence[1]

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Abstract

This paper analyzes the institutional and legal evolution of Anti-Money Laundering and Combating Financing of the Terrorism (AML/CFT) policies in Brazil and its connection with the decisions and recommendations of international organizations. It is intended to demonstrate the convergence of domestic policies with international guidelines. By applying the logic of two-level games interactions between recent historical facts, recommendations of international organizations and the normative and institutional developments at the national level will be established.

Global leaders through international organizations can lead to institutional convergence among nations, such as AML/CFT policies. When AML/CFT policies adopted by Brazil are analyzed, the strong influence of international forums on the formation of the Brazilian institutional structure can be noted. Of course, the political will to adopt them comes from the local authorities, considering nations have the right of not foreign interference in their domestic affairs.

Key words: two levels game – global convergence – money laundering

JEL codes: F59 - G18 - K42

I Introduction

Globalization and growing economic interdependence, that have for so long been regarded as pacifying and stabilizing factors of financial transactions and international relations, have strongly encouraged, the transformation of organized and serious crime, over the last 30 years, beyond borders, places and people and, in some cases, even, identifiable victims. Improved communication networks and information technologies, have increasingly blurred national borders, improved the mobility of people, goods and services across countries, and have consolidated the globalized economy. These have all acted as facilitators, enabling the more traditional forms of organized and serious crime to go beyond their supposed local dimension and conventional explanations. Thus, the dialectics between local and global has emerged as a distinctive aspect of contemporary forms of crime.

The fight against the money laundering and terrorism financing crimes is supported by and shows the political will to act by the G-20, the top group in international politics, as revealed in their Toronto summit declaration. Backed by the G-20, the Bank for International Settlements (BIS) has granted powers to the Financial Stability Forum (FSF), turned the latter into the Financial

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Stability Board (FSB), and reinforced the guidelines from the principles set by the Basel Committee on Banking Supervision (BCBS) with respect to the matter. The International Monetary Fund in conjunction with the World Bank have also emphasized their concerns about ML/TF as well as they consider including the issue in peer-reviews of the national financial systems led by those institutions whenever there is evidence that such practice may endanger the integrity of domestic financial markets. All of the aforementioned agencies support and operate in collaboration with the FATF-GAFI, the international body specializing in AML/CFT.

To reach our goal, we are going to apply the two level games theory to show the global and domestic interaction works. Economic theory of crime and the principal-agent approach will assist the analysis. It is important to keep in mind that, although most papers cited are related to money laundering as a cross-border crime, such crime may take place within the borders of any country and cause losses similar to the ones discussed in the course of this paper.

II Theoretical Foundation: Two Level Games: internal versus external arena

Any theory of international relations lacks a definition of the level of analysis (States or regions or even the international system), along with an ontological definition of the theory (which is the structure of international relations?). The first question refers to who are the agents of international relations and, the second one, to the structure of international relations. After the definition of who and what, one must define the relationship between the agent and the structure.

The internal and external policies became inextricably connected by a fine line. The interactions of domestic political groups may prove useful in the practice of diplomacy. Governments take advantage of these interactions to fix concessions limits they can make under penalty of popular rejection. The internal interactions become instruments of foreign policy that negotiators use to mark their positions. In parallel, international negotiations are leverages of domestic politics. They serve to justify unpopular reforms (LANDAU, 1996, 169-170).

Each state gets to decide on policies and actions in accordance with their own internal processes, but their decisions are shaped by the presence of other states as well as by its interactions with them. States, or those who work for them, try, in more or less sensible ways, to use the means available to achieve the intended purposes. Waltz recognizes that the international political theory must be complemented by a domestic policy theory. The internal political configuration offers the filter to the understanding of structural constraints and to the international action decisions (WALTZ, 2002, 95 and 164).

Robert Putnam (1988) points out that often the decisions of domestic policy are intertwined with international negotiations. Putnam also emphasizes that the policies of many international negotiations can be designed as a two-level game. Domestically, groups pursue their

interests by pressing the government to adopt favorable policies, and politicians seek power by building coalitions among those groups. At the international level, national governments seek to maximize their own ability to satisfy domestic pressures while minimizing the consequences of external developments. Neither game can be ignored by central decision maker, as well as their countries remain interdependent, even if sovereign.

Putnam described the political leaders as situated between two tables: 1) international negotiation, both in crisis situations and outside them, 2) pressures from internal political forces. The diplomatic path has to be adapted to what the other states will find it acceptable, but also to what the various domestic actors can be persuaded to accept.

Stiglitz makes defense of international cooperation and multilateralism stating that, internationally, the theory identifies why individual governments may fail to serve the global economic well-being, and how the global collective action – a joint action of various governments working together, usually through international institutions – would improve the situation (STIGLITZ, 2002, 243).

Pflatzgraff and Dougherty (2003) report that many authors present common elements regarding the mental pictures they use to analyze the international systems. Firstly, most of them showed interest in the factors that contribute to the stability or instability of the international system. Secondly, there is a common concern about the coping mechanisms that allow the system to remain in balance and stability. Thirdly, there is a common interest in assessing the impact on the system of the presence of units with different capacities to mobilize resources and to use advanced technology. Fourth, there are many authors who agree on the fact that forces that move within the national political units exert a great influence in the international system. Fifthly, these authors show interest, even as part of their interest in the nature of balance, in the international community's ability to contain and treat effectively the disturbances that develop in its interior. This leads to a shared interest in the role of national and supranational actors as regulators of an international system characterized by dynamic change (DOUGHERTY JR and PFALTZGRAFF. 2003, 154).

