SOVEREIGN

EXPLAINER – THE FATF AND EU 'BLACK' AND 'GREY' LISTS

There is continual debate about the practice of 'naming and shaming' countries that fail to meet the international community's anti-financial crime standards, but it seems likely that such lists are here to stay – evidence suggests that such lists provide the necessary political impetus for change and have "become a dynamic contributor to peace and security".

The Sovereign Group supports such initiatives provided that their operation is transparent, defensible and absent of politics. There is no doubt that coercing an improvement in standards has strengthened the ability of countries to identify and respond to financial crime. Laws have been passed, new policymaking institutions and law enforcement agencies have been established, and financial institutions have responded to tighter regulation.

On a practical level, we have found that listings generally have no serious impact for clients and their structures, although some transactions may take a little longer than normal due to the need to apply Enhanced Due Diligence. A listing can also make banking more difficult in jurisdictions where the banking options are already limited.

To assist clients, we have compiled this 'Explainer' which sets out the processes followed by the Financial Action Task Force (FATF) and the European Union (EU) in compiling and maintaining their lists. This will be updated periodically to take account of any changes to the lists or to the listing criteria.

If you have any concerns or further questions about the 'listing' process, you should contact your nearest Sovereign office for further information.

THE FINANCIAL ACTION TASK FORCE (FATF)

The FATF is an inter-governmental policymaking body whose purpose is to establish international standards, and to develop and promote policies, both at national and international levels, to combat money laundering and the financing of terrorism.

It was formed in 1989 to set out measures to be taken in the fight against money laundering. Since then, the FATF has issued 40 Recommendations to fight money laundering and nine Special Recommendations to fight terrorist financing.

To secure worldwide implementation of its Recommendations, the FATF relies on a strong global network of FATF-Style Regional Bodies (FSRBs), in addition to its own 39 members. The nine FSRBs have an essential role in promoting the effective implementation of the FATF Recommendations by their membership and in providing expertise and input in FATF policymaking.

- Asia/Pacific Group on Money Laundering (APG)
- Caribbean Financial Action Task Force (CFATF)
- Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL)
- Eurasian Group (EAG)
- Eastern & Southern Africa Anti-Money Laundering Group (ESAAMLG)
- Intergovernmental Action Group against Money Laundering in Africa (GIABA)
- Task Force on Money Laundering in Central Africa (GABAC)
- Financial Action Task Force of Latin America (GAFILAT)
- Middle East & North Africa Financial Action Task Force (MENAFATF)

Over 200 jurisdictions around the world have committed to the FATF Recommendations through the global network of FSRBs and FATF memberships. The FATF continually identifies and reviews jurisdictions with strategic

AML/CFT deficiencies that present a risk to the international financial system and closely monitors their progress. The FATF's International Co-operation Review Group (ICRG) oversees the process.

A jurisdiction that enters the ICRG review process has a one-year 'Observation Period' to work with the FATF or its FSRB to address its deficiencies before possible public identification and formal review by the FATF. The FATF then prioritises the review of those countries with more significant financial sectors.

During the review process the FATF considers the strategic AML/CFT deficiencies identified both in terms of technical compliance and effectiveness of measures in place, and any relevant progress made by the jurisdiction. If the FATF deems the progress insufficient, it will develop an 'Action Plan' with the jurisdiction to address the remaining strategic deficiencies.

Since 2007, the ICRG has reviewed 125 countries, and publicly identified (i.e., 'listed') 98 countries. Of these 98, 72 have since made the necessary reforms to address their AML/CFT weaknesses and have therefore been removed from the process.

The FATF publishes two statements at the end of each plenary meeting – February, June and October – in respect of "High-Risk Jurisdictions subject to a Call for Action" (this list is often called the 'blacklist') and "Jurisdictions under Increased Monitoring" (this list is often called the 'grey list'). These statements provide a short summary of the recent actions taken in accordance with each jurisdiction's Action Plan, as well as a list of the strategic deficiencies that remain to be addressed.

