BIASES IN NATIONAL AML RISK ASSESSMENTS

Charles Littrell[1]

Central Bank of The Bahamas

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PART 1: INTRODUCTION

National anti-money laundering (AML) and countering the financing of terrorism (CFT) jurisdictional assessments are prominent in the international AML/CFT movement. These assessments are a material element in determining the extent to which any nation and its financial system can participate in the global payments system, and the terms and conditions upon which that participation will be allowed. At the extreme, badly rated countries not only lose access to routine payments, but find it difficult to import essential food, medicines, and other supplies, even if they possess the funds to make payments.

National AML/CFT assessments are created by a number of official and private agencies. If the international AML movement relies upon legitimacy to meet its ends, then it is critical that jurisdictional AML/CFT assessments are reasonably accurate, and reasonably unbiased.

This paper investigates empirically identifiable biases in the two leading global jurisdictional AML risk assessments: the Financial Action Task Force (FATF) mutual evaluation reports (MERs[2]), and the U.S. State Department's International Narcotics Control Strategy Report, Part II (INCSR II[3]).

Some biases are legitimate: a bias against regimes that welcome dirty money, for example, would make a great deal of sense in AML/CFT terms. Other biases would be illegitimate, such as biases against (for example) poor, non-white, or small jurisdictions. In this paper we examine four apparent biases, which if true would be illegitimate:

1) The FATF MER assessments appear heavily biased in favour of four Anglophone ex-colonies: the United States, Canada, Australia, and New Zealand.
2) MERs appear biased against non-white and particularly black majority countries.
3) MERs appear biased against small island states of every ethnicity.
4) The INCSR II report contains a strong geographic bias. Third party users of INCSR II will fall into bias against Hispanic and Caribbean black majority jurisdictions, if they use INCSR II to form global AML assessments or rankings.

The International AML Assessment Regime

Per Littrell (2018[4]), there are several entities offering public ratings of a jurisdiction's AML effectiveness. In this paper we will broadly describe this group as "AML rating agencies."

AML rating agencies fall into two groups: those conducting original assessments, and those building weighted indexes based upon the original assessments, plus other available databases.

The two main original assessment sources are the FATF and the U.S. State Department.

The FATF MERs comprise a 40 item technical compliance assessment and an 11 item effectiveness assessment. The FATF does not convert these assessments into single grades (Such as a Moody's or Fitch sovereign debt rating) but many users of FATF assessments deploy their own conversion metrics to rank

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[2] https://www.fatf-gafi.org/countries/

[3] https://www.state.gov/2021-incsr-volume-ii-money-laundering-as-submitted-to-congress/

[4] Littrell, C.: "A Field Guide to the AML Sovereign Risk Rating Agencies", *ACAMS Today,* December 2018.

countries on MER results. All users of which we are aware deploy the technical assessment results separately from the effectiveness results, and may weight these two items differently.

The FATF further delineates two lists: a "blacklist" comprising Iran and North Korea, and a "grey list" of jurisdictions assessed to possess strategic deficiencies in their AML arrangements. The grey list flows from deficiencies in specified technical compliance and effectiveness items.

The INCSR II report lists countries which the State Department is legislatively mandated to deem "major money laundering countries". There are currently 79 listed jurisdictions, not all of which are independent nations. The INCSR II report is preceded by an "INCSR I" report, which lists countries producing and transporting narcotics to the United States.

It is important to understand that the State Department does not think of itself as providing an AML sovereign ratings service. It is evident, however, that many users treat the FATF and INCSR II assessments as equivalent to ratings. Users include public sector agencies and governments, correspondent banks, and other parties interested in financial crime, possibly including professional money launderers.

Among the index ranking services, the following are prominent:

1) The Basel Institute on Governance's Basel AML Index[5];
2) Refinitiv's Country Risk Ranking[6]; and
3) Know Your Country's Country Ratings Table.[7]

There are several other competitors to these services, and no endorsement or disendorsement by the author should be inferred.

We will focus this paper upon the two original assessment services. To the extent that an index ranker relies relatively heavily upon more (less) biased inputs, then its ranking will become more (less) biased. At this point the three FATF inputs (technical compliance, effectiveness, and gray listing) plus INCSR status tend to dominate results for many index rankers.

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[5] https://baselgovernance.org/basel-aml-index
[6] https://www.refinitiv.com/en/products/country-risk-ranking
[7] https://www.knowyourcountry.com/country-ratings-table

PART 2: SIMPLE RACIAL DIFFERENCE ANALYSIS IN THE FINANCIAL ACTION TASK FORCE (FATF) RESULTS

The FATF has in recent years pursued its fourth round of mutual evaluation reports (MERs)[8]. The results from these MERs are published on a country by country basis[9], comprising the 40 technical compliance elements and the 11 effectiveness elements. The FATF also publishes a blacklist (comprising Iran and North Korea) and a grey list of jurisdictions asserted to display "strategic deficiencies"[10], with publication updated thrice yearly.

There is a striking pattern in the FATF MERs that large, wealthy, white majority countries receive favourable assessments relative to jurisdictions not displaying these characteristics. This paper quantifies these outcomes, and considers whether they represent justified or unjustified bias.

FATF Technical Compliance and Effectiveness Ratings

The first three rounds of FATF jurisdictional assessments focused upon technical compliance, which focuses upon legislative, regulatory, and criminal justice regimes and outcomes. From the fourth round of assessments since 2014, the FATF has included a separate rating of "effectiveness".

For both technical compliance and effectiveness, FATF MERs follow an International Monetary Fund precedent and assign one of four descriptions. These range from "Compliant" through "Noncompliant" for technical compliance, and from high to low effectiveness on the effectiveness assessment. We have scored the results as the square of the numbers 1 through 4, with 1 representing the best score. Jurisdictional rankings are based upon average technical compliance and effectiveness ratings. We tested other conversion methods such as a (0, 1, 2, 3) scoring map, and linear vs. exponential weights. These produce nearly identical results, with rank correlations among the competing methods typically exceeding 0.95.

Following Littrell and O'Brien (2019[11]), we have extracted the FATF's MER results as of April 2021, and ranked countries by their aggregate technical compliance and effectiveness scores. Where relevant, we have also included macroeconomic data from the 195 jurisdictions listed in the IMF's 2021 World Economic Outlook[12]. For a handful of very small and often non-country jurisdictions, we have relied upon other economic data sources.

Ethnic classifications

This paper initially looks at FATF MER differences by ethnicity, then delves deeper to delineate differences by jurisdictional ethnic subgroups.

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[8] https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatfissuesnewmechanismtostrengthenmoneylaunderingandterroristfinancingcompliance.html

[9] https://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf

[10] http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-february-2021.html

[11] Littrell, C., and O'Brien, D.: *Comparing Sovereign Debt Ratings to Sovereign AML Ratings*, 2020. Available at: https://drive.google.com/drive/folders/1Qu4Ocd5NMF_gK6xVhFXeBTmX2InQ4Gft

[12] https://www.imf.org/en/Publications/WEO/weo-database/2021/

Ethnic classifications are a fraught topic. In this paper we have first defined the following ethnic majority groups:

- White, mainly in Europe but including white majority ex-colonies in the new world plus Israel
- Asian and Pacific Islands (AAPI)
- Black, in both sub-Saharan Africa and the Caribbean
- Hispanic/Latin American
- Moslem.

Our general approach was based upon geography, so (for example) Albania is both European and majority Moslem, but is classified as white. Israel is *sui generis*, but also classified as white. Spain and Portugal are arguably Hispanic, but are classified as white. Countries very often display mixed ethnicities, but in most cases there is an obvious majority.

Given the global focus over the past 20 years on terrorism financing, we have separated the African and middle eastern Moslem majority counties (broadly, Morocco to Pakistan) into a Moslem group, while Asian majority Moslem countries (Indonesia, Malaysia) are included in the Asian group.

We acknowledge that there are competing ways to classify countries, and in fact this initial classification proved simplistic. The Asian, Hispanic, and Moslem groups (see Table 1a and Chart 1) fall broadly into the middle of the FATF classifications, and in an econometric sense offer few insights. The black and white jurisdictions, however, are clearly heterogeneous.

