

# Chapter 4

## Financial Action Task Force Recommendations and Their Compliance

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### 4.1. Evolution of the FATF

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The Financial Action Task Force was established in 1989 by the G7 to develop viable options and methods to combat money laundering, as a response to the absence of any unified international process. A year after the creation of the FATF, the first report containing 40 voluntary recommendations was released. These recommendations, vague and general at first, were updated to target current issues and the evolution of money laundering techniques. The 1980s was a period when criminal organizations started using money laundering as a way to legitimize their operations when mainly drug-related operations began to use this “legitimization business model”. This was the major reason for the international collaboration on the anti-money laundering agenda (Nance, 2018).

Over time the FATF has evolved to address new and emerging threats. A set of new recommendations was issued in 2001 to address terrorist financing, which can be seen as a direct response to the 9/11 terrorist attack in the USA. In this century, the FATF has continued to strengthen its recommendations against criminal exploitation of financial markets and added the undercover financing of weapons of mass destruction as a new threat. In recent years, digital financial technologies, such as cryptocurrencies, have introduced new vulnerabilities to financial systems. In response, the FATF revised its recommendations in 2019 to include guidelines for regulating virtual assets and virtual asset service providers (VASPs), emphasizing the need for transparency and risk-based oversight (FATF, 2024b).

This expanded scope reflected the dynamic nature of financial crimes and the necessity for adaptive responses. By setting internationally recognized standards, the FATF plays a major role in safeguarding the integrity of financial systems globally, and its mission is to strengthen the overall capacity of individual nations to respond to the economic threats mentioned.

Currently, the FATF is the umbrella body for the global network of organizations focused on AML/CTF agenda and other financial issues. This global network comprises the FATF and the nine FATF-Style Regional Bodies (FSRB)<sup>1</sup>. The active participation of the FSRBs in the work of the FATF is crucial to ensure the global implementation of effective measures to combat terrorist operations and the proliferation of their financing, and money laundering. The global network comprises more than 200 governments and 20 observer international organizations (Borlini & Montanaro, 2017).

## 4.2. FATF Jurisdiction

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The FATF provides a comprehensive framework, in the form of its recommendations, for the mitigation of financial crimes. These standards are designed to be adaptable, allowing jurisdictions to integrate them into their unique legal, regulatory, and institutional systems. The core principles of the recommendations emphasize transparency and accountability, vital for maintaining the integrity of financial systems (Manning et al., 2021).

However, the FATF recommendations are not legally binding in themselves, but they are rather a set of soft rules on anti-money laundering (AML) and counter-terrorist financing (CTF). Soft law instruments have generally been considered more suitable for regulating such an agenda. Individual nations are usually wary of undertaking strict obligations and multinational law regulations. Soft-law instruments are characterized by a sufficient degree of freedom and flexibility to allow adaptation to changing regulatory needs. This kind of openness and flexibility to change is particularly required within national laws and regulations. Legal action must keep pace with criminal organizations using money laundering and terrorist financiers, in order to remain effective (Nance, 2018).

There is also some criticism regarding the primary setting of the FATF recommendations and their status. International networks are likely to replicate, or even reinforce, the unequal power distribution between individual nations. General recommendations could benefit certain countries more than others, and this could affect their influence within the international network. Academics argued that the FATF has been a way through which developed economies, including the European Union countries and the USA, declare their preferences for other jurisdictions. Furthermore, the specific characteristics of the FATF make it rather difficult to determine whether it can qualify as a valid international organization on its own (Borlini & Montanaro, 2017).

Another criticism is directed at the lack of jurisdiction or coercive powers of the FATF, as it has no legal personality and cannot issue binding regulations. However, practitioners and academics argue that the FATF has a strong impact as it sets global standards on AML and is the only international body with a clear mandate to bring all countries up to speed with this agenda. Furthermore, the FATF standards have been adopted worldwide with little or no option, which happened because these standards aim to prevent the misuse of virtual assets for money laundering and terrorist financing. With such a strong mission statement, the reason behind compliance cannot be far-fetched, as the trajectory unfolds in line with forceful international diplomacy (Otudor & Bagheri, 2023).

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<sup>1</sup> Members of this global networks are Action Group against Money Laundering in Central Africa (GABAC), Asia/Pacific Group on Money Laundering (APG), Caribbean Financial Action Task Force (CFATF), Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL), Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), Eurasian Group (EAG), Financial Action Task Force of Latin America (GAFILAT), Inter Governmental Action Group against Money Laundering in West Africa (GIABA) and Middle East and North Africa Financial Action Task Force (MENAFATF).