The 'High Risk' (black) list serves to alert financial service providers to the risks of doing business with certain countries, and to encourage the governments of those countries to take appropriate action to implement the FATF's AML/CFT Recommendations. As of 24 February 2023, the countries listed as 'High Risk' are: **the Democratic People's Republic of Korea (DPRK), Iran and Myanmar**.

The FATF calls on Member States to apply enhanced due diligence measures when dealing with customers from blacklisted countries and to "apply countermeasures to protect the international financial system from the money laundering, terrorist financing, and proliferation financing (ML/TF/PF) risks" that they pose.

The 'Increased Monitoring' (grey) list countries are actively working with the FATF to address strategic deficiencies in their ML/TF/PF regimes. When the FATF places a jurisdiction under increased monitoring, it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes and is subject to increased monitoring.

As of 24 February 2023, the 23 countries listed as subject to 'Increased Monitoring' are: **Albania, Barbados, Burkina Faso, the Cayman Islands, the Democratic Republic of Congo (DRC), Gibraltar, Haiti, Jamaica, Jordan, Mali, Mozambique, Nigeria, Panama, the Philippines, Senegal, South Africa, South Sudan, Syria, Tanzania, Türkiye, Uganda, the United Arab Emirates (UAE) and Yemen**.

While inclusion on the 'grey list' denotes an elevated level of AML/CFT risk, the FATF does not advise enhanced due diligence (EDD) when dealing with designated countries.

As the FATF conducts its periodic reviews and Mutual Evaluation Reports (MERs), countries may be added to or withdrawn from the black and grey lists depending on the progress that they have made in addressing relevant issues.

The updated FATF statements concerning the three currently 'grey listed' jurisdictions where the Sovereign Group has offices are as follows:

- **GIBRALTAR** – Since June 2022, when Gibraltar made a high-level political commitment to work with the FATF and MONEYVAL to strengthen the effectiveness of its AML/CFT regime, Gibraltar has taken steps to do so, including by demonstrating that the supervisors for trust and company service providers, lawyers, gaming businesses, real estate agents, and other non-bank entities are now using a range of effective, proportionate, and dissuasive sanctions for AML/CFT breaches, specifically by taking more enforcement actions, imposing financial penalties, and publishing the results of cases, where appropriate. Gibraltar should continue to work on implementing its action plan to address its strategic deficiencies, including by showing that it is able to pursue more final confiscation judgments commensurate with the risk and context of Gibraltar.

- **SOUTH AFRICA** – In February 2023, South Africa made a high-level political commitment to work with the FATF and ESAAMLG to strengthen the effectiveness of its AML/CFT regime. Since the adoption of its MER in June 2021, South Africa has made significant progress on many of its recommended actions to improve its system, including by developing national AML/CFT policies to address higher risks and newly amending the legal framework for TF and targeted financial sanctions (TFS), among others. South Africa will work to implement its FATF action plan by: (1) demonstrating a sustained increase in outbound mutual legal assistance (MLA) requests that help facilitate ML/TF investigations and confiscations of different types of assets in line with its risk profile; (2) improving risk-based supervision of Designated Non-Financial Businesses and Professions (DNFBPs) and demonstrating that all AML/CFT supervisors apply effective, proportionate, and effective sanctions for non-compliance; (3) ensuring that competent authorities have timely access to accurate and up-to-date beneficial ownership (BO) information on legal persons and arrangements and applying sanctions for breaches of violation by legal persons to BO obligations; (4) demonstrating a sustained increase in law enforcement agencies' requests for financial intelligence from the Financial Intelligence Centre (FIC) for its ML/TF investigations; (5) demonstrate a sustained increase in investigations and prosecutions of serious and complex money laundering and the full range of TF activities in line with its risk profile; (6) enhancing its identification, seizure and confiscation of proceeds and instrumentalities of a wider range of predicate crimes, in line with its risk profile; (7) updating its TF Risk Assessment to inform the implementation of a comprehensive national counter financing of terrorism strategy; and (8) ensuring the effective implementation of targeted financial sanctions and demonstrating an effective mechanism to identify individuals and entities that meet the criteria for domestic designation.

