

The International Anti-Money Laundering and Combating the Financing of Terrorism Regulatory Strategy: A Critical Analysis of Compliance Determinants in International Law

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Abstract

Concerns about the risks money laundering (ML) and terrorist financing (TF) present to the stability of the international financial system have resurfaced in the context of the liquidity problems faced by financial institutions as a result of the recent credit crisis (2008). Because ML and TF evolve with new criminal activities and methodologies, ML and TF present systemic threats to the stability of the financial system. Addressing new developments in ML/TF and their associated risks requires a sufficiently flexible and adaptable international regulatory strategy. In this paper, I examine the international anti-money laundering and combating the financing of terrorism (AML/CFT) regime based on soft regulation and institutions and how it has shaped countries' compliance with the Financial Action Task Force's (FATF) AML/CFT international standards. The origins of the AML/CFT regime are located in the dual consequences of globalization, both the rapid economic growth resulting from increasing financial and capital liberalization and negative externalities undermining the financial system, and the changing pattern in global governance toward new, softer types of international regulation and institutions as alternative regimes to address issues of global concern. Compliance with the AML/CFT international standards is examined using the assumption that states' behavior, or misbehavior, regarding their international obligations can be analyzed in terms of causality with different variables. Inspired by regime and managerial approaches, I argue that compliance is a function of specific determinants of which the regime is made acting on their own but more often with greater impulse arising out of their interaction. The present analysis relies on a mixed analytical-empirical methodology to analyze selected variables such as the soft law nature of the AML/CFT normative regime, its institutional design, compliance monitoring and sanction process, and legitimacy.

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I. INTRODUCTION

Concerns about the threat of money laundering and terrorist financing (ML/TF)¹ to the stability of the international financial system have recently resurfaced on the global agenda in the context of the 2008 credit crisis.² The crisis, which resulted in many financial institutions facing serious

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¹ In their simplest forms, ML refers to the process whereby proceeds from illicit activities are disguised in order to conceal their illicit origin, whereas TF captures the financial support, in any form, of terrorism or of those who facilitate, encourage, plan or engage in terrorist acts.

² See *A Note from the President*, FATF GAFI E-NEWS (FATF & OECD, Paris), April 2009, at 1, available at <http://www.fatf-gafi.org/dataoecd/26/38/42601904.pdf>.

liquidity problems,³ led some banks to rely on inter-bank loans funded by illicit money to survive.⁴ Recent concerns are based on the fear that criminal organizations can profit from the current crisis by buying control of struggling businesses, thereby infiltrating financial sectors in different parts of the world.⁵ ML/TF threats are often explained in terms of negative externalities associated with the increasing movement of capital across borders resulting from the liberalization of financial markets in the context of globalization.⁶ Synonymous with rapid economic growth,⁷ globalization was also accompanied, perhaps incidentally, by changing patterns in global governance. Newer, softer, and more flexible forms of international regulation and institutions were designed to address such negative externalities,⁸ in the search for an “ordered world.”⁹ These changing

³ See, e.g., Paolo Mauro & Yishay Yafeh, *Financial Crises of the Future*, 44 FIN. & DEV. 26 (2007), available at <http://www.imf.org/external/pubs/ft/fandd/2007/12/pdf/mauro.pdf>; Nicholas Chan, Mila Getmansky, Shane M. Haas & Andrew W. Lo, *Do Hedge Funds Increase Systemic Risk?*, ECON. REV., Fourth Quarter 2006, at 49, available at http://www.frbatlanta.org/filelegacydocs/erq406_lo.pdf.

⁴ *Financial Crisis Window for Mafia Money Laundering*, CALGARY HERALD, Feb. 10, 2009, available at <http://www2.canada.com/calgaryherald/news/calgarybusiness/story.html?id=ef2bfcd6-c4eb-4f3f-8e47-23c74905f026> (Antonio Maria Costa, Executive Director of the U.N. Office on Drugs and Crime, warns that “[c]ash-rich mafia groups have been channeling funds into banks desperate to survive the global credit crisis.”); *Financial Crisis: UN Crime Chief Says Drug Money Flowed into Banks*, GLOB. RES., Mar. 15, 2009, available at <http://www.globalresearch.ca/index.php?context=va&aid=12718> (indicating that “[i]n the second half of 2008, liquidity was the banking system’s main problem and hence liquid capital became an important factor” and that there were signs some banks were rescued through “interbank loans . . . funded by money that originated from drug trade and other illegal activities”).

⁵ See, e.g., *Financial Crisis Window for Mafia Money Laundering*, supra note 4 (“You have the supply—an organized crime industry with enormous amounts of cash, estimated at \$322 billion in 2005, not any more stored in banks—and the demand, a banking sector strapped for liquidity.”); Steve Scherer & Vernon Silver, *Mafia Cash Increases Grip on Sinking Italy Defying Berlusconi*, BLOOMBERG, May 27, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aHtly5QjUYzo> (Italy’s President, Giorgio Napolitano, notes, “There’s a risk that Mafia organizations can profit from the current crisis by buying control of struggling businesses, infiltrating all regions of the country.”).

⁶ See generally KERN ALEXANDER, RAHUL DHUMALE & JOHN EATWELL, GLOBAL GOVERNANCE OF FINANCIAL SYSTEMS: THE INTERNATIONAL REGULATION OF SYSTEMIC RISK 14–33 (2006).

⁷ *Compare A Bigger World: A Special Report on Globalization*, ECONOMIST, Sept. 20, 2008, at 4 [hereinafter *A Bigger World*] (contending that globalization “is creating huge opportunities . . .”), with M. Ayhan Kose, Eswar Prasad, Kenneth Rogoff & Shang-Jin Wei, *Beyond the Blame Game: A New Way of Looking at Financial Globalization Reexamines its Costs and Benefits*, 44 FIN. & DEV., Mar. 2007, at 9, 10 (contending that “the effects of financial globalization have not been conclusively determined”).

⁸ See generally Howell E. Jackson, *The Selective Incorporation of Foreign Legal Systems to Promote Nepal as an International Financial Services Center* (Oct. 7, 1998) (Harv. L. Sch. John M. Olin Ctr. L. Econ. & Bus. Discuss Paper Series, Paper No. 241), available at http://lsr.nellco.org/cgi/viewcontent.cgi?article=1029&context=harvard_olin.

patterns had the effect of expanding the scope of international law to cover transnational criminal behaviors and activities threatening order, justice, and security. In response to the ML/TF concerns, the international community adopted the global “anti-money laundering and combating the financing of terrorism” (AML/CFT) regulatory strategy¹⁰—a set of soft rules associated with international financial regulation¹¹—to address or preempt potential damage to the stability of the international financial system.¹² The constantly evolving ML/TF criminal activities and methodologies, which extended to financial and non-financial institutions,¹³ required the design of an international regulatory strategy, sufficiently flexible and adaptable, to meet the challenges and changing faces of ML/TF. The international AML/CFT strategy provided the basis for such a comprehensive and adaptable framework to address those concerns. In search of new and more adaptable tools and techniques to address evolving ML/TF threats more effectively, the international AML/CFT regulatory framework has, in the last decade, adapted to meet those challenges with critical normative and institutional initiatives. Seemingly isolated, those initiatives interconnect in a regulatory ensemble forming the global AML/CFT regime¹⁴ that has, directly or indirectly, encouraged greater compliance with the Financial Action Task Force (FATF) international

⁹ See Mary Ellen O’Connell, *The Role of Soft Law in a Global Order*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM 100, 100 (Dinah Shelton ed., 2000). See generally JEFFREY ROBINSON, *THE SINK: TERROR, CRIME AND DIRTY MONEY IN THE OFFSHORE WORLD* 3–7 (2003); GARRY J. SCHINASI, *SAFEGUARDING FINANCIAL STABILITY: THEORY AND PRACTICE* 8 (2006); Edgardo Buscaglia, *The Paradox of Expected Punishment: Legal and Economic Factors Determining Success and Failure in the Fight against Organized Crime*, 4 REV. L. & ECON. 290, 293 (2008).

¹⁰ See Houston Economic Summit, Hous., Tex., July 11, 1990, *Houston Economic Declaration*, ¶¶ 75–83, available at <http://www.g7.utoronto.ca/summit/1990houston/declaration.html> [hereinafter *Houston Economic Declaration*]; Summit of the Arch, Paris, Fr., July 14–16, 1989, *Paris Economic Declaration*, ¶ 53, available at <http://www.g7.utoronto.ca/summit/1989paris/communique/drug.html> [hereinafter *Economic Declaration of the Summit of the Arch*].

¹¹ Curzio Giannini, *Promoting Financial Stability in Emerging-Market Countries: The Soft Law Approach and Beyond*, 44 COMP. ECON. STUD. 125, 126 (2002).

¹² *Economic Declaration of the Summit of the Arch*, *supra* note 10, ¶ 53 (declaring the creation of a task force “to assess the results of cooperation already undertaken in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field . . .”).

¹³ FINANCIAL ACTION TASK FORCE, *FATF 40 RECOMMENDATIONS 7* (2010) available at <http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF> [hereinafter *FATF 40 RECOMMENDATIONS*] (noting that the category of designated non-financial businesses and professions (DNFBPs) embraces all non-bank financial institutions and categories of professionals such as accountants, lawyers and notaries).

¹⁴ See Kern Alexander, *The International Anti-Money-Laundering Regime: The Role of the Financial Action Task Force*, 4 J. MONEY LAUNDERING CONTROL 231, 231 (1993) (defining international regime as “a system of norms, standards, procedures, institutions and rules of conduct that constrain and shape state behaviour in a particular issue area”).

standards.¹⁵ Often referred to as “variables” or “determinants,” embodied in the “normative” (rules) and “operating” (institutions and actors) structures of the AML/CFT framework, relying essentially on soft norms,¹⁶ these initiatives, and their incessant interaction, resulted in a growing internationalization and legalization that has shaped the AML/CFT process into a more specific regime which continues to bind many states.¹⁷ Since its inception, the AML/CFT strategy has gradually evolved into a powerful and adaptable international regime construction that has been critical in generating compliance with the AML/CFT standards.¹⁸ Contrary to a single variable approach, a framework combining mixed variables potentially offers benefits of multi-causal linkages with valuable insights into compliance with the AML/CFT standards. A multi-causal approach, however, presents challenges in a complex environment with risks of losing their weight and impact on compliance.¹⁹ Because of the wide variety of theories using different variables to examine compliance, there is bound to be a multitude of overlap regarding the use, definition and impact of the different variables across disciplines,²⁰ often blurring the dividing lines.

