

THE MINISTRY OF EDUCATION OF THE REPUBLIC OF AZERBAIJAN
AZERBAIJAN STATE UNIVERSITY OF ECONOMICS
INTERNATIONAL GRADUATE AND DOCTORATE CENTER

MASTER DISSERTATION

ON THE TOPIC

**COMPLIANCE OF FINANCIAL INSTITUTIONS WITH INTERNATIONAL
ANTI-MONEY LAUNDERING AND COUNTER-TERRORISM FINANCING
REQUIREMENTS: CASE OF AZERBAIJAN**

Jafarli Nurlan Mais

BAKU-2021

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REQUIREMENTS: CASE OF AZERBAIJAN**

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Elm andı

Mən, Cəfərli Nurlan Mais and içirəm ki, “Compliance of Financial Institutions With International Anti-Money Laundering and Counter-Terrorism Financing Requirements: Case of Azerbaijan” mövzusunda magistr dissertasiyasını elmi əxlaq normalarına və istinad qaydalarına tam riayət etməklə və istifadə etdiyim bütün mənbələri ədəbiyyat siyahısında əks etdirməklə yazmışam.

MALİYYƏ QURUMLARININ ÇİRKLİ PULLARIN YUYULMASI VƏ TERRORİZMİN MALİYYƏLƏŞDİRİLMƏSİNƏ QARŞI BEYNƏLXALQ TƏLƏBLƏRƏ ƏMƏL ETMƏSİ: AZƏRBAYCAN NÜMUNƏSİ

XÜLASƏ

Tədqiqatın aktualığı: Çirkli pulların yuyulması və terrorizmin maliyyələşdirilməsi maliyyə sisteminin sağlamlığı, beynəlxalq kapital axını və xarici investisiyalar üçün risk faktorudur. Maliyyə qurumları maliyyə sisteminin fəaliyyətinin davamlılığını və inkişafını təmin etmək məqsədi ilə bu kimi halların vaxtında aşkarlanmasını təmin etməlidirlər.

Tədqiqatın məqsədi: Bu tədqiqatın məqsədi Azərbaycanda maliyyə qurumlarının çirkli pulların yuyulması və terrorizmin maliyyələşdirilməsinə qarşı beynəlxalq tələblərə uyğunluğunu araşdırmaq, həyata keçirilən mübarizə tədbirlərinin təkmilləşdirilməsi məqsədi ilə mövcud qanunvericilik bazasının beynəlxalq təcrübə ilə uyğunluğunu təhlil etməkdir.

İstifadə olunmuş tədqiqat metodları: Tədqiqatın metodik əsasları müasir metodlara əsaslanır: sistematik yanaşma, analoji metod, müqayisəli və ekspert qiymətləndirmə metodları, proqnozlaşdırma və s.

Tədqiqatın informasiya bazası: Tədqiqat işinin informasiya bazasının əsasını Azərbaycanın qanunvericilik aktları, bu sahəyə dair yerli və xarici ədəbiyyatlar, eləcə də müstəqil yoxlama təşkilatlarının Azərbaycanla bağlı monitoring hesabatları təşkil edir.

Tədqiqatın məhdudiyyətləri: Tədqiqatın məhdudiyyətləri sırasında əsasən mövzu predmetinin informasiya bazasının, iqtisadi və statistik göstəricilər sisteminin məhdud xarakterliyi və Azərbaycanda son dövrlərdə tədqiq edilməsi önə çəkilir.

Tədqiqatın elmi yeniliyi və praktiki nəticələri: Bu mövzuda tədqiqatın olmaması və dissertasiya işinin müvafiq sahədəki ədəbiyyata verəcəyi töhfə onun elmi yeniliyini səciyyələndirir. Çirkli pulların yuyulması və terrorizmin maliyyələşdirilməsinə qarşı mövcud bazanın beynəlxalq tələblərə uyğunluğunun təhlili mövcud boşluqların aradan qaldırılmasına töhfə verəcəkdir.

Nəticələrin istifadə oluna biləcəyi sahələr: Bu tədqiqatın nəticəsi, maliyyə qurumlarının çirkli pulların yuyulması və terrorizmin maliyyələşdirilməsinə qarşı mübarizədə tətbiq etdikləri mövcud prosedurların qiymətləndirilməsində və eyni zamanda onun müasir tələblərə uyğunlaşdırılmasında istifadə edilə bilər.

Açar sözlər: çirkli pulların yuyulması, terrorizmin maliyyələşdirilməsi, Azərbaycan

COMPLIANCE OF FINANCIAL INSTITUTIONS WITH INTERNATIONAL ANTI-MONEY LAUNDERING AND COUNTER-TERRORISM FINANCING REQUIREMENTS: CASE OF AZERBAIJAN

SUMMARY

The actuality of the subject: Money laundering and terrorist financing are risk factors for health of financial system, international capital inflows and foreign direct investment. Timely detection of such cases should be ensured for sustainability and development of financial system.

Purpose and tasks of the research: The purpose of this research is studying compliance of financial institutions in Azerbaijan with international requirements against money laundering and terrorist financing and analysing compatibility of existing legislation with international practice.

Used research methods: Methodological bases of research are based on modern methods: systematic approach, analogue method, comparative and expert evaluation methods, forecasting, etc.

The information base of the research: Information base of research is based on legislation of Azerbaijan, local and foreign literature in this field and independent organizations' monitoring reports on Azerbaijan.

Restrictions of research: Among limitations of study are poor nature of subject's information base, scarcity of economic and statistical indicators, and the late start of research investigations in this area in Azerbaijan.

The novelty and practical results of investigation: The lack of research on this topic, contribution of dissertation to the existing literature and gaps in this field characterize its scientific novelty.

Scientific-practical significance of results: Results of study can be used to assess existing procedures used by financial institutions to combat money laundering and terrorist financing and to bring procedures into line with modern requirements.

Keywords: money laundering, terrorist financing, Azerbaijan

ABBREVIATIONS

ACD	Anti-Corruption Department with the Prosecutor General of Azerbaijan
ACN	Anti-Corruption Network for Eastern Europe and Central Asia
AML/CFT	Anti-money laundering/combating the financing of terrorism
ASAN	Azerbaijan Service and Assessment Network
CBA	Central Bank of the Republic of Azerbaijan
CDD	Customer Due Diligence
CFT	Combating the financing of terrorism
CoE	Council of Europe
CIS	Commonwealth of Independent States
CSC	Civil Service Commission
EU	European Union
FATF	Financial Action Task Force
FIMSA	Financial Markets Supervisory Authority
FIU	Financial Intelligence Unit
FMS	Financial Monitoring Service
FSRB	FATF style regional bodies
GPO	General Prosecutor's Office
GRECO	Secretariat of the Group of States against Corruption
IMF	International Monetary Fund

INTERPOL	International Police Organization
KYC	Know Your Customer
MLA	Mutual Legal Assistance
ML and FT	Money laundering/ the financing of terrorism
NGO	Non-Governmental Organization
OECD	Organisation for Economic Co-operation and Development
OJSC	Open Joint Stock Company
OSCE	Organization for Security and Cooperation in Europe
PGG-AZ	CoE/EU Partnership for Good Governance in Azerbaijan
SCS	State Committee for Securities
SEC	State Examination Center
UN	United Nations

TABLE OF CONTENTS

INTRODUCTION.....	9
CHAPTER I. LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURE.....	12
1.1. The Institutional Framework For Combating Money Laundering And Terrorist Financing.....	12
1.2. Overview of Strategy to Prevent Money Laundering and Terrorist Financing.....	19
1.3. Major institutional actors	28
CHAPTER II. GENERAL SITUATION OF MONEY LAUNDERING AND FINANCING OF TERRORISM.....	35
2.1. Risks and General Situation in Azerbaijan.....	35
2.2. National and International Cooperation.....	38
2.3. Overall Level of Compliance and Effectiveness in Azerbaijan	48
2.4. Impacts of Money Laundering and Financing of Terrorism on the Country's Level of Development.....	57
CHAPTER III. DISCUSSION AND APPLICATION: CASE OF AZERBAIJAN	
3.1. Summary of Findings.....	62
3.2. Discussion and Possible Applications of Results.....	68
CONCLUSION AND RECOMMENDATIONS.....	71
REFERENCES.....	75
List of tables.....	79

INTRODUCTION

Relevance of the research topic: Money laundering and terrorism financing pose significant risks to the stability of the financial system. Money laundering can endanger the health of financial institutions and financial systems, international capital inflows and foreign direct investment. Theft, fraud, bribery, corruption, drug trafficking, market manipulation, tax evasion, etc. all are the money laundering process. In order for the money earned as a result of criminal operations to appear legitimate, it must be covered up and cleaned. In addition, variety of methods are used to finance terrorist groups through remittances and other financial institutions that are an important part of terrorist financing. As a result, anti-money laundering provisions and the level of compliance of financial institutions with the International Anti-Money Laundering and Combating the Financing of Terrorism Requirements are key to preventing crime and ensuring the health of financial systems.

Evaluating compliance of financial institutions with national and international anti-money laundering and counter-terrorist financing requirements and recommendations are the measures to assess visibility of the existence of money laundering and terrorist financing risks in Azerbaijan.

Statement of the problem and learning level: To begin with, it is worth to mention that money laundering and financing of terrorism is a new subject for Azerbaijan and almost, this topic has never been studied before. As well as, this area is characterized with the lack of economic and statistical data and poor nature of investigation. As a result of insufficient number of previous research done, this research is going to contribute existing literature by analyzing compliance of financial institutions with international anti-money laundering and counter-terrorist financing requirements. Theoretical foundations have been built proposed by books, academic journals and publications by the regulatory institutions, which specify institutional

measures and recommendations for financial institutions to combat money laundering and terrorism financing.

Purposes and objectives of the research: The main purpose of conducting this research is to assess the compliance of financial institutions in Azerbaijan with international anti-money laundering and counter-terrorist financing requirements and analysing compatibility of existing legislation with international practice. However, to be able to achieve the purpose of the study, as a foundation to evaluate the level of compliance, institutional framework for combating money laundering and terrorism financing will be explored.

In addition, the dissertation aims to gauge the general situation of money laundering and financing of terrorism, and then, identify the risks, national and international co-operation, as well as overall level of compliance and effectiveness in Azerbaijan. Finally, the research summarizes the findings and discuss the possible applications of results to improve compliance of financial institutions with international anti-money laundering and counter-terrorist financing requirements in Azerbaijan.

Object and subject of the research: The main object of this research is the legal framework and institutional measures for anti-money laundering and counter-terrorist financing. And the subject of research is compliance of financial institutions with legal system against money laundering and terrorist financing.

Research methods: This study uses the descriptive research design. The descriptive research design was preferred, as the general objective of the study was simply analysing the compliance of financial institutions with international anti-money laundering and counter-terrorist financing requirements. Moreover, other research methods used are based on various modern methods: systematic approach, analog method, comparative and expert evaluation methods, forecasting, etc.

Research database: Firstly, theoretical foundations have been explored proposed by books, academic journals and publications by the regulatory institutions which specify institutional measures and recommendations for financial institutions to combat against money laundering and terrorism financing.

Research limitations: Among the limitations of the study are the poor nature of the subject's information base, scarcity of the economic and statistical indicators, and the late start of research investigations in this area in Azerbaijan.

Scientific novelty of the research: This research provides high novelty due to the reasons below:

To begin with, previous research does not exist where The Compliance of Financial Institutions in Azerbaijan with International Anti-money Laundering and Counter-Terrorism Financing Requirements is evaluated. Some researches assess the international co-operation of local standard setters with international peers but this research on the compliance of local financial institutions with international requirements against money laundering and terrorism financing, meaning that a novelty of the research will contribute to the currently existing literature.

Secondly, compliance of Azerbaijan government with international regulatory bodies' recommendations have been analyzed in a holistic way with the compliance level of local financial institutions. Therefore, this research is ambitious in contributing to the extant literature.

Scientific and practical significance of the results: The results of this study can be used to assess existing procedures used by financial institutions in the fight against money laundering and terrorist financing, as well as to bring procedures into line with modern requirements.