- **UNITED ARAB EMIRATES** – Since February 2022, when the UAE made a high-level political commitment to work with the FATF and MENAFATF to strengthen the effectiveness of its AML/CFT regime, the UAE has demonstrated significant progress, including by demonstrating a sustained increase in outbound MLA requests to help facilitate the investigation of TF, ML, and high-risk predicates, showing greater use of financial intelligence to pursue high-risk ML threats, and combating UN sanctions evasion, including by demonstrating a better understanding among the private sector. The UAE should continue to work to implement its FATF action plan by: (1) enhancing and maintaining a shared understanding of the ML/TF risks between the different DNFBP sectors and institutions; (2) showing an increase in the number and quality of Suspicious Transaction Reports (STRs) filed by Financial Institutions (FIs) and DNFBPs; (3) ensuring a more granular understanding of the risk of abuse of legal persons and, where applicable, legal arrangements, for ML/TF; and (4) demonstrating a sustained increase in effective investigations and prosecutions of different types of ML cases consistent with UAE's risk profile.

THE EUROPEAN UNION LIST OF 'HIGH-RISK THIRD COUNTRIES'

Under the EU's Fourth Anti-Money Laundering Directive (AMLD4), which was implemented in 2017, the European Commission was legally obligated to identify high-risk third countries having strategic deficiencies in their AML/CFT regimes. The objective was to protect the EU internal market through the application of enhanced due diligence (EDD) measures by obliged entities.

The methodology provides that the Commission will consider the FATF lists as a starting point and complement this by an autonomous assessment of additional countries using the following approach:

- Identify the risk profile and the level of threat to which the country is exposed
- Assess the legal framework and its effective application in eight key areas by analysing the country's measures on:
  - Criminalisation of money laundering and countering the financing of terrorism;
  - Customer due diligence requirements, record keeping and reporting of suspicious transactions in the financial sector;
  - The same requirements in the non-financial sector;
  - The existence of dissuasive, proportionate and effective sanctions in case of breaches;
  - The powers and procedures of competent authorities;
  - Their practice in international cooperation;
  - The availability and exchange of information on beneficial ownership of legal persons and legal arrangements;
  - Implementation of targeted financial sanctions

Although similar in aim, the FATF and EU listing regimes are not currently aligned because the EU maintains a single list while the FATF maintains two ('grey' and 'black') lists. As a result, the EU 'high-risk list' currently includes those countries that are cooperating with the FATF to implement an Action Plan for addressing their strategic AML deficiencies.

The EU also does not list the 27 EU Member States themselves, or the three European Economic Area (EEA) Member States of Iceland, Liechtenstein and Norway.

In addition, the European Commission will double-check the work of the FATF when adding a country to or omitting it from the 'grey list' and will, as far as possible, participate in developing FATF Action Plans. In some cases, the Commission will conduct its own assessment even before the FATF's ICRG observation period is completed.

If the Commission is not satisfied with the final approved Action Plan, the EU will develop its own 'benchmarks' to enhance the FATF's action plan. When drafting EU benchmarks, the Commission will determine whether the priority and recommended actions in the FATF's approved mutual evaluation reports (MERs) cover all its concerns. It they don't, the Commission may 'top up' these requirements.

The EU's countermeasures can range from requiring EU financial institutions (FIs) to apply EDD to transactions involving designated third countries, to prohibiting EU FIs from establishing branches in those countries.

Even though being placed on the FATF 'grey list' inevitably results in being added to the EU high-risk list, being removed from the FATF 'grey list' does not necessarily have a corresponding effect. To be removed from the EU list, the assessment will focus on the three following requirements:

1. First, the legislation of the country should be considered by the Commission services as technically compliant at least with the 'EU fundamental criteria: requirements on criminalising money laundering and terrorist financing; applying customer due diligence requirements, record keeping and reporting of suspicious transactions in the financial and non-financial sector; transparency of beneficial ownership for legal persons and legal arrangements, and international cooperation.
2. To the extent that the first set of exit requirements is fulfilled, the Commission will assess the effectiveness of the country's regime in ensuring the transparency of beneficial ownership information of legal persons and legal arrangements.
3. To the extent that the first two exit requirements are fulfilled, the Commission will assess whether the country's efforts are adequate to demonstrate a tangible and positive impact.