Understanding compliance with the international AML/CFT standards, however, is distinctively marked by the considerable impact of soft power. The intrinsically soft law nature of the AML/CFT standards contributed significantly in shaping the policies and laws of many countries, forcing recognition of the ML threat.²¹

The AML/CFT discourse, embodied in the strength of its obligations²²

¹⁵ *See id.* at 233.

¹⁶ *See generally* CHARLOTTE KU & PAUL F. DIEHL, *INTERNATIONAL LAW: CLASSIC AND CONTEMPORARY READINGS* 31–44 (3d ed. 2009).

¹⁷ FINANCIAL ACTION TASK FORCE, *FINANCIAL ACTION TASK FORCE ANNUAL REPORT 2008-2009* 30–32 (2009), *available at* <http://www.fatf-gafi.org/dataoecd/11/58/43384540.pdf> (indicating that many countries have implemented FATF recommendations).

¹⁸ *See generally* TRANSNATIONAL RELATIONS AND WORLD POLITICS (Robert O. Keohane & Joseph S. Nye, Jr. eds., 1972); Ernst B. Haas, *Why Collaborate? Issue-Linkage and International Regimes*, 32 *WORLD POL.* 357, 385, 396–97 (1980).

¹⁹ *See, e.g.*, Kal Raustiala & Anne-Marie Slaughter, *International Law, International Relations and Compliance*, in *HANDBOOK OF INTERNATIONAL RELATIONS* 538, 553 (2002) (discussing international rules and “the complexity of the interaction between compliance and effectiveness”).

²⁰ Beth A. Simmons, *Compliance with International Agreements*, 1 *ANN. REV. POL. SCI.* 75, 75–93 (1998).

²¹ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 36.

²² *See, e.g.*, FINANCIAL ACTION TASK FORCE, *METHODOLOGY FOR ASSESSING COMPLIANCE WITH THE FATF 40 RECOMMENDATIONS AND FATF 9 SPECIAL RECOMMENDATIONS 5* (2004) (updated 2009), <http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf> [hereinafter *FATF METHODOLOGY*] (The 2004 Methodology defines the process and mechanism through which countries’ compliance with the FATF 40+9 AML/CFT Recommendations is assessed, and the “essential criteria are those elements that should be present in order to demonstrate full compliance with the mandatory elements of each of the Recommendations.”).

and exceptions,²³ history and purpose demonstrates legal characteristics of “public international law as an aggregate of legal norms governing international relations” and its specific functions.²⁴ In a rapprochement to hard-type norms, the FATF AML/CFT Recommendations reflect legal norms with prescriptive and prohibitive obligations for its targets.²⁵ As such, they provide a normative order of sufficiently “good quality” resulting from the substantive nature and strength of its norms. Implementation of the AML/CFT standards is supported by an effective institutional setup,²⁶ the cohabitation of both soft and hard norms,²⁷ and procedures and rules that shape and constrain states’ behavior.²⁸ In addition, a compliance assessment mechanism,²⁹ under the threat of sanctions through a ‘name and shame’ procedure,³⁰ transformed the international AML/CFT system into a comprehensive international legal regime to control financial crime.³¹

The flexibility of the FATF AML/CFT normative structure to constantly adapt to new and changing ML/TF activities and methodologies³² provides compliance recipients and drivers with an

²³ See, e.g., FINANCIAL ACTION TASK FORCE, FATF 40 RECOMMENDATIONS, *supra* note 13, § A (2004) (indicating that “countries may provide that the offence of money laundering does not apply to persons who committed the predicate offence”).

²⁴ Prosper Weil, *Towards Relative Normativity in International Law?*, 77 AM. J. INT’L L. 413, 413 (1983).

²⁵ Dinah Shelton, *Introduction: Law, Non-Law and the Problem of ‘Soft Law,’ in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM*, *supra* note 9, at 1, 16 [hereinafter Shelton, *Introduction*] (identifying targets of norms as one of the factors that can influence compliance). Targets include not only member countries but also nonmembers and private sector entities including financial institutions and designated non-financial businesses and professions, which are directly affected by the FATF Recommendations. See FATF 40 RECOMMENDATIONS, *supra* note 13, Recommendation 5 (outlining preventive measures for directly financial institutions), Recommendation 12 (outlining preventative measures for non-bank financial institutions).

²⁶ See FINANCIAL ACTION TASK FORCE, ABOUT THE FATF, http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html (describing the purpose of FATF as a standard-setter in matters related to AML/CFT and developing and promoting the AML/CFT 40 +9 AML/CFT recommendations).

²⁷ See generally United Nations Convention against Transnational Organized Crime, Nov. 15, 2000, 2225 U.N.T.S. 209 (150 states have ratified this UN convention); International Convention for the Suppression of the Financing of Terrorism, Dec. 9, 1999, 2178 U.N.T.S. 229 (169 countries have ratified this UN convention); United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, Dec. 20, 1988, 1582 U.N.T.S. 164 (FATF AML/CFT international standards rely on the provisions of this UN convention).

²⁸ Alexander, *supra* note 14, at 68, 150–51.

²⁹ FATF METHODOLOGY, *supra* note 22.

³⁰ The Non Cooperative Countries and Territories (NCCT) List fulfills the same function of a sanctions procedure whereby non-compliant countries are placed on a blacklist until they comply with the FATF Recommendations.

³¹ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 10.

³² Christine M. Chinkin, *The Challenge of Soft Law: Development and Change in*

adaptable framework to deal with an evolving criminal behavior. Initially developed to address transnational illicit money generated by drug-trafficking and organized criminal activities,³³ the AML regime later stretched its reach to capture TF and new ML techniques. In addition, the cumulative effect on compliance—through cooperation among the vast regional and international network³⁴ developed around the FATF³⁵ to promote and spread the FATF AML/CFT message across the globe, despite serious economic and other constraints—has been far from negligible.³⁶

The landmark achievement of the FATF regime, however, has been its comprehensive compliance monitoring process and mechanism, integrating recent international law concepts such as compliance, implementation, and effectiveness in its 2004 compliance assessment Methodology. The monitoring process,³⁷ designed to evaluate countries' behavior (or misbehavior) toward their international obligations, acts as a significant inducement for compliance. The availability of sanctions—through a system of blacklisting countries, accompanied by countermeasures—to address non-compliance with the FATF Recommendations has been critical in enhancing compliance with the FATF standards. Supported by a delegation of its assessment mandate to regional groupings (FSRBs) and the Non-Cooperative Countries and Territories (NCCT) sanctions process, the FATF peer review mechanism developed into a credible compliance assessment process, analyzing both members' and nonmembers' compliance with its standards. Further, despite the soft nature of its norms, the FATF peer review mechanism discourages non-compliance. Its third

International Law, 38 INT'L & COMP. L.Q. 850, 852–53; Mario Giovanoli, *Reflections on International Financial Standards as 'Soft Law,'* in ESSAYS IN INTERNATIONAL FINANCIAL & ECONOMIC LAW, No. 37, 2002, 5, 12–13. Cf. Sungjoon Cho, *An Identity Crisis of International Organizations* (Chi.-Kent Coll. of L., Ill. Inst. of Tech., Working Paper, 2009), available at http://works.bepress.com/cgi/viewcontent.cgi?article=1048&context=sungjoon_cho (proposing a new perspective on international organizations drawing on 'identity theory,' which captures an IO's institutional development, through which one can witness a dynamic process of its identity crisis and identity formation).

³³ United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, *supra* note 27, art. III; UN Convention against Transnational Organized Crime, *supra* note 27, art. VI.

³⁴ This network includes work carried out by the IMF, World Bank, UNODC, and Commonwealth Secretariat, as well as a series of regional organizations known as FATF Styled Regional Bodies (FSRBs).

³⁵ The agencies include the FATF itself, the IMF, the World Bank, Egmont Group of FIUs, Basel Committee on Banking Supervision, OISCO, and FATF-Styled Regional Bodies (FSRBs).

³⁶ John McFarlane, *Regional and International Cooperation in Tackling Transnational Crime, Terrorism and the Problems of Disrupted States*, 12 J. FIN. CRIME, 301, 301 (2005).

³⁷ References to the FATF AML/CFT assessment process in this paper should be read as including AML/CFT assessments conducted by the IMF, World Bank, and the FSRBs which carry out their evaluations using the FATF Recommendations and its 2004 Methodology and other documents.

round of evaluation of countries, which was initiated in 2005³⁸ and integrated the experience gained by the two previous rounds,³⁹ achieved a level of performance not reached in the past. Mutual evaluation by FATF countries gives increased credibility to its AML/CFT mechanisms,⁴⁰ forcing countries to become more proactive in enforcement through a higher level of participation and involvement. A good indication of countries' changing behavior is their participation in the global AML/CFT initiatives and their willingness to adopt legislation.⁴¹ As of 2009, 127 countries had endorsed the FATF 40+9 AML/CFT Recommendations, and from 2005 to 2009, 123 jurisdictions—all either a member of FATF or a FSRB⁴²—have been assessed by the FATF and other regional and international organizations using the revised 2004 Methodology.⁴³ This result is significantly higher than the 103 countries assessed under the previous Methodology from 1995–2003.⁴⁴ In addition, the direct endorsement of the FATF standards by 184 jurisdictions, representing more than 85% of the world, confirms the effective reach of its compliance process.⁴⁵ Together with its eight FSRBs—some of which have recently graduated to associate membership—and covering more than 170 countries and twenty-two observer organizations and bodies,⁴⁶ the FATF is able to address a wider geographical network and provide more effective coverage and standard implementation.

However, assessing compliance with the AML/CFT standards requires

³⁸ FATF ANNUAL REPORT 2008-2009, *supra* note 17, at 13.

³⁹ *Id.* at 17 (illustrating levels of compliance with the FATF Recommendations).

⁴⁰ Jackie Johnson & Y.C. Desmond Lim, *Money Laundering: Has the Financial Action Task Force Made a Difference?*, 10 J. FIN. CRIME 7, 9 (2002).

⁴¹ *Id.*

⁴² The FATF-Styled Regional Bodies are mini-FATF organizations set up and operating at regional level.

⁴³ FATF ANNUAL REPORT 2008-2009, *supra* note 17, at Annex 3 and Annex 4, 30–36.

