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**The Impact of Weak AML/CFT Frameworks on Financial Stability**

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This paper is about a subject of vital importance to the international community: “The Impact of Weak AML/CFT Frameworks on Financial Stability”, a first priority in the multilateral negative agenda of most advanced countries in the world.

As we all know, there is a strong relationship between financial stability and sustained economic growth, a social asset that each State should pursue and protect. As directors of the Central Bank of Argentina, we are responsible, under our Charter, for “supervising the good performance of the financial market”. In order to reach this primary objective and a sustained stability of our financial system, the Central Bank’s regulatory and supervisory powers on liquidity and soundness should be supplemented with a strategy extending to preventive and control policies to combat money laundering and terrorist financing. The implementation of these kinds of policies requires analyzing the relationship between Systems for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and Financial Stability taking into account:

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- Firstly, the consequences that may arise in the absence of a proper AML/CFT system, bearing in mind the great economic power of criminal organizations. In fact, they may affect the economic-financial and political-institutional arena, and, consequently, financial stability.
- Secondly, an increasing amount of funds that States are using to adopt mechanisms for controlling this kind of criminal conduct.
- Lastly, a growing need for implementing international standards on banking supervision related to AML/CFT to protect and reinforce financial stability.

As we all know, the world has to face criminal organizations marked by a distinctive characteristic: transactions involving huge amounts of money. The following legislation in force will help us to better understand the extent to which States have to face criminal organizations, namely:

- The USA Patriot Act, Section 302<sup>2</sup>, based on the IMF's data, which shows that money laundering ranges from 2 % to 5 % of the Gross Domestic Product in the world, around US\$ 600 bn.
- The United Nations 2005 World Drug Report<sup>3</sup>, which shows that a 5 % of the world population between 15 and 64 years old takes drugs. In addition, drug

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<sup>2</sup> SEC. 302. FINDINGS AND PURPOSES. (a) FINDINGS- The Congress finds that— (1) money laundering, estimated by the International Monetary Fund to amount to between 2 and 5 percent of global gross domestic product, which is at least \$600,000,000,000 annually, provides the financial fuel that permits transnational criminal enterprises to conduct and expand their operations to the detriment of the safety and security of American citizens;

<sup>3</sup> Chapter 1: Trends in World Drug Markets. Some 200 million people, or 5% of the world's population age 15-64, have used drugs at least once in the last 12 months.  
Chapter 2: Estimating the value of illicit drug markets. The value of the global illicit drug market for the year 2003 was estimated at US\$13 bn at the production level, US\$94 bn at the wholesale level (taking seizures into account), and US\$322 bn at the retail level (based on retail prices and taking seizures and other losses into account).

trafficking amounted to US\$ 320 bn over 2003, exceeding 90 % of the worldwide Gross Domestic Product.

- The Report of Typologies on Money Laundering and Terrorist Financing<sup>4</sup> published by the Financial Action Task Force in June 2005, which shows that people-trafficking and illegal immigration reaches around US\$ 10 bn.
- The 2002 Basel Committee's research work on fraud related to the banking sector, which analyzed 89 international banks and showed that their losses reached around US\$ 1,700 m due to domestic and foreign fraud.
- The research work made by the Association of Certified Fraud Examiners<sup>5</sup>, which estimates that US losses for fraud could go well beyond US\$ 600 bn.
- The World Bank estimates that bribes paid worldwide were over US\$ 1 bn in a single year.

This information reveals that we are facing real supra-states that generate more wealth than many advanced countries in the world. Their economic power may not only affect the stability of worldwide financial systems but may also be used with funding purposes. As a matter of fact, cross-border criminal organizations conduct, and even enlarge, their transactions, harming the peace of society and, in many cases, the most sophisticated security structures in the world.