For example, the dilemma of making decisions in two arenas – internal and external – is faced by the Central Bank of Brazil when it regulates and supervises the banking and credit system, when it negotiates the external debt, when it manages international reserves, when it regulates and supervises the foreign exchange market, when it sets Brazilian interest rate. In all these decisions there is a pressure from the structure of the international financial system and from the demands of Brazilian society. (SALVO, 2013)

A relevant debate, which can be analyzed from the two-level perspective, refers to the shape of domestic institutions. A country that does not choose isolationism should develop institutions that are in accordance not only with the means and the ends desired for their own

country, but also be in line with what the country expects to obtain in the relations with the rest of the world. In other words, one cannot expect to take advantage of international relations if their domestic institutions are not prepared to do so.

A moral hazard problem exists when the action of the agent is not verifiable or when the agent receives private information after the relationship has begun. Arrow (1985) classified moral hazard problems as being of the hidden action type, which are actions that cannot be fully observed or inferred by others, therefore making it impossible to establish or stipulate complete contracts on the basis of such actions.

Regulatory measures can and must also be for the purpose of increasing information, and need to include the requirement to provide information regularly. Since the government has an incentive to try and reduce the moral hazard problem created by asymmetric information, it should establish laws forcing firms to comply with principles and maintain internal controls that help check their conduct.

Monitoring is one of the ways the principal can reduce the agency dilemma, engaging in the production of information through greater monitoring of the activities of agents, such as via frequent audits to certify the strength of the information. The problem with this method is that the monitoring process can be costly in terms of money and time – that is – verification costs are high.

Solving the problem of informational flaws would help improve results, providing a better knowledge (meaning measurement) of criminal or unusual/suspicious activity, as well as its costs and benefits. After this would be the adjusting of regulatory measures and monitoring, in addition to increasing the transaction cost of criminals and their perception of the likelihood of being punished.

Ferwerda (2008) demonstrates in a theoretical model that the probability of getting caught, the sentence for money laundering, the probability of being convicted for the crime and the transaction costs of money laundering carry a negative weight in relation to the value generated by the crime.

Regulation/supervision/punishment must lend themselves to decreasing the asymmetry of information, increasing the criminals' perception of the likelihood they will be punished and, thus, dissuading them. Preventative money laundering actions must alter the crime's equation by increasing the costs of performing the criminal activity and the likelihood of punishment.

III Governance without Government and Globalization

In two centuries of globalization, multinational corporations, nations, societies and economic regions have suffered and continue to be subject to changes inherent to the technological advances of more prosperous societies, but certainly the prerogatives of the past of dependency theory will not serve as a method of analysis, as the globalization of this century there will be an

increasingly interdependent relationship between developed and developing countries (LOZARDO, 2007, 35).

There are new dimensions in globalization, which are causing political and economic transformations, especially among emerging nations. Without this understanding, it becomes difficult to understand the direction of trade policies, of international direct investment, of the references of the global consumer, of the role of multinational corporations, of the challenges of entrepreneurs and governments of each nation. In this sense, the international institutions of the West, such as the WTO, the World Bank and the IMF, as well as regional institutions and central banks, will be adopting policies with the character of co-responsibility with respect to growth with economic openness, with co-responsibility of each government concerning public policy, administrative transparency and international investment policies aimed at the welfare of all, the reduction of discrepancies and the increase of income between countries and inside them (LOZARDO, 2007, 35).

Globalization means that there is a growing recognition of arenas whose impacts are global. It is these arenas that it is required a global collective action – and global governance systems are essential (STIGLITZ, 2002, 272).

There is no world government, responsible for the peoples of all countries and for overseeing the process of globalization. Instead, we have a system that could be called global governance without global government, in which a few institutions - the World Bank, IMF, WTO - and some participants - the ministries of finance (and central banks) and trade, closely linked to certain financial and commercial interests - dominate the scene. It is time to change some of the rules that govern the world economic order, giving less emphasis to ideologies and paying more attention to what really works, to think again about the way decisions are made at the international level - and in whose interest (STIGLITZ, 2002, 49).

The issue raised by Stiglitz in the previous paragraph introduces the problem of coordination in global actions, especially in an environment of economic interdependence. This issue has gained importance on the international agenda when international finance became the central theme of international relations. When the main topic was national security, behaviors were more predictable, because we had fewer agents (primarily states), less variables and less interdependence. Although we also lived in an anarchic society, it was clearer leadership conditions, its allies and the threats, and there was a better chance to quantify gains and losses resulting from different agents movements. The coordination of the international system, although not formal, it was implied.

We continue in an anarchic society, however with the economy as the engine of international politics; other non-state actors, thus, have gained strength (companies, banks,

emerging markets, NGOs, terrorist organizations etc.). Having more agents, there are more interests at stake, more variables, increases in difficulty of coordination, because the leadership role becomes diffuse, and decreases in predictability. Gains and losses (pay-offs) of interactions are unclear hindering the establishment of international cooperation.

