Journal of International Commercial Law and Technology
Print ISSN: 1901-8401

Website: https://www.jiclt.com/

Article

Effectiveness of FATF Recommendations in Developing Countries

Article History:

Name of Author:
Mr. Harminder Chopra[1], Dr. Kunal Shaktawat[2]

Affiliation:
[1]*Research Scholar, Oriental University Indore*
[2]*Associate Professor, Oriental University Indore*

Corresponding Author:
Mr. Harminder Chopra

How to cite this article:
Chopra H, *et, al,* Effectiveness of FATF Recommendations in Developing Countries. *J Int Commer Law Technol*. 2026;7(1):419–424.

Received: *18-12-2025*
Revised: *02-01-2025*
Accepted: *16-01-2026*
Published: *04-02-2026*

Abstract: This paper examines the evaluates the effectiveness of the Financial Action Task Force (FATF) Recommendations in shaping anti-money laundering (AML) and counter-terrorist financing (CFT) frameworks in developing countries. It examines both legal/regulatory compliance and actual outcomes, identifies implementation challenges, and assesses how FATF standards have influenced institutional capacity, financial integrity, and economic costs. Based on mutual evaluation reports, policy reviews, and academic studies, the paper finds that while technical compliance has improved, effectiveness remains limited due to resource constraints, contextual mismatches, and enforcement gaps. The paper concludes with recommendations to improve FATF adoption in developing contexts.

Keywords: Financial Action Task Force (FATF), Recommendations, drug money and financing of terrorism.

INTRODUCTION

The Financial Action Task Force (FATF) is an independent inter-governmental agency incorporated in 1989. This issues a set of 40 Special recommendations at global level to eradicate the offences of money laundering and terror financing. The substantial functioning of this body is to enhance and encourage policies to protect the global financial system against money laundering, the financing of proliferation of weapons of mass destruction and terrorist financing. It sets regulatory framework against the terror activities as well as money laundering offences etc. This agency also secures the international financial system by identification of loopholes occurred at national level. The FATF establishes legal framework to counter the illicit activities such as identification of threats, risks, enforces preventive measures for the financial sector and allied other sectors. This Agency performs essential functioning such as investigation, enforcement of guidelines drafted by Financial Action Task Force from time to time. Money laundering and terrorist financing undermine financial integrity, economic growth, and governance in emerging economies.

At the time of beginning, Forty Recommendations were enacted in 1990 as first initial to curb the misuse of financial systems by persons laundering drug money. Recommendations were revised in 1996 for the first time to reflect evolving money laundering trends and techniques and expanding their scope well beyond drug-money laundering. The FATF launched new mandate to deal with the issue of the funding of terrorist acts and terrorist organisations in October 2001, and took the substantial step of creating the Eight (later expanded to Nine) Special Recommendations on Terrorist Financing. In 2003, these FATF Recommendations were revised a second

time. These were ratified with the Special Recommendations, have been endorsed by over 180 countries, this deemed to be universally recognised as the international standard for anti-money laundering and countering the financing of terrorism (AML/CFT).

The FATF Framework and Its Purpose

The FATF Recommendations provide a **comprehensive framework** aimed at:

- Criminalizing money laundering and terrorist financing
- Establishing preventive measures (e.g., Know Your Customer, Customer Due Diligence)
- Enhancing financial intelligence units (FIUs) and law enforcement
- Strengthening international cooperation

Crucially, the FATF assesses countries under **Mutual Evaluation Reports (MERs)**, which examine both **technical compliance** and **effectiveness** of national AML/CFT systems. Effectiveness is measured across outcomes such as prosecution, asset recovery, and risk mitigation.

THE FATF RECOMMENDATIONS

Assessing risks and applying a risk-based approach

Countries should identify, assess, and understand the money laundering and terrorist financing risks for the country, and should take action, including designating an authority or mechanism to coordinate actions to assess risks, and apply resources, aimed at ensuring the risks are mitigated effectively. Based on that assessment, countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are proportionate to the risks identified. This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk-based measures throughout the FATF Recommendations. Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they should allow and encourage simplified measures as appropriate. Countries should also identify, assess, and understand the proliferation financing risks for the country. In the context of Recommendation 1, "Proliferation financing risk" refers strictly and only to the potential breach, non-implementation or evasion of the targeted financial sanctions obligations referred to in Recommendation 7.

