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CLIENT MEMORANDUM

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FATF "Gray Lists" Turkey, Citing Concerns with Turkey's Banking and Real Estate Sectors and Potential Terrorism Financing

In a significant move, the Financial Action Task Force ("FATF"), the international anti-money laundering body tasked with developing policies to combat money laundering and terrorism financing, has added Turkey to its list of jurisdictions subject to increased monitoring (also known as the FATF "Gray List").[1] With the addition of Turkey (as well as, through separate actions, Jordan and Mali), the FATF Gray List now includes 23 countries that FATF has determined to have "strategic deficiencies" in their anti-money laundering ("AML") and counter-terrorism financing ("CFT") laws and regulations compared to international best practices and the standards maintained by FATF.[2] Turkey is the largest economy to be included on the Gray List.

While inclusion on the Gray List does not have any direct legal prohibitions or legal effects on the ability of individuals and entities to engage in transactions in or with Gray List jurisdictions, many national AML/CFT regulators and international financial institutions view transactions in or involving Gray List jurisdictions as being higher risk and, as a result, in the case of financial institutions, may seek to reduce their exposure to Gray List jurisdictions due to AML/CFT concerns or subject transactions involving such jurisdictions to heightened due diligence. Therefore, inclusion on the Gray List generally makes doing business with a Gray List jurisdiction or financial institutions in a Gray List jurisdiction more burdensome, as many international financial institutions will require enhanced due diligence on such transactions. Additionally, researchers at the International Monetary Fund performed a study earlier this year that determined that a jurisdiction's inclusion on the Gray List "has a significant negative impact on a country's capital flows" as international investors and financial institutions are less likely to engage in transactions in the jurisdiction due to AML/CFT compliance concerns.[3]

Below we provide more detail on FATF's action and its implications.

[1] FATF, "Outcomes FATF Plenary, 19-21 October 2021" (Oct. 21, 2021), available here.

[2] As of October 2021, the following jurisdictions are included on the FATF Gray List: Albania, Barbados, Burkina Faso, Cambodia, the Cayman Islands, Haiti, Jamaica, Jordan, Mali, Malta, Morocco, Myanmar, Nicaragua, Pakistan, Panama, the Philippines, Senegal, South Sudan, Syria, Turkey, Uganda, Yemen, and Zimbabwe.

[3] Mizuho Kida and Simon Paetzold, "IMF Working Paper – The Impact of Gray-Listing on Capital Flows: An Analysis Using Machine Learning" (May 27, 2021), available here.

The FATF Gray List

FATF states that jurisdictions listed on the Gray List are those that are actively working with FATF to address FATF-identified strategic deficiencies in their national AML/CFT laws and regulations.[4] These deficiencies are identified via FATF's mutual evaluation process, through which FATF and representatives of a FATF member state perform an assessment of a country's AML/CFT laws and regulations in light of FATF's main guidance document, *Recommendations for International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation*.[5]

Once FATF determines that a jurisdiction's AML/CFT laws and regulations have strategic deficiencies, FATF encourages the jurisdiction to work with FATF and so-called FATF-style regional bodies ("FSRBs") to create a plan to address and remediate their strategic deficiencies within agreed upon timeframes and publicly available goals and workplans.[6] FATF periodically updates the Gray List based upon its ongoing mutual evaluation process as well as Gray List jurisdictions' progress reports on addressing their strategic deficiencies and meeting the goals agreed to with FATF and the FSRBs. Regarding the treatment of jurisdictions included on the Gray List, "FATF does not call for the application of enhanced due diligence measures to be applied to these jurisdictions, but encourages its members and all jurisdictions to take into account the information [in the Gray List] in their risk analysis."[7]