It also became clear that there are probably non-racial biases in the FATF MER rankings, especially a large bias in favour of the white ex-colonies, and against small island states. These issues will also be further explored later in the paper.

FATF MER results by broad ethnic group

We first examine the results based upon median effectiveness and technical compliance rankings across countries[13].

The difference between technical compliance and effectiveness ranks tells us something about the overall opinion formed for a jurisdiction. Jurisdictions with large negative differences (TC rank better than effectiveness rank) are assessed to have better rules and regulations than actual performance on the ground. Jurisdictions with large positive differences are the opposite.

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[13] We also considered technical compliance and effectiveness on average rankings, but these are insignificantly different from the median comparisons.

Table 1a: Summary FATF MER Results by Jurisdiction Ethnicity

Ethnicity	Count	Effectiveness Rank of 106 (Median)	Compliance Rank of 106 (Median)	Rank Median Difference
White	38	27	43.5	16.5
Asia/Pacific	24	66	55	(11)
Hispanic	11	46	35	(11)
Moslem	10	61	65	4
Black	23	87	71	(16)
Total	106	53.5	53.5	0

The count shown in Table 1a counts the number of countries (106) receiving at least one fourth round MER as of April 2021.

The FATF fourth round MER results assess Hispanic countries the best for technical compliance, with white countries somewhat behind. Both groups rank somewhat better than the global average. Moslem and AAPI countries rank slightly worse than average. Black countries bring up the rear.

For effectiveness, the rank order has white countries well in front, with Hispanic, Moslem, AAPI, and black countries following in that order. The spread on effectiveness medians is about double the spread on technical compliance medians.

As a general observation, FATF technical compliance ratings are more resistant to opinion bias than are effectiveness ratings. The former are based upon detailed standards. The latter rely more upon, in the first instance, the conclusions of the international MER assessment team, and in the second instance, the adjustments to the assessment team's ratings by the FATF secretariat and the FATF plenary. These adjustments are typically not shared with non-member assessed jurisdictions until they are decided.

We consider that the differences between technical compliance and effectiveness rankings show the extent to which any MER has "forgiven" poor technical compliance with good effectiveness ratings, or vice versa. From the last column of Table 1a, we see the increasingly familiar pattern of white countries in front, with black countries bringing up the rear.

CHART 1
MER Differences by Simple Ethnic Classification

EFFF Rank (y-axis), TC Rank (x-axis)

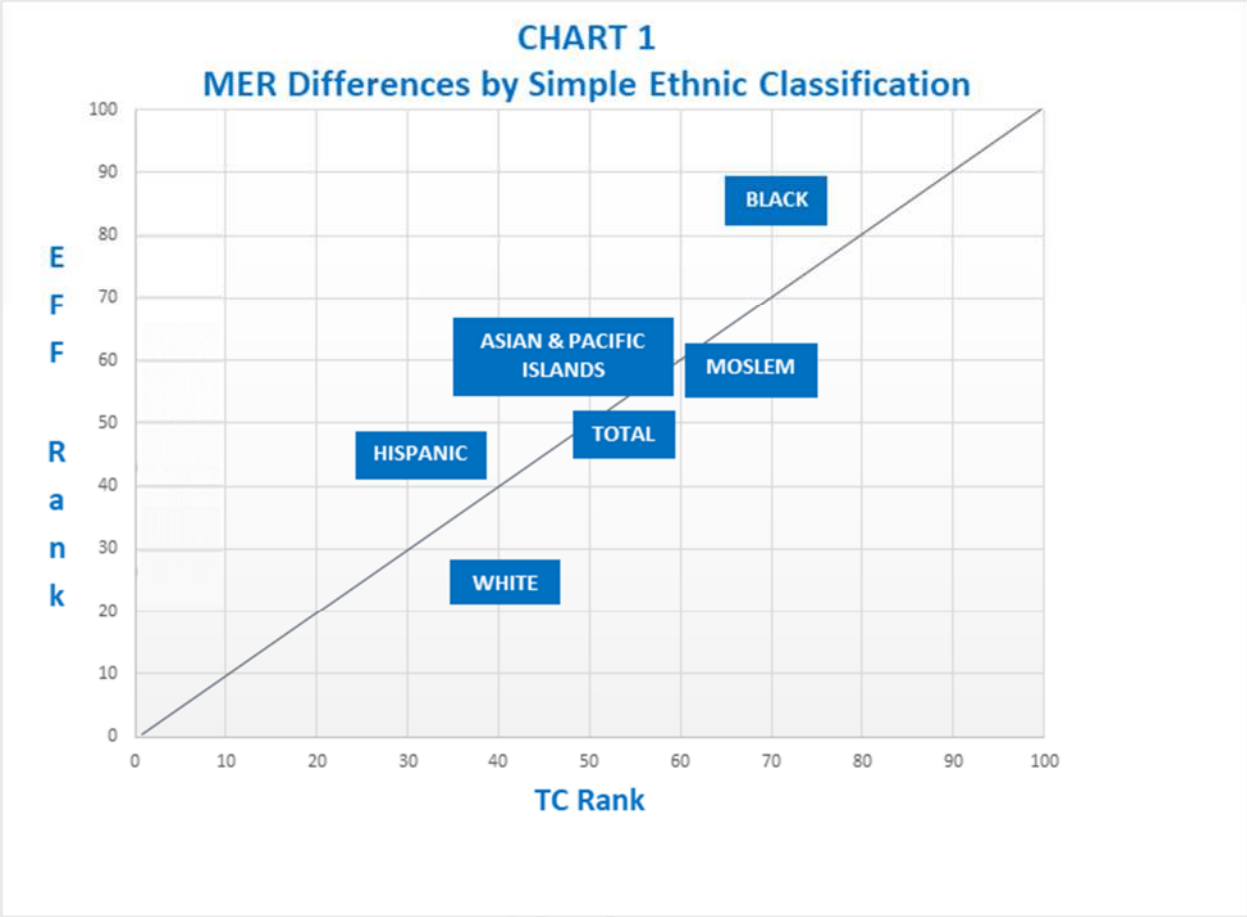BLACK, ASIAN & PACIFIC ISLANDS, MOSLEM, HISPANIC, TOTAL, WHITE

Chart 1 demonstrates a broadly linear relationship between technical compliance ranks and effectiveness ranks, across simple ethnic groups. Groups above the line are assessed with better technical compliance than effectiveness, and vice versa. The upper right of this chart is the worst quadrant, and the lower left the best.

White countries are conspicuously favoured on effectiveness relative to technical compliance, particularly relative to Hispanic countries, but in general technical compliance is a reasonable predictor for effectiveness rank. This says nothing about whether the MER assessments are accurate, but indicates at least one strong correlation.

Moving away from medians for a moment, there are substantial differences in the "TC Rank Minus Effectiveness Rank" indicator for individual jurisdictions, and they demonstrate two striking patterns.

Table 1b: Five Most and Least Advantaged Jurisdictions on Effectiveness vs. Compliance

Jurisdiction	Effectiveness Rank (of 106)	Technical Compliance Rank (of 106)	TC Rank Minus Effectiveness Rank
Vanuatu	102	9	(93)
Mauritius	82	10	(75)
Cayman Islands	74	4	(70)
Iceland	78	10	(68)
Trinidad and Tobago	74	7	(67)
United States	4	77	73
Australia	13	81	68
New Zealand	6	72	66
Canada	24	83	59
Switzerland	8	55	47

From Table 1b, we see that small island states of every ethnicity are rated exceptionally badly on effectiveness vs. technical compliance. Conversely the four white majority ex-colonies seem to be getting a very large credit for effectiveness vs. technical compliance. It is difficult to believe that the United States, for example, can truly rank 77th of 106 on technical compliance and 4th on effectiveness, but those are the current FATF results.

One issue to consider is whether or not the FATF focuses its attention more upon member nations than non-member nations. Table 2 looks at this issue.