⁴⁴ Discussion with FATF representatives based on statistics provided by the FATF Executive Secretariat and its Annual Reports about countries that have agreed to publish the mutual evaluation.

⁴⁵ FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 2007-2008 ii (2008) [hereinafter FATF ANNUAL REPORT 2007-2008].

⁴⁶ FINANCIAL ACTION TASK FORCE, FATF REVISED MANDATE 2008-2012 2 (2008) [hereinafter FATF REVISED MANDATE 2008-2012]; FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 2; see FATF ANNUAL REPORT 2008-2009, *supra* note 17, at 33–36 for a list of all Associate Members and FSRBs. The eight FSRBs are the Asia/Pacific Group on Money Laundering (APG); Caribbean Financial Action Task Force (CFATF); Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval); Financial Action Task Force on Money Laundering in South America (GAFISUD); Middle East and North Africa Financial Action Task Force (MENAFATF); Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG); Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG); and Intergovernmental Action Group against Money-Laundering in Africa (GIABA).

a theoretical framework that captures the impact on countries of the different components of the AML/CFT regime without the rigid dichotomy between hard and soft types of norms. Compliance theory is often defined as one of the pathways to international law issues,⁴⁷ which entails seeking answers to its functions and effectiveness through international instruments and institutions addressing specific concerns.⁴⁸ Numerous theories have offered varying explanations about states' compliance and their related complexities,⁴⁹ captured in a corpus of literature defined as "International Legal Compliance."⁵⁰ However, this literature has remained largely dominated by disagreements among scholars about states' motivations.

⁴⁷ Kal Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, 32 CASE W. RES. J. INT'L L. 387, 391 (2000).

⁴⁸ *Id.*

⁴⁹ KU & DIEHL, *supra* note 16, at 10. Theories can be grouped into rationalists, normative, managerial, and the liberal approach. Most prominent is the "managerial theory" arguing for compliance in terms of players participating in regimes through which they comply out of self-interest and non-coercive measures. International organizations are the main drivers of the compliance process in this theoretical framework, providing a platform or forum for problem-solving. Lack of administrative or financial capacity, inconsistency, or ambiguity in treaty interpretation has serious effects on compliance. ABRAM CHAYES & ANTONIA HANDLER CHAYES, *THE NEW SOVEREIGNTY: COMPLIANCE WITH INTERNATIONAL REGULATORY AGREEMENTS* 1–22 (1995). Rationalists, on the other hand, use different variables focusing on interests, actors, and incentives, which interact in a problem-structure and problem-solving framework based on the collaboration and coordination dichotomy with competing or varying compliance results. While the number of relevant players is part of the problem-structure, the problem-solving framework defines other variables, including the rules standards and creation of institutions, sanctions, settlement of disputes mechanisms, and nature and content of rules. Kenneth W. Abbott, "Trust But Verify": *The Production of Information in Arms Control Treaties and Other International Agreements*, 26 CORNELL INT'L L.J. 1 (1993). For normative theories, it is the power of the norms that determines the extent of compliance, often characterized by the focus on the nature of the international norm, whose power to influence compliance depends on these qualities. Central to compliance in the normative theory is the question of legitimacy of the process where compliance is related to a perception by the addressees that the rule is legitimate. An additional perspective on the normative theory emphasizes the interplay of domestic and international players in an "internationalization" of international norms through different channels of participants whose overall effect is to activate and facilitate the internalization process. The nature and hardness of the norm is another contributing factor in the normative theory where the very fact of the norm being law has a positive impact on the norm. CHAYES & CHAYES, *supra*, at 112–34. These are only a fraction of the numerous theories and themes developed in relation to compliance. See William Bradford, *In the Minds of Men: A Theory of Compliance with the Laws of War*, 36 ARIZ. ST. L.J. 1243, 1249 (2004); see Simmons, *supra* note 20, at 76–77 (examining four theoretical approaches to compliance); see also George W. Downs, David M. Rocke & Peter N. Barsom, *Is the Good News About Compliance Good News About Cooperation?*, 50 INT'L ORG. 379 (1996); see generally Andrew T. Guzman, *A Compliance-Based Theory of International Law*, 90 CALIF. L. REV. 1823 (2002).

⁵⁰ William C. Bradford, *International Legal Compliance: An Annotated Bibliography*, 30 N.C. J. INT'L L. & COM. REG. 379, 379 (2004); see also Bradford, *In the Minds of Men: A Theory of Compliance with the Laws of War*, *supra* note 49, at 1243.

Perspectives on compliance are, however, not mutually exclusive,⁵¹ and most theories rely on a common set of variables that characterize states' behavior.⁵² The recent prominence of compliance in international law and international relations debates, however, is largely due perhaps to the emergence of soft, legally non-binding norms with their considerable potential for achieving global order subject to being theoretically understandable, prescriptively manageable, and empirically demonstrable.⁵³ Soft law⁵⁴—a regular topic in recent international law and international relations discourse⁵⁵—occupies an important part in the international legal system due to its normative features giving rise to compliance expectations.⁵⁶ Opinions as to the legal validity of these norms,⁵⁷ focused essentially on the “binding and non-binding effect” argument, differ. At

⁵¹ Simmons, *supra* note 20, at 76.

⁵² See Jonathan L. Charney, *Compliance with International Soft Law*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM, *supra* note 9, at 115, 117–18, for an indication of some factors.

⁵³ Raustiala & Slaughter, *supra* note 19, at 540; Simmons, *supra* note 20, at 75–77; CHAYES & CHAYES, *supra* note 49, at 2–3; Downs, Rocke & Barsoom, *supra* note 49, at 379; Guzman, *supra* note 49, at 1825, 1828, 1879–81.

⁵⁴ Ignaz Seidl-Hohenveldern, *General Course on Public International Law*, 198 RECUEIL DES COURS 55, 61–71 (1986); Dinah Shelton, *Normative Hierarchy in International Law*, 100 AM. J. INT'L L. 291, 319 (2006) (explaining “[t]here is no accepted definition of ‘soft law,’” and common definitions include reference to “any international instrument other than a treaty that contains principles, norms, standards, or other statements of expected behavior”); see also Joseph Gold, *Strengthening the Soft International Law of Exchange Arrangements*, 77 AM. J. INT'L L. 443, 443 (1983).

⁵⁵ Shelton, *supra* note 54, 291–323; Andrew T. Guzman, *The Design of International Agreements*, 16 EUR. J. INT'L L. 579, 580 (2005).

⁵⁶ See Raustiala & Slaughter, *supra* note 19, at 551–52.

⁵⁷ For a detailed analysis of “soft law”, see Chinkin, *supra* note 32, at 851–52. The debate is animated by those who reject outright these norms as law-making for reasons of uncertainty and instability and those who adopt a more liberal attitude acknowledging them as part of the complex and deeply layered international law-making process in a “brave new world of international law.” Harold Hongju Koh, *A World Transformed*, 20 YALE J. INT'L L. ix, xii (1995); Chris Ingelse, *Soft Law*, 20 POLISH Y.B. INT'L L. 75, 75 (1993). Others, although accepting that the category of law itself is nuanced, have argued for the redundancy of soft law on the basis of imputing legal characteristics to soft norms albeit of its rather different nature. Jan Klabbbers, *The Redundancy of Soft Law*, 65 NORDIC J. INT'L L. 167, 170 (1996). Others have sought to argue that soft law originates from a continuing dialogue between norm and fact and between means and ends, which shapes politics and leads to emergence of meanings, the basis for common values and standards (e.g., Toope). Scholars have argued that states' choice of softer forms of regulation is conditioned by numerous factors such as implementation cost, uncertainty, national sovereignty, and flexibility (e.g., Raustiala, Abbot, and Snidal). Some international lawyers dismiss soft law outright as undermining the entire normative system of international law. Weil, *supra* note 24, at 413–15; Hiram E. Chodosh, *Neither Treaty nor Custom: The Emergence of Declarative International Law*, 26 TEX. INT'L L.J. 87, 88 (1991); Christopher C. Joyner, *U.N. General Assembly Resolutions and International Law: Rethinking the Contemporary Dynamics of Norm-Creation*, 11 CAL. W. INT'L L.J. 445, 446–48 (1981).

any rate, arguments based on this distinction offer limited insights into soft law and its relationship with compliance.⁵⁸ Scholars concur that legal norms are not monolithic⁵⁹ and that the dichotomy approach does not diminish their relevance for compliance.⁶⁰ A deeper understanding of compliance with AML/CFT soft law, therefore, requires a paradigm shift that moves away from an over-emphasis on the binding-nonbinding dichotomy⁶¹ toward an approach that captures the increasing legalization of soft law's normative structure, relying on content, precision, delegation, monitoring and sanctions⁶² as a means to achieve world order and security through international cooperation. Compliance with the FATF AML/CFT standards somehow weakens the assumption based on the rigid divide between hard and soft law which relies on the binding and non-binding distinction as vital to explain compliance. The absence of a strict hard law character has not necessarily prevented compliance with the AML/CFT standards, as national jurisdictions have been willing or persuaded to incorporate them into their legal systems, giving them the status of internally binding legal obligations.⁶³ In fact, compliance with the AML/CFT international obligations provides an additional perspective on compliance, focusing more on the impact of the norms as opposed to their non-binding character. Under this perspective, soft norms, in cohabitation with harder norms, can positively influence compliance behavior. Claims that soft law lacks preordained penalties for failures to comply, unambiguous language imposing obligations, or precision stand contradicted⁶⁴ by the AML/CFT compliance performance. Further, such claims are often misguided because soft law with specific and detailed rules exists,⁶⁵ and even hard law often suffers from a lack of the aforementioned indicators.⁶⁶ Far from being mere voluntary cooperative codes of non-

⁵⁸ Karl Zemanek, *Is the Term 'Soft Law' Convenient?*, in LIBER AMICORUM: PROFESOR IGNAZ SEIDL-HOHENVELDERN, IN HONOUR OF HIS 80TH BIRTHDAY 843, 844–45 (Gerhard Hafner et al. eds., 1998).

⁵⁹ Myers S. McDougal & W. Michael Reisman, *The Prescribing Function in the World Constitutive Process: How International Law is Made*, 6 YALE STUD. WORLD PUB. ORD. 249, 256-68 (1980).

⁶⁰ Charles Lipson, *Why Are Some International Agreements Informal?*, 45 INT'L ORG. 495, 495–538 (1991); Koh, *supra* note 57, at ix, xi; Cynthia Crawford Lichtenstein, *Hard Law v. Soft Law: Unnecessary Dichotomy?*, 35 INT'L LAW. 1433, 1438 (2001).