CHAPTER I. LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES

1.1. The institutional framework for combating money laundering and terrorist financing

Azerbaijan is a member state of Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL), which is a Council of Europe's permanent monitoring mechanism and a FATF-style regional body. Azerbaijan is also ratified a number of international Conventions on Anti-money Laundering and Counter-Terrorism Financing (AML/CFT) such as; The United Nations Convention for the Suppression of the Financing of Terrorism, 1999 (The Terrorist Financing Convention); The United Nations Convention against Illicit Traffic in Narcotic and Psychotropic Substances, 1998 (Vienna Convention); The United Nations Convention against Transnational Organized Crime, 2000 (Palermo Convention and its two protocols) and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime, 1990 (Warsaw Convention); Council of Europe's 2005 Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (CETS 198). Besides that, the Law ratified The European Convention on Mutual Assistance in Criminal Matters, 1959 and its Protocols as well as The European Convention on Extradition, 1957, and its additional Protocols of 15 October 1975 and 17 March 1978. Azerbaijan is also part of the Commonwealth of Independent States (CIS) 1993 Minsk Convention on Legal Assistance and Legal Relations in Civil, Family and Criminal Matters.

Furthermore, Azerbaijan continues to take steps to set-up a dedicated AML/CFT Law in line with the Financial Action Task Force (FATF) Recommendations. The FATF is an independent inter-governmental body that develops and promotes policies

to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognized as a global anti-money laundering and counter-terrorist financing standard (FATF, 2020: p. 7).

The Republic of Azerbaijan attaches special importance to the fight against money laundering and terrorist financing and continues its initiatives in this area in accordance with international legal instruments and the Recommendations of FATF. As a result of progressive reforms carried out within the framework of these initiatives, by the Decree of the President of the Republic of Azerbaijan dated February 23, 2009, the necessary legislative framework had been formed by the adoption of AML/CFT Law and the foundation of institutionalization in this area was laid with the establishment of the Financial Monitoring Service (FMS) as an independent structural unit under the Central Bank of the Republic of Azerbaijan.

The Law of the Azerbaijan Republic was adopted in 2009 “On combating against the legalization of criminally obtained funds or other property and the financing of terrorism” (hereafter ‘AML/CFT Law’). The adopted law consisting of four chapters and twenty-two articles is the basic legislative framework that criminalizes money laundering and terrorist financing operations and profits by the adequacy of the legal and institutional framework in the implementation of procedures and measures that contribute to anti-money laundering efforts and combating the financing of terrorism. The law aimed at establishing a legal mechanism for the detection and prevention of offenses related to the legalization of criminally obtained funds or other property or the financing of terrorism. Furthermore, the law was directed to create conditions that exclude the possibility of using the financial system for the purpose of legalization of such funds or other property and the financing of terrorism, as well as protecting the interests of the state and society in this area.

To serve as a single, comprehensive source of legal information for financial institutions and other users to fight money laundering and terrorist financing the first chapter of this law clearly defines the basic concepts used. For example, the law explains “criminally obtained funds or other property” as any cash, movable or immovable, tangible or intangible property, legal documents confirming property rights, directly or indirectly obtained as a result of the commission of crimes established by the Criminal Code of the Republic of Azerbaijan.

It is worth to mention the definitions of the main two concepts “legalization of criminally obtained money or other property” and “terrorist financing” as defined in the law.

The law defines the term of “legalization of criminally obtained money or other property” as “the conversion or transfer of such funds or other property for the purpose of concealing the true source of the acquisition of funds or other property, knowing that it was obtained through criminal means, or to assist the perpetrator in evading liability, the real nature, source, location, disposition, displacement, or disbursement of funds or other property, knowing that financial transactions or other transactions have been made with the use of funds or other property, or that it has been obtained through criminal means; or concealment or concealment of rights to other property or to whom it belongs” (AML/CFT Law, 2009).

The Criminal Code of the Republic of Azerbaijan also criminalizes money laundering and terrorist financing. Thus, Article 193-1 deals with illegalization of money or other property obtained by crime, while Articles 214-1.,12.3 and 99-1.1.4 deal with the terrorism financing issues (Səməndərov F. Y., 2002).

Despite its comprehensive definition as the definition adopted the Palermo Convention, 2000, money laundering is process by which proceeds from a criminal activity are disguised to conceal their illicit origins (Paul A. S., 2006: p. 20).

As for the concept of "terrorist financing", AML/CFT Law sets up definition as “willful provision or collection funds or other property by any means, in full or in part, directly or indirectly, with the intention that they should be used or in the knowledge that they are to be used in order to finance the preparation, organization or carrying out by a person or by a group (organization, community) of persons of an act which constitutes a crime within the scope and as defined in the articles 102, 214, 214-2, 214-3, 215, 219, 219-1, 219-2, 226, 227, 227-1, 270-1, 277, 278, 279, 280, 282 and 283-1 of the Criminal Code of the Republic of Azerbaijan, or by an individual terrorist or by a terrorist organization” (AML/CFT Law, 2009). Again, The law defined concept of it demonstrates compliance with the UN International Convention for the Suppression of the Financing of Terrorism ,1999.

Besides that, The Republic of Azerbaijan has a law “On Fight Against Terrorism”, which came into force by the Decree of the President of the Republic of Azerbaijan No. 687 of 1999. There have been a number of amendments to this law over the years (the last amendment was in 2019) and in general law determines the legal and organizational basis of the fight against terrorism in the Republic of Azerbaijan, coordinates the activities of state bodies engaged in the fight against terrorism, as well as establishes the rights and responsibilities of these bodies and citizens (The Law of The Republic of Azerbaijan “On Fight Against Terrorism”, 1999).

Chapter 3 of The AML/CFT Law deals with the organization of the activities of the financial monitoring organ and defines the requirements for the body exercising the powers of the financial monitoring organ, as well as for the employees of the financial monitoring organ.

In 2018, according to the decree of the President of the Republic of Azerbaijan FMS was transformed into an independent agency. As of now, the FMS (the financial intelligence unit (FIU) of Azerbaijan) is a public legal entity that is financed from the state budget. FMS carries out unified regulation and control as well as coordinates

activities in the field of prevention of money laundering and terrorist financing in the Republic of Azerbaijan. It works explicitly to improve the productivity and viability of the institutional framework for anti-money laundering and combating the financing of terrorism. FMS participates in the formation of a policy in the field of prevention of money laundering and terrorist financing in the Republic of Azerbaijan (Charter of the FMS of the Republic of Azerbaijan, 2018).

According to the Charter of FMS, it is independent in its activities and is guided by the Constitution of the Azerbaijan Republic, international agreements to which the Azerbaijan Republic is a party, laws of the Azerbaijan Republic, this Charter, other decrees of the President of the Azerbaijan Republic as well as orders, decisions and orders of the Cabinet of Ministers. While performing its duties and exercising its rights, FMS interacts with other state and local self-government bodies, international and non-governmental organizations, and other legal entities and individuals.

The main purpose of FMS is to monitor compliance with the requirements established by law, to implement a single regulation in the relevant field, as well as to coordinate the activities of monitoring participants, other persons involved in monitoring, control and government agencies, to ensure transparency and efficiency to prevent money laundering and terrorist financing in the Republic of Azerbaijan.

In the field of preventing the legalization of criminally obtained funds or other property and the financing of terrorism the activities of FMS are as follows:

- To participate in the formation of a policy and the implementation of this policy;
- To carry out regulation as well as exercise control over the compliance of the legislation in force;
- To carry out national risk assessment and coordinate the activities of state bodies and institutions in this direction;

- To coordinate the activities of monitoring participants, other persons participating in monitoring, control and other state bodies, to collect and analyze the information received from them;

- To ensure the application of a unified information system;

- To adopt normative acts and participate in the preparation of drafts of relevant legal acts;

- To ensure the development of the relevant field.

In accordance with the activities defined by The Charter of FMS, its duty is to carry out monitoring in the relevant field in accordance with the Law of the Republic of Azerbaijan on "Preventing the legalization of criminally obtained funds or other property and the financing of terrorism". In addition, FMS is obliged to collect and analyze information from monitoring participants and other persons participating in monitoring as well as open and other sources, and to take measures based on the results. The responsibilities of the FMS include studying and analyzing the situation in the fight against money laundering and terrorist financing, as well as making proposals and recommendations, as well as adopting normative acts and perform other duties defined by the Charter of it.

Besides its duties, FMS has the right to participate in the preparation and improvement of normative legal acts, conduct research, prepare analytical and methodological materials and make proposals for the development of this field. Moreover, making inquiries to state bodies and institutions, local self-government bodies, legal entities and individuals on necessary information and receive such information from them and other actions defined within its Charter are included among its rights.

The FMS applies advanced corporate governance standards in its operations and management, and the governing body is the Board of Directors. The Board of Directors manages and supervises the FMS.

Important legislative reforms had taken place in Azerbaijan after the mutual co-operation with international standard setters. In addition to amendments to the Criminal Code (April 2015 and June 2017) and the AML/CFT Law (November 2015 and March 2016) the Republic of Azerbaijan adopted the following laws (MONEYVAL, 2018):

- “On amendments to the Law of the Republic of Azerbaijan “On state registration and state register of legal persons”, 14 April 2017;

- “On amendments to “The Statute of the Anti-Corruption Commission of the Republic of Azerbaijan” approved by the Law of the Republic of Azerbaijan 906-IIQ dated 3 May 2005”, 14 April 2017;

- “On amendments to the Law of Republic of Azerbaijan “On securities market”, 14 April 2017;

- “On amendments to the Law of Republic of Azerbaijan “On combating the legalization of criminally obtained funds or other property and financing of terrorism”, 14 April 2017;

- “On amendments to the Law of Republic of Azerbaijan “On insurance activity”, 13 June 2017;

- “On amendments to the Criminal Code of the Republic of Azerbaijan”, 13 June 2017;

- “On amendments to the Law of the Republic of Azerbaijan “On currency regulation”, 13 June 2017;

- “On amendments to the Code of Administrative Infringements of the Republic of Azerbaijan”, 13 June 2017;

- “On amendments to the Criminal Code of the Republic of Azerbaijan”, 10 October 2018;

- “On combating the legalization of criminally obtained funds or other property and financing of terrorism”, 10 October 2018; and

- “On amendments to the Code of Execution of Punishment of the Republic of Azerbaijan”, 10 October 2018.

In addition, a number of Presidential Decrees and Ordinances of the Cabinet of Ministers have been adopted, relating to, inter alia, financial supervision, beneficial ownership information, declaration of the national currency in cash and targeted financial sanctions. Guidance on asset freezing, money laundering in free trade zones, confiscation and asset recovery, financial investigations, know your customer and risk-based-approach for credit institutions had also been produced (MONEYVAL, 2018).

1.2. Overview of strategy to prevent money laundering and terrorist financing

Money launderers and terrorism financiers utilize different kinds of financial institutions to render in their criminal activities. Indeed, access to such entities is vital if criminals are successful because financial institutions equip them with the means to transfer funds to other financial institutions, both locally and globally; to convert currencies, and to alter receipts of crime into different financial instruments and other assets.

The second chapter of the AML/CFT Law was dedicated to the preventative measures against the money laundering and financing of terrorism.

The first preventative measure is monitoring which is defined as “control measures carried out by the financial monitoring organ on the basis of information provided by the monitoring participants, other persons participating in the monitoring or the supervisory authorities, as well as other information on funds or other property transactions”.

The next preventive measure is the development and implementation of internal control system by monitoring participants and other persons participating in monitoring. This system should consist of internal rules and procedures, identification, assessment of risks as well as taking measures to manage and reduce these risks. Internal procedures also include ongoing training that keeps employees informed and up-to-date about developments on anti-money laundering and countering the financing of terrorism.

Employee training needs to set out the nature and processes of money laundering and terrorist financing and explain AML/CFT laws and regulatory requirements as well as clarify an institution’s policies and systems with regard to reporting requirements regarding suspicious activity, with underlining on customer identification, due diligence and reporting requirement. In addition, financial institutions should screen job candidates for possible intention to use their institutions to launder money and/or to finance terrorism.

An audit function is also a required internal policy and procedure that needs to be established. Moreover, audit function should be apart from the compliance administration function, in order to test and assure the adequacy of the overall compliance function. Internal policies and procedures will vary among different institutions and different types of institutions, but they should nevertheless all take into account the size, scope, and nature of that institution’s operation. Furthermore, monitoring participants should have internal rules and procedures for regulating

business relationships or operations established without direct contact using technological means. Monitoring participants should apply these internal rules and procedures in establishing a business relationship with the client, as well as in regularly updating the information obtained on the client's business relationship and operations.

Another preventative measure is the prohibition of informing the client or other persons about the measures taken against the legalization of criminally obtained money or other property and the financing of terrorism.