We are certainly exposed to conducts marked by multiple crimes affecting different aspects of society at the same time. According to international doctrine, the most relevant aspects are

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<sup>4</sup> *CHAPTER III - PROCEEDS FROM TRAFFICKING IN HUMAN BEINGS AND ILLEGAL MIGRATION/HUMAN SMUGGLING. It is estimated that USD 10 billion a year is generated by the facilitation of human trafficking and illegal migration.*

<sup>5</sup> *2006 ACFE Report to the Nation on Occupational Fraud & Abuse. Executive Summary. Participants in our study estimate U.S. organizations lose 5 % of their annual revenues to fraud. Applied to the estimated 2006 United States Gross Domestic Product, this 5 % figure would translate to approximately US\$ 652 bn in fraud losses.*

related to economy and finance, policy and society. The economic-financial aspect is basically affected by three concepts: 1) a reduction in resources from the formal economy; 2) an investment contrary to economic expectations; and 3) disregard for the “Profit” approach. In other words, illegal funds are, in general, invested for speculation, accumulation, or concealment. This causes a drop in the rate of international economic growth and may even damage the regular functioning of financing and capital markets.

The inflow or outflow of funds of criminal origin may adversely affect market stability, with the following consequences:

- A change in variables such as interest rate, exchange rate, the price of properties, liquidity, quotation of shares and debt instruments, etc.
- A decreasing level of transparency, soundness, confidence and reliance on financial markets.
- Transfer of a domestic problem to worldwide system.

As regards Argentina, the country has experienced a macroeconomic recovery over the last few years. In January 2005, it adopted measures geared to promote long-term investments with a view to softening speculative capital inflows and outflows.

The political-institutional aspect of States is affected. An example of this is the fact that criminal organizations may afford any costs to generate ideal legal and institutional conditions for obtaining their objectives, particularly because they do not intend to obtain profits. In general, they are ready to do anything to reach their goals, with the inclusion of corrupting the executive, legislative and judicial powers, and enforcement bodies in their decision-making.

These conditions clearly show that corruption is one of the main prices the international community has to pay for having to live with transnational criminal organizations.

The second aspect involves the growing resources States are assigning to carry out compliance controls. In this regard, it would be advisable to estimate how much they spend in that respect; in other words, how much societies contribute, through taxation, to fight criminal organizations.

Facts such as the 9/11 attacks clearly show a worldwide homogeneous trend in preventing and punishing measures against these crimes. In many cases, States increased their budgets to a great extent in order to enforce these measures. Under these circumstances, it was necessary to adopt stronger legislation, and even interfere with the private sector for preventive purposes. This affected, in many cases, the normal operation of private business.

Another variable is the aging of population and a resulting drop in demographic growth in more developed countries. Then, economically active population has had to pay higher contributions. In short, the combination of these facts produces a critical factor, the cost of which is born by society. Accordingly, institutional efforts should be strengthened with a view to preventing criminal organizations from operating.

As a matter of fact, several international bodies, either public or private, implemented, over the last few years, a number of regulations and recommendations for preventing and reducing risks arising from different kinds of criminal conduct, combating increasingly complex and sophisticated crimes, and protecting the stability of States and their markets.

By way of illustration, the following guidelines are included: the Financial Action Task Force Recommendations and its new methodology of evaluation; the Resolutions of the United Nations Security Council; Basel II – A Basel statement on operating risks, and a Revision of Core Principles, the new Sarbanes-Oxley Act of 2002, and the control of this regulation by the Public Company Accounting Oversight Board; the new principles of Corporate Governance by the Organisation for Economic Co-operation and Development; the new accounting rules such as International Financial Reporting Standards; the updated International Standards on Auditing; the revision of Committee of Sponsoring Organizations of the Treadway Commission (C.O.S.O.) methodology, etc.