FATF's Concerns Regarding Turkey

The FATF publication of the updated Gray List noted that in October 2021 Turkey made a "high-level political commitment" to work with FATF to strengthen the effectiveness of its AML/CFT laws and regulations.[8] While the FATF publication stated that Turkey had made some progress in enhancing its AML/CFT laws and regulations since the completion of its mutual evaluation report with FATF in October 2019, FATF President Marcus Pleyer stated that FATF expects Turkey to address "serious issues of supervision" in its banking and real estate sectors as well as with precious metals and stones dealers.[9] President Pleyer went on to state that "Turkey needs to show it is effectively tackling complex money laundering cases and show it is pursuing terrorist financing prosecutions" as well as "prioritizing cases [related to] U.N. designated terrorist organizations such as ISIL and al-Qaeda."[10]

FATF's concerns regarding terrorism financing are heightened with regard to Turkey because of its proximity to Syria, Iraq, and Lebanon, and, in particular, FATF has concerns that terrorist groups may be purchasing real estate in Turkey and otherwise using the Turkish financial sector to launder funds and participate in the global economy.[11] The European Commission also recently encouraged Turkey to improve its legal framework relating to AML/CFT laws in line with FATF guidance, noting concerns regarding Turkey's "limited progress" in the fight against organized crime.[12]

[4] FATF, "Jurisdictions under Increased Monitoring – October 2021" (Oct. 21, 2021), available here (the "FATF Gray List").

[5] *Id*.

[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] Jonathan Spicer, "Finance Watchdog 'Grey Lists' Turkey in Threat to Investment," REUTERS (Oct. 21, 2021), available here.

[10] *Id*.

[11] *See id*.

[12] European Commission, "Key Findings of the 2021 Report on Turkey," (Oct. 19, 2021), available here.

The FATF publication noted seven key areas of enhancements that FATF expects Turkey to implement to address the strategic deficiencies that FATF has identified:

- Dedicating more resources at Turkey’s financial intelligence unit (“FIU”) to the supervision of AML/CFT compliance by high-risk sectors and increasing on-site inspections overall;
- Applying sanctions for breaches of AML/CFT laws and regulations, in particular for unregistered money transfer services and exchange offices, and implementing more uniform requirements for adequate, accurate, and up-to-date beneficial ownership information;
- Enhancing the use of financial intelligence to support AML investigations and increasing proactive alerts and guidance by Turkey’s FIU;
- Undertaking more complex money laundering investigations and prosecutions;
- Setting clear responsibilities and measurable performance objectives and metrics for the authorities responsible for recovering criminal assets and pursuing terrorism financing cases and using statistics to update risk assessments and inform policy;
- Conducting more financial investigations in terrorism cases, prioritizing terrorist financing investigations and prosecutions related to UN-designated terrorist groups, in line with Turkey’s risk profile; and
- Fully implementing a risk-based approach to supervision of non-profit organizations (“NPOs”) to prevent their abuse for terrorist financing, conducting outreach to a broad range of NPOs in the sector and engaging with their feedback, ensuring that sanctions applied are proportionate to any violations, and taking steps to ensure that supervision does not disrupt or discourage legitimate NPO activity, such as fundraising.[13]

Implications

Turkey’s inclusion on the FATF Gray List will almost certainly lead to Turkey being considered a jurisdiction of increased AML/ CFT risk by both national AML and financial crime regulators as well as major international financial institutions. In light of this, it will be important for financial institutions and other companies to consider their risk assessments for Turkey and whether it may be appropriate to update such assessments in light of this FATF action. Additionally, financial institutions and other companies with exposure to Turkey may wish to review the compliance and risk mitigation measures they have in place with regard to counterparties in Turkey and whether any enhancements may be necessary in light of its addition to the FATF Gray List. Finally, financial institutions and other companies may wish to consider increasing diligence procedures for transactions involving Turkey, including by applying enhanced due diligence, to subsets of (or potentially even all) transactions involving Turkey.

We will continue to monitor actions taken by FATF and provide further updates as appropriate.

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[13] The FATF Gray List.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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