⁶¹ Lichtenstein, *supra* note 60, at 1434.

⁶² Kenneth W. Abbott, Robert O. Keohane, Andrew Moravcsik, Anne-Marie Slaughter & Duncan Snidal, *The Concept of Legalization*, 54 INT'L ORG. 401, 401–02 (2000).

⁶³ Giovanoli, *supra* note 32, at 72.

⁶⁴ JOSEPH GOLD, INTERPRETATION: THE IMF AND INTERNATIONAL LAW 302 (1996) (“A *lex imperfecta* creates an obligation but fails to establish a clear penalty or even any penalty at all for breach of the obligation.”).

⁶⁵ NILS BRUNSSON & BENGT JACOBSSON, A WORLD OF STANDARDS 3 (2000).

⁶⁶ Ulrika Mörth, *Introduction*, in SOFT LAW IN GOVERNANCE AND REGULATION, *supra* note 62, at 1, 6.

binding norms, the AML/CFT legal and preventive measures⁶⁷ are mandatory obligations for countries to adopt in their domestic legal system.⁶⁸ Failure to comply is sanctioned under the NCCT process. Choice of softer forms of regulation is often deliberate and preferable for reasons of flexibility and adaptability where one or more of the three elements of precision, delegation, and sanction can be relaxed making it easier to achieve compliance.⁶⁹

Inspired by regime approach to international affairs,⁷⁰ where inter-governmental organizations produce norms designed to regulate states' activities in specific areas, I critically examine compliance with the AML/CFT international standards based on the assumption that states' performance of, or misbehavior regarding, their international obligations can be analyzed in terms of causality with different variables. Relying on a mixed analytical-empirical methodology using selected variables, including the soft law structure of the FATF AML/CFT regime with its prescriptive or proscriptive obligations, cohabitation of hard and soft norms, institutional design, monitoring process and sanctions, and legitimacy, I argue that compliance is a function of specific determinants acting either on their own or, more often, together. After an introduction to globalization followed by a brief exposé of negative externalities associated with ML/FT on the stability of the international financial system, the paper puts forth a critical analysis of how the interplay among those selected variables has over the years converged into a formidable international AML/CFT regime, maximizing compliance with the FATF standards. Existing theories about compliance are, however, underpinned by an absence of empirical studies⁷¹—indicating a deeper concern about a one-sided approach to international law—and the failure to provide adequate narratives of how compliance theory moulds itself while interacting with the specific

⁶⁷ Examples include criminalizing ML and TF, identification, seizure, freezing and confiscation of assets, law enforcement measures and international cooperation (legal); both financial and non-financial institutions have responsibilities to put in place AML/CFT measures.

⁶⁸ FATF METHODOLOGY, *supra* note 22, at 3–10.

⁶⁹ Kenneth W. Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421, 423 (2000); Francisco Sindico, *Soft Law and the Elusive Quest for Sustainable Global Governance*, 19 LEIDEN J. INT'L L. 829, 831 (2006); see Shelton, *Introduction*, *supra* note 25, at 12–13 (discussing reasons that motivate countries' choice for soft law).

⁷⁰ For a discussion of the concept of “international regime” as a concept used in international organization theory that has been defined as “norms, rules, and procedures agreed in order to regulate an issue area,” see Haas, *supra* note 18, at 358; TRANSNATIONAL RELATIONS AND WORLD POLITICS (Robert O. Keohane & Joseph S. Nye, Jr. eds., 1973); Alexander, *supra* note 14.

⁷¹ Simmons, *supra* note 20, at 77; Peter M. Haas, *Why Comply, or Some Hypotheses in Search of an Analyst*, in INTERNATIONAL COMPLIANCE WITH NON-BINDING ACCORDS 9, 21 (Edith B. Weiss ed., 1997); CHAYES & CHAYES, *supra* note 49, at 176.

environments that provide the bases for its testing. In fact, very little is known about the degree of states' compliance with their international commitments, and whatever empirical studies have been carried out suggest compliance is uneven at best⁷² and that estimates of compliance are overstated.⁷³

II. GLOBALIZATION AND THE MONEY LAUNDERING AND TERRORIST FINANCING CHALLENGES

Globalization produced rapid economic growth,⁷⁴ financial development beneficial for both industrial and developing economies,⁷⁵ and changed patterns in global governance.⁷⁶ Such developments presented the global community with new challenges in controlling activities generated by forces of globalization.⁷⁷ This "quantitative" and "qualitative" transformation⁷⁸ gave a new outlook to business generally identified with rapid and growing movement of capital, information, trade and individuals across borders,⁷⁹ where "all is about competing with everyone from everywhere for everything."⁸⁰ Three forces⁸¹ of technical change—the

⁷² Peter M. Haas, *Choosing to Comply: Theorizing from International Relations and Comparative Politics*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM, *supra* note 9, at 43, 44; Raustiala & Slaughter, *supra* note 19, at 539; Beth A. Simmons, *International Law and State Behavior: Commitment and Compliance in International Monetary Affairs*, 94 AM. POL. SCI. REV. 819, 819–35 (2000); Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 391.

⁷³ Downs, Rocke & Barsoom, *supra* note 49, at 379–80.

⁷⁴ JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS (2002); *A Bigger World*, *supra* note 7, at 4; Kose, Prasad, Rogoff & Wei, *supra* note 7, at 9, 13; Santha Vaithilingam, *Factors Affecting Money Laundering: Lesson for Developing Countries*, 10 J. MONEY LAUNDERING CONTROL 352, 352 (2007).

⁷⁵ Kose, Prasad, Rogoff & Wei, *supra* note 7, at 19; *A Bigger World*, *supra* note 7, at 1; Vaithilingam, *supra* note 74, at 352.

⁷⁶ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 23, 32–70. Examples of these new types of international regulations and institutions are portrayed in the Basel Committee on Banking Supervision and its Capital Accord, known as Basel II, the International Organization of Securities Commission standards (IOSCO), and the International Association of Insurance Supervisors (IAIS). *Id.* at 34–66.

⁷⁷ O'Connell, *supra* note 9, at 100.

⁷⁸ Wolfgang H. Reinicke & Jan Martin Witte, *Challenges to the International Legal System, Interdependence, Globalization, and Sovereignty: The Role of Non-Binding International Legal Accords*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM, *supra* note 9, at 75, 75; ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 14.

⁷⁹ *Globalization: The Story Behind the Numbers*, 39 FIN. & DEV. 9, 9 (2002), reprinted in INTERNATIONAL MONETARY FUND, FINANCIAL GLOBALIZATION: THE IMPACT ON TRADE, POLICY, LABOR, AND CAPITAL FLOW 14 (2007).

⁸⁰ HAROLD L. SIRKIN, JAMES W. HEMERLING & ARINDAM K. BHATTACHARYA, *GLOBALITY: COMPETING WITH EVERYONE FROM EVERYWHERE FOR EVERYTHING I* (2008).

⁸¹ Raghuram Rajan, *Risky Business: Skewed Incentives for Investment Managers May be*

radical reduction of communication costs and information acquisition,⁸² deregulation, and institutional change—facilitated international trade and finance by removing barriers to competition. These led to penetration by foreign firms, opening of capital accounts, and easing of restrictions on capital flows.⁸³ The emergence of new financial instruments and new political, regulatory and legal arrangements led to increasing interconnection which expanded and deepened international financial markets.⁸⁴ The explosion of private capital flows due to intense financial activities⁸⁵ from the 1990s onwards⁸⁶ catalyzed the world economy, leading not only to maximization of profits but also systemic risks and vulnerabilities seriously impacting international financial stability.⁸⁷

Adding to Global Financial Risk, 42 FIN. & DEV. 54, 54 (2005); Gerd Hausler, *The Globalization of Finance*, 39 FIN. & DEV. 10 (2002), reprinted in INTERNATIONAL MONETARY FUND, FINANCIAL GLOBALIZATION: THE IMPACT ON TRADE, POLICY, LABOR, AND CAPITAL FLOW 44, 44–45 (2007).

⁸² Paul Masson, *Globalization: Facts and Figures* (Oct. 2001) (Int'l Monetary Fund, Policy Discussion Paper No. PDP/01/4). Note the considerable reduction in costs between 1920 and 1990 with a seventy percent reduction in cost of ocean freight transport; eighty-four percent reduction in cost of air transport, cost of a three-minute telephone call from New York to London from \$60.42 in 1960 to \$0.40 cents in 2000, the price of computer and peripheral equipment from \$1,869,004 in 1960 to \$1,000 for an equivalent computer in 2000.

⁸³ SCHINASI, *supra* note 9, at 7; DANI RODRIK, HAS GLOBALIZATION GONE TOO FAR? 9 (1997).

⁸⁴ Kern Alexander, Eilís Ferran, Howell E. Jackson & Niamh Moloney, *A Report on the Transatlantic Financial Services Regulatory Dialogue* (Jan. 2007) (Harv. L. Sch. John M. Olin Ctr. L. Econ. & Bus. Discuss Paper Series, Paper No. 576).

⁸⁵ Ceyla Pazarbaşıoğlu, Mangal Goswami & Jack Ree, *The Changing Face of Investors*, 44 FIN. & DEV. 28, 28–29 (2007); Beth Simmons, *International Efforts Against Money Laundering*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM, *supra* note 9, at 244, 244.

⁸⁶ See Pazarbaşıoğlu, Goswami & Ree, *supra* note 85 (Foreign direct investment became the dominant source of private capital flows to emerging markets although equity flows also increased considerably. Cross border flows tripled during the past decade to \$6.4 trillion, reaching about 14.5 per cent of world GDP by 2005 as a result of increasing investment across borders, integration of global capital markets due to financial liberalization. Global bond and equity markets witnessed unprecedented growth in the past 15 years with the size of the world's equity and bond markets now doubled the level of world GDP, with global stock market capitalization reaching \$38 trillion in 2005, compared with \$45 trillion for bond markets. In addition, investment also contributed to the rapid growth of cross-border flows marked by increasing growth in assets under management of institutional investors, spectacular growth of hedge funds, and the rise of emerging market central banks and sovereign wealth funds. Assets under management such as pension funds, insurance companies and mutual funds grew from \$21 trillion in 1995 to about \$53 trillion in 2005. The number of hedge funds multiplied from 530 in 1990 to 6,700 in 2005 and assets managed by the hedge fund industry grew from \$30 billion in 1990 to \$1.4 trillion in 2005. Cross-border portfolio assets increased to reach around \$19 trillion in 2005.); Simmons, *supra* note 85, at 244.