Failing to adopt the FATF standards may cause severe consequences for national financial systems as it may limit international monetary cooperation. If a country does not comply with the FATF Recommendations, it can be placed on the 'blacklist'<sup>2</sup>. Countries or jurisdictions on the blacklist are identified to have serious strategic deficiencies to AML/CFT. For all countries identified as high-risk, the FATF calls on all members and urges all jurisdictions to apply enhanced due diligence. Chohan (2019) lists the economic implications for high-risk countries can take the following forms:

- stringent terms or loan conditions from international monetary organizations such as the IMF,
- a drop in foreign direct investment,
- limitation of international commerce,
- close monitoring and bank investigation,
- remittance inflow difficulties,
- constraints of payments and financial instruments for individuals.

Only three countries<sup>3</sup> were blacklisted in 2024, while over twenty were listed as jurisdictions under increased monitoring. Threats of exclusion from major markets raise the cost of non-compliance with the FATF standards, which provides a strong incentive to cooperate to combat threats to the international financial system.

### 4.3. FATF Recommendations

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The FATF Recommendations are sometimes referred to as the FATF Standards, which comprise the Recommendations themselves and their interpretive notes, together with the applicable definitions. Countries around the world have different legal, administrative and operational frameworks and diverse financial systems, so they should adapt the FATF Recommendations to their particular circumstances.

The backbone of the FATF Recommendations is the risk-based approach which focuses on the need of countries to be able to identify and tackle the money laundering and terrorist financing risks they are exposed to. The FATF continuously monitors new and evolving threats to the financial system and regularly updates and refines its Recommendations so that countries have up-to-date tools to pursue any criminal financial activity (Murrar & Barakat, 2021).

The FATF methodology identifies 11 key areas, designated as immediate outcomes, that are imperative to protecting the financial system from any criminal exploits. The FATF methodology is also used to evaluate the country's actions and their compliance with the technical requirements of the FATF Recommendations. Below is the list of all 11 immediate outcomes of the FATF methodology (FATF, 2024c).

1. Money laundering and terrorist financing risks are already identified, assessed and understood for policies to be developed and legal actions are coordinated to combat these risks.
2. International co-operation delivers appropriate information, financial intelligence, and evidence, and facilitates action against criminals and their property.

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<sup>2</sup> Official name for the blacklist is "High-Risk Jurisdictions subject to a Call for Action".

<sup>3</sup> Democratic People's Republic of Korea, Iran and Myanmar.

3. Supervisors monitor and regulate financial institutions for compliance with AML/CFT requirements, and financial institutions adequately apply AML/CFT preventive measures, and report suspicious transactions.
4. Supervisors monitor and regulate DNFBPs<sup>4</sup> for compliance with AML/CFT requirements, and DNFBPs adequately apply AML/CFT preventive measures commensurate with the risks, and report suspicious transactions.
5. Legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediment.
6. Financial intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations.
7. Money laundering offences and activities are investigated, and offenders are prosecuted and subject to effective, proportionate, and dissuasive sanctions.
8. Asset recovery processes lead to confiscation and the permanent deprivation of criminal property and property of corresponding value.
9. Terrorist financing offences and activities are investigated and persons who finance terrorism are prosecuted and subject to effective, proportionate, and dissuasive sanctions.
10. Terrorists, terrorist organizations, and terrorist financiers are prevented from raising, moving, and using funds.
11. Persons and entities involved in the proliferation of weapons of mass destruction are prevented from raising, moving, and using funds, consistent with the relevant United Nations Security Council Resolutions.

The FATF methodology assesses the level of effectiveness for each immediate outcome using four ranks. The ratings reflect the extent to which a country's measures are effective, and the ranking is as follows.

1. High level of effectiveness (HE) – the immediate outcome is achieved to a very large extent. Minor improvements are needed.
2. Substantial level of effectiveness (SE) – the immediate outcome is achieved to a large extent. Moderate improvements are needed.
3. Moderate level of effectiveness (ME) – the immediate outcome is achieved to some extent. Major improvements are needed.
4. Low level of effectiveness (LE) – the immediate outcome is not achieved or achieved to a negligible extent. Fundamental improvements are needed.

Within these key areas, 40 FATF Recommendations are established, and contain different obligations, including measures of criminal law, preventive administrative and financial measures to be imposed on financial institutions and other businesses, and measures to ensure transparency on the ownership of legal persons and arrangements. They also include establishing competent authorities with appropriate functions and mechanisms for cooperation while also including arrangements to cooperate with other nations (Omar & Johari, 2015).

Forty comprehensive recommendations are listed in Table 4.1. They are divided into seven categories (A-G).