Previously, the international game could be compared to a game of checkers with a single piece type (states) doing only one type of motion (defending the national interest). Currently the game more appropriate to describe international relations would be kings with many kinds of pieces (state and non-state actors) doing different movements (each in defense of their own interests).

Nowadays the foundation for international financial cooperation is weaker than in the 70s and 80s. If we are concerned with the stability of the International Financial System, it is important to understand what the weaknesses of its fundamentals are and why they happen. The pace of technological innovations in the world of finance has been greatly accelerated and the magnitude and importance has grown conspicuously in the economic field; nevertheless, the political capacity to adjust to these changes has been decreasing. The main problem of international finance is that it is driven by many hands (governments, international organizations and national authorities). In all these issues, the international political system, based on an outdated principle of sovereignty, is in a state of unfortunate delay regarding the global market economy, which has great power, but with little sense of social and moral responsibility (STRANGE, 1999, 57-8).

In the book "Globalization", George Soros ponders on the advantages and disadvantages of globalization. To Soros, the international financial markets have built an unleveled playing field, which has become unsustainable in its current form. There is no international equivalent to the political process that occurs within different states. As markets became global, the policy remained firmly rooted in State sovereignty. Although anachronistic, the concept of sovereignty remains the basis of support of international relations. We must accept it as a starting point for the creation of an open society (SOROS, 2003, 29, 50, 186).

So what is sovereignty? Say that a state is sovereign means that it decides for itself how it will meet its internal and external problems, including whether or not to seek assistance from others and, in doing that, limit their freedom, reaching commitments with them. States develop their own strategies, map their own paths, and make their own decisions about how to respond to any need or desires they develop. It is not more contradictory to say that sovereign states are always constrained, and, very often, very constrained, than to say that free individuals, very often, make decisions under the immense pressure of events (Waltz 2002, 136).

IV How the issue has been addressed

The goal of this section is to show how international financial institutions have incorporated the crimes of money laundering (ML) and terrorism financing (TF) to their financial stability governance framework. As we are going to detail below, ML and TF are deemed global, priority concerns for several reasons, including this type of crime's destabilizing potential.

Money laundering and measures to counter it have become the focus of an intense international effort. Evaluation of the resource costs and benefits of the countermeasures depends in part on an understanding of the macroeconomic effects of money laundering. The wide range of activities and financial instruments involved in money laundering is not directly observable, and comprehensive, microeconomic-based estimates are difficult to compile. Indirect macroeconomic-based techniques that involve estimating the extent of money laundering are, therefore, the focus of most empirical work.

Money laundering can have devastating economic consequences. Fighting it should be a priority for all countries and is not incompatible with financial market liberalization. By the nature of the subject there is difficulty inherent in obtaining any measure of money laundering, however defined. There is a broad range of activities and financial instruments involved in money laundering, which is not directly observable, and comprehensive and meaningful estimates are difficult to compile. This difficulty has been reflected in the extensive literature that examines the measurement of the illegal or "underground" economic transactions in which transactors attempt to conceal their sources of income. Given the seriousness of the problem, there is clearly a need for better data. On the one hand, while estimates based on macroeconomic data can provide indications of both direct and indirect influences of money laundering, the inclusion of indirect influences creates uncertainty as to exactly what is being measured. On the other hand, a micro-based approach requires the creation of a very large amount of data specifically for measurement purposes. Sampling and survey approaches offer a means of extrapolating to otherwise unobservable aspects of money laundering, although care needs to be taken to ensure that a comprehensive methodology is applied in the sampling and in-depth follow-up of transactions. A consistent international methodology would offer economies of scale as well as the sharing of insights across countries. The measurement problems extend beyond the lack of statistics. They cover also conceptual questions such as when money that has been laundered in the past stops being considered "laundered". (TANZI, 1996, p. 4 footnote)

The problem would be related to the money launderer's economic rationale as opposed to that of regular investors. Money launderers maximize their return and minimize their risks in non-financial terms. In other words, such optimization is achieved by decreasing the odds of having the provenance of their resources found and thus of being exposed and punished. Therefore, at given

times the flows may follow directions contrary to those expected and muddle the risk/financial return rationale. To the extent possible, it would be up to regulators and supervisors to sort the transactions according to their rationales. Or at least keep always in mind that not all transactions follow the same reasoning. (SALVO, 2014)

The fight against the money laundering and terrorism financing crimes is supported by and shows the political will to act by the G-20, the top group in international politics, as revealed in their Toronto summit declaration. Backed by the G-20, the Bank for International Settlements (BIS) has granted powers to the Financial Stability Forum (FSF), turned the latter into the Financial Stability Board (FSB), and reinforced the guidelines from the principles set by the Basel Committee on Banking Supervision (BCBS) with respect to the matter. The International Monetary Fund and the World Bank have also emphasized their concerns about ML/TF and consider including the issue in peer-reviews of the national financial systems led by those institutions whenever there is evidence that such practice may endanger the integrity of domestic financial markets. All of the aforementioned agencies support and operate in collaboration with the FATF-GAFI, the international body specializing in AML/CFT.