At the scope of AML/CFT preventative measures, the law also specifies requirements for financial institutions on cash or other property transactions determined by FMS, monitoring of import or export of foreign currency to the Republic of Azerbaijan, identification and verification of the client and the beneficial owner on opening accounts and anonymous savings accounts under fictitious names, as well as record keeping, reporting and disclosure of suspicious transactions. Moreover, the law involves other measures determined by the laws of the Azerbaijan Republic and international agreements to which the Azerbaijan Republic is a party for preventing money laundering and the financing of terrorism (ML and FT).

Financial institutions operating in the Azerbaijan Republic develop and enforce their internal policies against ML and FT. For example, in case of commercial banks operating in Azerbaijan, procedure defining bank's policy against money laundering is based by Civil Code of the Republic of Azerbaijan, Law of the Republic of Azerbaijan on Banks, normative acts of the FMS of the Republic of Azerbaijan, "Wolfsberg Principles" against money laundering, Recommendations of FATF, Guidelines of Basel Committee on Banking Supervision, as well as internal documents of financial institutions ("Rabitəbank" ASC, 2020).

At the sample of the "Rabitəbank" OJSC policy against ML and FT, Board of Directors of the bank is fully responsible for the implementation of this policy. It states

that all executive bodies of the bank must resolutely fight against money laundering through the bank, prevent the implementation of unusual and suspicious transactions through the bank and be guided by this policy in their activities. The main purpose of this policy is to prevent the use of the bank as a tool in the legalization of criminally obtained funds or other property and in the financing of terrorism.

The second main objectives of the policy is to continuously improve the risk of operations and services offered to customers and to provide appropriate control measures to eliminate the risks to which the bank is exposed. The main principle of the policy is to comply with the requirements of the legislation of the Republic of Azerbaijan in the field of AML/CFT and the principle of "Know Your Customer" and application of internal risk assessment methods of the bank.

The bank applies the "Know Your Customer" (KYC) principles to manage customer risks which are the identification and verification of customer profile based on a risk-based approach. Such profiles include standard risk indicators such as background of person, country of origin, occupation of a public or high profile position, linked accounts, and nature and type of business activity.

Maintaining records is crucial for both prevention and detection of ML and FT. If a potential customer knows that records are being preserved, the client may not be as likely to try to utilize the institution for these illicit purposes.

Retaining record also helps detect those involved and provides a financial track to help competent authorities pursue those involved. For this purpose, seventh article of bank's internal policy states that bank employees must have a customer database about their customers and their beneficiaries and constantly update it (Rabitəbank" ASC, 2020).

Although the fight against money laundering is a new concept for Azerbaijan, positive progress has been made in meeting global standards to ensure that commercial

banks have established sufficient standards to support the prevention of the movement of illicit funds through the financial sector.

Considering the functions of commercial banks and their area of activity, it is worth to review the measures within the bank against money laundering in the example of “Rabitøbank” OJSC. The bank has policy that customer information should be updated within a specified period, depending on their level of risk.

When an unusual or suspicious transaction is carried out on a customer's account, the customer service staff officially informs the bank's supervisory authorities and this information include the following:

- Cash flow on the client's account that is not directly related to his activities;
- Unusual monetary transactions for unusual sponsorship or activities not related to the activities of the beneficiary;
- Use of the account for transit purposes.

The bank's supervisory authorities investigate unusual and suspicious transactions by monitoring of operations, analysis of customer relationships, analysis of data from media and other independent sources and analysis internal sources of bank. To deal more effectively with unusual and suspicious transactions management and supervisory authorities take the measures like conducting operations only after monitoring of the bank's supervisory authorities, re-evaluating the business relationship with the client if he refuses to provide information on the transaction.

At the last resort, the supervisory body of the bank informs the Financial Monitoring Service if there is confidence in the illegality of the transaction on the basis of the information available in the bank on the suspected transactions.

With the purpose of developing knowledge base and practices of staff, all employees of the bank, especially customer service staff (front and back office), bank supervisors and lawyers are involved to the trainings on the topic of anti-money

laundering, and at least once a year such trainings take place. Staff trainings describe the nature and processes of ML and FT, explain AML/CFT laws and regulatory requirements and review bank's policies and systems with regard to reporting requirements on suspicious activity, with emphasis on customer identification, due diligence and reporting requirement.

Besides that, The Bank's Financial Monitoring Department regularly informs its staff about innovations in international relations against anti-money laundering, changes in local legislation and regulations and conducts internal trainings.

In order to minimize the risks in the area of AML/CFT the bank conducts internal audit. Main function of internal audit is to check the effectiveness of the implementation of normative acts and rules and procedures adopted within the internal control system, timely detect and prevent potential errors and shortcomings in the application of the rules. Moreover, the audit function is autonomous from the compliance function, in order to test and ensure the adequacy of the overall compliance function.

The final conclusion of bank's AML/CFT policy defines responsibilities of bank's structural levels for compliance with the requirements of the policy.

As a continuation of the strategy to prevent ML and FT Azerbaijan undertook a national AML/CFT risk assessment. To achieve this goal, a special working group, which is in charge of the national risk assessment, was organized in 2012 and the World Bank risk assessment methodology was chosen. The major technical and financial issues agreed with World Bank project managers and the national risk assessment in the AML/CFT field conducted throughout the years 2014 and 2015 (MONEYVAL, 2014).

Furthermore, the President of the Republic of Azerbaijan approved the "National Action Plan against Corruption 2012-2015" in 2012. It was aimed at ensuring the sustainability of measures implemented within the framework of the "National Strategy for Increasing Transparency and Combating Corruption" approved by the Presidential

Decree of 2007, as well as improving the regulatory framework and institutional mechanisms and ensuring the implementation of international obligations in this area.

The Action Plan covered matters concerning AML/CFT measures and a separate section entitled for preventing the legalization of proceeds from crime and strengthening institutional mechanisms in this area.

Becoming a party to Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Warsaw Convention), establishing national mechanisms on asset recovery and setting up integrated AML/CFT statistical database are the major targets of this Action Plan (MONEYVAL, 2014).

In order to ensure the sustainability of systematic and comprehensive measures taken in this area to strengthen the fight against the legalization of criminally obtained funds or other property and the financing of terrorism next national action plan was confirmed in 2016. As well as taking into account the new international challenges, the Republic of Azerbaijan has implemented a risk assessment project to define the framework of a risk-based control system in the fight against AML/CFT in the country. The President of The Republic of Azerbaijan adopted a Decree On approval of the “National Action Plan for 2017-2019 on Combating the Legalization of Criminally Obtained Funds or Other Property and The Financing of Terrorism” to eliminate the risks identified at the result of the assessment.

For ensuring accountability, the Ministry of Justice, Finance, Economy, Internal Affairs, State Security Service, State Border Service, State Customs Committee and Financial Monitoring Service of the Republic of Azerbaijan were obligated to submit annual reports on the implementation of measures envisaged in the "National Action Plan" to the Cabinet of Ministers of the Republic of Azerbaijan and the Anti-Corruption Commission of the Republic of Azerbaijan.

The main purpose of the National Action Plan was to continue the complex and systematic measures implemented in our country in the fight against AML/CFT. The National Action Plan provides for the establishment of a coordination mechanism to ensure effective coordination of government agencies' activities in this area, increase the efficiency of cooperation and information exchange between them, fully bring legislation in line with international standards, strengthen international cooperation, strengthen the capacity of government agencies covers issues.

With the purpose of eliminating shortcomings in the field of public administration, “A National Strategy for Increasing Transparency and Combating Corruption 2016-2018” was also adopted on 27 April 2016 by Presidential Decree. This was the fourth policy document addressing anti-corruption issues in Azerbaijan.

According to the government, it would serve as an anti-corruption action plan and open government partnership action plan at the same time. Objectives were pertaining to enhanced transparency in state institutions, accountability and public participation and the use of new technologies.

The National Strategy identifies measures to improve anti-corruption legislation, involve civil society more closely, increase the anti-corruption culture, modernize the activities of government agencies, and eliminate obstacles to economic and social development.

The National Strategy stipulates increasing transparency in the activities of government agencies as a key condition for combating corruption. If transparency is ensured, the public will have more information about the decisions made by government agencies, the conditions for public discussion will be created, public confidence in government agencies will be strengthened, and the accountability and responsibility of these bodies will increase. Furthermore, transparency serves to improve the performance of government agencies, to more effectively analyze and evaluate the performance of government agencies. Transparency is also a key condition

for economic development, creating a favorable business environment and attracting foreign investment.

The National Strategy defines decision-making mechanisms and rules, measures to increase transparency in the civil service, state budget revenues and expenditures, financing of political parties, public procurement, privatization, investment, activities of state and local self-government bodies and other issues. The national strategy envisages the continuation of measures for the full implementation of the UN Convention against Corruption, the Council of Europe Conventions on Criminal and Civil Liability for Corruption and other international documents to which the Republic of Azerbaijan is a party.

Well-planned, structured and targeted anti-corruption awareness and education measures are critical in countries like Azerbaijan with systemic corruption, where society remains tolerant to corruption and is engaged in these practices. Awareness raising and education can create intolerance of society to corruption, increase trust in reforms and stimulate society to engage in fighting corruption (UN, 2003).

In 2020, the Coordinating Council was established to conduct regular national risk assessments of AML/CFT system by the Cabinet of Ministers to regularly analyze the situation with the implementation of the Order of the President of the Republic of Azerbaijan of 2020, "On approval of the" National Action Plan for the promotion of open government for 2020-2022".

The main purpose of the Coordinating Council is to understand the risks of ML and FT at the national level in accordance with the requirements of Recommendation 1 of the FATF (Risk Assessment and Risk-Based Approach), identify strategic targets for these risks and mitigate identified risks. Another goal in establishing the Coordination Council is to ensure the preparation of the Council of Europe's MONEYVAL Committee for the 5th round of evaluation of Azerbaijan's AML/CFT system, which is scheduled to begin in 2022 (FMS, 2020).

Moreover, Azerbaijan government works in close cooperation with major international organizations, including the International Monetary Fund (IMF), the World Bank, the United Nations, and FATF style regional bodies (FSRBs). In order to set up effective AML/CFT system, Azerbaijan also follows the FATF issued list of recommendations that set out a basic, universally applicable framework of measures covering the criminal justice system, the financial sector, certain non-financial businesses and professions, transparency of legal persons and arrangements, and mechanisms of international cooperation.

1.3. Major institutional actors

Those involved in the fight against money laundering and terrorist financing must have access to certain kinds of financially related information in order to conduct financial investigations. In this regard, the financial intelligence unit (FIU) plays an increasingly important role in this process (IMF, 2004).

Money launderers manipulate their illicit proceeds in an endeavor to conceal or disguise their true nature, source, location, disposition, and movement, with the ultimate objective of integrating these proceeds into, and through, the legitimate economy (UN Vienna Convention, 1988). Those who finance terrorism look for the ways of concealing the source of the funds and disguise the illegal use of funds in support of terrorism.

Country's comprehensive regime that requires the reporting of certain information and record keeping assists financial investigations. That facilitates information sharing among competent authorities, both domestically and internationally. The primary goals of financial investigations are to identify, trace, and document the movement of funds; to identify and locate assets that are subject to law enforcement measures; and to support the prosecution of criminal activity (Paul A. S., 2006: p. 114).

The Financial Action Task Force on Money Laundering provides in The Forty Recommendations on Money Laundering (The Forty Recommendations), that each country should establish an FIU. Moreover, FATF drives countries to implement measures on financial institutions urging them to keep records on the identities of their customers and their transactions, and to report any suspicious transactions (FATF, 2020).

Information gathered by these reporting and record keeping requirements is to be reported to the country's FIU and is used to reinstate transactions, to set up the connection between individual clients and a particular business, to ratify the "state of mind" of an individual, and finally, to reveal the role of an individual in a criminal or terrorist financing activity.

Information reporting and record keeping requirements generate significant financial information, much of which is not simply useable by experienced authorities without further exploration. To have effective AML and CFT institutional frameworks, the country must establish a reliable, efficient system for processing, investigating, and distributing this data. Without such a system in place, it is much more difficult to disclose criminal or terrorist financial relations. The actual need for effective data analysis of possible financial crime explains the rapidly growth of FIUs and the increasing significance of their roles in the international effort to prevent, detect and incriminate ML and FT.

In 2004, the international standard setter for FIUs, Egmont Group of Financial Intelligence Units (Egmont Group) adopted definition of an FIU. It defines FUI as "A central, national agency responsible for receiving (and, as permitted, requesting), analyzing, and disseminating to the competent authorities, disclosures of financial information concerning suspected proceeds of crime and potential financing of terrorism, or required by national legislation or regulation, in order to counter money laundering and terrorist financing" (The Egmont Group, 2004).