Table 2: FATF Membership Composition vs. MER Coverage

Member Ethnicity	Total Members	Rated	Not Yet Rated
White	24	20	4 (France, Germany, Luxembourg, Netherlands)
Asia/Pacific	6	4	2 (India, Japan[14])
Hispanic	3	1	2 (Argentina, Brazil)
Moslem	3	3	0
Black	1	0	1 (South Africa)
Total	37	28	9

Remembering that 106 jurisdictions have received MERs, the bulk of the FATF's focus is upon non-members. It is curious that the FATF has imposed itself substantially on small and very small states, while not yet evaluating many much larger member states. This suggests that the FATF views non-member states as more of an AML/CFT target than its own members. The FATF has so far failed to

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[14] Japan's MER was in progress as this paper was written.

subject 4 of its G10 members and 9 of its total members to an MER, having had the last eight years to do so.

FATF Quartile Analysis: Effectiveness and Technical Compliance

Table 3a: FATF Effectiveness quartiles

	White	Non-white	Black countries within the non-white total
First (best)	18	8	1
Second	12	14	0
Third	6	20	7
Fourth (worst)	1	27	15

Table 3a demonstrates that white countries consistently score better, and non-white (in particular, black) countries score worse, than the average. The eight best rated jurisdictions in the above table are all white. Had the worst-ranked white jurisdiction (Iceland) rated one spot better, there would have been zero white countries in the bottom quartile. According to FATF evaluations, only one black jurisdiction (Bermuda) ranks in the top half of the effectiveness quartiles, with all the remaining 22 jurisdictions in the bottom half. Nine of the ten original (and all white) FATF members receiving a fourth round effectiveness MER are in the top quartile, with the remaining original member (Austria) in the second quartile.

Table 3b: FATF Technical Compliance Quartiles

	White	Non-white	Black countries within the non-white total
First (best)	13	3	3
Second	7	19	3
Third	12	14	7
Fourth (worst)	4	24	10

The technical compliance table remains racially differentiated, but to a lesser degree than the effectiveness quartiles. Six of the ten original white FATF members with an MER are in the top quartile, with none in the second, two in the third, and two in the fourth quartiles.

FATF Grey List

For many years the FATF has published a "grey list" of jurisdictions asserted to exhibit strategic deficiencies on their AML technical compliance and effectiveness MER results. Grey list presence is determined by performance on the technical compliance and effectiveness ratings, with more practical weighting given to the effectiveness ratings. The April 2021 grey list[15] comprises 19 jurisdictions, distributed as per Table 3:

Table 4: FATF Grey List by Membership and Ethnicity

	FATF non-Member	FATF Member
White	Albania[16]	None
Non-White	Barbados, Botswana, Burkina Faso, Cambodia, Cayman Islands, Ghana, Jamaica, Mauritius, Morocco, Myanmar, Nicaragua, Pakistan, Panama, Senegal, Syria, Uganda, Yemen, Zimbabwe	None

There are approximately 190 relevant global AML jurisdictions, of which one in ten are on the FATF grey list, and roughly one in five of jurisdictions receiving an MER. This grey list composition suggests that either:

a) The world's AML/CFT non-compliance problems are heavily concentrated among non-white, non-FATF member countries; or
b) There is substantial illegitimate bias in the FATF's MER assessments and related outcomes.

Summary: FATF MER racial differences at the macro level

It is worth repeating that racial difference in assessment is not the same thing as racism in assessment. The large differences shown here may reflect a reality that white countries are the most effective at AML risk management matters, and non-white (particularly black) countries are the worst. That question will be addressed later in this paper. Before moving to this question, however, we need to more carefully consider the FATF MER differences between and within black and white majority countries.

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[15] As of February 2021: http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-february-2021.html
[16] Albania is ethnically European and majority Moslem

PART 3: DELVING MORE DEEPLY INTO THE FATF MERs

The above analysis leads to two additional questions:

1) Are the defined ethnic groups monolithic, or are there intra-group differences; and
2) Can we deploy econometric tools to determine why there are inter-group MER differences?

Better defining white and black country groups

The analysis in the previous section indicated that any racial differences are probably greatest between white and black countries, but also that non-racial differences are in some cases important. We therefore have disaggregated our 61 white and black jurisdictions into seven segments that share common elements:

- Four "White ex-colonies" (WEC)[17];
- The seven original FATF members[18] not in the WEC group. All of these are larger western European high income jurisdictions;
- 14 Eastern European countries[19], which are low or middle income;
- Eight small, wealthy, Western (and northern) European countries (and including Israel) that were not original FATF members[20]
- Five European small islands[21]
- Fifteen low income black countries, all but two[22] of which are from sub-Saharan Africa. Although the cutoff for this group was USD 10,000 in per capita income, they are typically very much poorer, with median GDP per capita at USD 1,300;
- Eight middle and high income black countries[23], which are Caribbean[24] and are small island jurisdictions.

What are our candidate economic explanatory variables?

Based upon several years of exposure to MERs, we conjectured that we would see significant differences for two economic variables:

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[17] The United States, Australia, Canada, New Zealand
[18] Spain, Italy, Belgium, Austria, Sweden, Switzerland, and the United Kingdom. Germany, France, Luxembourg and the Netherlands have yet to receive an MER.
[19] Low income is defined as under USD 10,000 GDP per capita, with middle income ranging from USD 10,000 to 20,000. There were few if any significant quantitative differences between the two European groups, which have been combined here.
[20] Andorra, Denmark, Finland, Greece, Ireland, Israel, Norway, Portugal
[21] Cyprus, Isle of Man, Malta, Iceland, Gibraltar. Gibraltar is geographically a peninsula, but politically an island.
[22] Haiti and Jamaica
[23] There was insufficient quantitative difference between middle and high income black countries to split this category.
[24] Bermuda and The Bahamas are geographically not in the Caribbean, but are included in this group.

1) GDP for a country. Broadly, large economies tend to do better than small economies; and
2) GDP per capita. Rich countries tend to do better than poor countries.

Working on this paper led to the following additional observations:

3) There is a clear difference in MER ratings between small islands and all other jurisdictions, but large islands are indistinguishable from continental jurisdictions; and
4) **WEC status is a major determinant of MER ranking.**

Table 5: Disaggregated white and black groups, macro inputs, and MER rankings

All in medians	TC Rank (from 106)	ERank (from 106)	TC Rank – Erank [25]	GDP (Median USD bn)	GDP per capita (Median USD 000s)
All jurisdictions (106)	53.5	53.5	0	59	11.4
White (38)	43.5	27	10.5	226	31.4
Eastern European (14)	60.5	38.5	19.5	61	9.3
Small Western European (8)	31.5	15	14	343	46.1
Original FATF, not WEC (7)	15	8	3	825	46.3
White Ex-colony (4)	79	9.5	67	1,745	50.5
Small White Islands (5)	21	55	(9)	16	67.1
Black (23)	71	87	(5)	15	2.2
Low income black (15)	80	90	(3)	19	1.3
High Income black islands (8)	60	74	(15.5)	5.5	23.8

There are some extraordinary results in Table 5, which may show more readily in Chart 2.

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[25] This column is not the subtraction of the first column entries from the second column, but instead calculates the median at the individual jurisdiction level within each group.

CHART 2 - MER Differences by Sub Groups

As with Chart 1, "good" is lower left, and "bad" is upper right. We can think of "disfavoured" as above the line, and "favoured" as below the line.

We see that there are clear variances from the line of equality, notably:

a) Small islands do badly, with both white and black small islands in negative territory relative to their assessed technical compliance.

b) The WEC outcome is difficult to explain. Their MER technical compliance rankings are near the worst in the world, and their effectiveness ranking is near the best in the world. The WEC members simultaneously display sub-Saharan technical compliance ratings with some of the world's best aggregate effectiveness rankings.

c) Black country effectiveness is scored appreciably worse than technical compliance for both groups, with the wealthier Caribbean islands clearly different from the mainly sub-Saharan poor black countries.

d) Eastern European countries score about average on technical compliance, but much better than average on effectiveness.