The leaders of G-20 agreed to build a more resilient financial system that serves the needs of all economies, reduces moral hazard, limits the build up of systemic risk, and supports strong and stable economic growth. They have strengthened the global financial system by fortifying prudential oversight, improving risk management, promoting transparency, and reinforcing international cooperation. A great deal has been accomplished. (G-20, Toronto Declaration, 2010)

At the G-20 meeting in Toronto (2010) the agenda of commitments was organized around four pillars. The first pillar is a strong regulatory framework. It was taken stock of the progress of the Basel Committee on Banking Supervision (BCBS) towards a new global regime for bank capital and liquidity and we welcome and support its work. The second pillar is effective supervision. The leaders agreed that new, stronger rules must be complemented with more effective oversight and supervision. (G-20, Toronto Declaration, 2010)

Capital movements induced by attempts at laundering money are not promoted by differences in economic fundamentals, such as differences in after-tax rates of return to real investment or, in real interest rates. Rather, they are largely induced by differences in controls and regulations which make money laundering a safer activity in some countries than in others. (TANZI, 1996, p. 6)

The third pillar is resolution and addressing systemic institutions. All members of the group committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden, and adopted principles that will guide implementation. To reduce moral hazard

risks, there is a need to have a policy framework including effective resolution tools, strengthened prudential and supervisory requirements, and core financial market infrastructures. (G-20, Toronto Declaration, 2010)

The fourth pillar is transparent international assessment and peer review. It was strengthened the commitment to the IMF/World Bank Financial Sector Assessment Program (FSAP) and pledge to support robust and transparent peer review through the FSB. Non-cooperative jurisdictions will be addressed based on comprehensive, consistent, and transparent assessment with respect to tax havens, the fight against money laundering and terrorist financing and the adherence to prudential standards. (G-20, Toronto Declaration, 2010)

The Finance Ministers and Central Bank Governors agreed to prepare policy options to strengthen global financial safety nets and to build a more stable and resilient international monetary system. Corruption was considered as a threat to the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust and undermines the rule of law. The leaders called for the ratification and full implementation by all G-20 members of the United Nations Convention against Corruption (UNCAC) and encourage others to do the same. They encouraged the fully implementation of the reviews in accordance with the provisions of UNCAC. Building on the progress made since Pittsburgh to address corruption, it was established a Working Group to make comprehensive recommendations on how the G-20 could continue to make practical and valuable contributions to international efforts to combat corruption and lead by example, in key areas that include, but are not limited to, adopting and enforcing strong and effective anti-bribery rules, fighting corruption in the public and private sectors, preventing access of corrupt persons to global financial systems, cooperation in visa denial, extradition and asset recovery, and protecting whistleblowers who stand-up against corruption. (G-20, Toronto Declaration, 2010)

Leaders of G-20 pledged to support robust and transparent independent international assessment and peers review of financial systems through the IMF and World Bank's Financial Sector Assessment Program and the FSB peer review process. The mutual dependence and integrated nature of our financial system requires that we all live up to our commitments. Weak financial systems in some countries pose a threat to the stability of the international financial system. International assessment and peer review are fundamental in making the financial sector safer for all. (G-20, Toronto Declaration, 2010)

G-20 fully support the work of the Financial Action Task Force (FATF) and FATF-Style Regional Bodies in their fight against money laundering and terrorist financing and regular updates of a public list on jurisdictions with strategic deficiencies. They also encourage the FATF to continue monitoring and enhancing global compliance with the anti-money laundering and counter-terrorism financing international standards. (G-20, Toronto Declaration, 2010)

Thus the G-20 endorsed technically and politically guidelines issued by various international organizations involved in AML/CFT politics. Furthermore, it played the role of coordinator of policies giving greater transparency to the roles of each one.

Being aware of the risks incurred by banks of being used, intentionally or unintentionally, for criminal activities, the Basel Committee on Banking Supervision issued guidelines, whose main aim is to describe how banks should include money laundering (ML) and financing of terrorism (FT) risks within their overall risk management. The Committee's commitment to combating money laundering and the financing of terrorism is fully aligned with its mandate "to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability".

In its role of stipulating guidelines of good practice for the financial system BIS recommends sound ML/FT risk management, recognizing it as of particular relevance to the overall safety and soundness of banks and the financial system and the main objective banking supervision, the extent that:

- it contributes to the protection of the reputation of both banks and national banking systems by preventing and deterring the use of banks to launder illicit proceeds or to raise or move funds in support of terrorism; and

- it preserves the integrity of the international financial system as well as the work of governments in addressing corruption and in combating financing of terrorism. (BIS, 2013, pg.1-2)

The Committee believes that the inadequacy or absence of sound ML/FT risk management can increase the exposure of banks to serious risks, especially reputational, operational, compliance and concentration risks. Recent developments, including robust enforcement actions taken by regulators and the corresponding direct and indirect costs incurred by banks due to their lack of diligence in applying appropriate risk management policies, procedures and controls, have highlighted those risks. These costs and damage could probably have been avoided had the banks maintained effective risk-based AML/CFT policies and procedures. (BIS, 2013, pg.2)

