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ANALISYS OF IMPLEMENTATION OF FATF RECOMMENDATION 8 TO COUNTER MONEY LAUNDERING AND TERRORISM FINANCING

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1 INTRODUCTION: MONGOLIA & FATF

The Financial Action Task Force (FATF) is an intergovernmental organization established in 1989 responsible for setting and implementing common standards against money laundering and terrorism. The organization provides a total of 40 recommendations against money laundering and terrorist financing including 9 special recommendations, and takes measures to bring the legal regulations of its member countries in line with these standards. Countries incorporate these recommendations into their legislation, tailored to their country's circumstances, and conduct mutual evaluations to ensure that they are implemented. Today, the FATF has 39 member countries and several regional offices, covering most of the world. Mongolia joined the Asia-Pacific Group on money laundering (APG) as a member in 2004 and was obligated to improving its anti-money laundering and anti-terrorism financing system. In 2007, the organization assessed the adequacy of Mongolia's legal framework and measures against money laundering and terrorist financing for the first time. A decade later, in 2017, a second evaluation was conducted and it was concluded that the Government of Mongolia did not make sufficient progress despite having promised to address the violations and shortcomings identified in the initial evaluation. As a result, Mongolia has been included in the FATF's so-called "grey list" of high-risk countries since October 2019. The FATF requires its members to take into account any deficiencies identified in the evaluation, to identify sources of funding, and to verify any additional information when dealing with countries from the high-risk category. Following the FATF's listing, on May 7th 2020, the European Union also took steps to include Mongolia in the list of high-risk third countries that could potentially harm the financial system of the EU and the date of entry into force is to be determined. Recommendation 8 that covers civil society and the non-profit sector is as follows:

Recommendation 8: Non-Profit Organizations

Countries should review the adequacy of laws and regulations that relate to non-profit organizations which the country has identified as being vulnerable to terrorist financing abuse. Countries should apply focused and proportionate measures, in line with the risk-based approach, to such non-profit organizations to protect them from terrorist financing abuse, including:

(a) by terrorist organizations posing as legitimate entities;

(b) by exploiting legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset-freezing measures; and

(c) by concealing or obscuring the clandestine diversion of funds intended for legitimate purposes to terrorist organizations.

Technical compliance ratings by FATF

Compliant (C) – There are no shortcomings.

Largely compliant (LC) – There are only minor shortcomings.

Partially compliant (PC) – There are moderate shortcomings.

Non-compliant (NC) – There are major shortcomings.

Not applicable (NAA) – requirement does not apply, due to the structural, legal or institutional features of a country.

Recommendation 8 requires that countries review laws and regulations covering non-profit organizations and ensure that these regulations are in line with FATF's standards. However, FATF recommends countries apply these measures only to at-risk NPOs, not to the entire non-profit sector. Nevertheless, many countries around the world have taken measures to restrict the operations and civic space of non-profit organizations in the name of implementing these standards.

1.2 OVERVIEW OF NON-PROFIT ORGANIZATIONS IN MONGOLIA

Mongolia's constitution validated the freedom of association in 1992, and an NGO-specific law was first enacted in 1997. According to the 2017 state records of legal entities, there are 17,685 officially registered non-governmental organizations. According to Mongolia's Ministry of Justice, 48.5 percent or 8,578 of them are actively operating. In total, six amendments have been made to the NGO Law, accompanying amendments to other laws and acts since its initial conception in 1997. In 2018, the Government of Mongolia attempted to revise this law and introduced the draft Law of Non-Profit Legal Entities (NPLE) under the Government's Action Program of Improving Legislation for the period of 2016-2020. The draft law purportedly provided provisions that consists of FATF's recommendation against terrorism financing[1]. Moreover, in defense of the draft NPLE, Government officials stated that the vast majority of Mongolian NGOs have been receiving foreign funds, which put them at risk of money laundering and terrorist financing. However, in fact, FATF does not seek to take such measures and recommends focusing on only at-risk NPOs, not the entire non-profit sector. This is an important distinction because it means that countries should first identify and review the risks based on risk-based approach and take additional measures only if it is necessary (ICNL, 2020). Several parts of the 2013 Law on Combating Money Laundering and Terrorist Financing were revised between 2018 and 2020. However, per Article 4 - The list of persons and entities obliged to reporting their financial transactions does not include non-profit organizations, such as NGOs and foundations.

According to the Mutual Evaluation Report of September 2017, Mongolia was rated 'partially compliant' with FATF's Recommendation 8 on NPOs. The report indicated that "Mongolia has not identified at risk NPOs and the nature of threats posed to the NGOs". The deficiencies identified were following:

1 *The draft law on Non-Profit Legal Entitites, 2020, p. 3 https://mojha.gov.mn/wp-content/uploads/2019/10/TBB-huuliin-tusul3.pdf*

I) encouraged or undertaken outreach to raise awareness among at-risk NGO,

II) worked with at-risk NGOs to develop best practice to address Terrorism Financing risks and vulnerabilities, and

III) encouraged NPOs to conduct transactions via regulated financial channels[2]

Following MER (Mutual Evaluation Report) in 2019, Mongolia has made progress in addressing these deficiencies and requested FATF to re-rate its progress. However, Mongolia remained 'partially compliant' with Recommendation 8 in FATF's 2nd follow-up ratings[3]. Besides, Mongolia has remained on the list of jurisdictions under increased monitoring but not due to NPOs and Recommendation 8 (ICNL, 2020).