Economic Drivers for Technical Compliance and Effectiveness Ranks

Having broken the overly simplistic white and black groups into seven more homogenous sub-groups, we can further investigate group differences. We are seeking to answer three questions:

1) What are the determinants of technical compliance rank?
2) What are the determinants of effectiveness rank?

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3) Do the answers to the above two questions vary with the racial composition of the ranked jurisdictions?

We will commence with a correlation summary, then move to regressions.

Table 6: Correlation results (negative Erank and TC Rank correlation indicates positive ranking effect)

	TC Rank vs. ERank	ERank vs. ln GDP	ERank vs. ln GDP per capita	TC Rank vs. ln GDP	TC Rank vs. ln GDP per capita
White Ex-Colonies (4)	0.82	-0.15	-0.35	0.34	0.24
Original FATF (large Western Europe) (7)	0.11	-0.76	0.29	-0.40	0.88
Eastern Europe (14)	0.20	-0.28	0.10	0.09	0.26
Small Western Europe (8)	0.49	-0.05	0.19	0.04	0.02
Small White Islands (5)	-0.04	-0.20	0.62	-0.33	-0.28
Low Income Black/Africa (15)	0.51	-0.15	0.00	-0.36	0.03
Black Islands/Caribbean (8)	0.59	0.15	-0.72	-0.66	-0.71
All White (38)	0.15	-0.65	0.21	0.01	-0.26
All Black (23)	0.65	-0.20	-0.57	-0.08	-0.52
White plus Black (61)	0.49	-0.67	-0.64	-0.23	-0.50
All jurisdictions (106)	0.45	-0.57	-0.61	-0.16	-0.48

Comparing the first seven rows of numbers in Table 6 with the last four produces the commonplace insight that correlations among group ranging from 23 to 106 members are likely to be more useful than correlations for groups ranging from 4 to 15 members. We can also see our starting conjectures about likely effects are broadly supported:

- Technical compliance correlates reasonably well across the group.

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- Economic size and national income levels are typically strongly correlated with effectiveness rankings across all jurisdictions, and are less correlated for technical compliance rank. Note that other than the first column, negative correlations signify a positive effect on ranks (rank 1 is superior to rank 106).

There are however substantial differences between the groups. Some of the more notable outcomes, remembering that we are dealing with small data samples, include:

- Technical compliance is weakly correlated with effectiveness for white countries, but strongly correlated for black countries. This may be due to the strong and opposite outlier status of the small white islands and the WECs, which between them exceed a quarter of the white country group.
- Effectiveness rank strongly correlates with income (GDP per capita) across all jurisdictions, but is weakly (or perversely) correlated within many subgroups. This suggests that per capita income is important for MER evaluations between groups of countries, but considerably less so within each of those groups.
- Economic size is strongly correlated across the white country population for effectiveness, but not for black countries, where the smaller Caribbean economies are ranked better than the larger but poorer African countries. This result suggests, similarly to the GDP per capita findings, that economic size matters between some groups for effectiveness, but not so much within groups.

At the highest level, our original economic conjectures seem sound: Better MERs attach weakly to larger economies and strongly to richer economies. Table 6's results, however, demonstrate large variances from the general case.

Regression analysis: is there a Beta for racial identity?

With the insights from our correlations and previous analyses, we can deploy regression equations to directly query racial inputs into the FATF MER results. Our approach will be:

a) To build regression equations using the two economic variables (size and income) and the two idiosyncratic variables (WEC status and small islands), and
b) Then run the same regressions adding a new dummy variable for black majority status.

If the regressions with a racial identity variable don't improve upon the original regression's predictive power, or generate insignificant coefficients, then this would indicate weak statistical support for explicit racial bias in our data sample. If the converse applies, this may indicate racial bias, or may indicate other variables which have not been picked up in the regression equations.

We run four regressions. The first two regressions determine coefficients for TC rank and E rank without use of a racial identity signifier. Equations 3 and 4 replicate equations 1 and 2, but with an additional racial signifier binary variable.

1) $\text{TCRank}_{BW} = \alpha + \beta_1 \text{LnGDP} + \beta_2 \text{LnGDPPC} + \beta_3 \text{WEC} + \beta_4 \text{Island} + \varepsilon$
2) $\text{ERank}_{BW} = \alpha + \beta_1 \text{LnGDP} + \beta_2 \text{LnGDPPC} + \beta_3 \text{WEC} + \beta_4 \text{Island} + \beta_5 \text{TCRank} + \varepsilon$

3) $\text{TCRank}_{BW} = \alpha + \beta_1 \text{LnGDP} + \beta_2 \text{LnGDPPC} + \beta_3 \text{WEC} + \beta_4 \text{Island} + \beta_6 \text{Black} + \varepsilon$
4) $\text{ERank}_{BW} = \alpha + \beta_1 \text{LnGDP} + \beta_2 \text{LnGDPPC} + \beta_3 \text{WEC} + \beta_4 \text{Island} + \beta_5 \text{TCRank} + \beta_6 \text{Black} + \varepsilon$

We trust that most regression terms are obvious from the previous discussion. "BW" refers to the MER dataset containing the 61 white and black majority countries. WEC, Island, and Black are binary dummies for White Ex-Colony, small island, and black majority status respectively. Variable 5 is the technical compliance rank. The ranks in all equations are based upon the 106 MER sample, not the 61 MER sample.

Regression Results

Table 7: Regression results (Betas shown with T-values, with 5% significant P-values shown in bold)

Dependent Variable	α	B_1 Ln GDP	B_2 Ln GDPPC	B_3 WEC	B_4 Small Island	B_5 TC Rank	B_6 Black	R-Squared
1: TCRank$_{BW}$	96	-5.76 (-2.35) **0.02**	-8.12 (-2.90) **0.005**	58 (4.18) **0.0001**	-15 (-1.27)	N/A	N/A	0.44
2: ERank$_{BW}$	66	-1.90 (-1.00)	-11.91 (-5.41) **0.000**	-16 (-1.43)	33 (3.67) **0.0006**	0.30 (3.05) **0.0035**	N/A	0.74
3: TCRank$_{BW}$	89	-5.60 (-2.27) **0.03**	-6.38 (-1.77)	57 (4.07) **0.0002**	-19 (-1.47)	N/A	8 (0.76)	0.45
4: ERank$_{BW}$	49	-1.62 (-0.93)	-7.23 (-2.88) **0.006**	-18 (-1.66)	20 (2.21) **0.03**	0.27 (2.95) **0.005**	22 (3.18) **0.002**	0.78

We first acknowledge that we could be fairly accused of data torture, by running five and six-variable regressions on a 61 item data set. Having acknowledged this, however, small data sets can be indicative if they vary appreciably.

There are at least three comparisons of interest from the above table:

1) What drives technical compliance (equations 1 and 3) vs. effectiveness (2 and 4)?
2) Does black majority status have any effect on technical compliance (1 vs. 3)?
3) Does black majority status have any effect on effectiveness (2 vs. 4)?

Technical compliance and effectiveness drivers

National income per capita levels (β_2) are consistently significant for technical compliance. Economic size (β_1) is also consistently associated with better rankings, but with low coefficients and little statistical significance. This is unsurprising, given we know many small states score better than larger economies on technical compliance. WEC membership is surprisingly powerful given the small group size. There is an estimated 58 (!) technical compliance ranking variance from what would otherwise be predicted by economic size and wealth. Small island status is perhaps positive, but with at best vague statistical significance.

The resultant R^2 result at 0.44 in Equation 1 indicates that slightly over half of the variance in technical compliance national rankings flows from idiosyncratic issues associated with each country or perhaps each group of countries. Alternatively, we are missing something useful in the regression equation.

As for effectiveness (equation 2), we receive a substantial head start from the technical compliance scores (correlation = 0.45). Unsurprisingly the R^2 is much higher at 0.74. National income per capita remains a strong predictor, remembering that this is also a large factor in the technical compliance result. It may be the case that national income per capita is double-counted in the overall FATF effectiveness assessments. Small island status becomes important, with a 33 place effectiveness ranking penalty, and strong statistical significance. If we don't consider racial composition, then effectiveness rank is reasonably well determined by technical compliance rank, per capita income, and small island status. Considering WEC status also improves the regression.