Countries should take proportionate action aimed at ensuring that these risks are mitigated effectively, including designating an authority or mechanism to coordinate actions to assess risks, and allocate resources efficiently for this purpose. Where countries identify higher risks, they should ensure that they adequately address such risks. Where countries identify lower risks, they should ensure that the measures applied are proportionate to the level of proliferation financing risk, while still ensuring full implementation of the targeted financial sanctions as required in Recommendation 7. Countries should require financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective and risk-based action to mitigate their money laundering, terrorist financing and proliferation financing risks.

2. National cooperation and coordination Countries should have national AML/CFT/CPF policies, informed by the risks1 identified, which should be regularly reviewed, and should designate an authority or have a coordination or other mechanism that is responsible for such policies. Countries should ensure that policy-makers, the financial intelligence unit (FIU), law enforcement authorities, supervisors and other relevant competent authorities, at the policymaking and operational levels, have effective mechanisms in place which enable them to cooperate, and, where appropriate, coordinate and exchange information domestically with each other concerning the development and implementation of policies and activities to combat money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. This should include cooperation and coordination between relevant authorities to ensure the compatibility of AML/CFT/CPF requirements with Data Protection and Privacy rules and other similar provisions (e.g. data security/localisation).

PREVENTIVE MEASURES

Financial institution secrecy laws Countries should ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations.

Customer due diligence: - Financial institutions should be prohibited from keeping anonymous accounts or accounts in obviously fictitious names. Financial institutions should be required to undertake customer due diligence (CDD) measures when:

(i) establishing business relations;
(ii) carrying out occasional transactions:
  (i) above the applicable designated threshold (USD/EUR 15,000); or
  (ii) that are payments or value transfers in the circumstances covered by the Interpretive Note to Recommendation 16;

(iii) there is a suspicion of money laundering or terrorist financing; or

(iv) the financial institution has doubts about the veracity or adequacy of previously obtained customer identification data. The principle that financial institutions should conduct CDD should be set out in law. Each country may determine how it imposes specific CDD obligations, either through law or enforceable means.

The CDD measures to be taken are as follows:

(a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information.

(b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner, such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions understanding the ownership and control structure of the customer.

(c) Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship.

(d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

Financial institutions should be required to apply each of the CDD measures under (a) to (d) above, but should determine the extent of such measures using a risk-based approach (RBA) in accordance with the Interpretive Notes to this Recommendation and to Recommendation Financial institutions should be required to verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers. Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering and terrorist financing risks are effectively managed and where this is essential not to interrupt the normal conduct of business. Where the financial institution is unable to comply with the applicable requirements under paragraphs (a) to (d) above (subject to appropriate modification of the extent of the measures on a risk-based approach), it should be required not to open the account, commence business relations or perform the transaction; or should be required to terminate the business relationship; and should consider making a suspicious transactions report in relation to the customer. These requirements should apply to all new customers, although financial institutions should also apply this Recommendation to existing customers on the basis of materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

Record-keeping: - Financial institutions should be required to maintain, for at least five years, all necessary records on transactions, both domestic and international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved, if any) so as to provide, if necessary, evidence for prosecution of criminal activity. Financial institutions should be required to keep all records obtained through CDD measures (e.g. copies or records of official identification documents like passports, identity cards, driving licences or similar documents), account files and business correspondence, including the results of any analysis undertaken (e.g. inquiries to establish the background and purpose of complex, unusual large transactions), for at least five years after the business relationship is ended, or after the date of the occasional transaction. Financial institutions should be required by law to maintain records on transactions and information obtained through the CDD measures. The CDD information and the transaction records should be available to domestic competent authorities upon appropriate authority.