It is worth noting that all these risks are interrelated. However, in addition to incurring fines and sanctions by regulators, any one of them could result in significant financial costs to banks (eg through the termination of wholesale funding and facilities, claims against the bank, investigation costs, asset seizures and freezes, and loan losses), as well as the diversion of limited and valuable management time and operational resources to resolve problems. (BIS, 2013, pg.2)

With respect to the scope of application, the guidelines should be read in conjunction with other standards and guidelines produced by the Committee which promote supervision of banking groups on a consolidated level. This is particularly relevant in the context of AML/CFT since

customers frequently have multiple relationships and/or accounts with the same banking group, but in offices located in different countries. (BIS, 2013, pg. 3)

In accordance with the updated Core Principles for Effective Banking Supervision (2012), all banks should be required to "have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the banking sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities". This requirement is to be seen as a specific part of the banks' general obligation to have sound risk management programmes in place to address all kinds of risks, including ML and FT risks. Therefore, "adequate policies and processes" in this context requires the implementation of other measures in addition to CDD rules and compliance with the banks' own risk assessment of ML/FT risks. (See BCP 29 in Core Principles for Effective Banking Supervision, September 2012). (BIS, 2013, pg. 3)

Banking supervisors are expected to comply with FATF Recommendation 26, which states in part: "For financial institutions subject to the Core Principles, the regulatory and supervisory measures that apply for prudential purposes, and which are also relevant to money laundering and financing of terrorism, should apply in a similar manner for AML/CFT purposes. This should include applying consolidated group supervision for AML/CFT purposes." The Committee expects supervisors to apply the Core Principles for Effective Banking Supervision to banks' ML/FT risk management in a manner consistent with and supportive of the supervisors' overall supervision of banks. Supervisors should be able to apply a range of effective, proportionate and dissuasive sanctions in cases when banks fail to comply with their AML/CFT requirements. (BIS, 2013, pg. 16)

Supervisors should adopt a risk-based approach to supervising banks' ML/FT risk management. Such an approach requires that supervisors i) develop a thorough understanding of the risks present in the jurisdiction and their potential impact on the supervised entities; ii) evaluate the adequacy of the bank's risk assessment based on the jurisdiction's national risk assessment(s); iii) assess the risks present in the target supervised entity to understand the nature and extent of the risks in the entity's customer base, products and services and the geographical locations in which the bank and its customers do business; iv) evaluate the adequacy and effectiveness in implementation of the controls (including CDD measures) designed by the bank in meeting its AML/CFT obligations and risk mitigation; and v) utilise this information to allocate the resources, scope the review, identify the necessary supervisory expertise and experience needed to conduct an effective review and allocate these resources relative to the identified risks. Supervisors have a duty to ensure their banks maintain sound ML/FT risk management not only to protect their own safety and soundness but also to protect the integrity of the financial system. (BIS, 2013. pg 17)

Supervisors should also consider a bank's overall monitoring and oversight of compliance at the branch and subsidiary level as well as the ability of group policy to accommodate local regulatory requirements and ensure that where there is a difference between the group and local requirements, the stricter of the two is applied. Supervisors should also ensure that in cases where the group branch or subsidiary cannot apply the stricter of the two standards, the reasons for this and the differences between the two should be documented and appropriate mitigating measures implemented to address risks identified as a result of those differences. (BIS, 2013. pg 18)

The IMF undertook to make the connection between the existence of not recommendable practices keeping in mind that money laundering and the financing of terrorism are financial crimes with economic effects. They can threaten the stability of a country's financial sector or its external stability more generally. Effective anti-money laundering and combating the financing of terrorism regimes are essential to protect the integrity of markets and of the global financial framework as they help mitigate the factors that facilitate financial abuse. Action to prevent and combat money laundering and the financing of terrorism thus responds not only to a moral imperative, but also to an economic need. (IMF, 2013, factsheet).

In 2000, the IMF responded to calls from the international community to expand its work in the area of anti-money laundering (AML). Money laundering can undermine the integrity and stability of financial institutions and systems, discourage foreign investment, and distort international capital flows. It may have negative consequences for a country's financial stability and macroeconomic performance, resulting in welfare losses, draining resources from more productive economic activities, and even have destabilizing spillover effects on the economies of other countries. The work of the FATF, as well as the IMF's in AML/CFT efforts, has been supported by the G-20, most recently in the context of initiatives to address the 2008-9 international financial crises and the aftermath. (IMF, 2013, factsheet)

In line with a growing recognition of the importance of financial integrity issues for the IMF, the AML/CFT program has evolved over the years. In 2004, the Executive Board agreed to make AML/CFT assessments and technical assistance a regular part of IMF work. On June 1, 2011, the Executive Board discussed a report reviewing the evolution of the IMF's AML/CFT program over the past five years and provided guidance as to how to move forward in this area. The key outcomes of the discussion can be found here. On December 14, 2012, a Guidance Note on the inclusion of AML/CFT in surveillance and financial stability assessments (FSAs) was issued. It provides a framework to deal with cases where money laundering, terrorism financing, and related crimes are so serious as to threaten domestic stability, balance of payments stability, the effective operation of the international monetary system—in the case of Article IV surveillance, or the stability of the domestic financial system—in the case of FSAs. (IMF, 2013, factsheet)

After all formal expressions of several international organizations regarding their concerns about the potential destabilizing of money laundering and financing of terrorism, the FATF/GAFI have seen further strengthened in their duties to stipulate guidelines and policies in their AML/CFT reviews of implementation of these recommendations. In addition, such manifestations demonstrate the key to give greater effectiveness in addressing the problem international cooperation.