Black majority status vs. technical compliance

The reader is invited to compare the Beta coefficients, t-values, and R^2 results for equations 1 vs. 3. They are remarkably similar. The black majority status indicator (β_6 in equation 3) is fairly small, statistically insignificant, and not adding much to equation 3. The R^2 results are nearly unchanged.

It would be fair to conclude from this dataset that these two equations demonstrate small and arguably zero difference in national technical compliance scores, based solely on black majority status.

On the other hand, what does count for technical compliance rankings?

1) National income per capita—and nonwhite countries are poorer on average, with all the poorest countries black majority.
2) WEC status—and all four of those countries are white majority.

One reasonable inference to draw from this analysis is that the FATF technical compliance MER assessment *process* is not significantly biased, in a racial composition sense. The underlying *framework*, however, consistently favours rich countries over poor countries, and usually favours white countries over black countries.

Black majority status vs. effectiveness

Consistent with the above section, the reader is invited to compare equations 2 and 4. We see little change in the economic size (GDP) or technical compliance Betas and t-values. Whatever is happening with effectiveness and black majority status isn't happening in these two variables. GDP per capita, by contrast, remains significant but reduces in importance for the "black and white" 61 nation sample.

This leaves small islands status, and black majority status. We see the shift in equations 2 and 4: small islands rank penalties drop from 33 to 20, with more statistical variance. One inference that can be drawn from this is that the effectiveness ranking penalty for small islands is relatively heavier on black majority islands, hence the drop in size and significance of this item from equations 2 to 4.

What then are we to make of β_6 in equation 4? The estimate is that black majority status worsens effectiveness rank in the 106 country pool by 22 places respectively—a substantial difference. Black majority small islands suffer a 42 rank drop for effectiveness—a very substantial penalty. This bias is also significant in statistical terms. These differences arise even after taking into account the two

economic variables, two idiosyncratic variables, and the technical compliance rank of all the MER-rated jurisdictions.

We also see that equation 4 explains 78 per cent of the effectiveness variance in its data sample, and both the largest coefficient and strongest statistical explanatory power is associated with black majority status. The α for equation 4 is 49, the closest constant to the 53 median for the 4 equations. The combination of this factor with a high R^2 gives additional confidence that equation 4 is reasonably well specified. One troubling implication from this specification is that under the MER process, jurisdictions vary relatively little in their rank based upon their idiosyncratic features—but they vary a lot based upon their income levels, small island status, and black majority status. In fact, equation 4 indicates that black majority status is both the largest and most statistically significant predictor of an MER effectiveness ranking.

β_6 is a measure of direct racial differentiation in MER ranking. It looks not unlike zero in the regression equations for technical compliance—and a lot like a large and highly significant number in the regression equations for effectiveness.

Our conclusion here is that, whatever the biases built into the FATF's underlying methodology, the practice of MER evaluation shows unpersuasive evidence of bias for technical compliance assessment, but persuasive evidence of bias for effectiveness assessments.

FATF grey list status is a semi-automatic mapping from technical compliance and effectiveness assessments. The distilled result in bias terms is depicted in Table 4.

Having demonstrated racial bias in FATF MER effectiveness assessments and grey listings, we repeat an essential reminder: racial difference, even racial bias, is not the same thing as racism. The conclusions in this section of the paper, however, make it clear that the FATF should be comfortable that its demonstrable biases are matched by equally demonstrable facts. Those facts should include, most relevantly for this paper:

a) Poor countries are more of an AML/CFT problem than rich countries;
b) White countries are less of a problem than non-white countries in AML/CFT terms; and
c) The WEC countries are particularly good, and small island states particularly bad, at AML/CFT risk management.

If all three of these conditions do not hold, or can't be demonstrated, then the FATF will need to consider whether the biases in their MERs are legitimate or illegitimate.

PART 4: THE STATE DEPARTMENT INTERNATIONAL NARCOTICS CONTROL STRATEGY REVIEW, PART II (INCSR II)

Relative to the FATF assessments, the State Department list is analytically simple.

The United States Department of State's Bureau of International Narcotics is statutorily responsible for delivering two annual reports to Congress. Part 1 addresses narcotics flows, and Part II, the subject of this paper, purportedly identifies "major money laundering countries."[26]

In recent years the U.S. State Department has tried to clarify that:

Inclusion in Volume II is not an indication that a jurisdiction is not making strong efforts to combat money laundering or that it has not fully met relevant international standards. The INCSR is not a "black list" of jurisdictions, nor are there sanctions associated with it.[27]

Despite this disclaimer, INCSR II is broadly used by the AML community as a jurisdictional rating of AML capability. For example, ACAMS, which is one of two global AML professional associations, prominently features INCSR II status in its country summaries. Several of the index rating providers include INCSR II status in their ratings models.

Among the many drawbacks associated with deploying INCSR II as an AML ratings input, the following are probably most relevant:

1) INCSR II was not developed and is not operated by the State Department as a ratings service, so its use in that context is rather like using a hammer as a screwdriver; and
2) As it has historically developed, INCSR II's listings are from a global perspective highly selected against countries in the western hemisphere. This may be suitable for INCSR II's statutory purposes, but it is distinctly biased in a global ratings context.

This paper will further examine the second point above.

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[26] https://www.state.gov/wp-content/uploads/2021/02/21-00620-INLSR-Vol2_Report-FINAL.pdf See page 13.
[27] Ibid

INCSR II and hemispherical bias

The 2021 INCSR II lists 79 countries. Tables 8a and 8b give a geographic breakdown on these listings.

Table 8a: INCSR II Western Hemisphere Listings

Western Hemisphere Regions	Total Jurisdictions	INCSR II Listed Jurisdictions
North America	3	3
Central America	7	7
South America	12	10
Caribbean Nations	15	14
Caribbean Territories[28]	N/A	3
Total	37	34 (+3)

It will be evident from the above table that the U.S. State Department has listed nearly all the independent countries in the western hemisphere, plus some protectorates. Congratulations are due to Chile, Uruguay, and Grenada as the "missing persons" on this list.

With this level of coverage, there is essentially zero risk sensitivity in the INCSR II western hemisphere listings. Furthermore, 35 of the 37 listed jurisdictions are either black or Hispanic majority.

Now let's look at INCSR outside the western hemisphere. Consistent with its non-intent to be used as a ratings service, the State Department provides no INCSR II "white list" of unlisted countries, so we don't know who the State Department has considered for inclusion. Some regimes are presumably too small for consideration. We will assume that the State Department looked at the top 150 countries by GDP (including in the western hemisphere) in the IMF World Economic Outlook for 2021. This assumption is doubtless wrong at the margins, but likely sufficiently correct for our needs.

Table 8b: INCSR outside the western hemisphere

National ethnic majority	Total Jurisdictions	INCSR II Listed Jurisdictions (% of each group)
White	40	11 (27%)
Asian/Pacific	21	11 (52%)
Moslem	28	12 (43%)
Black	32	9 (28%)
Total	121	43 (36%)

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[28] There are competing assignments of western hemisphere jurisdictions by region, and the definition of "Caribbean" can be particularly fuzzy. This paper classifies islands as Caribbean, and continental countries as Central or South American.

This table differs from the western hemisphere results. Just over a third of the assumed countries are listed.

Summary: Is INCSR II racially biased?

Comparing the two INCSR II hemispherical tables demonstrates that we are looking at two separate ratings systems. INCSR II's western hemisphere focus is not so much racial as geographic. Other users misapplying INCSR II as a global AML jurisdictional ratings input, however, are strongly biasing against the western hemisphere vs. the rest of the world. This strong bias creates in turn an unjustified bias against all Hispanic plus Caribbean black jurisdictions.

PART 5: WHERE IS THE WORLD'S MONEY?