Considering all these elements, it is evident that the money laundering and terrorist financing countermeasures devised by the FATF constitute a new paradigm of security governance.

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<sup>4</sup> Designated nonfinancial businesses and professions – these could mean casinos, real estate agents, lawyers, notaries, accountants and dealers in precious metals and stones.

**Table 4.1.** List of FATF Recommendations

Number	FATF Recommendation
<b>A – AML/CFT policies and coordination</b>	
1	Assessing risks and applying a risk-based approach
2	National cooperation and coordination
<b>B – money laundering and confiscation</b>	
3	Money laundering offence
4	Confiscation and provisional measures
<b>C – terrorist financing and financing of proliferation</b>	
5	Terrorist financing offence
6	Targeted financial sanctions related to terrorism and terrorist financing
7	Targeted financial sanctions related to proliferation
8	Non-profit organizations
<b>D – preventive measures</b>	
9	Financial institution secrecy laws
10	Customer due diligence
11	Record keeping
12	Politically exposed persons
13	Correspondent banking
14	Money or value transfer services
15	New technologies
16	Wire transfers
17	Reliance on third parties
18	Internal controls and foreign branches and subsidiaries
19	Higher-risk countries
20	Reporting of suspicious transactions
21	Tipping-off and confidentiality
22	DNFBPs: Customer due diligence
23	DNFBPs: Other measures
<b>E – transparency and beneficial ownership</b>	
24	Transparency and beneficial ownership of legal persons
25	Transparency and beneficial ownership of legal arrangements
<b>F – powers and responsibilities of competent authorities</b>	
26	Regulation and supervision of financial institutions
27	Powers of supervisors
28	Regulation and supervision of DNFBPs
29	Financial intelligence units
30	Responsibilities of law enforcement and investigative authorities
31	Powers of law enforcement and investigative authorities
32	Cash couriers
33	Statistics
34	Guidance and feedback
35	Sanctions
<b>G – international cooperation</b>	
36	International instruments
37	Mutual legal assistance
38	Mutual legal assistance: freezing and confiscation
39	Extradition
40	Other forms of international cooperation

Source: (FATF, 2024c) with own modifications.

These are achieved through three principal methods: criminalization, consisting of the emergence of new criminal offenses, the mobilization of the private sector to cooperate with the authorities in the fight against money laundering, and private sector information. Overall, the international AML/CFT regime shaped by the FATF standards is thus characterized by a multidisciplinary approach mainly developed as two tracks: measures aimed at repressing ML and TF and those designed to prevent proceeds of crime from entering into the legitimate financial system (Borlini & Montanaro, 2017).

#### **4.4. Compliance with FATF Recommendations**

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The FATF compliance refers to the implementation of the specific requirements of the FATF Recommendations, including the specific legal framework and enforceable means, and the existence of powers and procedures of competent authorities. Compliance does not include the specific requirements of the standards that relate principally to effectiveness. These are assessed separately through the effectiveness component of immediate outcomes. Provided the FATF Recommendations are complied with, countries are entitled to implement the FATF Standards in a manner consistent with their national legislative and institutional systems, even though the methods by which compliance is achieved may differ (FATF, 2024c).

The mutual evaluation method is used to assess and report the level of compliance with the FATF recommendations. The FATF mutual evaluations are in-depth country reports analysing the implementation and effectiveness of AML and measures to combat terrorist and proliferation financing. The reports are peer-reviewed, where members from different countries assess another country. During a mutual evaluation, the assessed country must demonstrate that it has an effective system to protect the financial system from criminal abuse (Levi & Gilmore, 2002).

Mutual evaluations have two main components – effectiveness and technical compliance. The country's effectiveness ratings originated from an on-site visit by a team of experts. During this visit the assessment team will require evidence demonstrating that the assessed country's measures are working to deliver the desired results. What is expected from a country differs, depending on the money laundering, terrorist financing and other risks it is currently exposed to.

The assessment of technical compliance is also an important part of a mutual evaluation. The assessed country must provide information on the current laws, regulations, and any other legal instruments it has in place to combat money laundering and the financing of terrorism and proliferation (FATF, 2024c).

Mutual evaluations include an overall assessment of a country's actions to address the risks originating from designated terrorists or terrorist organizations. The mutual evaluation report is without prejudice to the status or justification that led to the designation of an entity as a terrorist or terrorist group or organization.

This chapter contains the latest report of the mutual evaluations for the V4 countries and Ukraine. Table 4.2 shows the assessment of the effectiveness of a country's AML/CFT system based on their intermediate outcomes.