Financial Intelligence Unit of Azerbaijan - Financial Monitoring Service under The Central Bank of the Republic of Azerbaijan (no longer exists) was established by the Decree No. 66 of the President of the Republic of Azerbaijan, dated 23 February 2009.

Then, according to Decree No. 760 of the President of Azerbaijan, dated February 3, 2016, the Financial Market Supervisory Authority (no longer exists) of Azerbaijan was established and the Financial Monitoring Service continued its activities as a structural division of the that authority. The Financial Monitoring Service was separated from the Financial Market Supervisory Authority by Decree No. 95 of the President of Azerbaijan, dated May 25, 2018. Currently, the FMS continues to operate as an independent public legal entity under the auspices of the Ministry of Economy.

The FMS serves as a national center for receiving, requesting, analysis and dissemination of suspicious transaction reports and other information regarding potential money laundering or terrorist financing. Its tasks also comprise the implementation of the state policy, improvement of the supervision system and coordination of the activities of relevant state authorities in the AML/CFT area. The FMS is also in charge of international relations with regard to money laundering and terrorist financing. The FMS is also the supervisory authority for pawnshops and dealers in real estate sector.

The next institution involved in combating money laundering or financing of terrorism is Prosecutor General's Office of Azerbaijan which is an independent constitutional agency responsible for managing the criminal investigation and public prosecution in the Republic of Azerbaijan.

In accordance with the Presidential Decree on Application of The Law of The Republic of Azerbaijan of 2009 “On combating against the legalization of criminally obtained funds or other property and the financing of terrorism”, the Office of the

General Prosecutor was officially granted the authority to investigate money laundering cases. According to the 17th article of The Law, The FMS should submit information on the legalization of criminally obtained funds or other property to the Office of the General Prosecutor, if FMS identifies signs of money laundering or terrorist financing in the operation carried out because of the investigation.

By the Order № 114 of the President of the Azerbaijan Republic of 2004 The Anti-Corruption Department (ACD) of the Office of the General Prosecutor was established which is specialized law enforcement anti-corruption agency. In 2011, by an order of the President of the Republic, the Anti-Corruption Department of the Office of the General Prosecutor has been expanded to a hundred employees (previously was 40). This is of particular importance as this specific department also has the competence to investigate money laundering issues (MONEYVAL, 2014).

One of the essential bodies involved in combating money laundering and financing of terrorism is the Central Bank of The Republic of Azerbaijan. The goals of the Central Bank are maintaining price stability, organizing and ensuring operations of centralized interbank and other unlicensed payment systems, as well as supporting the stability of the banking system within its authorities set by the Law of the Republic of Azerbaijan of 2004 “On the Central Bank of the Republic of Azerbaijan”. Additionally, Central Bank of Azerbaijan issues licenses, supervises commercial banks, and issues binding regulations for the banking sector. It has rights to impose sanctions on commercial banks for breaches of laws or regulations. There is a special division dealing with AML/CFT issues within the Banking Supervision Department of the Central Bank. Besides that, CBA is also the supervisory authority for investment companies, brokers, who professionally take part in the securities market and those, who are involved in management of assets, insurance companies, money exchange bureaus.

The Ministry of Justice is involved in the development of legislation through the creation of proposals on legislation, drafting and general legal advice on legislation. According to the AML/CFT Law, the Ministry of Justice has been appointed as the supervisory authority for notaries and non-profit organizations. The Ministry may make agreements with foreign countries and international organizations on legal aid. The ministry is also responsible for the enforcement of judicial decisions and the organization of the courts, including the collection of court statistics. It is also a supervisory body for notaries and NGOs.

The State Tax Service under the Ministry of Economy of the Republic of Azerbaijan is the central executive authority for the implementation of the state tax policy and collection of taxes. The Service supervises other persons who provide legal services. The Service is also in charge of the State registrations of the representatives and branches of commercial and commercial legal entities. In this process, it records the registered information of the companies and provides data to the State authorities regarding the information it has, as required and within the time periods determined by the Azerbaijani legislation. The Service takes part in AML/CFT in dual capacity. It is a supervisory body for the persons providing legal, accountancy and tax consultancy services as well as a law enforcement body for tax related crimes. And thus may be receive relevant disseminations from FMS.

The Ministry of Foreign Affairs has an overall coordinative role in respect of financing of terrorism issues. In particular, it proposes and submits reports to the United Nations Counter-Terrorism Committee. It also coordinates the entry by Azerbaijan into international agreements generally including on AML/CFT issues. It is also represented as an expert Group on AML/CFT under the Cabinet of Ministers.

In addition, the Ministry of Finance exercises supervision over the dealers in precious metals and stones.

The State Committee for the Works with Religious Associations exercises supervision over religious associations. The Chamber of Auditors of Azerbaijan is a supervisory body for auditors, while Azerbaijan Bar Association is for advocates.

Pursuant to the Law of The Republic of Azerbaijan of 2009 “On combating against the legalization of criminally obtained funds or other property and the financing of terrorism”, the State Security Service was officially granted as authority to investigate terrorism and terrorist financing cases. According to the 17th article of The Law, The FMS should submit information on information on terrorist financing to the State Security Service, if FMS identifies signs of money laundering or terrorist financing in the operation carried out at the result of the investigation. Besides that, State Security Service cooperates closely with the Ministry of Internal Affairs and the Prosecutor General’s Office in the fight against terrorism. Following the 2015 presidential decree, Azerbaijan Government abolished the Ministry of National Security in 2016 and divided it into two new organizations, the State Security Service and the Foreign Intelligence Service. Among other duties, the State Security Service is obliged with detecting and preventing criminal activities by terrorist groups, and fighting against international terrorism and transnational crimes.

Another institution involved in combating money laundering or financing of terrorism is the State Customs Committee. In addition to its original competencies, the State Customs Committee was authorized in 2009 by application of the AML/CFT Law to detect physical cross-border transportation of currency and bearer negotiable instruments. At the same year, the State Customs Committee provided a declaration form for currency brought into or out of country, which was subsequently approved by an Order of the Cabinet of Ministers.

There is a special article of the Law on Monitoring of foreign currency brought into or out of the Republic of Azerbaijan. According to this article, if the State Customs

Committee or the State Border Service of the Republic of Azerbaijan reveals the traces of money laundering or terrorist financing when currency is brought into or out of the Republic of Azerbaijan, then they should take measures to protect and follow traces of crime, as well as send the obtained documents to the Office of the General Prosecutor and submit the information to the FMS.

The Ministry of Internal Affairs is a centralized body with responsibility for protection of the public and the prevention and detection of crime, including analysis of and strategic planning in respect of crime situation. The National Central Bureau of Interpol operates within the Ministry of Internal affairs. It has the right to exchange information with FMS.

CHAPTER II. GENERAL SITUATION OF MONEY LAUNDERING AND FINANCING OF TERRORISM

2.1. Risks and general situation in Azerbaijan

Azerbaijan is located in the Caucasus region and is the largest country in the region with the area of 86,600 km². It shares borders with the Caspian Sea to the east, Russia to the north, Georgia to the north-west, Armenia to the west and Iran to the south. The strategic location of Azerbaijan on the border of Asia and Europe has been conducive to the development of trade and transportation routes that connect the two continents and pass through the country. Thus, it is apparent that, strategic location is attractive for criminals and organized crime groups, this has been reinforced by the existing transport infrastructure.

Azerbaijan was part of the Union of the Soviet Socialist Republics until it declared its state independence in 1991, October 18. Today Azerbaijan is a legal, unitary and secular Republic.

Azerbaijan Government actively participates in international relations. Azerbaijan became a member of the United Nations in 1992. Within Europe, it is also a member of the Organization for Security and Cooperation in Europe (OSCE) and is a member of the Council of Europe from 2001. Azerbaijan is also a member of the Commonwealth of Independent States, the Organization of Islamic Cooperation and others. In July 2011, the Financial Monitoring Service (Azerbaijan's Financial Intelligence Unit (FIU)) was accepted as a member of the Egmont group.

According to Transparency International's 2020 Corruption Perception Index, Azerbaijan was ranked at 129 among 180 countries, scoring 30 over 100 (average score

is 43 over 100) and score has been improved three points (+3) since 2012 (<https://www.transparency.org/en/cpi/2020/index/aze>, 2021).

Azerbaijan ratified the United Nations Convention against Corruption of 2005 on October 2005. As well as, Azerbaijan became a full party to the Council of Europe's Criminal and Civil Law Conventions on Corruption in 2004 and joined the Group of States against Corruption (GRECO) at the same time.

While evaluating Azerbaijan in 2006, GRECO report concluded that corruption was a major problem, which according to the authorities of Azerbaijan could jeopardize the strong economic growth of the country and represent a threat to its social and political development. To address this problem, the government implemented a State Program on Combating Corruption and still this program continuous in different progressive phases.

Illicit drug trafficking through Azerbaijan remains a major concern, compounded by the country's position on major drug trafficking routes from Afghanistan and Iran to Europe (MONEYVAL, 2014).

In Azerbaijan, criminally obtained funds are often laundered through real estate, insurance, financial and non-financial institutions, shell companies and bulk cash smuggling schemes (US INCSR, 2019).

According to the authorities, the most common predicate offences investigated for money laundering are theft, fraud, tax evasion, embezzlement, drug and weapons production and trafficking, smuggling and corruption. However, based on the disclosures disseminated to law enforcement agencies from the Financial Monitoring Service the most common predicate offences, , are tax evasion, counting for more than 75%, followed by corruption almost 10%, embezzlement, fraud, drug crimes and cybercrime (MONEYVAL, 2014).

The FMS has also revealed a few means applied by criminals to launder proceeds of criminal activities. They particularly presented patterns, such as skeptical transfers of funds from different persons to a single person, massive fund transfers from a legal person to a natural person, use of false documents to set up accounts and transactions that seem uncertain and do not mate the customer's profile. These examples all illustrate that the major cases of money laundering traces in Azerbaijan are usually at some point bounded up with official banking sector.

While increasing foreign investment is very welcomed to Azerbaijan, it also opens up more possibilities for money laundering in Azerbaijan by persons abroad. Moreover, domestically the risks are also high. The close geographical proximity to Iran, which continues to be listed by the FATF as a high-risk and non-cooperative jurisdiction, poses a potential threat of money laundering and terrorist financing. FMS conducts a comprehensive research on transactions taken into the database on Iran and regularly analyzed and kept under control. The Central Bank has confirmed that transactions with Iranian citizens are closely monitored and that money transfers to Iran are prohibited.

Illicit drug trafficking through Azerbaijan remains a major concern, worsening due to the country's location along major drug trafficking routes from Afghanistan and Iran to Europe and Russia, although the proceeds from these crimes are not normally considered to be laundered through Azerbaijan.

Drug use and cultivation exist on a relatively small scale in Azerbaijan and are less significant problems (US State Department International Narcotics Control Strategy Report, 2020). As reported over the past five years, human traffickers exploit domestic and foreign victims in Azerbaijan, and traffickers exploit victims from Azerbaijan abroad. In previous years, Azerbaijan has been used as a transit country for victims of sex and

labor trafficking from Central Asia to Iran, Turkey, and the UAE (US State Department Trafficking in Persons Report, 2020).

Targeted legal and institutional measures were implemented to prevent illicit drug consumption and trafficking, and the relevant authorities in the Republic of Azerbaijan took a risk-based approach.

Terrorist attacks in Azerbaijan occur relatively frequently, as in the past few years the authorities handled several cases of either undertaken attacks or attempted attacks (MONEYVAL, 2014). For example, armed attack to Azerbaijan State Oil and Gas University (formerly Azerbaijan State Oil Academy) in 2009 (<http://asoiu.edu.az/public/index.php/en/news/1194-the-appeal-of-the-asoiu-s-rectorate-in-connection-with-the-11th-anniversary-of-the-april-30-terrorist-attack>, 2020), an explosion occurred in the Abu-Bakr mosque in Baku, committed by a terrorist group “Forest Brothers” (<https://apa.az/en/accidents-incidents-news/-104443>, 2009) and etc.

Thus, by considering all the problems have been faced and the risk assessed, policy makers should heavily focus on the legal systems and related institutional measures. As it has been recommended by FATF, countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified (FATF, 2020).

2.2. National and international co-operation

Cooperation is essential at all stages of AML/CFT procedures especially in obtaining information related to money laundering and terrorist financing from the external source as preventive measures. Laws and procedures should, therefore, encourage and facilitate mutual legal assistance in obtaining evidence for use in AML/CFT investigations and prosecutions (FATF, 2020).