As of 24 February 2023, the EU has identified the following 25 countries as 'high-risk third countries': **Afghanistan, Barbados, Burkina Faso, Cambodia, the Cayman Islands, Democratic Republic of the Congo, Gibraltar, Haiti, Jamaica, Jordan, Mali, Morocco, Mozambique, Myanmar, Panama, the Philippines, Senegal, South Sudan, Syria, Tanzania, Trinidad & Tobago, Uganda, the United Arab Emirates, Vanuatu and Yemen**.

However, the European Commission is committed to greater alignment with the FATF listing process and recently published a new draft AML/CFT Regulation proposing that the EU regime should be aligned with the FATF dual list approach and distinguish between:

- Third countries where significant strategic deficiencies in the legal and institutional AML/CFT framework of the third country have been identified
- Third countries with compliance weaknesses.

The new EU AML/CFT regulatory framework, including the draft AML/CFT Regulation, is expected to be fully operational by 2024.

EUROPEAN UNION LIST OF ‘NON-COOPERATIVE JURISDICTIONS FOR TAX PURPOSES’

Confusingly, the EU also maintains two further lists in respect of ‘non-cooperative jurisdictions for tax purposes’, as part of its work to counter tax evasion and avoidance. It is composed of countries that have failed to fulfil their commitments to the EU to comply with tax good governance criteria within a specific timeframe, as well as countries that have refused to do so.

This process was begun in November 2016, when the European Council mandated the Code of Conduct group (Business Taxation), a special group established by the Council, to carry out the preparatory work to establish the list. The Code of Conduct group started by screening 92 jurisdictions, selected on the basis of their economic ties with the EU, their institutional stability and the importance of the financial sector in that country.

To be considered ‘cooperative for tax purposes’, jurisdictions are screened on the following criteria.

- For tax transparency, jurisdictions should:
  - Exchange tax data with all EU member states through automatic exchange of tax information (AEOI), either through the common reporting system (CRS) established by the OECD or through equivalent arrangements
  - Be able to exchange tax information on request (EOIR)
  - Be party to the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, or have a network of exchange arrangements in place that covers all EU member states

- For fair taxation, jurisdictions should:
  - Not have harmful preferential tax measures
  - Not facilitate offshore structures or arrangements seeking to attract profits without any real economic activity

- For anti-Base Erosion & Profit Shifting (BEPS) measures, jurisdictions should:
  - Commit to implementing the OECD anti-BEPS minimum standards, which concern harmful tax measures, treaty shopping, country-by-country (CbC) reporting and dispute resolution
  - Receive positive peer-review assessments for the effective implementation of the anti-BEPS minimum standard on country-by-country reporting

According to the EU, the aim of the list of non-cooperative jurisdictions (the so-called EU ‘blacklist’), which is published as ‘Annex I’ to the conclusions adopted by the Economic & Financial Affairs (ECOFIN) Council, is not to ‘name and shame’ countries but to encourage positive change in their tax legislation and practices through cooperation.

‘Annex I’ – the so-called EU ‘blacklist’ – includes countries that either have not engaged in a constructive dialogue with the EU on tax governance or have failed to deliver on their commitments to implement the necessary reforms to comply with international good governance criteria.

‘Annex II’ – the so-called EU ‘grey list’ – includes countries that do not yet comply with all international tax good governance standards reflects but which have made commitments to reform their legislation to achieve compliance. Once a jurisdiction meets all its commitments, its name will be removed from the annex.