**Table 4.2.** Effectiveness rating<sup>5</sup>

Country	IO 1	IO 2	IO 3	IO 4	IO 5	IO 6	IO 7	IO 8	IO 9	IO 10	IO 11
Czechia	ME	SE	ME	ME	ME	ME	ME	SE	SE	ME	ME
Hungary	LE	SE	ME	ME	LE	SE	LE	LE	ME	ME	ME
Poland	ME	SE	ME	SE	SE	ME	ME	LE	ME	ME	ME
Slovakia	ME	SE	ME	ME	ME	ME	ME	LE	ME	ME	ME
Ukraine	SE	ME	ME	ME	ME	SE	LE	ME	ME	ME	ME

Source: (FATF, 2024a) with own modifications.

None of the countries had the highest rating (high level of effectiveness) for any immediate outcome, which means there is room for improvement for every outcome, however, based on mutual evaluations, the situation in Hungary requires some fundamental improvements as it achieved the lowest rating in four outcomes out of eleven. Other countries show a critical need for improvement in one immediate outcome except for the Czech Republic, which does not have the lowest rank in any outcome.

One can check the situation in each country in more detail comparing compliance ratings with the FATF recommendations, as seen in Table 4.3. For each Recommendation, the assessor should conclude the extent of a country's compliance with the standard. Four possible levels of compliance exist but in exceptional circumstances, a Recommendation may also be rated as not applicable. These ratings are based only on the criteria specified in the technical compliance assessment and are as follows.

1. Compliant (C) – there are no shortcomings.
2. Largely compliant (LC) – there are only minor shortcomings.
3. Partially compliant (PC) – there are moderate shortcomings.
4. Non-compliant (NC) – there are severe shortcomings.
5. Not applicable (NA) – a requirement does not apply due to a country's structural, institutional, or legal features.

**Table 4.3.** Compliance ratings of FATF Recommendations<sup>6</sup>

Country	Czechia	Hungary	Poland	Slovakia	Ukraine
Report date	Dec.22	May.24	Dec.23	Mar.24	Sep.20
R1	LC	LC	PC	LC	LC
R2	LC	LC	LC	C	C
R3	LC	LC	LC	LC	LC
R4	C	C	LC	LC	LC
R5	LC	LC	PC	LC	LC
R6	PC	LC	LC	LC	PC
R7	PC	LC	PC	LC	PC
R8	LC	PC	PC	PC	LC
R9	C	C	C	LC	C
R10	LC	LC	LC	PC	LC

<sup>5</sup> There are four ranks of effectiveness given by mutual evaluations: high level, substantial level, moderate level, and low level. For more information check the previous FATF methodology.

<sup>6</sup> The colour scheme follows methodology in FATF (2024a). Shortcuts explained in the section above the table.

R11	LC	LC	LC	LC	C
R12	LC	LC	LC	PC	LC
R13	C	LC	PC	PC	C
R14	C	LC	LC	LC	LC
R15	PC	LC	PC	PC	PC
R16	LC	LC	LC	LC	C
R17	LC	LC	PC	LC	N/A
R18	LC	LC	PC	PC	LC
R19	LC	LC	PC	PC	C
R20	LC	C	PC	C	C
R21	C	LC	LC	LC	LC
R22	LC	LC	PC	LC	LC
R23	LC	LC	LC	PC	LC
R24	LC	LC	LC	LC	LC
R25	LC	LC	LC	LC	PC
R26	LC	LC	PC	LC	LC
R27	LC	LC	LC	LC	LC
R28	LC	LC	PC	PC	PC
R29	LC	C	C	PC	C
R30	LC	C	LC	C	C
R31	C	LC	LC	LC	C
R32	PC	PC	PC	PC	LC
R33	PC	LC	PC	C	PC
R34	LC	LC	LC	LC	C
R35	LC	LC	PC	PC	LC
R36	LC	LC	LC	LC	LC
R37	LC	LC	LC	C	LC
R38	LC	LC	LC	LC	LC
R39	LC	LC	LC	LC	LC
R40	LC	LC	LC	LC	LC
# of C	6	5	2	5	11
# of LC	29	33	22	23	22
# of PC	5	2	16	12	6
# of NC	0	0	0	0	0

Source: (FATF, 2024a) with own modifications.

None of the countries have the worst rating (non-compliant) for the FATF Recommendations compliance. This is a positive outcome as it shows national efforts to tackle money laundering and terrorist financing, yet there are some differences in the level of compliance among the observed countries. Poland and Slovakia have a high number of partially compliant ratings. This result shows significant room for improvement, especially in preventive measures.



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