The UN states that in order to construct an effective international cooperation, countries should meet following three prerequisites (The World Bank, 2004). They are:

- Building a comprehensive and efficient domestic capacity.
- Endorsing and implementing the international conventions.
- Complying with the FATF Recommendations and other sector-specific international standards.

Moreover, pursuant to the economic and environmental needs, country has to acknowledge priorities, build up its effective domestic capacity, and appoint the means for combating money laundering and financing of terrorism. A country's capacity building depends on its people and institutions, technological capabilities, geographical conditions and so forth. In order to reinforce international cooperation, endogenous capacity is essential and the efforts of the countries in partnership with relevant United Nation organizations are required to gain endogenous capacity.

Strengthening measures on prevention of money laundering effectively requires knowledge of banking, finance, accounting and other related economic activities in addition to that of laws and regulations, investigation and analysis. There may be unsurmountable barriers not only getting the information from financial institutions but also rapid exchanges of information with foreign counterparts without the assistance of a financial intelligence unit.

FIU ensures the possibility of rapid exchange of information between financial institutions and law enforcement/prosecutorial authorities, as well as among jurisdictions. In the simplest form, a FIU defined as a central agency to receive, analyze, and disseminate financial information to combat money laundering and terrorist financing serves as a crucial element in an AML/CFT program to provide for the exchange of information and cooperation at the local and international context between financial institutions and law enforcement agencies.

At this regard, The Law of the Azerbaijan Republic of 2009 “On combating against the legalization of criminally obtained funds or other property and the financing of terrorism” contains special articles on the international co-operation and coordination of activities at this area.

In accordance with the legislation of the Republic of Azerbaijan and the international treaties to which the Republic of Azerbaijan is a party, state bodies operating in the field of AML/CFT should cooperate with the relevant competent authorities of foreign states for the exchange of information, criminal prosecution, enforcement of court decisions, as well as implementation of control measures on the crimes committed for the legalization of criminally obtained funds or other property as well as financing of terrorism.

Furthermore, FMS shall submit information on issues as defined in this Law to the foreign competent authorities upon their requests or on its own initiative. This information should be submitted to the competent authority of the foreign state only if it does not contradict with the legislation of the Republic of Azerbaijan and does not affect its national interests. As well as, FMS is able to request such information from the foreign competent authorities in accordance with the legislation of the Republic of Azerbaijan and the international treaties to which the Republic of Azerbaijan is party.

At a policy level, the FMS is the state authority empowered to provide implementation of the state policy in the sphere of prevention of the legalization of criminally obtained funds or other property and the financing of terrorism, to improve the inspection system and to coordinate the activity of the relevant state authorities. The FMS coordinates the components of the national AML/CFT system.

At an operational level, in 2010 the FMS signed a Memorandum of Understanding with the Anti-corruption Directorate under the General Prosecutor’s Office and the Ministry of National Security. Similar Memorandum were also concluded with all

supervision authorities in Azerbaijan, namely the Central Bank, State Tax Service, Ministry of Transportation, Communication and Information Technologies, Chamber of Auditors, State Committee on Securities and State Committee on Work with Religious Organizations.

These agreements provide mainly for effective cooperation means, including regular working meetings, consultations and joint trainings and providing information and technical supports between counterparts. According to the Memorandum concluded with the General Prosecutor's Office and the State Security Service (no longer exists), these authorities are required to provide the FMS with feedback on the cases, which were disseminated to them.

At the fourth assessment visit of MONEYVAL in 2014, reporters pointed out that, very good bilateral cooperation relationships were observed between the FMS and other actors with AML/CFT responsibilities. Within this cooperation framework, the FMS specialists and General Prosecutor and Ministry of National Securities' representatives meet regularly to discuss money laundering and terrorist financing cases, trends and schemes. In addition, such meetings are held with supervision authorities to point out on the weaknesses in the reporting system. In addition, on issues on suspicious physical transportation of values, the specialists within the FMS meet also on an ongoing basis with the representatives of the State Customs Committee (MONEYVAL, 2014).

As regards coordination with policy makers, the FMS organized direct meetings dedicated to discussions on possibilities to improve the legislative with attendance of specialists from the FMS. In addition, a number of meetings were organized with officials from the President Administration and Cabinet of Ministers regarding state policy on AML/CFT and legislative development in this field.

MONEYVAL representatives also confirmed that, during on-site interviews, most of the interviewed authorities mentioned their good cooperation relationships with FMS and there were even examples of cooperation between supervision authorities and law enforcement in which auditors involved as experts in ML and FT cases investigated/prosecuted by the General Prosecutor's Office.

At the time of the on-site visit of MONEYVAL in 2008, there was no AML/CFT strategy adopted in Azerbaijan. However, significant progress in national cooperation on anti-money laundering and terrorist financing issues was achieved after the third evaluation round, especially at operational level. In this respect, operational mechanisms dedicated to cooperation between FMS and law enforcement authorities or between FMS and monitoring entities and their supervision authorities are in place. Such mechanisms are however bilateral (MONEYVAL, 2014).

By the Decision of the Director of the FMS of 2011, the "Form of submission of statistical information on the offences related to the legalization of criminally obtained funds or other property and the financing of terrorism to the Financial Monitoring Service" was approved and included to state registration. According to the Item 2 of this form, the State Security Service and the General Prosecutor's Office submit statistical information on the offences related to the legalization of criminally obtained funds or other property and the financing of terrorism once in six months to the FMS. By using this information, the FMS generalizes this information and uses it in its strategic analyses. This way the FMS determines its priorities and spheres of risk.

For the periods, 2010-2013 and 2014-2017 strategic plans had been developed by the FMS dedicated to institutional development and performance sustainability. They included some specific objectives dedicated to increasing the level of national cooperation, especially with the financial and non-financial sector.

As a continuation of the policy pursued in this area, “National Action Plan on combating legalization of criminally obtained funds or other property and financing of terrorism for 2017-2019” was accepted in 2016. National Action Plan aims to ensure the sustainability of systematic and comprehensive measures taken in this area to strengthen the fight against money laundering and terrorist financing.

Azerbaijan was also elected a full member of the Egmont Group by the decision of the 19th plenary meeting of this organization held on July 11-15, 2011. Note that, The Egmont Group, a united body of 166 countries headquartered in Canada, was established on June 9, 1995 with the purpose of fostering international co-operation between the FIUs. The support of FIUs for national and international AML/CFT initiatives particularly actualize this organization, as well as makes it a reliable platform for the exchange of information by using technology, such as the Egmont Secure Web at the international level in accordance with world standards on AML/CFT (FMS, 2020). The Egmont Secure Web is an electronic communication system that allows encrypted sharing among members of emails and financial intelligence, as well as other information of interest to members and to the functioning of the Egmont Group (http://www.egmontgroup.org/info_paper_final_092003.pdf, 2015).

Azerbaijan is a member of MONEYVAL. After entering the Council of Europe as a fully legitimate member country in January 2001, it has started to be represented in the MONEYVAL since 2002. The mutual relations of our country with MONEYVAL was established in accordance with the organizational procedures and currently continue cooperation.

The Committee of Experts on the Evaluation of Anti-Money Laundering Measures of the Council of Europe – MONEYVAL, was established in 1997. The goal of MONEYVAL is to ensure that its Member States have in place effective systems to

fight against money laundering and terrorist financing and comply with the relevant international standards in these fields.

The mission of MONEYVAL is assesses its members' compliance with all relevant international standards in the legal, financial and law enforcement sectors through a peer review process of mutual evaluations. MONEYVAL's assessment reports provide very detailed advice on ways to improve the effectiveness of local regimes in combating money laundering and terrorist financing, and opportunities for states to cooperate in these areas internationally.

MONEYVAL's first AML/CFT status assessment report on Azerbaijan was accepted in 2004. Then, Azerbaijan was evaluated by MONEYVAL again in 2008 and the subject report was developed. The evaluation reports contained suggestions and recommendations on formation and development of AML/CFT system in the country. The suggestions and recommendations played a key role during the implemented reforms on formation and development of AML/CFT system in the country.

The MONEYVAL 4th round evaluation of Azerbaijan was conducted in 2014.

One the interviews of FMS to public news agency AZERNEWS said that upcoming V assessment of the Council of Europe expert group on Azerbaijan's fight against terrorist financing and the legalization of money and other property obtained as a result of criminal activity is possible no earlier than 2021 (FMS, 2019).

In addition, Azerbaijan is a party to the Partnership for Good Governance (PGG-AZ) program implemented by Council of Europe and European Union (CoE/EU). Through this program the CoE/EU are working together to strengthen governance in the Eastern Partnership region (Azerbaijan, Georgia, Republic of Moldova, Ukraine, Belarus).

PGG provides tailor-made support to Eastern Partnership countries to raise legislation and practice closer to European standards in the fields of human rights, rule of law and democracy. PGG in Azerbaijan carried out two successful phases of program since 2015 which of three were country-specific projects with a budget of EUR 2,082,600 (PGG-AZ, 2020).

The first phase of PGG-AZ program covered from 2015 till 2018. During this period, the projects on “Strengthening capacities to fight and prevent corruption in Azerbaijan” (2015-2017) and “Strengthening Anti-Money Laundering in Azerbaijan” (2018) were specifically tailored to respond to the needs of Azerbaijan in the area of fight against corruption and money-laundering. The Projects assisted Azerbaijan prevention and repression entities with building up their internal capacities and supported the Azerbaijan Government in setting future priorities in the field (PGG-AZ, 2018).

The program on “Strengthening Capacities to Fight and Prevent Corruption in Azerbaijan” (2015-2017) provided support to improving the training capabilities of the Commission on Combating Corruption, the State Examination Centre and specialised operational capacities of the Anti-Corruption Directorate under the General Prosecutor, as well as other judicial, investigative and financial intelligence bodies, including the Financial Monitoring Service. Furthermore, it served as the main facilitator of expert and public dialogue regarding the draft National Action Plan on Promotion of Open Government 2016-2018 (PGG-AZ, 2018).

The project implementation during 2018, on “Strengthening Anti-Money Laundering in Azerbaijan” mainly focused on anti-money laundering, following the request of assistance from authorities in view of their upcoming Moneyval evaluation in 2019 and its relevant obligations (PGG-AZ, 2018).

During the three-year implementation period (Phase I, 2015-2018), the PGG in Azerbaijan project carried out 47 activities. Achievements of project outcomes and expected results for the Project on “Strengthening Anti-Money Laundering in Azerbaijan” (2018) was the ratification of CoE Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (CETS No.198) in 2017 by the Azerbaijan’s Parliament.

Within the scope of CoE/EU Partnership for Good Governance Phase II (PGG-AZ II), the Project on “Strengthening Anti-Money Laundering and Asset Recovery in Azerbaijan” was implemented at the period of 2019-2021 (duration - 36 months). This project is one of the six projects which constitute the second phase of the EU/CoE Partnership for Good Governance program interventions to support Eastern Partnership countries to counter economic crime.

The Project is specifically tailored to respond to the needs of Azerbaijan in the area of the fight against money laundering, terrorist financing and asset recovery. This project represents a continuation of actions to strengthen capacities to fight and prevent corruption (2015-2017) and to strengthen anti-money laundering (2018), implemented in the country within the first phase of the PGG-AZ program. It has been designed to contribute to the EU 2020 targets set out in priority area “Strengthening the rule of law and anti-corruption mechanisms” (European Commission, 2017) and is aligned with the cooperation priorities identified in the EU-Azerbaijan Action Plan, and Council of Europe Action Plan for Azerbaijan 2018-2021. Project activities will focus on prevention, enforcement and strategic actions.

Azerbaijan is also part to the Istanbul Anti-Corruption Action Plan, which is a sub-regional peer-review programme launched in 2003 in the framework of the Anti-Corruption Network for Eastern Europe and Central Asia (ACN) of Organisation for Economic Co-operation and Development (OECD). It supports anti-corruption reforms

in Azerbaijan, Georgia, Kyrgyzstan, Kazakhstan, Mongolia, Tajikistan, Ukraine and Uzbekistan through country reviews and continuous monitoring of participating countries' implementation of recommendations to assist in the implementation of the UN Convention against Corruption and other international standards and best practice.

Fourth Round of Monitoring of the Istanbul Anti-Corruption Action Plan in Azerbaijan was completed in 2016. The report focused on four areas: anti-corruption policy, prevention of corruption, enforcement of criminal responsibility for corruption and prevention and prosecution of corruption in education sector (OECD, 2016).