⁸⁷ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 14; Pazarbaşıoğlu, Goswami & Ree, *supra* note 85, at 31.

Examples of goods that possess properties of negative externalities include maintenance of social law and order, provision of national defense against aggression, unregulated environment, and facilitation of crime across borders.⁸⁸ Rapid movement of massive international capital flows created huge opportunities as well as threats.⁸⁹ One form of threat was the inadvertent opening up of opportunities to criminals, increased cross-border criminality, facilitated ML/FT, and increased potential risk to the stability of the international financial system.⁹⁰ Money launderers, terrorists, drug dealers,⁹¹ and human traffickers all operate within global networks,⁹² making it as sinister as it is ubiquitous. The 2008 financial crisis further exemplifies recent concerns about the continuous threat of ML and TF to the stability of the international financial system.⁹³ For example, financial institutions faced with serious liquidity problems⁹⁴ seek to rely on illicit funds to survive the crisis.⁹⁵ There have been claims that “as the rest of the world tightens its belt in the global recession,” money launderers seek to profit “by lending and investing what’s become a scarce commodity these days: a growing hoard of cash.”⁹⁶ The Madoff scam, the Stanford fraud, and the collapse of Bear Stearns hedge funds exemplify suspected criminal activities associated with the recent crisis.⁹⁷ Although measuring the

⁸⁸ O’Connell, *supra* note 9, at 103–04; McFarlane, *supra* note 36, at 301.

⁸⁹ *A Bigger World*, *supra* note 7, at 4.

⁹⁰ Rémy Davison, ‘Soft Law’ Regimes and European Organisations’ Fight Against Terrorist Financing and Money Laundering, in *TERRORISM, ORGANIZED CRIME AND CORRUPTION: NETWORKS AND LINKAGES* 60 (Leslie Holmes ed., 2007); Jean-François Thony, *Le Rôle du Fonds Monétaire International dans la Lutte Contre le Blanchiment de L’Argent*, [The Role of the International Monetary Fund in the Fight against Money Laundering], in *TEN YEARS OF FIGHTING AGAINST MONEY LAUNDERING IN BELGIUM AND IN THE WORLD* 199, 200 (2003) (Proceedings of the International Symposium organized by the CTIF the opportunity of its tenth anniversary with the support of the federal public service Justice and Finance, March 14, 2003).

⁹¹ See *On The Trail of Traffickers*, *ECONOMIST*, Mar. 7, 2009, at 30 (discussing recent events in Mexico that are indicative of the security risks associated with organized crime).

⁹² ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* 1 (2004).

⁹³ *A Note from the President*, *supra* note 2, at 4.

⁹⁴ Mauro & Yafeh, *supra* note 3, at 7; Chan, Getmansky, Haas & Lo, *supra* note 3, at 56–57; Hugo Cox, *Hedge Fund Administration: Lifting the Veil*, *INSTITUTIONAL INVESTOR*, Apr. 2009, at 59, 60–61.

⁹⁵ Mark Heinrich, *Anti-Narcotics Drive Has Fuelled Drug Cartels: U.N.*, *REUTERS*, Mar. 11, 2009, <http://www.reuters.com/article/idUSTRE52A44I20090311>.

⁹⁶ See Steve Scherer & Vernon Silver, *Mafia Cash Increases Grip on Sinking Italy Defying Berlusconi*, *BLOOMBERG*, May 26, 2009, <http://www.bloomberg.com/apps/news?sid=aHtly5QjUYzo&pid=20601109> (“There’s a risk that Mafia organizations can profit from the current crisis by buying control of struggling businesses, infiltrating all regions of the country,” Italian President Giorgio Napolitano cautioned in May.”).

⁹⁷ See James Quinn, *Case Will Throw Light on Funds Before Bear Stearns Collapsed*, *TELEGRAPH*, Aug. 20, 2009, http://www.telegraph.co.uk/finance/financetopics/financial_crisis/6061849/Case-will-throw-light-on-funds-before-Bear-Stearns-collapsed.html (“The [Bear and Stearn’s] funds collapsed as billions of dollars of bets made on mortgage-backed

precise amount of ML is impossible⁹⁸ due to its secretive nature,⁹⁹ measuring it is relevant to understand its impact on the flow of illegal funds in the legal economy, risk in the financial sector,¹⁰⁰ and threats to national and international security. These systemic risks in financial markets often originate in one country but affect other countries (contagion).¹⁰¹ The main types of risks associated with ML/FT are reputational risk, concentration risk, operational risk,¹⁰² adverse macroeconomic consequences,¹⁰³ and damages caused to financial institutions by destabilizing customer trust, distorting allocation of resources, and facilitating crime.¹⁰⁴ Arguments suggesting adverse macroeconomic effects of ML, however, have been challenged as unconvincing “given that anti-money-laundering policies are fundamentally the tools of crime prevention” and the motivation for these

bonds and collateralised debt obligations (CDOs) unraveled, and when the time came to try to sell some of the funds’ sub-prime mortgages, no one wanted to buy them.”); Robert Lenzer, *Bernie Madoff’s \$50 Billion Ponzi Scheme*, FORBES, Dec. 12, 2008, available at http://www.forbes.com/2008/12/12/madoff-ponzi-hedge-pf-ii-in_rl_1212croesus_inl.html; *An \$8 Billion Scandal Goes a Long Way: The Stanford Affair*, ECONOMIST, Feb. 26, 2009, http://www.economist.com/world/americas/displaystory.cfm?story_id=13185500; *Howzat! Financial Fraud*, ECONOMIST, Feb. 18, 2009, http://www.economist.com/businessfinance/displayStory.cfm?story_id=13136627.

⁹⁸ Johnson & Lim, *supra* note 40, at 10. Kochan suggests that US \$ 2.5 trillion per year would not be unreasonable. NICK KOCHAN, *THE WASHING MACHINE: MONEY, CRIME & TERROR IN THE OFFSHORE SYSTEM* xxxiv (2006). Robinson suggests that in 2000, an estimated \$600-\$700 billion in dirty money moves around the globe looking to get cleaned. This figure is a jump from \$100-\$300 billion in the 1990s and represents only 10% of the wealth hidden in offshore centers, leading to an estimate of about \$6-\$7 trillion moving through the offshore world. ROBINSON, *supra* note 9, at 4–5. The IMF approximates the yearly volume of illicit money to be around US \$500 billion. Vito Tanzi, *Money Laundering and the International Finance System* 3–4 (Int’l Monetary Fund, Working Paper No. 96/55, 1996); see also Rowan Bosworth-Davies, *Money Laundering—Chapter Five: The Implications of Global Money Laundering Laws*, 10 J. MONEY LAUNDERING CONTROL 189, 191 (2007) (estimating insurance payments for burglary losers, which amounted to £568 million in 2001, and £424 million of credit card losses, totaling £992 million in activities which provide the highest degree of likelihood of producing cash assets with the capability of being laundered).

⁹⁹ PAUL ALLAN SCHOTT, *REFERENCE GUIDE TO ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM* 1–6 (2d ed. 2006).

¹⁰⁰ Antonello Biagioli, *Financial Crimes as a Threat to the Wealth of Nations: A Cost-Effective Approach*, 11 J. MONEY LAUNDERING CONTROL 88, 89–90 (2008); Peter J. Quirk, *Macroeconomic Implications of Money Laundering* 1–2, 6–7 (Int’l Monetary Fund, Working Paper No. 96/66, 1996).

¹⁰¹ James M. Boughton & Colin I. Bradford, Jr., *Global Governance: New Players, New Rules - Why the 20th Century Model Needs a Makeover*, 44 FIN. & DEV. 10, 10 (2007).

¹⁰² Brent L. Bartlett, *The Negative Effects of Money Laundering on Economic Development* 5 (May 2002) (Asian Dev. Bank, Regional Technical Assistance Project No. 5697 - Countering Money Laundering in the Asia and Pacific Region).

¹⁰³ Quirk, *supra* note 100, at 1, 16–18; Donato Masciandaro, *Money Laundering: The Economics of Regulation*, 7 EUR. J.L. & ECON. 225, 226 (1999).

¹⁰⁴ Bartlett, *supra* note 102, at 5, 8, 17.

policies is not macroeconomic.¹⁰⁵ On the other hand, the “terror of 11th September, 2001 [and] fractured globalization”¹⁰⁶ made obvious the macroeconomic relevance of terrorist financing on the stability of the financial markets.¹⁰⁷ Terrorist financing is where terrorists use the financial system to finance their illegal activities.¹⁰⁸ Terrorists depend on criminal business to finance their terrorist operations.¹⁰⁹ The impact of terrorism on financial institutions can take different forms from the perspectives of victims, perpetrators, or instrumentalities.¹¹⁰ Terrorists can also benefit from financial institutions specially set up to finance their operations. Financial institutions can also unknowingly channel terrorist funding.¹¹¹ Concerns about the global reach of ML/FT for the stability of the financial system¹¹² started to raise questions about the adequacy of prevailing regulatory frameworks to address challenges associated with managing globalization and its negative externalities.¹¹³ These negative externalities undermine the financial system’s ability to allocate funds efficiently.¹¹⁴ The spread of financial instability (“financial contagion”) became a global public bad, but avoiding it is a global public good.¹¹⁵ Justification of

¹⁰⁵ Richard K. Gordon, *Anti-Money-Laundering Policies - Selected Legal, Political, and Economic Issues*, 1 CURRENT DEVS. MONETARY & FIN. L. 405, 410–11 (1999).

¹⁰⁶ Jon Mills & Robert Ware III, *Responding to Terrorism and Achieving Stability in the Global Financial System: Rational Policy or Crisis Reaction?*, 11 J. FIN. CRIME 380, 380 (2004).

¹⁰⁷ R. Barry Johnston & Oana M. Nedelescu, *The Impact of Terrorism on Financial Markets*, 13 J. FIN. CRIME 7, 18–19 (2006).

¹⁰⁸ Ricardo Azevedo Araujo, *The Effects of Money Laundering and Terrorism on Capital Accumulation and Consumption*, 9 J. MONEY LAUNDERING CONTROL 265, 266 (2006).

