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BOGUSLAVSKA

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– Basel AML Index 2023

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Basel AML Index 2023:

Snapshot of Money Laundering Risks and Trends

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Introduction

Why are governments so challenged to implement financial sanctions? How are terrorist groups able to receive the financing to launch horrific attacks – why weren't these transfers detected and halted? What on earth is happening with cryptocurrencies? And why are less than one percent of illicit financial flows estimated to be intercepted and recovered?

These questions are among those explored in the 2023 Basel AML Index Public Edition report, released on November 13, 2023 for the 12th year running. This year, due to increased data availability, 152 countries were covered in the Public Edition.

The Basel AML Index is widely known and respected as an independent ranking of money laundering and terrorist financing (ML/TF) risks around the world. It is a composite index that provides risk scores for countries based on data from 18 publicly available sources in five categories:

1. Quality of anti-money laundering and counter financing of terrorism (AML/CFT) framework
2. Bribery and corruption
3. Financial transparency and standards
4. Public transparency and accountability
5. Legal and political risks

Journalists tend to go straight to the public ranking to see who's at the top and bottom of the risk scale, whether their country has improved or worsened since the year before, and how it stands in relation to its neighbors.

But we have long encouraged users to go beyond that "good country, bad country" approach – not least because small changes from year to year are often statistically insignificant or a result of a small methodological tweak – and to explore the data behind the ranking.

Below is a short overview of this year's key findings and what data on ML/TF can tell us about global events. Find more on the website and in the report (in the Downloads section).

THE BASEL AML INDEX – AN OVERVIEW

The aim of the Basel AML Index is to provide a holistic picture of ML/TF risk. Risk, as measured by the Basel AML Index, is defined as a jurisdiction's vulnerability to ML/TF and its capacities to counter it. It is not intended as a measure of the actual amount of ML/TF activity in a given jurisdiction.

The 18 indicators differ in focus and scope in order to create this holistic picture. Data from individual indicators is collected and normalized on a 0–10 scale, where 10 indicates the highest risk level. Each of the indicators is given a weight in the overall score depending on its relevance to assessing ML/TF risk. For example, Financial Action Task Force (FATF) evaluations make up 35 percent of the overall score as a major source of information on the quality of a country's AML/CFT framework. Conversely, indicators of the rule of law and judicial independence each correspond to only 2.5 percent of the overall score; while important, they are less directly relevant to assessing ML/TF risk.

The indicators and weighting are reviewed annually by an independent expert group. The full methodology and list of indicators are available on the Basel AML Index website (methodology page).

GENERAL TRENDS

Standout findings this year were rather depressing. First, the average global risk of ML/TF across all 152 countries increased slightly from 5.25 in 2022 to 5.31 this year. This is on a scale from 0–10, where 10 is the maximum risk. Though the change is small, it indicates that efforts to crack down on ML/TF are still not having enough impact.

Why aren't they having enough impact? One reason may be an apparent fall in *effectiveness*. Our analysis of data from the FATF shows a continued decline in the measured effectiveness of AML/CFT systems globally. Scores dropped from the already low level of 30 percent effectiveness to 28 percent.

Some of the biggest problem areas in terms of effectiveness are those that are most critical to the world right now: the misuse of non-profit organizations for terrorist financing, transparency of beneficial ownership information, and the quality of supervision of both financial institutions and designated non-financial businesses and professions (including lawyers). Efforts to prosecute those who commit ML/TF offenses and confiscate illicit assets are also languishing.

Beyond FATF data and indicators of the "quality of AML/CFT framework" specifically, we also saw increased risk scores in all four other domains measured by the Basel AML Index: corruption and bribery, financial transparency and standards, public transparency and accountability, and legal and political risks.

THREE FOCUS AREAS

Though sometimes questioned over issues of transparency, the FATF evaluations provide the most robust and quantitative data on specific aspects of AML/CFT policy and implementation. This year, we looked at what the data says about three areas of particular pertinence given global events:

Confiscation: the missing key to preventing crime

Our analysis shows that countries' law enforcement authorities are doing fairly well at identifying and freezing illicit funds and other assets during investigations. (In the West, the recent rush to identify and freeze assets of sanctioned individuals and the Russian state in connection with the Russian invasion of Ukraine likely gave this a boost.) Technical compliance with the FATF's Recommendation 4 on confiscation is high at 76 percent, with no jurisdictions assessed as non-compliant.