This report concluded that, Azerbaijan achieved progress in preventing corruption in several sectors, such as public services delivery, traffic police and public education. Reforms started in customs and business licencing. However, serious and complex corruption challenges have yet to be tackled. Addressing the corruption-prone areas requires stronger political will, efforts and healthy environment for broad stakeholder participation in the fight against corruption.

Taking into account the new international, the Republic of Azerbaijan implemented a risk assessment project to define the framework of a risk-based control system in the fight against AML/CFT in the country. The National Action Plan was adopted to address the risks identified as a result of the assessment.

The National Action Plan covered the establishment of a coordination mechanism to ensure the effective coordination of the activities of government agencies in this area, increasing the effectiveness of cooperation and information exchange between them, the full harmonization of legislation with international standards, strengthening international cooperation, strengthening the capacity of government agencies in the fight against ML and TF and other issues (“National Action Plan on combating legalization of criminally obtained funds or other property and financing of terrorism for 2017-2019”, 2016).

With the purpose of ensuring periodically conduct of national risk assessments, establishment of the Coordinating Council by the Cabinet of Ministers is also designated to respond to existing challenges in a timely manner by coordinating the activities of various government agencies and the relevant private sector in the field of AML/CFT, as well as to establish an effective risk management framework for the national system.

2.3. Overall level of compliance and effectiveness in Azerbaijan

In order to establish a strong and effective AML/CFT system with comprehensive rules covering anti-money-laundering and counter-terrorist financing requirements, it is essential to set up an adequately operational legal and institutional or administrative framework not only with the regulatory power that provides competent authorities with the necessary duties, powers and sanctions but also with the laws that create money laundering and terrorist financing offenses, plus enforcement power that provides for freezing, seizing and confiscation of the proceeds of crime and terrorist funding.

On Fourth Assessment Visit in 2014, MONEYVAL commended that, the FMS has been very active in improving national cooperation in the area of AML/CFT. Nevertheless, the AML/CFT system in Azerbaijan seems to be lacking an overarching policy coordination mechanism dedicated to revision and strategic coordination of its components. According to that Evaluation, Azerbaijan was reported as Compliant (C) for four and Largely Compliant (LC) for twenty-five of the FATF Recommendations. It was Partially Compliant (PC) or Non-Compliant (NC) for two of the six Core Recommendations (MONEYVAL, 2014).

Although, cooperation appeared to be working effectively on a policy level the evaluators noted that the Ministry of the Internal Affairs, which is responsible for the investigation of general financial crime did not have direct access to information held

by the FIU and did not always receive FIU disseminations via the General Prosecution Office.

While Azerbaijan has made progress on certain technical elements of AML/CFT, the 2014 MONEYVAL mutual evaluation questioned the effectiveness of many aspects of the AML/CFT regime. Although authorities have made efforts to address a number of technical deficiencies, the indications suggested that both the preventive and enforcement regimes continue to lack effectiveness.

Consistent with the recommendations of the 2014 MONEYVAL mutual evaluation, a clear need was identified to enhance the level of compliance of financial institutions; effective risk-based supervision and inspections by the relevant supervisors could help to achieve this result.

The follow up to the 2015-2017 phase of the Project therefore identified new priorities to be achieved in 2018. As result in 2018, the project focused on achieving the increased risk-based approach to supervision and inspections capacities, strengthened capacities of judges and prosecutors on ML and FT proceedings and investigative techniques and improved institutional capacities to fight and prevent economic crime.

In 2018, MONEYVAL issued an exit follow-up report on progress in respect of the core and key recommendations. The purpose of this report was to analyze the progress that the Republic of Azerbaijan had made to remedy the deficiencies identified in its Fourth Round Mutual Evaluation Report, which was adopted at MONEYVAL's 46th Plenary in December 2014. Azerbaijan was then asked to submit an expedited follow-up report on actions taken to address certain significant shortcomings.

At the 49th Plenary in December 2015, Azerbaijan submitted its First Fourth Round FUR. The Secretariat noted that amendments to the AML/CFT Law had improved the legal framework for applying targeted financial sanctions, amendments

to the Criminal Code of The Republic of Azerbaijan (April 2015) had addressed concerns expressed in the MER in relation to the money laundering offence, new criminal cases on self-laundering had been opened and training for investigators, judges and prosecutors had been organized to continue increasing awareness and understanding of third-party and stand-alone money laundering and a new regulation had provided more clarity on the scope of simplified customer due diligence measures. Given the progress made, the Plenary agreed that Azerbaijan should not be required to submit another expedited follow-up report and should seek to exit the regular follow-up process by December 2017 (MONEYVAL, 2018).

Azerbaijan presented an interim FUR to the 52nd Plenary in December 2016. The Secretariat noted that further progress appeared to have been achieved under several Core and Key Recommendations. Nevertheless, a number of deficiencies were yet to be addressed, in particular in the areas of confiscation and customer due diligence. The Plenary concluded that Azerbaijan had made progress, adopted the interim report and took note of the country's wish to exit regular follow-up at the 54th Plenary (MONEYVAL, 2018).

At the 54th Plenary in September 2017, Azerbaijan submitted a 3rd FUR and applied for removal from the follow-up process. The Secretariat noted that sufficient progress appeared to be achieved under several Core and Key Recommendations. However, a number of deficiencies were yet to be addressed in particular important remaining gaps relating to the liability of legal persons, the criminalization of the offences defined in the treaties annexed to the Convention on Terrorist Financing, risk-based supervision, and the scope of the 'fit and proper' tests for financial institutions.

The Plenary reached the conclusion that, in spite of the progress, Azerbaijan had not yet fulfilled the conditions for removal from the follow-up process and welcomed

Azerbaijan's proposal to submit a further report in December 2018 and to seek removal from the 4th round at that occasion (MONEYVAL, 2018).

In October 2018, Azerbaijan submitted a 4th FUR to the MONEYVAL Secretariat and applied for removal from the follow-up process. According to the Fourth Round Rules of Procedure, in order to exit that process, countries must have an effective AML/CFT system in force, under which they have implemented those FATF Recommendations that are considered to be Core and Key at a level essentially equivalent to a "compliant" (C) or "largely compliant" (LC).

The Plenary may retain some limited flexibility with regard to Key Recommendations if substantial progress has been made on the overall set of recommendations that were rated "partially compliant" (PC) or "non-compliant" (NC) (MONEYVAL, 2018).

The FMS had been very active in improving national cooperation in the area of AML/CFT. The FMS should certainly be commended for the current level of operational cooperation with other AML/CFT stakeholders. Nevertheless, the AML/CFT system in Azerbaijan seems to be lacking an overarching policy coordination mechanism dedicated to revision and strategic coordination of its components.

Although, cooperation appeared to be working effectively on a policy level, the Ministry of the Internal Affairs, which is responsible for the investigation of general financial crime, did not have direct access to information held by the FIU. In order refrain such kind of problems, FMS followed the MONEYVAL evaluators recommendations and implemented a continuous and consistent, multilateral cooperation and coordination mechanism dedicated to problem identification at AML/CFT system level and adopted proactive or reactive policies to cope with emerging or existent issues.

According to the exit follow-up report submitted to MONEYVAL at November 2018, Secretariat concluded that overall, Azerbaijan has taken sufficient steps for removal from regular follow-up. Since the adoption of its MER in December 2014, Azerbaijan has addressed the vast majority of the deficiencies. A very small number of outstanding deficiencies remained. However, these deficiencies were expected to be addressed with the coming into force of various amendments very shortly (MONEYVAL, 2018).

At the Final Narrative Report (2015-2018) PGG-AZ concluded that, there was an upward trend of activities in the field of investigation and confiscation by the Anti-Corruption Directorate. According to the annual results reported to the press by the Anti-corruption Directorate under the General Prosecutor's Office, in 2018, the authorities had completed the investigation of 278 corruption-related criminal cases against 431 individuals, following the investigation the cases were referred to the relevant courts (PGG-AZ, 2018).

During 2018, the PGG-AZ carried out two legal reviews of implementation of AML/CFT measures as a follow up to MONEYVAL recommendations. First review was to evaluate the compliance of the national legal framework with international standards in view of implementing outstanding MONEYVAL recommendations in relation to "fit and proper" standards.

The legislation under review included the Law on Banks, Law on Non-Bank Credit Institutions, Law on Insurance Activity, Law on Securities Market, and Law on Investment Funds. The review aimed to assist the Financial Monitoring Service in identifying potential changes to the country's AML/CFT regime, including amendments to laws, regulations and other measures.

The second legal review was carried out following an ad-hoc request by the Commission on Combatting Corruption concerning the Draft law on Regulations of Ethical Conduct of Members of the Parliament of the Republic of Azerbaijan.

Finally, as a separate effort to enhance the capacities of the financial and non-financial sector, the PGG developed a training program on terrorism financing and proliferation of Weapons of Mass Destructions.

Recommendations of both legal reviews were taken into account by Azerbaijan authorities. Concerning the legal review on “Fit and Proper” standards, the FMS has amended the AML/CFT Law accordingly on 12 October 2018. Most importantly, the “fit and proper” requirements were extended to those who are “associates” to criminals, in relation to entities, which are subject to financial monitoring.

Banks and other reporting institutions have enhanced their capacities on how to carry out a robust risk assessment of money laundering and terrorism financing risks. Through the capacity-building activity facilitated by the Project, they have strengthened their knowledge and skills to better identify higher risk entities or individuals and obtain a better understanding of TF and Weapons of Mass Destructions proliferation risks.

In 2018, Financial Markets Supervisory Authority (FIMSA) (Dissolved in 2019, its tasks were placed under the CBA), with participation of the FMS, conducted a series of onsite AML/CFT inspections across all banks using survey forms with a set of typical control questions.

However, it was noticed that supervisory bodies need to ensure a more standardized methodology for implementing risk assessments across not only financial institutions, but also non-financial institutions. In that regard, a “Risk assessment methodology for supervisory authorities” was produced under the project in order to

help relevant supervisory authorities to tailor it according to their needs and to be better positioned to carry out an effective AML/CFT supervision.

At this regard, to increase implementation of risk-based approach to supervision and to develop inspections capacities of supervisory authorities, the PGG-AZ Project produced and delivered “Guidelines for effective implementation of risk-based AML/CFT procedures in the financial sector.

During the scoping process, the PGG-AZ Project team worked separately and jointly with the regulatory authority (FMS), as well as with commercial banks, in order to be able to tailor both documents to their specific needs. This goal was achieved successfully.

A methodology for carrying out a risk assessment in the banking sector was developed, following an extensive scoping exercise with main financial supervision authorities and commercial banks, due to which Azerbaijani authorities and reporting institutions are now better equipped to carry out their own risk-assessments independently. Moreover, in order to effectively apply risk-based procedures, sector-specific guidelines for financial institutions have been developed, which has further enhanced the risk-based approach capacities of supervisory and reporting entities.

Both technical papers were presented during the “Workshop on Risk Assessment Methodology and Sector-Specific Guidelines” for representatives of financial institutions, including banks. The risk assessment methodology provided a model for a database, which will assist the Azerbaijani authorities to assess the money laundering and terrorism financing risks influencing the financial sector. The workshop also served as an open platform for both supervisory and reporting entities to jointly discuss the necessary steps needed to understand the extent of the exposure of the financial system to ML and FT risks and to implement relevant risk mitigation measures (PGG-AZ, 2018).

At the PGG-AZ II Annual Report covering achievements during the first year of Phase II (2019-2021), shared key areas where progress was made during the reporting period. These key areas were improved capacities of the law enforcement and judiciary in successfully sending and receiving mutual legal assistance requests and strengthened financial intelligence capabilities to effectively leverage open source intelligence and create advanced strategic analysis products (PGG-AZ, 2019).

With a view to support the government in addressing the recommendations of international monitoring institutions, the Project contributed to enhancing the capacities of thirty law enforcement practitioners, namely prosecutors, investigators, judicial officers, on how to initiate and successfully conduct requests for mutual legal assistance related to anti-money laundering and countering financing of terrorism investigations.

The Anti-Corruption Directorate under the General Prosecutor's Office (ACD) pointed out that capacity building activities for the law enforcement and judiciary implemented within the first phase of the PGG-AZ and continued during the second phase, have contributed to attaining these results along with other complex measures they have carried out in this direction.

Furthermore, during the reporting period, the Project aimed to strengthen strategic and operational capacities of the Financial Monitoring Service. A training on open source intelligence enhanced capabilities of twelve financial intelligence analysts and law enforcement officers to apply advanced techniques and strategies to effectively develop intelligence for the purpose of anti-money laundering investigations and asset recovery.