The FATF-GAFI considers that implementation of its recommendations has a number of benefits, connecting those who adhere to international obligations, and avoid the risk of sanctions or other measures by the international community. They also ensure a more transparent and stable financial system that is more attractive to foreign investors. Corrupt and opaque financial systems are inherently unstable. Excessive money laundering can cause increased volatility of international capital flows and exchange rates, market disparities, and distortions of investment and trade flows. (FATF/GAFI, 2010)

Furthermore, they ensure that financial institutions are not vulnerable to infiltration or abuse by organised crime groups. Financial institutions that are exploited in this manner are exposed to reputational risk, financial instability, diminished public confidence, threats to safety and soundness, and direct losses. Implementation helps to build the capacity to fight terrorism and trace terrorist money.

At last, meet binding international obligations, and avoid the risk of sanctions or other action by the international community and avoid becoming a haven for criminals. Countries with weak AML/CFT systems are attractive to criminals because they provide an environment in which criminals can enjoy the profits of their crimes and finance their illicit activities with little fear of facing punishment. (FATF/GAFI, 2010)

The IMF has determined three keys to risk assessment — threat, vulnerability, and consequences — and their application to LD and FT. International risk management standards define risk as a function of the likelihood of occurrence and the consequence of risk events, where likelihood of occurrence is a function of the coexistence of threat and vulnerability. In other words, risk events occur when a threat exploits vulnerability. Formally, R, a jurisdiction‘s level of LD risk, can be represented as: $R = f\,[(T), (V)] \times C$, where T represents threat, V represents vulnerability, and C represents consequence. Accordingly, the level of risk can be mitigated by reducing the size of the threats, vulnerabilities, or their consequences. (IMF, 2011 pg. 64)

In ML, a “threat” is largely related to the nature and scale of the potential demand for LD, i.e., the pool of illegally-acquired assets that need to be laundered. Thus, LD risk assessment implies understanding and generating indicators for the proceeds of crime (POC) that are generated in or brought to a jurisdiction. For the purposes of FT risk assessment, threat is mainly related to

the nature and scale of the funds raised for use by terrorists that are in a jurisdiction in need of processing. (IMF, 2011 pg. 65)

“Vulnerability” in ML or FT risk assessment encompasses the products, services, distribution channels, customer bases, institutions, systems, structures, and jurisdictions (including weaknesses in systems, controls, or measures) that enable ML or FT abuse. The vulnerability indicators are numerous but they can be grouped into categories such as geographic location, financial services and products, levels of informality in various sectors, weaknesses in the AML/CFT systems and the adequacy of existing AML/CFT controls, general levels of corruption, the effectiveness of law enforcement agencies (LEAs) and the criminal justice system (CJS), and other characteristics of the jurisdiction that could facilitate successful ML or FT. In the staff‘s framework, vulnerability indicators are aggregated and combined with the threat indicators to produce an overall analysis of the likelihood of substantial ML or of FT occurring successfully. (IMF, 2011 pg. 65-6)

“Consequences” relate to the outcomes that result from the occurrence of risk events. Consequences can relate to cost, damage caused, or the significance of outcomes. From one perspective, ML and FT processes generate two types of consequence: first, those associated with laundering itself; and, second, those associated with the use of the assets after they have been successfully laundered. . (IMF, 2011 pg. 66)

Dirty money tends to flow to countries with less stringent controls. The international laundering of money has the potential to impose significant costs on the world economy by (a) harming the effective operations of the national economies and by promoting poorer economic policies, especially in some countries; (b) slowly corrupting the financial market and reducing the public's confidence in the international financial system, thus increasing risks and the instability of that system; and, (c) as a consequence of (a) and (b), reducing the rate of growth of the world economy. (TANZI, 1996, p. 2)

The income distribution effects of money laundering must also be considered. To the extent that the underlying criminal activity redirects income from high savers to low savers, or from sound investments to risky, low-quality investments, economic growth will suffer. The Quirk study (1996) also conducted empirical tests on the relationship between GDP growth and money laundering in 18 industrial countries for the first time. It found evidence that significant reductions in annual GDP growth rates were associated with increases in the laundering of criminal proceeds in the period 1983–90.

The channels identified in the paper through which macroeconomic consequences of money laundering are transmitted can be summarized as follows: a) policy mistakes due to measurement errors in macroeconomic statistics arising from money laundering; b) changes in the

demand for money that seem unrelated to measured changes in fundamentals; c) volatility in exchange rates and interest rates due to unanticipated cross border transfers of funds; d) other country-specific distributional effects or asset price bubbles due to disposition of "black money"; e) development of an unstable liability base and unsound asset structures of individual financial institutions or groups of such institutions, creating risks of systemic crises and hence monetary instability; f) effects on tax collection and public expenditure allocation due to misreporting and under reporting of income; g) misallocation of resources due to distortions in relative asset and commodity prices arising from money laundering activities; and h) contamination effects on legal transactions due to the perceived possibility of being associated with crime. (QUIRK, 1996)