But the data also shows that we are not managing to permanently confiscate enough illicit assets to create a deterrent effect. Globally, measures to confiscate illicit assets are just 28 percent effective, according to the FATF's Immediate Outcome 8. The score has remained static since last year. Just five of the 161 assessed jurisdictions demonstrate a high level of effectiveness in confiscation.

What's more – as we know from our own experience at the Basel Institute supporting law enforcement agencies in their asset recovery efforts – confiscations are even rarer when assets are hidden in a foreign jurisdiction. This may be because of mediocre scores for mutual legal assistance with regard to the freezing and confiscation of assets. According to FATF Recommendation 38 on mutual legal assistance, the global average for compliance is 66 percent, with less than 20 percent of countries fully compliant.

Our conclusion: stronger laws will help, but they won't solve problems with the implementation of those laws and with cross-border cooperation through mutual legal assistance.

However, a recent decision at the FATF's [October 2023 plenary session] may give confiscation outcomes a boost. Delegates agreed on major amendments to the FATF Recommendations that will, among other things, require states to:

- have policies and operational frameworks that prioritize asset recovery;
- establish non-conviction based confiscation regimes to facilitate the recovery of assets without a criminal conviction;
- have the power to suspend transactions related to money laundering, terrorist financing and serious crime.

These will take time to show up in the data. But we look forward to anything that will facilitate the detection and confiscation of illicit assets and their return to victims and victim states.

New technologies: what to do with virtual assets?

The crypto industry continues to hit the headlines with its breathtaking volatility and billion-dollar scandals. The news (though this was known for years) that terrorist groups such as Hamas had received funding via cryptocurrencies also gave policymakers a jolt.

Here, our analysis shows that compliance with the FATF's Recommendation 15 on new technologies – covering virtual assets and virtual asset service providers (VASPs) – has plummeted since the FATF strengthened its requirements. Average compliance levels have dropped from 63 percent in 2021 to 43 percent today. This is the second weakest of all 40 Recommendations after non-profit organizations (see below).

In the report, we point out that it is natural for regulators to be unsure how to react to the fast-evolving industry and its inherent risks and opportunities.

(Academy Fellow Dorothy Siron co-authored a most interesting Working Paper on this topic with our crypto lead Federico Paesano last year: *Cryptocurrencies in Asia and beyond: law, regulation and enforcement*.)

We also point to encouraging signs, such as stronger and more joined-up regulations in the E.U. and the amount of illicit virtual assets that law enforcement authorities in the U.S. and beyond are recovering.

But our message is strong: countries everywhere cannot relax. They need to move fast and firmly to understand the evolving financial crime risks of new technologies like cryptocurrencies and regulate/enforce appropriately in line with a risk-based approach.

Misuse of non-profit organizations for terrorist financing

The last of our three "deep dive" analyses looked at data on the misuse of non-profit organizations to fund terrorism. This is a topical issue right now, but also a long-running debate due to the unintended consequences of heavy-handed implementation of the FATF's Recommendation 8 on non-profit organizations.

This year, average compliance with Recommendation 8 is just 41 percent – the lowest level of all Recommendations. Effectiveness scores according to the FATF's Immediate Outcome 10 are also below average at 25 percent. Regions struggling with terrorism, including Sub-Saharan Africa and Southeast Asia, have worryingly low scores for effectiveness at just 2 and 8 percent respectively.

The report points out several things that public authorities, financial institutions, and non-profits themselves can do to build resilience against the abuse of this sector for terrorist financing. However, our analysis warns that simply increasing controls on *all* non-profits is not the way forward. It puts at risk the legitimate work of non-profits dedicated to helping the world's most vulnerable people – potentially endangering vital humanitarian assistance and violating human rights.

Again, the key lies in a risk-based approach: properly understanding *which* organizations are vulnerable, in *what way* they are vulnerable, *how* terrorists abuse these organizations, and applying resources accordingly.

CONCLUSION: RISKS AND REAL PEOPLE

Throughout this year's Basel AML Index Public Edition report is a constant theme: the need for a risk-based approach to ML/TF based on a thorough assessment of each country's or sector's specific context and threats.

We also wish to stress that AML/CFT is not just a technical field. All three focus topics illustrate how AML/CFT deficiencies impact economic prosperity, security, and sustainable development. Building resilience to ML/TF is not only about getting good scores from the FATF and Basel AML Index, but about preventing harm to people and the planet. It is also key to building a well-functioning society and economy based on trust, transparency, and the rule of law.

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