Are the demonstrable biases in AML ratings supported by equally demonstrable money laundering problems in disfavoured jurisdictions?

It may first be helpful to remind ourselves where the world keeps its money, and to review the limited evidence for where the world manages or welcomes dirty money.

Where is the world's money?

Broadly, the world's assets reside in managed investments, direct investments, banks, real estate, and currency.

Managed investments

At the end of 2018, the world's 500 largest asset managers[29] controlled over $90 trillion in assets.

An estimated 57 per cent of these assets were controlled by American firms, and 31 per cent by European (including UK) firms, and 5 per cent by Japanese firms. Investment managers in the rest of the world, including the major Asian countries and Australasia, controlled 7 per cent of the group's assets. The largest entity outside the U.S./European/Japanese triad was Banco do Brasil, ranking 79th out of 500. The largest entity from a black majority country, South Africa's Old Mutual, ranked 255th.

Stock Exchanges

The world's ten largest stock exchanges[30] are also worth about $90 trillion, with the two major American exchanges accounting for half the value, and various European and Asian exchanges accounting for the rest. The five largest American tech stocks, in aggregate worth more than $5 trillion, would constitute the world's sixth largest exchange.

Banks

Measured by assets, 37 of the world's 100 largest banks[31] are headquartered in western and northern Europe. 37 are headquartered in Asia, of which 19 including the largest 5 are Chinese. There are 16 North American banks on the list, with four each from Australia and Brasil. The remaining two banks are Russian (60th on the list) and Qatari (96th).

Real Estate

Real estate is a valuable but difficult to measure market. International broker Savills[32] estimated global value as of December 2017 at $281 trillion, of which $221 trillion was residential, and the remainder commercial and agricultural. Savills further estimated that North America and Europe each held 22 per

[29] https://www.thinkingaheadinstitute.org/research-papers/the-worlds-largest-fund-managers-2019/

[30] https://www.visualcapitalist.com/the-worlds-10-largest-stock-markets/

[31] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/the-world-s-100-largest-banks-2020-57854079

[32] https://www.savills.com/impacts/market-trends/8-things-you-need-to-know-about-the-value-of-global-real-estate.html

cent of the market, with Asia holding 48 per cent of the global value, of which China represented over half. This left about 8 per cent of value for the rest of the world put together.

There are competing estimates, but all support the propositions that the global real estate market is very large, and concentrated by value in Asia, Europe, and North America.

Currency

Currency notes are a relatively small asset class, but may be particularly problematic as facilitators for financial crime. The Bank for International Settlements[33] published a comparison in 2017, concluding that member countries of the Committee on Payments and Market Infrastructures (CPMI) had $4.7 trillion in currency notes outstanding. The United States ($1.5 trillion), Europe ($1.2 trillion), and Japan ($0.9 trillion) accounted for over three quarters of aggregate note issuance by value. This data excludes China, which we understand has on the order of $1 trillion in currency notes outstanding, and crypto-assets, which in aggregate are valued at more than $1 trillion. In terms of currency-based financial crime, the United States is a remarkable outlier for issuing more USD 100 denominated notes than USD 1 denominated notes.

Total Wealth by country

Credit Suisse[34] annually estimates the world's wealth by country. The 2020 estimate had global wealth at $400 trillion, of which the Asia/Pacific region held 39 per cent, the United States plus Canada 31 per cent, Europe 23 per cent, and the rest of the world the remaining 7 per cent.

Summary: where are the world's assets?

Based upon the data summarized above, over 90 per cent of the world's financial and property assets are resident in the United States, Western Europe, China, and Japan. Other countries control less than ten per cent of the world's assets.

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[33] https://www.bis.org/cpmi/publ/d172.htm
[34] file:///C:/Users/cwlittrell/Downloads/global-wealth-report-2020-en.pdf

PART 6: WHERE IS THE WORLD'S DIRTY MONEY?

Ideally, we could compare the world's AML jurisdictional ratings with authoritative estimates of the world's stocks and flows of dirty money. Unfortunately, such authoritative estimates have never been created.

On the other hand, we possess a great many data sources which allow inferences about the origination, throughput, and final homes of the world's dirty money. We will deploy some of these data sources in this paper.

What does the research say?

Several academic researchers have examined the degree to which various countries can be characterized as more or less open to dirty money flows and investment. Findley, Nielson, and Sharman (FNS) are among the most prominent of these researchers, having spent the last decade conducting tens of thousands of shadow shopping exercises on the world's banks and corporate services firms. Their work suggests[35] that professional money launderers have many avenues to incorporate shell companies[36]. Furthermore, their shadow shopping results suggest that the OECD jurisdictions are the most open to illicit company and bank account[37] formation, and that smaller countries, particularly island nations with international financial centres, are among the most resistant to illicit company and bank account formation.

In recent work, FNS conducted shadow shopping exercises on every bank in the world with a SWIFT address, including multiple propositions signaling more or less money laundering or terrorist financing risk. The responses from this exercise were classified as "compliant" (the bank required reasonably full and correct documentation to open an account), "non-responsive" (which may include banks deciding not to engage with suspect proposals), and "non-compliant", which indicated a willingness to open accounts without proper documentation.

Among other things, this FNS exercise has been aggregated at the national jurisdiction level, with the following responses[38].

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[35] Brent B Allred & Michael G Findley & Daniel Nielson & J C Sharman, 2017. "**Anonymous shell companies: A global audit study and field experiment in 176 countries**," Journal of International Business Studies, Palgrave Macmillan;Academy of International Business, vol. 48(5), pages 596-619, July

[36] http://www.globalshellgames.com/

[37] https://drive.google.com/drive/folders/105eyS6kydZl4VStt9ONBqan-NdHJbW3f

[38] The author thanks FNS for this material, which has been provided ahead of planned publication.

Table 10a: Perfectly compliant and non-compliant jurisdictions

Jurisdictions with zero non-compliant responses	Jurisdictions with zero compliant responses
The Bahamas Latvia Liechtenstein	Mexico Montenegro Italy Cayman Islands France The Netherlands Japan Colombia

Table 10b: Quartiles by National Ethnicity for 87 FNS Countries

	White	Non-white	Black countries within the non-white total
First (best)	15	6	1
Second	9	13	4
Third	10	12	8
Fourth (worst)	9	13	1
Total	43	44	14
Reference Quartile	10.75	11	3.5

Table 10b is ranked upon the proportion of total queries that generated non-compliant responses, so is calculated on a different basis from Table 10a, which ignores non-responses.

Tables 10a and 10b may be usefully compared with the FATF quartiles at tables 3a and 3b. In broad terms, the FNS quartiles are nothing like as white-positive and black-negative as the FATF quartiles. They do reflect a view that on average, white countries are perhaps slightly better than average, and non-white countries slightly worse, but any differences are small.

It is worth noting from Table 10a that four of the eight perfectly non-compliant entries originate from the "original 15" FATF countries, giving the lie to any notion that they are especially resistant to laundered funds. The distribution by quartile for the "FATF 15" in Table 10b is: first 5, second 3, third 5, fourth 2.

This is somewhat better than a random distribution—but insufficiently so to support any statistical assertion that there is anything world-leading about the FATF 15 in AML terms.

Other AML jurisdictional ranking research

FNS has provided the most data-intensive insights via their decade of shadow shopping exercises. Several other researchers have also examined AML national assessment systems. Littrell and O'Brien (2019)[39] demonstrated that among the competing AML jurisdiction rankings there are low and sometimes negative correlations, including a negative correlation between FATF and INCSR II ratings. This result is inconsistent with more than one AML ratings provider (and probably zero providers) possessing any predictive validity.

Aziani, Ferwerda, and Riccardi (2020)[40] deployed a database comprising 29 million shareholders across 41 European countries to determine that there is a high concentration of ownership in countries that are non-transparent or which possess attractive tax regimes. On the other hand, there is also an over-concentration of ownership in countries with strong reputations for transparency and low corruption. This research is consistent with broader findings that criminals prefer, all things being equal, to place their money in low risk and low corruption countries.