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2 Mongolia: MER, 2017, p. 111
http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Mongolia%20MER%202017%20-%20published%20version.pdf

3 Mongolia: MER, 2019, p. 8
http://www.fatf-gafi.org/media/fatf/documents/reports/fur/APG-Follow-Up-Report-Mongolia-2019.pdf

2.1 INTERNATIONAL PRACTICES OF APPLYING RECOMMENDATION 8

The analysis of mutual evaluation reports of 159 countries indicates that only five countries were rated "compliant" by FATF Recommendation 8, not having any violations or deficiencies in their non-profit sectors. In addition, 17 countries that have minor inconsistencies were rated "largely compliant". However, Eighty-five percent of countries evaluated for the recommendation in 2012 were "partially compliant" or "non-compliant". Moreover, 66 of the 159 countries were "partially compliant" and 69 were "non-compliant" by Recommendation 8. (Transnational Institute & Statewatch 2012).

Following the FATF Phase 4 assessment in 2016, 63 percent of all countries were rated as "partially compliant" or "non-compliant"[1]. As of December of 2019, out of a total of 90 countries, only four countries, the United States, Armenia, the United Kingdom, and Hong Kong, have been rated "compliant" with Recommendation 8. About 60 countries received "partially compliant" and "non-compliant" ratings. The fact that most countries do not comply with Recommendation 8 is directly linked to the absence of risk assessments in their non-profit sectors. Another factor directly contributing to the lower ratings is the governments' failure to consult with non-profit organizations and to provide information on the threats they face and on the financing of terrorism through the abuse of civil society funds.

Some Western European countries use sector-oriented specific laws, civil code, and corporate laws to regulate their non-profit sector, updating and enriching them over time. As a result, a unified and integrated system for recording them has been developed, and financial regulations have been put in place to ensure that funds are transferred through reliable and secure channels and that the owners behind the transactions are transparent. The authorities of Hong Kong, the international financial center of East Asia, were acknowledged for their work of ensuring that the financial relations of the civil society organizations are conducted through channels safe from abuse and terrorism financing, and that they do not become a tool for money laundering.

1 *FATF's 4th round ratings, 2020 https://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf*

2.1.1 SPAIN COMPLIANCE WITH RECOMMENDATION 8

The Mutual Evaluation Reports for Spain in years 2014 and 2019 indicate that the country is “largely compliant” (LC) with Recommendation 8, taking into account the efforts to expanding the monitoring system for nonprofits, particularly the requirement to identify individuals who have donated more than € 100 or received any funds. (Bartolozzi et.al, 2019) In Spain, civil society organizations are legally registered primarily under the titles of association or foundation and are responsible for acting in favor of the public interest, not the private sector. These legal entities are governed by the Organic Law, regulation on the rights of Associations of 22 March 2002 (Ley Orgánica 1/2002, de 22 de marzo, reguladora del Derecho de Asociación) and the Foundations Law of 50/2002 (Ley 50/2002, de 26 de diciembre, de Fundaciones) (Código de Asociaciones, 2020) Associations and foundations can be established by anyone residing in Spain. The Foundations Law of 2002 requires a minimum of 30,000 euros in initial assets to create a foundation, an annual income of no more than 150,000 euros and personnel of no more than five employees. The Spanish Civil Code regulates the other areas not covered by the two laws.

Spain’s 17 autonomous regions possess the right to enforce their own laws governing nonprofits in their territories, but they are fiscally and tax-wise subordinate to the federal government. The FATF deems the system of eight federal and seventy-eight local bodies operating in Spain for registration of non-profit organizations and storage of their information as too large. It is believed that the above-mentioned bureaucracy slows down the overall monitoring and hinders the prevention of terrorism financing through the sector. However, Spain’s system of oversight of public associations, foundations and religious organizations in general is largely consistent and in line with Recommendation 8.

2.1.2 UNITED KINGDOM COMPLIANCE WITH RECOMMENDATION 8

The United Kingdom's Mutual Evaluation Report (MEP) from December 2018 concluded that it was "compliant" (C) with Recommendation 8, and noted that the country recognized the high risk of non-profit organizations being used for money laundering and financing of terrorism and showed consistencey in taking concrete steps periodically. The FATF revised its assessment in the 2018 report to take into account the UK's adequate efforts to combat the financing of terrorism and its focus on the non-profit sector in contrast to the third follow-up report of the country, in which the rating for Recommendation 8 was "largely compliant" (LC).