¹⁰⁹ Patrick Hardouin & Reiner Weichhardt, *Terrorist Fund Raising Through Criminal Activities*, 9 J. MONEY LAUNDERING CONTROL 303, 305 (2006); Courtney J. Linn, *How Terrorists Exploit Gaps in US Anti-Money Laundering Laws to Secrete Plunder*, 8 J. MONEY LAUNDERING CONTROL 200, 201 (2005).

¹¹⁰ MONETARY AND EXCHANGE AFFAIRS AND POLICY DEVELOPMENT AND REVIEW DEPARTMENTS, FINANCIAL SYSTEM ABUSE, FINANCIAL CRIME AND MONEY LAUNDERING - BACKGROUND PAPER 6 (2001).

¹¹¹ Johnston & Nedelescu, *supra* note 107.

¹¹² ALEXANDER, DHUMALE, & EATWELL, *supra* note 6, at 67–71; KOCHAN, *supra* note 98, at 3; Vaithilingam, *supra* note 74, at 352–53; Louise Shelley, *The Globalization of Crime and Terrorism*, eJOURNAL USA GLOBAL ISSUES, Feb. 2006, at 42, 42–44; JYOTI TREHAN, CRIME AND MONEY LAUNDERING: THE INDIAN PERSPECTIVE 1–30 (2004); Edwin M. Truman, *Anti-Money Laundering as a Global Public Good*, in EXPERT PAPER SERIES THREE: FINANCIAL STABILITY 93, 94–96 (Secretariat of the International Task Force on Global Public Goods, 2006).

¹¹³ SCHINASI, *supra* note 9, at 48 (discussing “externalities” which arise when a financial activity imposes benefits or costs on third parties that are not directly involved in the activity).

¹¹⁴ ANDREW CROCKETT, MARRYING THE MICRO- AND MACRO-PRUDENTIAL DIMENSIONS OF FINANCIAL STABILITY 4 (2000), available at <http://www.bis.org/review/r000921b.pdf>.

¹¹⁵ Truman, *supra* note 112, at 95.

financial regulation to address such externalities,¹¹⁶ therefore, became an increasingly dominant feature of globalized economic policy-making.¹¹⁷

The over-emphasized quantitative approach often misrepresented globalization as a global phenomenon. On the other hand, the qualitative change associated with globalization, premised on new economic, financial and social inter-connectedness,¹¹⁸ laid the foundation for a new approach to address international ML/TF concerns.¹¹⁹ Increasing liberalization signaled qualitative changes in international transactional relationships with the convergence of public and private player networks pursuing different objectives with their own technical language and organizations, mandates, and specialized focus,¹²⁰ ready to service the globally expanding markets.¹²¹ These networks have specific aims to expand their regulatory reach, build institutions and relationships, and collaborate in a multitude of activities aimed at addressing problems of common concern in a vein of international cooperation.¹²² This new form of “transnational legal process,”¹²³ with its rules, institutions, and networks easily adapted as control mechanisms¹²⁴ and rooted in society’s crave for order and stability, offers a new approach to deal with global problems.¹²⁵ This new global governance defines a new form of international cooperation based on soft power and increasing reliance on soft, non-binding international rules and frameworks. The development of soft international financial standards originated with the notion of the “New International Financial Structure” (NIFA),¹²⁶ designed

¹¹⁶ Jackson, *supra* note 8, at 16–25.

¹¹⁷ Reuters, *supra* note 4, at 3–11.

¹¹⁸ Reinicke & Witte, *supra* note 78, at 75; O’Connell, *supra* note 9, at 101.

¹¹⁹ Reinicke & Witte, *supra* note 78, at 54; see Steven Bernstein & Benjamin Cashore, *Globalization: Four Paths of Internationalization and Domestic Policy Change: The Case of EcoForestry in British Columbia, Canada*, 33 CAN. J. POL. SCI. 67, 67–69 (2000).

¹²⁰ Boughton & Bradford, *supra* note 101, at 10.

¹²¹ KU & DIEHL, *supra* note 16, at 3, 8–10.

¹²² *Id.*

¹²³ Harold Hongju Koh, *Transnational Legal Process*, 75 NEB. L. REV. 181, 183–86 (1996); Harold Hongju Koh, *Why do Nations Obey International Law?*, 106 YALE L.J. 2599, 2620 (1997).

¹²⁴ See, for example, specialized standard-setting bodies such as the International Organization of Securities Commissions (IOSC); International Association of Insurance Supervisors (IAIS); Financial Stability Forum/Bank for International Settlement (FSF/BIS) (representing finance ministers, central banks, and regulatory agencies); and Basel Committee on Banking Supervision. See also Curzio Giannini, *Promoting Financial Stability in Emerging-Market Countries: The Soft Law Approach and Beyond*, 2 COMP. ECON. STUD. 125, 126–27 (2002).

¹²⁵ James N. Rosenau, *The Dynamics of Globalization: Toward an Operational Formulation*, 27 SEC. DIALOGUE 247 (1996); see also James N. Roseneau, *Governance and Democracy in a Globalizing World: Re-Imaging Political Community*, in RE-IMAGINING POLITICAL COMMUNITY: STUDIES IN COSMOPOLITAN DEMOCRACY 28, 36–38 (D. Archibugi et al. eds., 1998).

¹²⁶ Joseph J. Norton, *Taking Stock of the “First Generation” of Financial Sector Reform*

to address potential financial instability associated with globalization. The NIFA paved the way for reformed “best practices” or “principles,” and the proliferation of several international bodies,¹²⁷ including the Financial Actions Task Force. The multilateral AML/CFT regulatory framework spearheaded by the international community and providing global public goods¹²⁸ was born in this context based on the need for a common legal framework to be designed, interpreted, and enforced in a coherent and predictable manner within nation states and across transnational borders. Two issues are critical to this form of global governance approach in order to address global problems: capacity to create effective global regulations and compliance and the ability for the networks to translate global regulation into changes in behavior.

III. DETERMINANTS OF COMPLIANCE

A. The Soft Normative Structure of the AML/CFT Standards

The regulation of ML/TF is a rare topic in international law even though the AML international regulation has been in place since the late 1980s, and the FATF was established in 1989.¹²⁹ This rarity is perhaps due to the absence of a catalyzing factor to drive ML on the international agenda.¹³⁰ Or perhaps, and more important still, it is the soft law nature of the AML/CFT international regulatory framework which raises concerns about the effectiveness of legally ‘non-binding’ instruments. However, soft law norms have been implemented and complied with on their own merit.¹³¹ Compliance with the FATF AML/CFT norms is inextricably

14 (World Bank Law & Dev., Working Paper No. 4, 2007).

¹²⁷ Ramses A. Wessel & Jan Wouters, *The Phenomenon of Multilevel Regulation: Interactions Between Global, EU and National Normative Process*, in MULTILEVEL REGULATION AND THE EU 9, 28 (Follesdal et al. eds., 2007) (providing examples of soft international institutions created in the context of international financial regulation including the Basel Committee on Banking, in which “central bank directors of a limited number of countries harmonize” their policies so as to amount to regulation of capital markets, and the International Organization of Securities Commission (IOSCO), dealing with “the transnationalization of securities markets and attempts to provide a regulatory framework for them”).

¹²⁸ Truman, *supra* note 112, at 94–96.

¹²⁹ G7 Summit of the March, Paris, July 14–16, 1989; United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, *supra* note 27, at 170 (providing for the offence of money laundering in respect of illicit funds arising out of drug offences).

¹³⁰ Following the September 11, 2001 attacks on the World Trade Center, the eight Special Recommendations on the Financing of Terrorism were integrated into the existing FATF AML system.

¹³¹ Donald Rothwell, *The General Assembly Ban on Driftnet Fishing*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM, *supra* note 9, at 121, 121.

linked with its soft law nature and origin, located in increasing legalization¹³² of international (financial) regulation.¹³³ Regulating ML/FT, therefore, needs to be addressed in the context of the international legal system and domestic forces¹³⁴ where law is regarded as the necessary basis for ordering behavior¹³⁵ and in its normative nature and legal language creates expectations of compliance.¹³⁶ The basic tenet of the rule of law principle entails an expectation that necessary measures are adopted to encourage compliance and address defection caused by non-compliance, which in the long term undermines the very principle.¹³⁷ The AML/CFT standards, albeit of a soft form, have considerably shaped the policies and laws of many countries based on the intrinsic qualities of its normative and institutional structure, forcing recognition of the ML threat.¹³⁸ The strength of the AML/CFT system rests on its effective institutional setup, the cohabitation of soft and hard law norms,¹³⁹ and a strong compliance assessment mechanism under threat of sanctions for non-compliance (which are characteristics of major legal systems).¹⁴⁰ These transformed the AML/CFT framework into a comprehensive international legal regime for the control of financial crime.¹⁴¹ Its discourse—including the strength of the obligations contained in the 40+9 AML/CFT Recommendations and the Essential Criteria in the 2004¹⁴² and the exceptions—¹⁴³history, and purpose demonstrates sufficient legal characteristics of “public international law as the aggregate of the legal norms governing international relations.”¹⁴⁴ In a rapprochement to hard-type norms, the FATF Recommendations embody

¹³² Legalization theory is based on the belief that international law can independently constrain and shape states’ behavior. See, e.g., ALEXANDER, DHUMALE & EATWELL, *supra* note 6; Mörth, *supra* note 66, at 1.

¹³³ For a detailed analysis of the role of ‘soft law’ in international financial regulation, see ALEXANDER, DHUMALE & EATWELL, *supra* note 6 at Part 4.

¹³⁴ Anne-Marie Slaughter & William Burke-White, *The Future of International Law is Domestic*, in NEW PERSPECTIVES ON THE DIVIDE BETWEEN INTERNATIONAL AND NATIONAL LAW 110, 126–27 (Andre Nolkaemper & Janne Nijman eds., 2007).

¹³⁵ Shelton, *Introduction*, *supra* note 25, at 7.

¹³⁶ Charney, *supra* note 52, at 115.

¹³⁷ *Id.* at 8.

¹³⁸ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at part 3.

¹³⁹ See Jean-Francois Thony, *Money Laundering and Terrorism Financing: An Overview* (Int’l Monetary Fund, May 10, 2000), available at <http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/thony.pdf>.

¹⁴⁰ See FATF 40 RECOMMENDATIONS, *supra* note 13, Recommendation 21 (providing sanctions for departure from the FATF Recommendations and a chapter on NCCT).

¹⁴¹ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 10.

¹⁴² FATF 40 RECOMMENDATIONS, *supra* note 13; FATF METHODOLOGY, *supra* note 22, at 9 (outlining the mandatory obligations contained in the FATF Recommendations as detailed in the Essential Criteria).