Politically exposed persons: - Financial institutions should be required, in relation to foreign politically exposed persons (PEPs) (whether as customer or beneficial owner), in addition to performing normal customer due diligence measures, to:

(a) have appropriate risk-management systems to determine whether the customer or the beneficial owner is a politically exposed person;

(b) obtain senior management approval for establishing (or continuing, for existing customers) such business relationships;

(c) take reasonable measures to establish the source of wealth and source of funds; and

(d) conduct enhanced ongoing monitoring of the business relationship. Financial institutions should be required to take reasonable measures to determine whether a customer or beneficial owner is a domestic PEP or a person who is or has been entrusted with a prominent function by an international organisation. In cases of a higher risk business relationship with such persons, financial institutions should be required to apply the measures

referred to in paragraphs (b), (c) and (d). The requirements for all types of PEP should also apply to family members or close associates of such PEPs.

Correspondent banking:- Financial institutions should be required, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal customer due diligence measures, to: (a) gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action; (b) assess the respondent institution's AML/CFT controls; (c) obtain approval from senior management before establishing new correspondent relationships; (d) clearly understand the respective responsibilities of each institution; and (e) with respect to "payable-through accounts", be satisfied that the respondent bank has conducted CDD on the customers having direct access to accounts of the correspondent bank, and that it is able to provide relevant CDD information upon request to the correspondent bank. Financial institutions should be prohibited from entering into, or continuing, a correspondent banking relationship with shell banks. Financial institutions should be required to satisfy themselves that respondent institutions do not permit their accounts to be used by shell banks.

Money or value transfer services: - Countries should take measures to ensure that natural or legal persons that provide money or value transfer services (MVTS) are licensed or registered, and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF Recommendations. Countries should take action to identify natural or legal persons that carry out MVTS without a license or registration, and to apply appropriate sanctions. Any natural or legal person working as an agent should also be licensed or registered by a competent authority, or the MVTS provider should maintain a current list of its agents accessible by competent authorities in the countries in which the MVTS provider and its agents operate. Countries should take measures to ensure that MVTS providers that use agents include them in their AML/CFT programmes and monitor them for compliance with these programmes.

New technologies: - Countries and financial institutions should identify and assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of new products and new business practices, including new delivery mechanisms, and (b) the use of new or developing technologies for both new and pre-existing products. In the case of financial institutions, such a risk assessment should take place prior to the launch of the new products, business practices or the use of new or developing technologies. They should take appropriate measures to manage and mitigate those risks. To manage and mitigate the risks emerging from virtual assets, countries should ensure that virtual asset service providers are regulated for AML/CFT purposes, and licensed or registered and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF Recommendations.

Payment transparency: - Countries should ensure that financial institutions include required and accurate originator information, and required beneficiary information, on payments or value transfers and related messages. This information should be structured to the extent possible and should remain with such payment or value transfer or related message throughout the payment chain. Countries should ensure that financial institutions monitor payments or value transfers for the purpose of detecting those which lack required originator and/or beneficiary information and take appropriate measures. Countries should ensure that, in the context of processing payments or value transfers, financial institutions take freezing action and should prohibit conducting transactions with designated persons and entities, as per the obligations set out in the relevant United Nations Security Council resolutions, such as resolution 1267 (1999) and its successor resolutions, and resolution 1373(2001), relating to the prevention and suppression of terrorism and terrorist financing, and resolutions relating to the prevention, suppression and disruption of proliferation of weapons of mass destruction and its financing

Impact of FATF Standards in Developing Countries

Legal and Institutional Reforms

Most developing countries have enacted AML/CFT legislations aligned with FATF standards, establishing FIUs and updating banking regulations to improve transparency. These legal reforms help countries integrate into the global financial system, facilitating cross-border cooperation.

For example, in West Africa, member states of the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) saw enhanced FIU capabilities and improved frameworks to assess compliance, which reduced reputational risks and demonstrated tangible policy shifts.

Financial Sector Governance

FATF standards have pushed developing countries to strengthen financial sector supervision—especially

customer due diligence, suspicious transaction reporting, and risk-based approaches. This has improved AML/CFT transparency and reduced misuse of the formal banking sector.