Meeting strategic analysis needs of the FIU, ten financial intelligence analysts learned about how to use advanced tools and available data to prepare quality and valuable strategic analysis products in order to identify money laundering and terrorist

financing patterns and trends and preventing related threats. According to the results of the evaluation questionnaire and expert assessment, the training increased the knowledge and analytical skills of the participants. This should improve the quality of information they provide to decision makers on the development in the AML/CFT area.

The need to enhance the strategic and operational capacities of the FIU was clearly underlined in the 2014 MONEYVAL evaluation report. The report recognized the need to provide internal trainings to FIU staff on intelligence analysis on a regular basis, as well as continue and intensify capacities in reporting.

With this in mind, during the first year of implementation, the PGG-AZ Project delivered training activities on open source intelligence and strategic analysis. This exposure helped to develop strong awareness on how to successfully analyze and assess information in a manner that will enhance the effectiveness of analytical conclusions and recommendations provided to decision makers, as well as strongly contribute to better handling of due diligence activities and intelligence-led investigations.

The practical knowledge gained through this exercise will significantly contribute to the preparation of the National AML/CFT Risk Assessment report, as well as development of other internal reports, e.g. the reports released by the FIU on an annual basis.

The 2014 MONEYVAL mutual evaluation questioned several aspects of mutual legal assistance (MLA) process in Azerbaijan which included availability of statistics on mutual legal assistance, putting in place of formal arrangements for coordinating seizure and confiscation actions, and remaining gaps identified in compliance with the Terrorist Financing Convention.

The MONEYVAL mutual evaluation also recommended arranging regular trainings on money laundering and terrorist financing substantial, procedural and investigative issues to the judiciary system. It advised that stronger focus should be

placed by the investigative bodies competent to investigate proceeds producing crimes on the identification and recovery of proceeds of crime.

Furthermore, the OECD 4th Round of Monitoring report of the Istanbul Anti-Corruption Action Plan for Azerbaijan also encourages prosecutors to establish informal contact channels with foreign authorities in order to better prepare MLA requests and the execution thereof. The report also recommends provision of training and guidelines to the prosecutors and judges on the best practices in international judicial cooperation.

Addressing the recommendations and gaps outlined by the international monitoring institutions, the project strengthened the capacities of prosecutors, investigators, judges and other law enforcement authorities on how to successfully receive and send mutual legal assistance requests and hence minimize the grounds for refusals from foreign jurisdictions when seeking MLA.

Considering the nature of the project and the timeline it is too early to discuss any impact of the project, however the initial outcomes provide a good indication of potential impact in the future.

2.4. Impact of money laundering and financing of terrorism on the country's level of development

Criminal attempts and terrorist financing operations are so successful that they can conceal the origins or sources of their funds and sterilize their revenues through national and international financial systems (Zakharov A., 2011).

The absence of, or a lax or corrupt, anti-money laundering regime in a particular country permits criminals and those who finance terrorism to operate, using their financial gains to expand their criminal pursuits and fostering illegal activities such as

corruption, drug trafficking, illicit trafficking and exploitation of human beings, arms trafficking, smuggling, and terrorism (Paul A. S., 2006: p. 156).

While money laundering and the financing of terrorism can occur in any country, they have particularly significant economic and social consequences for developing countries, because those markets tend to be small and, therefore, more susceptible to disruption from criminal or terrorist influences (Paul A. S., 2006).

As a result, the economies, societies and security of countries used as a platform for money laundering and terrorist financing are under threat. However, it is difficult to assess the scale of these negative consequences, as it is impossible to accurately measure these negative effects, either for the international community in general, or for a single country in particular (İnönü, Akgün A., 2017).

On the other hand, an effective framework for combating money laundering and terrorist financing has significant benefits for a country, both locally and internationally. These benefits include lower crime and corruption, increased stability of financial institutions and markets, positive effects on economic development and reputation in the world community, advanced risk management practices for the country's financial institutions, and increased market integrity.

The most common adverse implications of ML and FT are increased crime and corruption, bad international reputation, lack of foreign investment, weakened financial institutions and compromised economy and private sector (Hacılı Z., 2010).

Just being recognized as a haven for money laundering or terrorist financing can have significant negative consequences for a country's development. Foreign financial institutions may decide to restrict transactions with institutions located in places of money laundering; that these processes are more expensive and subject to additional research; or to terminate the correspondent or credit relationship altogether.

Even legal entities and organizations engaged in money laundering may suffer from reduced or higher access to world markets because of additional analysis of property, organization and control systems.

Successful money laundering helps commitment of criminal activities profitable, so it rewards criminals. Thus, to the extent that a country is preferred as a haven for money laundering, it is likely to attract criminals and promote corruption. If money laundering is widespread in a country, it creates more crime and corruption. It also increases the use of bribery in critical gateways to make money laundering efforts successful.

The most common predicate offence in Azerbaijan is tax evasion, counting for more than 75%. Corruption and bribery are the second common predicate offences to money laundering in the case of Azerbaijan. Offences, then followed by embezzlement, fraud, drug crimes and cybercrime (MONEYVAL, 2014). Corruption exists in many aspects of life in Azerbaijan, ranging from government medical services and university entrance fees to bribes to traffic police or customs officials, money for business and construction permits or licenses. High levels of corruption have a negative impact on the efficiency and effectiveness of programs and investments in Azerbaijan, which hinder the development of the private sector.

Moreover, formal and informal monopolies dominate most business sectors in Azerbaijan. According to public opinion, monopolies have strong ties to government officials. The dominance of these monopolies hinders competition, innovation, price stability, improved service quality, and encourages corruption (Asiya İnkişaf Bankı, 2013).

Corruption promotes the shadow economy by aggravating the social burden of the transition period, as it is the opposite of healthy competition in the economic field and the free market economy. Therefore, the manifestation of corruption with the shadow

economy is one of the most serious and dangerous factors that hinders the successful policy of the state in the field of economic activity and hinders economic development.

Corruption and the shadow economy are often destructive activities that undermine democratic governance and the rule of law by acting together and in concert, as well as negatively affecting economic development. Both corruption and the shadow economy create conditions for tax evasion and tax revenues by evading the law, increasing public spending, and hindering productivity and development.

The shadow economy is the part of the economy that is hidden from the state and society, as well as the part of the state that is outside the control and accounting policy. At the same time, the shadow economy is an entrepreneurial activity that is not prohibited by law, but is carried out in order to evade certain payments, especially taxes. The most important factors in the emergence of a shadow economy are high tax rates and social security contributions. The higher the level of taxes and mandatory payments, the higher the tendency not to pay taxes.

In Azerbaijan beginning from 2019, significant reduction in income taxes and social security contributions for non-oil and private sector employees was an important and significant step taken to prevent tax evasion. The increase in tax and social security contributions and the number of registered employment contracts since the beginning of the year 2019 were the initial positive results of this reform.

The fight against the shadow economy and its consequences is not a unique problem for Azerbaijan alone, and it is an international challenge. When focusing on the positive experience in different countries, it is useful to take into account the important factors used in the emergence and fight against the shadow economy.

Finally, FATF maintains a list of countries that do not comply with AML requirements or that do not cooperate sufficiently in the fight against money laundering. Being placed on this list, known as the “non-cooperating countries and

territories” list, gives public notice that the listed country does not have in place even minimum standards. Beyond the negative impacts referred to here, individual FATF member countries could also impose specific counter-measures against a country that does not take action to remedy its AML/CFT deficiencies.

CHAPTER III. CONCLUSION, DISCUSSION AND APPLICATION: CASE OF AZERBAIJAN

3.1. Summary of findings

Besides being a concept dating back to the 1920s, money laundering has been felt seriously for the last 20-30 years around the world. These effects are directed not only in the economic sense, but also in the deterioration of the social, political and legal order. Since the money is hidden by its nature, its reflection is felt in countries from corruption to macroeconomic indicators. This is particularly effective in the long run.

Azerbaijan has achieved significant results in the fight against money laundering and terrorist financing. Improved legislation in accordance with international requirements, specialized institutional organs, its contribution to international initiatives and cooperation are among the main achievements of state policy in this area.

In 2009, with the adoption of the Law of the Republic of Azerbaijan “On prevention of Legalization of criminally obtained funds and Financing of Terrorism”, a new stage in the fight against AML/CFT began.

The Committee of Experts on the Evaluation of Anti-Money Laundering and Terrorist Financing of the Council of Europe appreciates the reforms in the fight against AML/CFT in Azerbaijan, including improvements in legislation, strengthening institutional capacity, accountability, and the application of advanced technology.

The Basel AML Index using data from publicly available sources, such as the FATF, Transparency International, the World Bank and the World Economic Forum, measures the risk of ML and FT in Azerbaijan. They cover five domains relevant to assessing ML/TF risk at the country level: (1) Quality of AML/CFT Framework; (2)

Bribery and Corruption; (3) Financial Transparency and Standards; (4) Public Transparency and Accountability; (5) Legal and Political Risks.

According to the Basel AML Index 2019, Azerbaijan was ranking at 59th place among 125 countries. Azerbaijan scores 5.31 with a change (-0.12) in comparison to year 2018 (Basel AML Index, 2019). Progress score (-0.12) reflects the progress made (lower risks for the country) in ML and FT risks. The Basel AML Index included Azerbaijan at the significant risk category in which countries have a risk score of 5.0 or above loosely are classified as having a significant risk of ML and FT in 2019. In 2019, the mean average level of risk is 5.39.

In terms of the legal and political risks which is fifth domain (sub-section) used for Basel AML index, Azerbaijan is grouped among lowest performing 10 countries. At this sub-section Azerbaijan scores 6.47 where the lowest performing score is 8.04 (Yemen) and top performing country score is 1.03 (Finland). This domain covers political and legal risks associated with media freedom and strength of the rule of law in the country. The data are taken from Freedom House, the World Economic Forum and the World Justice Project. Freedom of expression in the press is seen as an important tool to expose money laundering.

Additionally, a functioning and independent judicial system is a critical measure to deter crime, including financial crimes and money laundering, through the threat of punishment. Domain 5 has a 5% weighting in the overall score (Basel AML Index, 2019).

The Basel AML Index has introduced a special geographic scope to provide an in depth look at risks of ML and FT in post-Soviet countries, in 2019. In summary of post-Soviet countries, Analysis of ML and FT risks in the post-Soviet region shows that the average risk level is 5.4, with significant deficiencies associated with corruption and bribery.

In general, Central Asian countries (Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan) have a higher risk of ML and FT in comparison to Baltic countries (Latvia, Lithuania, Estonia). With regards to countries subjected to FATF assessments under the fourth-round methodology, Kyrgyzstan (27%) and Latvia (30%) demonstrate the lowest performance in terms of effectiveness.

Table 1: Basel AML Index risk scores since 2012

Country	2012	2013	2014	2015	2016	2017	2018	2019
AZERBAIJAN	6.49	6.48	6.46	4.9	4.84	4.77	5.43	5.31

Source: Basel AML Index 2019, “A country ranking and review of money laundering and terrorist financing risks around the world”.

Above table shows that, Azerbaijan’s ML and FT risks during the last six years have been on the way of decrease year-by-year. It should be noted that, small changes to the Basel AML Index methodology and indicators over the years, including the addition of a new indicator in 2019, might slightly influence results and comparability per year. Despite the sharp drop in 2015 was due mostly to the change in evaluation methodology, decreasing tendencies over the years apparently show that Azerbaijan is harvesting the results of its intended policies and on the way to achieve its goal. Overall, compliance level of financial institutions improves year-by-year in Azerbaijan.

In 2020, Basel Institute on Governance published recent Basel AML Index: 9th Public Edition which covers 141 countries around the world. According to, recent index, Azerbaijan scores 5.24 (-0.07) with a change in comparison to 2019 (Basel AML Index, 2020). Progress score, again emphasizes Azerbaijan success over ML and FT risks. At the regional focus, in which Azerbaijan is also included, risk score is close to the global average and slightly higher than the quality of the AML / CFT framework and Azerbaijan is achieved 8th place among 16 Europe and Central Asia Countries Region (Basel AML Index, 2020).

Azerbaijan achieved progress in its anti-corruption efforts in several sectors of public administration, such as public services delivery, police and education. The perception of corruption in police and education decreased as a result of the measures to reform the education system and the road police department.

Efficient service delivery by ASAN (Azerbaijan Service and Assessment Network) centers is a praiseworthy achievement. The performance of the Anti-Corruption Directorate increased and the State Examination Center started to show progress. Government efforts resulted in increased trust of citizens and positive changes in the level of corruption. However, addressing the corruption-prone areas requires stronger political will, efforts and healthy environment for broad stakeholder participation in the fight against corruption.