¹⁴³ FATF 40 RECOMMENDATIONS, *supra* note 13, at 15; FATF METHODOLOGY, *supra* note 22, Recommendation 1 (outlining exceptions such as “self-laundering”).

¹⁴⁴ Weil, *supra* note 24, at 413.

legal norms with prescriptive and prohibitive obligations for its targets,¹⁴⁵ providing a normative order of sufficiently “good quality” resulting from the substantive nature and strength of its norms and institutional setup. Its institutional structure is neither weak nor inadequate, nor are its norms too “controversial, weak, fragile, vague, and unconvincing”¹⁴⁶ for it to effectively govern the conduct of states. Crucial, however, has been the power and strength of the soft normative structure in ensuring compliance among countries.

The mandatory nature of the AML/CFT international obligations, as opposed to being merely “programmatory,” provides the strongest basis for understanding recent compliance impact. The substantive rules embodied in the FATF Recommendations¹⁴⁷ constitute the minimum international mandatory standards that have shaped and constrained countries’ regulatory practices in the fight against ML/FT¹⁴⁸ and form the all-embracing foundations upon which all compliant countries and territories base their approach to AML/CFT. Use of the terms “should”¹⁴⁹ or “should be required by law or regulation”¹⁵⁰ embodies mandatory obligations “requiring countries or their competent authorities to take measures that will oblige their financial institutions or DNFBBs to comply with the recommendations.”¹⁵¹ On the other hand, the term “should consider”¹⁵² reflects mere discretionary obligations allowing countries some flexibility in respect of the matter to be regulated. Of the 40+9 AML/CFT Recommendations, only three are of a discretionary nature,¹⁵³ while the remaining forty-six Recommendations illustrate precise and specific obligations which, although do not create legally enforceable rights (in the conventional sense), nevertheless create commitments and expectations in

¹⁴⁵ Shelton, *Introduction*, *supra* note 25, at 16 (identifying targets, i.e., recipient of norms as one of the factors that can influence compliance; targets include not only member countries but also nonmembers and private sector entities including financial institutions and designated non-financial businesses and professions, which are directly affected by the FATF Recommendations); *see* FATF 40 RECOMMENDATIONS, *supra* note 13, Recommendation 5 (preventive measures targeting directly financial institutions), Recommendation 12 (targeting non-bank financial institutions).

¹⁴⁶ Abbott & Snidal, *supra* note 69, at 423; Sindico, *supra* note 69, at 831, 832–34; *see* Shelton, *Introduction*, *supra* note 25, at 12–13 (discussing the reasons that motivate countries’ choice for soft law).

¹⁴⁷ FATF 40 RECOMMENDATIONS, *supra* note 13.

¹⁴⁸ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 68; FATF METHODOLOGY, *supra* note 22, ¶ 9, at 5 (“The Recommendations . . . are applicable to all countries.”).

¹⁴⁹ FATF METHODOLOGY, *supra* note 22, at 70 (“The word ‘should’ has the same meaning as ‘must’ for purposes of assessing compliance”).

¹⁵⁰ *Id.* ¶ 23, at 9; *see also id.* at 62, 70 (defining “should” and “consider”).

¹⁵¹ *Id.* ¶ 26–27, at 9.

¹⁵² *Id.* at 62 (defining “consider”).

¹⁵³ FATF 40 RECOMMENDATIONS, *supra* note 13, at 9, 19, 20; FATF METHODOLOGY, *supra* note 22, at 39, 63, 65.

softer forms, closer to hard-type obligations. Criminalization of ML/FT offences enshrined in the FATF Recommendation I and Special Recommendation II, for example, create clear and precise mandatory obligations for countries to adopt into their domestic legal systems.¹⁵⁴

Contrary to claims about soft norms containing merely “hortatory or promotional language,”¹⁵⁵ the FATF standards represent the hardest type of soft norms with more defined language¹⁵⁶ and considerable amount of precision in the rules, a highly desirable factor for implementation. The FATF’s detailed two hundred and fifteen (215) Essential Criteria (E.Cs) and thirty-seven (37) Additional Elements¹⁵⁷ specify clear objectives and expectations, narrowing down possibilities of ambiguity and facilitating countries’ implementation into domestic legal systems by providing sufficient level of precision regarding every Recommendation. “The essential criteria are those elements that should be present in order to demonstrate full compliance with the mandatory elements of each of the Recommendations.”¹⁵⁸ The E.Cs are determinate and relate to one another in a non-contradictory way, creating a framework of coherence,¹⁵⁹ spelling out prescribed or proscribed behavior, and giving a normative characteristic familiar in developed legal systems. Criminalization of the ML/FT offences is an example of such precision where the seven E.Cs supporting Recommendation 1 level down the four broad elements which countries should rely upon to define their national offence of money laundering to a degree of precision vital for ensuring compliance.¹⁶⁰ At the same time, the Recommendations create exceptions based on countries’ national

¹⁵⁴ Recommendation I stipulates that “Countries should criminalise money laundering on the basis of the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the Vienna Convention) and the United Nations Convention against Transnational Organized Crime, 2000 (the Palermo Convention).” FATF 40 RECOMMENDATIONS, *supra* note 13, at 3.

¹⁵⁵ Chinkin, *supra* note 32, at 850; Kal Raustiala, *Form and Substance in International Agreements*, 99 AM. J. INT’L L. 581, 588 (2005).

¹⁵⁶ Ross S. Delston & Stephen C. Walls, *Reaching Beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing Outside the Financial Sector*, 41 CASE W. RES. J. INT’L L. 85, 92 (2009).

¹⁵⁷ FATF METHODOLOGY, *supra* note 22. For each Recommendation, there is a set of EC and Additional Elements which guide the country as to the elements of the Recommendation that are required to be complied with in order to ensure conformity with the respective Recommendation. *Id.*

¹⁵⁸ FATF METHODOLOGY, *supra* note 22, ¶10, at 5.

¹⁵⁹ THOMAS FRANCK, THE POWER OF LEGITIMACY AMONG NATIONS (1990); THOMAS FRANCK, FAIRNESS IN INTERNATIONAL LAW AND INSTITUTIONS (1998).

¹⁶⁰ These four elements include the obligation to criminalize ML on the basis of the Vienna and Palermo Conventions; the provision for the widest range of predicate offences, a list of which is defined under “designated categories of offences” combining a *de minimis* provision; extraterritoriality of the predicate offence; and self-laundering guided by the fundamental principles of countries’ domestic law. FATF METHODOLOGY, *supra* note 22, at 11–12.

constitutional provisions or fundamental principles of their legal system,¹⁶¹ as in the case of the ‘self-laundering’ offence.¹⁶² Countries are also allowed to limit the application of certain Recommendations under specific conditions based on levels of risks and vulnerabilities.¹⁶³

The G7’s delegation in 1989¹⁶⁴ to the FATF, of the mandate to develop and implement the international AML/CFT standards across the world, provided a strong impetus for the development of a dynamic system with sufficient degree of legalization.¹⁶⁵ This mandate to develop and monitor implementation of the norms¹⁶⁶ resulted in a process combining a dispute settlement-like sanction process¹⁶⁷ and internal mechanisms (Working Groups and Plenary) to interpret the Recommendations and the E.Cs. It had become important for the effectiveness of the system to ensure that violation to comply with the norms was sanctioned. In addition, interpretation of the norms was required in order to remove uncertainty and inconsistency and ensure coherence as circumstances unfold.¹⁶⁸ The rules can be made precise through ‘adjudication’ via its Working Groups and Plenary or the issuance of Interpretative Notes and Best Practices, Red Flag Indicators, and Guidance.¹⁶⁹ Interpretation of “horizontal issues”¹⁷⁰—those

¹⁶¹ See FATF Recommendation 1 and EC.1.6, which state that countries may provide that the offence of money laundering does not apply to persons who committed the predicate offence where this is required by fundamental principles of their domestic law. FATF 40 RECOMMENDATIONS, *supra* note 13, at 3; FATF METHODOLOGY, *supra* note 22, at 12.

¹⁶² *Id.*

¹⁶³ FATF METHODOLOGY, *supra* note 22, ¶¶ 23–25, at 8–9 (“A country may therefore take risk into account and may decide to limit the application of certain FATF Recommendations provided that either of the following conditions . . .”).

¹⁶⁴ Houston Economic Declaration, *supra* note 10 (The G7 endorsed the report of the Financial Action Task Force (FATF) and committed countries to a full implementation of all its recommendations and “the FATF should be reconvened for a second year, chaired by France, to assess and facilitate the implementation of these standards.”); G7 Summit of the Arch, July 14–16, 1989, available at <http://www.g7.utoronto.ca/summit/1989paris/communique/drug.html> (convening a financial action task force from Summit participants).

¹⁶⁵ Delegation, one of the three components of the legalization process, means that third parties have been granted authority to implement, interpret, and apply the rules, to resolve disputes, and (possibly) to make further rules and ranges from simple consultative mechanisms to full-fledged bureaucracies, which help elaborate imprecise rules, implement agreed rules, and facilitate enforcement. Abbott, Keohane, Moravcsik, Slaughter & Snidal, *supra* note 62, at 401; Sia Spiliopoulou Akermark, *Soft Law and International Financial Institutions-Issues of Hard and Soft Law from a Lawyer’s Perspective*, in *SOFT LAW IN GOVERNANCE AND REGULATION* 61, 62 (Ulrika Mörth ed., 2004).

¹⁶⁶ G7 Summit Meeting, Genoa, It., July 20–22, 2001, *G7 Statement*, ¶ 14, available at <http://www.g8.utoronto.ca/summit/2001genoa/g7statement.html>.

¹⁶⁷ Kenneth W. Abbott & Duncan Snidal, *Why States Act Through Formal International Organizations*, 42 *J. CONFLICT RESOL.* 3, 4, 26–28 (1998).

¹⁶⁸ FINANCIAL ACTION TASK FORCE, *FATF ANNUAL REPORT 2006-2007* 2 (2007).