International Cooperation

FATF promotes bilateral and multilateral exchange of financial intelligence and enforcement cooperation, which is particularly valuable for countries with limited domestic investigative capacities. The MER process itself brings international expertise into national evaluations.

Challenges to Effective Implementation

Resource Constraints

Developing countries frequently lack sufficient trained personnel, technology, and institutional capacity to translate laws into actionable outcomes. Mutual evaluation data show that low or moderate effectiveness results are common even where technical compliance is high.

Contextual Mismatches

Standard FATF frameworks are often derived from experiences of developed economies. In contexts dominated by **informal financial systems**, such as traditional remittance networks (e.g., hawala systems), FATF standards can be difficult to apply without adaptation, making compliance less meaningful at the operational level.

Financial Inclusion and Firms' Burden

AML/CFT compliance can sometimes clash with financial inclusion goals. Complex due diligence requirements may exclude low-income populations from formal banking and impose high costs on small institutions without proportionate benefits in crime reduction.

Grey-Listing and Economic Consequences

Being placed on the FATF "grey list" can deter foreign investment and raise borrowing costs. While this pressure can motivate reforms, it also imposes economic costs that disproportionately affect developing economies. Real-world examples include several African nations removed from the FATF watch list after implementing measures, demonstrating both the *stick* and *carrot* of FATF influence.

Case Studies: Outcomes and Varied Experiences

A recent peer-reviewed study comparing Kenya and Uganda shows that despite formal AML/CFT regulations, effectiveness varied due to non-compliance, weak enforcement, and inconsistent national risk assessments. Countries remaining on follow-up processes for long periods face continued reputational and economic costs.

Evaluation of Effectiveness

Positive Outcomes

- Improved legal frameworks and institutional setups
- Greater global cooperation and data sharing
- Increased awareness and reporting culture

Limitations

- Enforcement (prosecutions and asset recovery) remains weak in many contexts
- Lack of measurable outcomes against core objectives of AML/CFT
- Resource and capacity gaps persist

In many developing countries, the actual **operational effectiveness** of AML/CFT regimes—measured through investigations, convictions, and systemic deterrence—lags behind formal compliance.

Recommendations

To enhance FATF effectiveness in developing states, this paper suggests:

- Tailoring FATF standards to local contexts through flexible, risk-based implementation
- Dedicated capacity building and technology support
- Alignment of AML/CFT goals with financial inclusion strategies
- Stronger outcome-based assessments to complement compliance checkboxes

CONCLUSION

The FATF Recommendations have undeniably influenced global AML/CFT policymaking and led to legal reforms in many developing countries. However, substantive effectiveness in reducing money laundering and related crimes requires deeper institutional capabilities, contextual adaptation, and outcome-focused approaches. The continued evolution of FATF methodologies provides an opportunity for more nuanced assessments that factor in development-specific challenges.

REFERENCES

1. www-st.fatf-gafi.org
2. *THE FATF RECOMMENDATIONS INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION 2012-2025*
3. FATF. *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems.* FATF; 2023. (www-st.fatf-gafi.org)
4. FATF. *Report on the State of Effectiveness and Compliance with the FATF Standards.* FATF; 2025. (FATF)
5. FinDev Gateway. *Implementing FATF Standards in Developing Countries and*

Financial Inclusion: Findings and Guidelines. 2008. (FindEvGateway)
4. "Efficacy of country legal frameworks and international guidelines in curtailing money laundering and terrorist financing activities in grey list countries: Case studies of Kenya and Uganda," *Journal of Economic Criminology*. (ScienceDirect)
5. Teichmann & Wittmann, "Global AML/CFT Regulatory Framework: A Critique," *MDPI Finance*. (MDPI)
6. "Role of FATF on financial systems of countries: successes and challenges," *Journal of Money Laundering Control*. (ScienceDirect)
7. South Africa & Nigeria exit FATF grey list, Reuters (2025).
8. UAE, Uganda, Barbados removed from FATF watchlist, AP News (2024).