Regarding the third aspect proposed in this paper, I believe that we, as Central Bankers and Banking Supervisors, should continue doing our best, optimizing the implementation of international standards and, particularly, regional AML/CFT regulations. In our particular case, the Central Bank of Argentina and the Superintendence of Financial and Exchange Institutions have revised money-laundering rules issued over the last two years and enforced a new regulation on prevention and control of terrorist financing, which is in line with international standards. We have found out that our “traditional” system for preventing money laundering could not be easily adapted to fight terrorist financing. Indeed, the impact on monitoring and reporting systems implemented by financial entities differs to a great extent from money laundering and terrorist financing.

In addition, we have designed a specific mechanism for supervising preventive structures against money laundering and terrorist financing. Full-time inspectors, who are in charge of rating financial entities’ in-house monitoring structures, instrument this mechanism.

Likewise, we are making regional efforts to reach an agreement on standards and better practices for banking supervision intended to fight money laundering and terrorist financing. We even support that such standards should be agreed at an international level. Let's bear in mind that this concern has not been addressed by any multilateral agency so far.

The implementation of the rules applicable to financial systems greatly differs among Latin-American countries. However, they all comply with regulatory standards issued by international agencies such as: Financial Action Task Force (FATF), Financial Action Task Force on Money Laundering in South America (GAFISUD) or the Inter-American Drug Abuse Control Commission of the Organization of American States (CICAD-OAS). For that reason, we want to supplement and emphasize effective regional "surveillance" mechanisms such as:

- FATF and GAFISUD New Methodologies of Mutual Evaluation; CICAD/OAS Mechanisms of Multilateral Evaluation; Article 4 and Financial Sector Assessment Program (FSAP) of the International Monetary Fund; Due Diligence Principles for business and correspondent activities with Latin-American banks provided by the US financial system in line with the USA Patriot Act (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism).

In short, we believe that our proposal on AML/CFT supervision should be implemented both on a regional and international basis. We do not mean that the regulatory standards in effect such as those provided by the Financial Action Task Force should be replaced. On the contrary, we think they should be supplemented with a banking supervisory mechanism.

Our proposal is based on four pillars:

- Firstly, REGULATION. The regulatory framework should be homogeneous and supported by the existing standards such as those provided by the Financial Action Task Force. We intend to agree on a homogeneous implementation rather than to innovate in regulations.
- Secondly, SPECIALIZED SUPERVISION. This implies designing an AML/CFT-oriented supervisory scheme based on a risk matrix to be implemented by a qualified and trained team of inspectors. Even though there are neither specific international standards nor standardized methodology so far, all preventive principles and recommendations focus on supervision.
- Thirdly, RATING. Specific rating mechanisms should be implemented on the basis of certain aspects such as the components to be rated and rating systems applicable to financial entities.

We have traditionally rated financial entities in terms of their liquidity and soundness position to protect the financial system stability. However, we should rate them in terms of their compliance with regulations on the prevention and control of money laundering and terrorist financing.

- Lastly, USE OF INFORMATION. Clear guidelines on the use of information and to which extent they may be shared should be implemented. For instance, channels for sharing information within public and private sectors, and



between them, and the ratings assigned. We should pay special attention to the legal frameworks of different jurisdictions.

The adoption of these four standards would allow to:

- Reinforce AML/CFT regulations and make financial entities aware of this concern.
- Provide financial systems with the necessary tools to do business on a more reliable basis, particularly to any such countries accepting the standards proposed.
- Generate information that may be shared among the private sector and among regulatory bodies.
- Segregate those countries or entities that do not endorse the standards proposed.
- Reduce the level of uncertain relations, since these guidelines may contribute to find out the characteristics of each region and design specific procedures on the basis of their different nature.

From another point of view, I would like to emphasize the fact that the International Monetary Fund and the World Bank have been giving technical support to this supervisory methodology, currently being implemented in our country. Indeed, this is a priority item on

the agendas of both the Central Bank and, particularly, the Superintendence, which are in charge of supervising the financial services' community, and warning them against this kind of criminal operations.

Last but not least, we believe that there is an enormous potential for implementing technical standards and better practices, particularly on AML/CFT banking supervision.