Jofre, Riccardi, Bosisio, and Guastamacchia (2021)[41] recently issued a study of European corporate ownership, which among other things found a heavy concentration of ownership in several suspect jurisdictions—notably the United Kingdom, Malta, and the Netherlands. Riccardi[42] produced a companion piece deploying a gravity model, which has been a well-known technique since the 1990s, to assess Italian exposure to money laundering in other countries. The candidate model was tested using a large dataset of cross-border Italian AML prosecutions. Riccardi concluded that jurisdictional AML risk is relative to the country from which the risk is being viewed. In the Italian case, this means that the riskiest countries (in order) in his model are San Marino, Luxembourg, the Netherlands, Austria, and Switzerland, with white-majority and mainly European countries occupying the top 18 positions. To quote from Riccardi's summary:

The popular perception is that secrecy countries are often small, exotic, and offshore, located

somewhere in the Caribbean or the Pacific sea. They pop up regularly in high-profile media leaks like

the Panama Papers or Paradise Papers. The (novel) measures of corporate opacity used in this thesis,

and employed for the construction of the indicator, demonstrate instead that certain European (and even

EU) countries have a level of secrecy that is equal, or even greater, than Caribbean countries and other

offshore jurisdictions. In particular, European countries have the highest volume of firms with anomalous

complexity of their corporate structure and with the lowest information on their beneficial owners. Most

notably, the Netherlands, Luxembourg, Malta, Ireland, Liechtenstein, Austria and, to a lesser extent, the

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[39] https://drive.google.com/drive/folders/1Qu4Ocd5NMF_gK6xVhFXeBTmX2InQ4Gft
[40] ibid
[41] https://drive.google.com/drive/folders/105eyS6kydZl4VStt9ONBqan-NdHJbW3f
[42] ibid

UK are the highest ranked at the global level. While these countries performed badly with respect to

actual corporate opacity, they perform well in terms of statutory measures of transparency (hence, why

they have pretty good scores in, e.g., the FATF ratings or the FSI's Secrecy Score). The gap between

actual opacity and lack of compliance with transparency requirements is something which current official

AML blacklists are not able to bridge.

Using a database of crypto-asset trading across exchanges in many countries, Nershi (2020)[43] concluded that many exchanges display suspicious activity grouped just below required trading volumes. The United States is an upside outlier, in that minimal suspicious activity is detected. To quote Nershi, however:

Finally, my results suggest that – contrary to widely held views in some academic and policy

circles– enforcing due diligence laws poses a significant challenge for developed countries.

My analysis shows significant levels of suspicious activity across countries, including devel-

oped countries like Japan and the United Kingdom. Indeed, this finding fits with a wealth

of evidence from recent events that show significant failures in the enforcement of customer

due diligence laws by wealthy, industrialized countries.

Here again we see the result that most of the financial activity is in the more developed, richer, and in AML terms well-rated countries—and most of the suspicious activity is concentrated in these countries too.

It is not this paper's purpose to conduct an extensive literature review. It would be fair to observe, however, that the near-unanimous consensus in the AML research community differs from the FATF and State Department views. That is: there is plenty of illicit activity, and very likely a substantial majority of illicit activity, in the large, rich, white-majority countries that are held out and hold themselves out as exemplars for AML ratings purposes.

The Panama and Paradise Papers

The Panama Papers[44] are a trove of several million documents stolen from Panamanian law firm Mossack Fonseca, and shared with the world's investigative journalists. These papers revealed a global network of shell companies, which were formed for more or less legitimate purposes by a great many people in a great many countries. Implicated persons, for example, included former prime ministers in the United Kingdom and Iceland.

The Paradise Papers[45] are a similar trove of data on shell companies held globally. As a general rule, the Paradise Papers exposed relatively few illegal arrangements, compared to the Panama Papers.

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[43] Ibid

[44] https://en.wikipedia.org/wiki/Panama_Papers

[45] https://en.wikipedia.org/wiki/Paradise_Papers

In both cases and with some other leaks, there has been broad attention to the fact that the documents were held in non-European countries such as Panama. Over time, however, interested observers have noted that a substantial proportion of the arrangements revealed people and firms in traditionally well rated countries in Europe, North America, and elsewhere.

Other Journalism

British journalist Oliver Bullough's book[46] and articles[47] argue the case that there is a small but efficient global group of lawyers and other money laundering enablers. This group often has access to useful jurisdictions in western countries who are willing to write legislation to order to facilitate anonymous funds, for example via trusts. This work is facilitated by the American non-participation on an outbound basis in FATCA or CRS international tax reporting. Bullough has also noted the extreme complexity and ineffectiveness of the AML regime in his home country.

Other books on money laundering scandals tend to follow the theme of major crimes facilitated by major western financial institutions, such as Goldman Sachs and the Malaysian 1MDB matter, HSBC in Mexico, and the like. There have also been large scandals involving Russian anonymous money, such as the Danske Bank matter in Estonia.

Leaving aside the general purpose press, several firms provide AML aggregation services for media articles and public sector press releases. As this paper was being drafted in May 2021, for example, RiskScreen's (an AML consulting firm) KYC360 weekly roundup[48] headlined seven articles:

- "DNB to be fined $48 million for AML Inadequacies"
- "The Posh London Address 4,000 Companies Call Home"
- "Inside the High-Stakes World of NFTs"
- "Malta: Cash Payments over EUR 10,000 for Gold, Cars, Boats, and Property no Longer Possible"
- "Former Ukrainian President Poroshenko Secretly Controlled Offshore Firms That Banked at Austria's Raiffeisen"
- "Germany Orders Deutsche Bank to do More to Prevent Money Laundering"
- "London School of Economics Accepted Risky Cash Years After Donations Warning"

We do not pretend that these seven articles are statistically comprehensive or compelling—but they are typical. It is notable that every article refers at least in part to a white majority country or countries, more often than not one of the countries constituting the original FATF 15.

Taking a somewhat more extensive case, we have also extracted four recent weekly summaries from www.moneylaundering.com, a service provided by ACAMS[49]. We then assigned geographic locations to any article referencing money laundering or financial crime incidents or sanctions. Tables 11a and 11b give the result.

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[46] https://www.amazon.com/Moneyland-Thieves-Crooks-Rule-World-ebook/dp/B01NBWDPW8
[47] https://www.theguardian.com/world/2019/nov/14/the-great-american-tax-haven-why-the-super-rich-love-south-dakota-trust-laws
[48] https://mail.google.com/mail/u/0/#inbox/FMfcgxwLtsrwrDnLccfZcBhZWHSMWBzl
[49] https://www.moneylaundering.com/ The news feed is a subscription service.

Table 11a: Late March through April 2021 Country Mentions on moneylaundering.com

Jurisdiction (in order of first mention)	Number of Articles (Separate Topics)
Germany	3
Turkey	1
USA	8
Cyprus	1
Guernsey	1
UK	4
UAE	1
China	3
Spain	1
Switzerland	2
Hong Kong	1
Australia	2
Malta	2
Bosnia and Herzegovina	1
Ireland	1
Belgium	2
Russia	1
Iran	1
Saudi Arabia	1
Venezuela	1
South Africa	1
Singapore	2
Bulgaria	1
India	1
Italy	1
France	1
Lebanon	1
Liechtenstein	1
Nigeria	1
Pakistan	1
Argentina	1
Cayman Islands	1
Mexico	1
Andorra	1
Syria	1
Tunisia	1
Luxembourg	1
Vatican City	1
Total	57

Table 11b: moneylaundering.com articles by ethnicity of jurisdiction

National ethnic majority	Total Countries (proportion of 38 %)	Proportion of Mentions (from 57 total %)
White	19 (50)	35 (61)
Of which: FATF original 15	10 (26)	25 (44)
Asia/Pacific	4 (11)	6 (11)
Moslem	9 (24)	9 (16)
Hispanic	3 (8)	3 (5)
Black	3 (8)	3 (5)
Total	38 (100)	57 (100)

As with the research and other media results, Tables 11a and 11b look nothing like what we would expect if the FATF and INCSR II assessments are valid. From Table 7b we see that half the countries mentioned are white majority, as are over half the articles, and the FATF original 15 make up a large proportion of these items. There are few mentions from the FATF grey and black lists.