These social, economic, and political consequences of ML have been further elaborated in the literature into 25 categories as set out as follow: 1) Losses to the victims and gains to the perpetrator; 2) Distortion of consumption; 3) Distortion of investment and savings; 4) Artificial increases in prices; 5) Unfair competition; 6) Changes in imports and exports; 7) Effects on growth rates; 8) Effects on output, income, and employment; 9) Lowers public sector revenues; 10) Threatens privatization; 11) Changes in demand for money, exchange rates, and interest rates; 12) Increases in exchange- and interest-rate volatility; 13) Greater availability of credit; 14) Higher capital inflows and outflows; 15) Changes in FDI; 16) Risks for financial sector solvency and liquidity; 17) Effects on financial sector profits; 18) Effects on financial sector reputation; 19) Illegal business contaminates legal; 20) Distorts economic statistics; 21) Corruption and bribery; 22) Increases in crime; 23) Undermines political institutions; 24) Undermines foreign policy goals; 25) Increases terrorism.

The monitoring of regulated markets involves, among other actions, the detection of atypical movements and behavior. When checked atypicity of information provided and/or collected will be up to the supervisors to identify remotely (off site) or presentially (on site) whether these abnormalities relate to:

a) Causes within the economic rationality;

b) Circumvent regulatory limits;

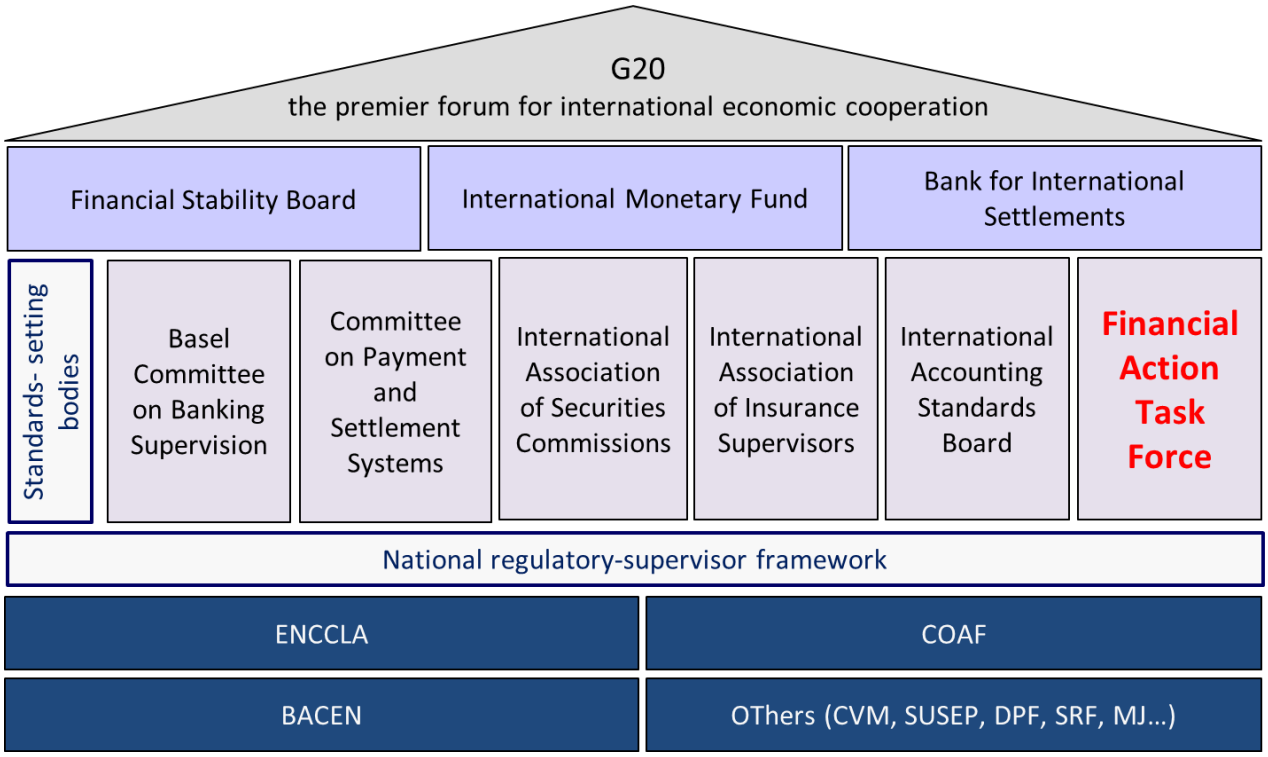
c) Operational errors;

d) Fraud in an attempt to get extra financial gains;

e) Concealment or hiding of assets of illicit origin-money laundering.

In short, in most cases it is difficult to do without direct questioning or request documents and other information to conclude about the real causes of abnormalities. Accurate diagnosis is essential to assess the consequences and seek appropriate solutions.

The figure below summarizes the international framework for preventing money laundering and combating the financing of terrorism. The structure highlights the relevance of the subject to global governance.



V Moving towards the best international practices

This section is meant to connect international guidelines and domestic decisions by setting up a cause and effect relationship. In other words, its purpose is to show that Brazilian laws and regulations are heavily influenced by efforts to move towards those which are considered the best international practices in the fight against money laundering and financing of terrorism.