Since it was first published in 2017, the lists have been updated regularly and revised as a result of monitoring of the measures implemented by jurisdictions to comply with their commitments. This is a continuous process which includes updating criteria in line with international tax standards, screening countries against these criteria, engaging with countries that do not comply, listing and de-listing countries as they undertake (or fail to undertake) reforms and monitoring developments to ensure that jurisdictions do not backtrack on previous reforms.

In 2019 the Council decided to limit updates of the list to twice a year starting in 2020, to allow the EU member states sufficient time to amend domestic legislation where needed.

The current Annex I (blacklist) adopted by the European Council on 14 February 2023 is composed of 16 jurisdictions: American Samoa, Anguilla, the Bahamas, the British Virgin Islands, Costa Rica, Fiji, Guam, the Marshall Islands, Palau, Panama, Russia, Samoa, Trinidad & Tobago, the Turks & Caicos Islands, the US Virgin Islands and Vanuatu.

The current Annex II (grey list) adopted by the European Council on 14 February 2023 is composed of 18 jurisdictions: Albania, Armenia, Aruba, Belize, Botswana, Curaçao, Dominica, Eswatini, Hong Kong, Israel, Jordan, Malaysia, Montserrat, Qatar, the Seychelles, Thailand, Türkiye and Vietnam.

In addition to a series of measures imposed by the EU, member states agreed in December 2017 to apply at least one of the following administrative measures against countries on the EU 'blacklist':

- Reinforced monitoring of transactions
- Increased risk audits for taxpayers who benefit from listed regimes
- Increased risk audits for taxpayers who use tax schemes involving listed regimes.

In December 2019, the European Council adopted guidance on coordination of national defensive measures in the tax area towards countries on the EU blacklist. Specifically, Member States agreed to apply at least one of the following legislative measures:

- Non-deductibility of costs
- Controlled Foreign Company (CFC) rules
- Withholding tax measures
- Limitation of participation exemption on profit distribution.

Please contact info@SovereignGroup.com or visit SovereignGroup.com

JURISDICTIONS LIST TABLE

JURISDICTIONS	FATF HIGH-RISK (BLACK)	FATF MONITOR (GREY)	EU HIGH-RISK (BLACK)	EU TAX NON-COOP (BLACK)	EU TAX NON-COOP (GREY)
Afghanistan			✓		
Albania		✓			✓
American Samoa				✓	
Angilla				✓	
Armenia					✓
Aruba					✓
Bahamas				✓	
Barbados		✓	✓		
Belize					✓
Botswana					✓
British Virgin Islands				✓	
Burkina Faso		✓	✓		
Cambodia			✓		
Cayman Islands		✓	✓		
Costa Rica				✓	
Curaçao					✓
North Korea (DPRK)	✓				
Dem Rep Congo (DRC)		✓	✓		
Dominica					✓
Eswatini					✓
Fiji				✓	
Gibraltar		✓	✓		
Guam				✓	
Haiti		✓	✓		
Hong Kong					✓
Iran	✓				
Israel					✓
Jamaica		✓	✓		
Jordan		✓	✓		✓
Malaysia					✓
Mali		✓	✓		
Marshall Islands				✓	
Montserrat					✓
Morocco			✓		
Mozambique		✓	✓		
Myanmar	✓		✓		
Nigeria		✓			

JURISDICTIONS	FATF HIGH-RISK (BLACK)	FATF MONITOR (GREY)	EU HIGH-RISK (BLACK)	EU TAX NON-COOP (BLACK)	EU TAX NON-COOP (GREY)
Palau				✓	
Panama		✓	✓	✓	
Philippines		✓	✓		
Qatar					✓
Russia				✓	
Samoa				✓	
Senegal		✓	✓		
Seychelles					✓
South Africa		✓			
South Sudan		✓	✓		
Syria		✓	✓		
Tanzania		✓	✓		
Thailand					✓
Trinidad & Tobago			✓	✓	
Türkiye		✓			✓
Turks & Caicos Islands				✓	
Uganda		✓	✓		
United Arab Emirates		✓	✓		
US Virgin Islands				✓	
Vanuatu			✓	✓	
Vietnam					✓
Yemen		✓	✓		