If we ran the above exercise for (say) a year, it is likely that the "total countries" column in Table 11b would become increasingly useless, as we would expect a great many countries to be mentioned at least once. On the other hand, the "Proportion of Mentions" column would likely become more useful as the number of mentions increased. The author's experience is that the proportions shown in the last column of Table 11b would remain more or less the same over any length of analysis.

One could argue that the large number of articles on white country and FATF 15 countries indicates their efficacy in finding dirty money, or perhaps the intensity of their media coverage. This argument would be more persuasive if the same pattern hadn't been in place for many years, and likely will remain in place for many years to come. A nation consistently reporting large numbers of AML prosecutions and fines may in FATF terms be demonstrating effectiveness, but in economic terms it is demonstrating that the country is awash in dirty money.

Which countries are generating AML Financial Institution Penalties?

The absence of an official league table of annual financial sanctions is among the many data shortcomings in the global AML movement. From the informal efforts that have been published, however, we can see that the bulk of sanctions fall upon purportedly legitimate major institutions in white countries:

- Fenergo's 2020 summary[50] noted that fines fell most heavily upon American, Swedish, German, and Israeli firms;

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[50] https://ibsintelligence.com/fenergos-study-reveals-increase-in-aml-kyc-and-sanctions-fines-for-global-financial-institutions/

- A payments industry newsletter[51] listed 2019 fines in 14 countries, of which most accrued in the United States, with a French firm paying the largest single fine, and the United Kingdom and Belgium third and fourth on the list.
- Another newsletter's[52] 2020 AML fine list had the United States in first place, followed by Australia, the Netherlands, Israel, and Sweden.

It is notable when reviewing the many data sources in this area that they don't necessarily agree upon their definitions and data, but the general conclusion is inescapable. Fines and similar sanctions fall most heavily upon financial institutions in white majority countries, often but not always for facilitating irregular financial dealings in non-white majority countries. There is also the consideration that the United States will likely always feature towards the top of any such list, given that country's public sector predilection for issuing large fines.

This raises the obvious question: if fines and similar sanctions are heavily concentrated among the leading financial institutions in white majority countries, why are these countries given the most favourable ratings from the FATF and (to a lesser extent) the State Department?

Summary: Where is the World's Dirty Money?

Much of the material in this section relies upon anecdotal or other narrow and inconsistent data sources. All this material, however, consistently suggests that:

a) Dirty money destinations are not all that different from clean money destinations. The great majority flows to the United States, the United Kingdom, western Europe, and to a lesser extent Asia; and
b) Too many private sector institutions in wealthy countries often seem happy to facilitate these illicit flows.

In other words, there is nothing in the research or media reports to suggest that the large racial differences in the two ratings providers studied in this paper are backed by facts. The rather unsatisfactory facts available to us suggest that if anything:

c) Dirty money in aggregate is much more of a problem in white countries and for major financial institutions in those countries, than in non-white countries; but
d) The proportion of illicit financial stocks and flows in non-white countries, often facilitated by financial institutions from white countries, is possibly larger than in white majority countries. If this is the case, however, these stocks and flows will often move to white majority countries, facilitated by financial institutions and other agents in those countries.

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[51] https://www.paymentscardsandmobile.com/8-14-billion-of-aml-fines-handed-out-in-2019-usa-and-uk-top-the-list/
[52] https://www.corporatecomplianceinsights.com/banks-15b-in-fines-in-2020/

PART 7: WHERE ARE THE BIASES IN NATIONAL AML ASSESSMENTS?

This paper has demonstrated that the FATF and users of INCSR II need to consider whether they have lapsed into unjustifiable biases in their work.

a) The FATF's MERs need to be split between their technical compliance and effectiveness assessments, and then their grey list results. Any future work would probably benefit from further splitting the technical compliance and effectiveness analyses into the underlying framework (standards) that are applied, and the way these standards are assessed.

b) This paper has not provided evidence that the FATF technical compliance assessment process is materially biased.

c) On the other hand, FATF technical compliance ranks are strongly driven by the wealth and (slightly) economic size of assessed jurisdictions. The FATF might usefully consider whether a more proportionate AML standards framework, offering a simpler technical compliance regime for poor countries, would be an improvement over current arrangements.

d) The FATF effectiveness vs. technical compliances assessments display three material statistical biases:

- A very large bias in favour of the United States, Australia, Canada, and New Zealand.
- Bias against small island states, of any ethnicity; and
- Bias against non-white and particularly black majority jurisdictions.

These statistical biases are possibly justified by factors outside the statistical analysis that would argue for worse AML results in small island states and black majority countries, and better results in the four white ex-colonies. As discussed briefly in this paper, however, the great weight of both clean and dirty money in the world provides no support for this view, and in fact argues the opposite position.

The FATF needs to consider, among several open questions, whether the current effectiveness framework is mis-specified. In particular: does it actually measure effectiveness in any way that word is commonly understood, or simply the degree to which a country looks like the United States?

e) The FATF's grey list is a mechanical exercise based upon technical assurance and effectiveness assessments. To the extent that these assessments are biased, the FATF grey list will distill these biases. The historic very heavy weight of list membership away from FATF members and white majority countries suggests that this distillation and resultant illegitimate bias is material.

f) It is curious that the FATF has managed to avoid producing mutual evaluation reports on many of its members, including five of its original members, while accepting or requiring a great many reports from non-member states around the world.

g) The State Department's INCSR II is not an AML ratings assessment, and we should not hold the State Department responsible for INCSR II misuse by index raters and other users.

h) Having said this, INCSR II in the western hemisphere produces a near-universal listing of Hispanic and black majority countries, while only about a third of jurisdictions in the rest of the world are listed. Any users applying INCSR II on a global basis are inevitably biasing their rating results against Hispanic countries and black majority Caribbean jurisdictions.

The most positive implication we can draw from this is: The FATF cannot persuasively argue, much less prove, that their national assessments are legitimately biased.

A more negative implication, which we consider this paper suggests but does not prove, is that the current FATF ratings system is strongly biased in favour of large, rich, white countries, particularly the four white ex-colonies, and strongly biased against everyone else.

In our much shorter analysis of the INCSR II list, readers will hopefully take the point that the list is not prepared as an AML ratings tool, but is misused by many people in that context. There is no predictive validity to the State Department's list, in any AML effectiveness context—and the State Department disclaims any such validity in the first place. INCSR II users, notably index raters, are the problem here, not the provider.

Index Rater Implications

Until now, most index raters have found it easy to include FATF MERs and INCSR II listings in their indices. Hopefully they will now reconsider their positions. Among other things:

- FATF technical compliance ratings are less racially differentiated than the effectiveness ratings or the grey list. Including and certainly up-weighting the latter two of these measures increases bias in any AML index. Including both the FATF effectiveness and grey list data double counts those elements.
- Applying INCSR II on a global basis, without adjusting for western hemisphere bias, increases the racial bias against Hispanic and black countries in any AML index deploying this approach.

PART 8: CONCLUSION

After 30 years of effort, the world has largely put in place the legislative and regulatory tools necessary to combat financial crime. We are now moving to the even more difficult task, not yet close to achievement, of recovering a material share of the world's illicit funds, and reducing the crimes supported by dirty money[53].

If the world's AML efforts are to become more effective, they must also become more legitimate. This paper has demonstrated a potential source of illegitimacy: unjustified biases in the current arrangements for national assessments of anti-financial crime capability.

To close on a happier note: there is no reason why the world couldn't move to more legitimate jurisdictional AML assessments. Other agencies have already demonstrated this ability in areas of mutual international interest. Ideally, the FATF will take the lead in this effort. Whatever their current MER flaws, they are the multilateral agency tasked with moving forward on the global AML effort.

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[53] https://www.economist.com/finance-and-economics/2021/04/12/the-war-against-money-laundering-is-being-lost