With the existing financial resources, growing skills and capacities in government institutions, Azerbaijan has the potential for more significant and comprehensive actions to cleanse public institutions and the business sector from deep-rooted corruption.

During the PGG-AZ 2019 reporting period trainings, the experts noted that several of the participants showed a propensity for the subject matter as they were operating in this area already. However, many stated that this was a new area for them, and they needed additional support. There was a clear disparity in knowledge and experience between the investigative background of the anti-corruption officers and the FIU practitioners, who had extensive commercial experience in banking and economics.

It appeared that the trainees may have limited access to online resources in their work office, so support and guidance will be necessary for them to establish secure, covert terminals to conduct online research that can access all resources provided. Furthermore, their respective departments within the FIU and the Anti-Corruption

Directorate will require a clear policy on how to operate online internet research in line with international standards and best practices.

There is clear need for monitoring of implementation. So a system should be instituted to closely monitor and discuss the authorities' actions in implementing the various recommendations delivered by the project at the scope of cooperation with local and international organizations and measure their progress.

The data provided by the FMS represents that when money laundering is pursued, provisional measures and confiscation of property is also ordered. Furthermore, the data above on the amounts of property seized, confiscated and recovered following conviction for money laundering show an improving trend, however, the effectiveness of confiscation in predicate offences to ML was not demonstrated to the evaluators. The evaluators were also concerned that there was a lack of clarity on whether confiscation of indirect proceeds and corresponding value are routinely made (MONEYVAL, 2014).

The Financial Monitoring Service has been established as the national center to gather, analyze and submit financial information to relevant law enforcement agencies. The FMS appears to be appropriately resourced both in terms of financial, technical and human resources. It was, however, noted that there was a lack of safeguards for removing the FMSs management from office and this could generate vulnerabilities for the system towards risks of undue influence or interference (MONEYVAL, 2014).

The engagement of local experts was further asserted through Pilot trainings delivered by local experts, certified by the project. The effectiveness and impact of the pilot trainings delivered in the regions was very high thanks to the local experts who not only possessed excellent level of knowledge on subject matter, but they also possessed excellent presentation and training skills. The response of the audience was also very positive, especially realizing that the trainings were delivered on a voluntary

basis. The piloting approach should be continued as a matter of good practice in similar Council of Europe projects.

Challenges encountered during the reporting period relate to the following areas (PGG-AZ, 2019):

- The institutional restructuring of the Financial Intelligence Unit of Azerbaijan in 2019 significantly delayed the planned targets of the PGG-AZ Project related to enhancing financial intelligence capacities, as well as supporting the development process of the National Risk Assessment.

- In the area of asset recovery, which constitutes the second outcome of the project, no concrete progress in the reform process was observed.

When it comes to implementation of project deliverables, passive approach was observed at policy level. Individual government agencies were highly active in project activities, and the main beneficiary served as a highly efficient coordinator for the entire range of authorities. However, this steadfastness in participation in activities has only in several cases translated into actual policy steps, institutional or legislative reforms at the Government level. The project can thus boast a large number of deliverables covering all areas and levels of the anti-corruption system, with relatively few of these deliverables serving as the starting point in a continuous reform process.

Another difficulties encountered by PGG-AZ project was the institutional reform which took place in April 2016. The Civil Service Commission, as one of the main Project beneficiaries, was dissolved, while its tasks were placed under the authority of a new body, State Examination Center. In view of uncertainty concerning the key functions of the State Examination Center that bear direct relevance to project implementation and the fact that the reforms were finalized only in November 2016, the project had to postpone all trainings until State Examination Center had informed the project they could continue with planned activities during the first quarter of 2017.

This also directly impacted the implementation of project, which also depended on completion of training handbooks and materials on order to be initiated.

However, Azerbaijan is not included in the list of FATF Countries identified as having strategic AML deficiencies. Azerbaijan is Partially Compliant with FATF 40 Recommendations. It has not previously been on FATF's blacklist. There are no international sanctions against Azerbaijan. In addition, Azerbaijan passed through the mutual evaluation by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL, 2014).

Azerbaijan still does not have clear and comprehensive conflict of interest rules for civil servants and effective mechanism for their implementation. A draft Law on the prevention of conflict of interest in the performance of public officials has been under development for several years. The issue of enforcement of asset declarations has remained unresolved since 2005 when the legislation was first adopted. The report calls upon Azerbaijan to develop without further delay the necessary form for asset declarations and to ensure implementation in practice. At that regard, Istanbul Anti-Corruption Action Plan recommended Azerbaijan to adopt legislation on conflict of interest and separation of political and professional public service and ensure effective coordination and implementation of reforms (OECD, 2016).

In conclusion, not excluded that, if there would be changes in the governmental structures and policy considerations, political will and commitment of national authorities may be reduced and this could have an effect on the anticipated support from the government to carry out reforms in the field of anti-money laundering, asset recovery, as well as adapt policies in line with international norms and standards.

3.2. Discussion and Possible Applications of Results

The focus of this study is the compliance of financial institutions with international AML/CFT in case of Azerbaijan. Money laundering activities are quite disturbing for Azerbaijan, and like in other countries, a number of measures are being taken to launder money in Azerbaijan.

The economy of Azerbaijan, which has a lot of natural resources at the crossroads of Europe and Central Asia, is growing rapidly. The illegal drug trade, producing illegal funds, theft, robbery, tax evasion, human trafficking are some of the crimes that have been growing in recent years. Corruption is endemic in the country (OECD, 2016).

Legal system and related institutional measures explored at the first chapter were the foundation to evaluate the level of compliance of financial institutions with international AML/CFT requirements. Despite the adoption of the Law of the Republic of Azerbaijan on Combating Money Laundering and Terrorist Financing in February 2009, Azerbaijan has passed a long way on this field and in 2018 Financial Monitoring Service was established which is a member of international organizations such as MONEYVAL, Financial Action Task Force, Egmont Group and etc.

By gauging general situation of money laundering and financing of terrorism in Azerbaijan at the second chapter risks, national & international co-operation and overall level of compliance and effectiveness in Azerbaijan was identified. In order to weigh up level of compliance and the factors affecting compliance level of financial institutions with AML/CFT in Azerbaijan the following tasks were put forward:

- To analyze the progress that the Republic of Azerbaijan has made to remedy the deficiencies on the area of the compliance of financial institutions with AML/CFT
- To identify the significant factors contributing to the compliance of financial institutions with AML/CFT.

- To determine the prospects for the development of the compliance of financial institutions with the AML/CFT in the country.

Lesson learned from the previous two chapters (1st and 2nd chapters) was monitoring of implementation, developing the capacity of local experts and delivering pilot trainings in the regions.

Different international organizations implement programs to reveal the gaps in the laws and procedures of local institutions and deliver recommendations to eliminate these gaps. There is a need to institute a system to closely monitor and measure whether local authorities implement the advice given. Furthermore, it has been noted during the trainings of local experts that the best results were achieved when combining international experts with local ones. Given the challenging and tactful nature trainings, the audience responded very positively to a local expert acting as an interlocutor with international experts. Thus, it makes effectiveness and impact of the pilot trainings delivered in the regions very high.

CONCLUSION AND RECOMMENDATIONS

The biggest problem that Azerbaijan has to fight in the field of money laundering and terrorist financing is corruption and bribery. Thus, in order to commit violations of the law, the involvement of control and legislative bodies in corruption and the cover-up of violations through bribery has become widespread.

Developing a coherent anti-money laundering and counter-terrorist financing policy and successful implementation of national risk assessment requires assisting with identification of future priority areas for strategic action.

Provision of research, expert advice, legal reviews, workshops and trainings should be considered at the assistance activities. Documentation of the activity results in technical papers, guidelines, or other written outputs definitely is able to contribute to the current study level of the research topic.

Efforts should be paid to implement a continuous and consistent, multilateral cooperation and coordination mechanism dedicated to problem identification at AML/CFT system level and the adoption of proactive or reactive policies to cope with emerging or existent issues.

Moreover, the FMS should have the authority to disseminate financial information to all relevant investigative bodies, when following analysis; indications of crimes other than money laundering or terrorist financing emerge. The FMS should be authorized to disseminate financial information, under proper safeguards, upon the request of another domestic authority for investigation purposes. Statistics collated and prepared by the FMS should be available to all key stakeholders and used to develop AML/CFT policy and strategy.

Above all, as long as criminals control financial institutions or hold senior management positions in financial institutions, it is extremely difficult for financial institutions not only to prevent but also to detect the crimes, and consequently they tend to pose dangerous obstacles to combating money laundering and financing of terrorism.

Financial institutions operating in Azerbaijan should form internal policies to fight against ML and FT. The purpose of this policy should be prevention of the use of the financial institutions as a tool in the legalization of criminally obtained money or other property and in the financing of terrorism.

More emphasis should be placed on preventive measures than seizure, confiscation and forfeiture of assets. Authorities should prevent the occurrence of money laundering and financing of terrorism in the first instance rather than let the criminals carry out illicit performance to obtain dirty profits at the highest magnitude and confiscate the proceeds.

Additional identification measures should be applied to high-risk customers and their transactions. Information about customer accounts and transactions performed by them, as well as the purpose and nature of customer business relationships, should be monitored on an ongoing basis.

Anti-corruption operations carried out in the regions of Azerbaijan during 2019-2021, one more confirms that operations in the financial institutions involving high-ranking government officials and their families should be given special attention and scrutiny. Customer service staff of banks should ensure that there is no illicit cash flow in transactions with such individuals.

On the ML and FT proceedings and investigative techniques, capacities of judges and prosecutors should be strengthened in order to investigating and processing money-laundering in line with national legislation and the Criminal Code. The

capacity-building measures should be targeted all investigative bodies, aiming to enhance their capability to address money laundering and terrorism financing from the substantial, procedural and investigative aspects. This would be achieved through the following actions:

- Providing a training toolkit on money laundering and terrorist financing investigative techniques;
- Delivering a training on investigative techniques in ML for law enforcement;
- Delivering a training on processing and adjudicating ML cases for judges and prosecutors;
- Delivering a training on terrorism financing for judges and prosecutors.

One of the main crosscutting issue, which is also raised by experts, is gender mainstreaming. At this regard, PGG-AZ project sought to promote gender-balanced participation in all capacity building activities. An average 31% representation of women was achieved during the events organized by the project.

PGG experts noted that, a low female to male ratio was observed during the training organized for prosecutors, investigators, and judges whereas these positions are predominantly occupied by men in Azerbaijan. However, almost equal representation of female and male participants (45% female vs 55% male) was secured during the two training activities specifically organized for the FIU and the Anti-Corruption Directorate. Therefore, as proposed, gender balance of employees should be achieved in government bodies, in case of State Customs Committee and State Tax Service there is noticeable achievement on this recruitment policy.

The most of the realized projects mainly focused on the implementation of specialized technical trainings in AML/CFT sector, which makes it difficult to engage civil society sector in these types of technical training activities. For engaging civil society and human rights approach, civil society was invited to the 2019 PGG-AZ

Annual Co-ordination Platform Meeting which created an open venue for Non-Government Organizations to address their questions and provide recommendations with regard to the project mid-term results and future project specific activities.

Furthermore, while crafting customer acceptance policies, financial institutions must take great attention to strike the appropriate balance between risk aversion regarding criminal activities and the willingness to take on new clients.

Generally, the rigidity of the acceptance standards should be commensurate with the risk profile of a potential customer. It is strongly recommended that only senior management should render decisions on customers whose profiles suggest they pose a high risk of money-laundering activities (Paul A. S., 2006: p. 209).

As well as, financial institutions should design their customer acceptance policies so that the socially disadvantaged are not excluded. Nor should these customer acceptance policies in any way restrict the general public's access to financial services. This is particularly important for countries moving toward a broader use of financial instruments, including the use of checks, credit or debit cards, electronic and other payment mechanisms, and shifting away from a cash-based economy.

In summary, as discussed above, the following essential components of an effective legal framework, such as: authorized authorities, countermeasures against ML and FT, effective implementation, investigation of ML and FT offenses, suspicious transaction reports, good control of proceeds of crime, knowledge of untraceable ML and FT methods, international cooperation, assistance and cooperation from financial institutions and non-financial institutions, technical assistance as well as income declaration are important factors in the performance of combating ML and FT within an efficient and effective AML/CFT framework.

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List of Tables

Table 1: Basel AML Index risk scores since 2012.....	64
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