The statement of reasons sent to Congress which led to the enactment of Law 9613/98 clearly expresses its adherence to the 1988 Vienna Convention against the illicit traffic of narcotic drugs and internationally pledges to criminalize it. In the time elapsed between the Vienna Convention and the enactment of the anti-money laundering law, other facts occurred which helped draw attention to the issue. A prominent one was the G7's creation of the Financial Action Task Force - FATF/GAFI in 1989.

In order to boost the efforts fighting international organized crime, in 2000 the UN adopted the Palermo Convention, which was ratified in Brazil by Decree 5015 in March 2004.

Soon after the September 11 terror attacks in the United States, the US government enacted the USA PATRIOT Act, which stands for "**U**niting and **S**trengthening **A**merica by **P**roviding **A**ppropriate **T**ools **R**equired to **I**ntercept and **O**bstruct **T**errorism Act of 2001." This act has greatly bolstered laws and other actions against money laundering and financing of terrorism worldwide.

As a result of the aforementioned acts, Brazil passed Law 10701/03, which amended the text of Law 9613/98 to increase the list of preceding crimes, and also passed Law 10744/03 on terrorist attacks. Additionally, in 2007 COAF published Resolutions nos. 15 and 16 based on decrees that had ratified other UN conventions related to financing of terrorism and the fight against corruption, respectively.

In the case of the fight against money laundering, the mutual evaluations carried out by the FATF are another instrument steering Brazil closer to international practices. Brazil was evaluated in 2009, and the results have significantly changed the country's legislation on the matter.

Some actions by the Brazilian authorities illustrate the move towards the best international practices. We can start by giving the example of a decision made by the Brazilian Central Bank's joint executive board. As the board was aware the bank was going to be evaluated under the provisions in the International Convention for the Suppression of the Financing of Terrorism adopted by the UN General Assembly and ratified in Brazil by Decree no. 5640 of 2005, the board acted in advance and sent out a circular letter consolidating the rules about the procedures to be adopted to prevent and fight activities related to the crimes addressed by Law no. 9613/98.

A number of other measures can be cited as deriving from the FATF's mutual evaluation. Said evaluation's repot pointed out deficiencies in the controls over the transit of bearer documents crossing Brazilian borders. As a response, the Brazilian Federal Revenue Service published regulatory instruction no. 1082 of 2010 that regulates the matter in order to collect information and set procedures and punishments.

In turn, in 2012 COAF (Brazilian financial intelligence unit) published resolutions nos. 21, 23, 24, 25, and 26 on factoring, jewelry trade, advisory and consulting services, luxury goods trade, and real estate market. Federal legislators passes Laws 12683/12, which updated the text of Law 9613/98, Law 12846/13, which makes criminals out of corruptors in acts against the public administration, and Law 12850/13, on criminal organizations.

The examples show the robust relationship between the guidelines set by international forums and their consequent influence on Brazilian laws and regulations, considering said domestic laws and regulations followed those set by international agencies. The causal relationship and the Brazilian legislation's move towards those considered the best practices for preventing and fighting money laundering and financing of terrorism seem to be clear.

VI Final considerations

In conclusion, the first principle that needs to be established is the importance of preventing money laundering to assist in the fight against crime and the underground economy. From there, a legal, non-statutory and institutional apparatus needs to be set up that supports the legislation/surveillance/punishment triad. If the major problem in regard to decision making is the insufficiency or absence of statistics upon which to base them, then it is up to the regulatory and surveillance bodies to require the agents to produce the necessary quantitative and/or qualitative information in order to solve the problem of information asymmetry.

Additionally, standardized statistical data needs to be gathered from the institutions involved in order to put together time and cross-section series, which will make it possible to build and use econometric models that will feed and permit improving the design of the model presented in this paper – for the purpose of guiding the formulation of public policies and even for adjusting the statutes for combating crime in general and money laundering in particular, taking into account its costs and benefits to society. The very lack of statistics to measure the problem could be considered an indication of leniency. Brazilian legislation on money laundering dates back to 1998, and after more than a decade a consistent statistical series has not yet been developed.

If the goal is to improve the financial system as an essential tool for the country's economic development, then it is up to all financial institutions, the government and citizens to make sure the system is not used by criminal organizations harmful to competition and which deteriorate healthy financial relationships. Allowing illegally-obtained resources to permeate the financial system may be a destabilizing factor for the entire economy and whose impacts may cross borders, given the global economy's interdependent character.

Before the Act anti-money laundering (ACT 9613/98) almost nothing has been done to combat this type of crime. Because without a law that defines the crime and sets out some punishment, the effectiveness of any action would be minimal. The policies recommended as the best international practices are set out in multilateral fora and applied domestically by the signatory countries that agree to do so.

As demonstrated in the article, Brazil has adopted measures that converge towards the best practices. The slow pace of convergence can be credited to the cultural and institutional features, as well as its effectiveness, however, it is undeniable that even the timid results so far have been achieved due to these developments. Thus, it is expected that gradually apply the measurements more widely and it reaches greater awareness of the importance of the issue and the damage that money laundering, their predicate offenses, and the financing of terrorism can cause.

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