There are more than 900,000 NPOs in the UK. (MER UK, 2018) The three bodies that register and regulate this considerably large sector are the Charity Commission for England and Wales (CCEW), the Scottish Charity Regulator (OSCR) and the Charity Commission for Northern Ireland (CCNI) and their operation has an edge over the Spanish system for regulating NPOs, being far more effective and compact. The UK government has repeatedly issued research and reports on the nonprofit sector's risk throughout the UK, has enhanced the rule of law, expanded the powers of certain regulatory bodies, and cracked down on money laundering, terrorism, and its financing. It was concluded by the FATF that the government had recognized the risk and threats and has accordingly taken adequate action promptly. For example, in 2015 and in 2017, Her Majesty's Treasury, in cooperation with the Home Office, conducted a National Risk Assessment. It was stressed that through 2016-2017 and 2017, CCEW and other bodies executed "The Annual Report on Tacking Abuse and Management" and "The Domestic Sector Review of the UK NPO". The high quality of these reports and reviews constitute the main grounds on which the FATF recognizes the United Kingdom for highlighting the importance in determining potential risks of money laundering and terrorist financing in the non-profit sector. The Charities Act was adopted in 2016 and came into force in 2017, creating a legal framework that necessitates elaborate financial reporting of nonprofits and foundations, and giving three regulatory bodies power for comprehensive monitoring over any NGOs and charities and, if necessary, dissolving them. The monitoring of money transfers and the confiscation of funds have been praised to be effective, comprehensive, and legitimate as appropriate measures against the threat of terrorism in the country. Imprisonment is inevitable for anyone found guilty of money laundering and terrorist financing.

The above-mentioned three entities work in close ties with the non-profit sector, raising awareness to the public and the civil society organizations, and providing training encompassing the threats of money laundering and terrorist financing to the latter. The Compliance toolkit, co-authored by the three organizations, requires any fund or nonprofit to make transactions through a secure financial channel. Charities operating in the UK may be subject to sanctions depending on the nature of the breach in the event of misconduct or breach of duty. These include: freezing accounts, deregistration, and fines (Charities Act 2011, pp.34, 41, 60, 75A, 76, 79, 80, 84B, 173, 181A, 183; Charities Act (Northern Ireland) 2008; 16, 19, 25, 33, 71, 134, 150-158; Charities and Trustee Investment (Scotland) 2005 Act, ss.6, 30, 31, 34, 45, 70, 83).

2.1.3 HONG KONG COMPLIANCE WITH RECOMMENDATION 8

As of September 2019, the Hong Kong Special Administrative Region of the People's Republic of China, alike the United Kingdom, rated "compliant" (C) with Recommendation 8, one level higher than the rating in FATF's 2012 Mutual Evaluation Report. As an international financial center, Hong Kong recognizes the risk of terrorist financing abroad through its territory and financial channels, for example, proximity to mainland China. Having assessed the risk of their domestic nonprofits as low, the administration focused on the risks of international non-profit organizations. The measures taken and the level of monitoring are considered to be consistent with the risk level the government estimated in the FATF report.

The mechanisms for penalizing the financing of terrorism, money laundering, including seizure and confiscation of property are in accordance with FATF standards, particularly Recommendation 8. Similar to the UK, an updated risk assessment for the sector was conducted in 2018 to determine how many of the registered NGOs and charities qualify to be categorized as non-profit organization by the FATF criteria (9000) and to define which ones are susceptible to more risk (international) and to establish enhanced financial monitoring for those at risk.

Non-profit organizations established in the form of associations, companies, or trusts are obliged to report their sources of income and expenses, and are legally liable for non-compliance with the law. (Association Ordinances pp.15, 16; Corporate Ordinances p.662 (1), (3), (6); Trustee Ordinances p.98) Article 82 of the Tax Law provides the Internal Revenue Department with the power to monitor non-profit organizations, suspend violators' tax-exempt status and impose legal penalties on individuals and legal entities for misreporting their finances in order to avoid taxes using civil society organizations. The state provides substantial funding to activities for the betterment of the communities. Thus, NGOs and charities that have benefited or are benefiting from the state funds are subject to increased oversight by the Social Welfare Department. The department has developed the "Best Practice Manual" for nonprofits, and statistically reviewed how many funded organizations followed the guidelines. This demonstrates the legitimate regulation and active cooperation the regional government maintains by the rule of law in regard to civil society and non-profit organizations.

3 CONCLUSION

Mongolia needs a small but effective, independent organization, similar to the UK, to monitor and regulate NGOs and ensure financial transparency without restricting the freedom of the civil society. Mongolia's partial compliance (PC) with the Recommendation 8 can be improved if the responsible bodies conduct a high-quality risk assessment and take practical action in conjunction with that prospective assessment. Mongolia also needs to follow in the steps of the UK and punish individuals that abuse non-profit organizations and facilitate money laundering and/or terrorism financing. It is possible to study the practice of regulatory laws concerning foundations in Spain as to determine the applicable limits and minimums of capital inflows into non-profit funds in Mongolia. Meanwhile, following the example of the Hong Kong Special Administrative Region and its nonprofit-oriented regulatory bodies, the corresponding Mongolian governmental body needs to disseminate information to the public and civil society organizations, work closely with them to assess and identify risks in the sector and to raise awareness.

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