¹⁶⁹ See FINANCIAL ACTION TASK FORCE, *FATF COMPILATION FATF COMPILATION-3-FATF COMPILATION-122* (2009). The FATF has produced a series of Interpretative Notes, International Best Practices, Red Flag Indicators, and Guidance Papers to guide

issues which demonstrate ambiguity in the norms themselves and their implementation—guarantees more normative certainty, accuracy, consistency, and clarity and is critical for ensuring maximum compliance. In addition, greater clarity and precision are provided in the “Introduction to the Interpretative Notes” to the Recommendations—interpretation to concepts such as “countries,” “jurisdictions,” “territories,” or “other enforceable means,”¹⁷¹ facilitating countries’ compliance.¹⁷² However, gray areas still exist in the norms, as illustrated by the lack of clarity in purpose between the Recommendation and the E.Cs.¹⁷³ Whether the E.C can go beyond and create additional rules or obligations not provided for in the Recommendation is unclear. Instances of discrepancies between the Recommendations and the E.Cs lead to inconsistency, reducing coherence and confidence in the rules and undermining compliance. Criminalization of TF has also given rise to intricate legal issues arising out of the implementation of the SRII in the context of the 1999 Convention and UN SCR Resolutions on TF.¹⁷⁴ Other instances of such legal complexities relate to the freezing of TF assets provisions aimed at non-state actors, financial institutions, and the issue of how to use international law instruments to target such players. A stronger interpretative mandate could, therefore, enhance “legalization” of the FATF process, build up its unique “software,” and lead to more institutional equilibrium through teleological interpretation where norms are strengthened by constructive interpretation through a more jurisprudential approach.

The capacity of the FATF AML/CFT normative structure to constantly

interpretation of the Recommendations and Essential Criteria. *Id.*

¹⁷⁰ FINANCIAL ACTION TASK FORCE, THIRD ROUND OF AML/CFT MUTUAL EVALUATION: PROCESS AND PROCEDURES (2009) ¶ 25, at 9, available at <http://www.fatf-gafi.org/dataoecd/20/14/41563294.pdf> (identifying any issues that require interpretation/clarification of the FATF standards, the 2004 Methodology (including “horizontal issues”) or regarding FATF procedures; Horizontal Issues arising in the FATF 3rd round of mutual evaluations related to interpretation of Recommendation 17 (sanctions), and 29 (powers to supervise and sanction), R32 and failure to keep statistics, R24 (internet casinos), R5 (CDD in casinos), SR VII (‘domestic wire transfer), SRIX (cross order transfer of funds), effectiveness and consistency in ratings).

¹⁷¹ See FATF METHODOLOGY, *supra* note 22, ¶ 27, at 9. The concept of “other enforceable means” has given rise to serious debate among countries, the issue being what its exact meaning is.

¹⁷² Recommendations that are supplemented by Interpretative Notes include 5, 6, 9, 10-16, 19, 23, 25-27, 38, and 40. TF Recommendations are supplemented by Interpretive Note to SR III relating to freezing and confiscating terrorist assets and Interpretive Note to SR 8 related to Alternative Remittance Systems (unpublished).

¹⁷³ An analysis I carried out recently reveals several areas of inconsistency between the Recommendations and the E.C’s (unpublished).

¹⁷⁴ For example, the definition of “terrorist act” is inconsistent in Article 2 of the UN Convention. UN International Convention for Suppression of the Financing of Terrorism, G.A. Res. 54/109, Article 2, SR II, E.C. II.1 (Dec. 9, 1999).

adapt to new and changing ML/TF environments and activities¹⁷⁵ provides compliance recipients and drivers with tools to deal with an evolving criminal behavior. With ML/FT channels constantly becoming targets of law enforcement and regulatory bodies, perpetrators search for new methods and channels of laundering their illicit money.¹⁷⁶ One evolution in ML/TF techniques is where illicit money is diverted from the financial system through jurisdictions with weak regulations—such as Offshore Financial Centers (OFCs), informal transfer systems,¹⁷⁷ or the use of non-financial sectors, until recently under lesser regulatory oversight. The capacity of the standards to adapt to new challenges, resulting from changing patterns of ML predicate offences and the cohabitation of hard and soft AML/CFT standards,¹⁷⁸ generates greater compliance impulse. The FATF's typological studies on ML/FT trends and patterns, taking into account changing circumstances, are highly valuable in ensuring normative adjustment,¹⁷⁹ expanding the Recommendations to extend the AML/CFT obligations to non-financial businesses, covering shell corporations, cross-border currency monitoring, controlled delivery techniques, bureau de change,¹⁸⁰ and “gatekeepers” such as lawyers, notaries, and accountants, often referred to as DNFBPs (Designated Non-Financial Businesses and Professions).¹⁸¹ A fundamental change in approach developed as a result of money launderers moving away from the financial sectors to the more real economy sectors.¹⁸² New and cutting edge money laundering methodologies represent a tremendous challenge for the financial, regulatory, legal, intelligence, and law enforcement communities.¹⁸³ The explosion of the internet drastically changed the environment for doing

¹⁷⁵ Chinkin, *supra* note 32, at 852; Giovanoli, *supra* note 32, at 12; Cho, *supra* note 32, at 2, 12–15.

¹⁷⁶ BENTON E. GUP, MONEY LAUNDERING, THE FINANCING OF TERRORISM AND SUSPICIOUS ACTIVITIES (2006).

¹⁷⁷ Nick Coates & Mike Rafferty, *Offshore Financial Centres, Hot Money and Hedge Funds: A Network Analysis of International Capital Flows*, in GLOBAL FINANCE IN THE NEW CENTURY: BEYOND DEREGULATION 38, 43 (Libby Assassi, Duncan Wigan & Anastasia Nesvetailova eds., 2007).

¹⁷⁸ See THIRD ROUND OF AML/CFT MUTUAL EVALUATION: PROCESS AND PROCEDURES, *supra* note 170, at 21.

¹⁷⁹ FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 1994-1995 15–17 (1995).

¹⁸⁰ FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 1995-1996 6–10 (1996).

¹⁸¹ As a result of the typologies experts' report issued in February 2002, four recommendations (12, 16, 24 and 25) were created incorporating under AML/CFT regulation additional DNFBP sectors including casinos, real estate agents, dealers in precious metals, dealers in precious stones, lawyers, notaries, other independent legal professionals and accountants, trusts and company service providers. G7/8 Summit Meeting, London, May 9, 1998.

¹⁸² FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 10–11.

¹⁸³ *Id.*; see also FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 2004-2005 (2005); FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 2005-2006 (2006); FATF ANNUAL REPORT 2006-2007, *supra* note 168.

business, allowing hackers and fraudsters to exploit criminal opportunities presented by cyberspace and providing support for cyber-launders—a group eager to wash the proceeds of both virtual and real-life crimes.¹⁸⁴ The FATF addresses new challenges posed by e-cash, online auctioneering, internet gambling, telemarketing fraud, and cyber terrorism¹⁸⁵ in addition to, more recently the football sector's vulnerabilities,¹⁸⁶ by regularly upgrading its norms and strategies.¹⁸⁷ The flexible nature of the Recommendations also enables participation and integration of all interested parties, including non-state actors, in the process of transnational law-making,¹⁸⁸ allowing increased openness which allows for more transparency, enhances agenda setting, and facilitates diffusion of knowledge.¹⁸⁹ In addition, built-in normative flexibility enables the FATF to review the overall substance and framework of the principles and practices that underpin its Recommendations every seven years, ensuring that the lessons from compliance assessments are captured.¹⁹⁰

Following the September 11, 2001 attacks, flexibility is also demonstrated through the integration of the 8 FT SRs¹⁹¹ into the existing AML normative structure, providing greater impetus to the AML compliance framework. It has been suggested that it was the September 11, 2001 attacks that changed the face of ML¹⁹² by providing greater impulse to the existing AML framework. This is comparable to when the growing problem of drug trafficking, not money laundering itself, first drove the AML movement. The 9/11 event elevated ML to a serious threat by virtue of the inextricable link between the financing of terrorism and ML¹⁹³ with the mandate of tracking down the funding of terrorist organizations. The normative and institutional linkage between ML/TF is based on the positive achievements and experiences of the FATF system and the need to bring together the two forms of transferring illicit money. Both are driven by similar criminal sources and methodologies, and both rely on illicit assets to

¹⁸⁴ KOCHAN, *supra* note 98, at xxix–xxxiv.

¹⁸⁵ TREHAN, *supra* note 112, at 5.

¹⁸⁶ FATF ANNUAL REPORT 2008-2009, *supra* note 17, at 5, 10, 17–19.

¹⁸⁷ *Id.*

¹⁸⁸ Reinicke & Witte, *supra* note 78, at 93, 97–100.

¹⁸⁹ Cho, *supra* note 32, at 11–12.

¹⁹⁰ FINANCIAL ACTION TASK FORCE, FATF PROPOSAL FOR A REVIEW OF THE FATF STANDARDS AND THE MUTUAL EVALUATION PROCESS (2008); *see also* FATF ANNUAL REPORT 2008-2009, *supra* note 17.

¹⁹¹ Gilles Favarel-Garrigues, *L'Évolution de la Lutte Anti-Blanchiment depuis le 11 Septembre 2001* [The Evolution of Anti-Money Laundering Since September 11, 2001], 20 *Critique Internationale* (2003), <http://www.ceri-sciencespo.com/publica/critique/article/ci20p37-46.pdf>.

¹⁹² Jackie Johnson, *11th September, 2001: Will it Make a Difference to the Global Anti-Money Laundering Movement?*, 6 *J. MONEY LAUNDERING CONTROL* 9, 10 (2002).

¹⁹³ *Id.* at 9–11.

carry out their activities.¹⁹⁴ Despite divergent views about the benefits of such links based on legitimacy concerns,¹⁹⁵ three arguments favor such association: terrorists have recourse to illicit activities to fund their activities; the two concepts of ML and FT rely on a common concern of the monitoring of the flow of capital; and the FATF's experience in monitoring movement of capital. This strategy of attacking the proceeds of crime, motivated by the concern to impede the laundering of wealth¹⁹⁶ and applied through the banking system to interdict criminal assets, is now being used against terrorists.¹⁹⁷ The integration of TF into the existing ML process and framework exerted greater compliance incentives for both ML/FT when compared with the relatively low levels of compliance prior to 2001, even though ML had been on the international agenda. This strategy has, however, been criticized for its limited success in the context of organized crime because of challenges associated with the difference between property linked to ML and terrorist property,¹⁹⁸ where the predicate offence is a concept defined in respect of a past event. Moreover, the source of terrorist funds may be clean at the point of inception but still be used for a criminal act.¹⁹⁹

The FATF's recent shift from the traditional rule-based system to a more risk-based approach²⁰⁰ to ML/FT demonstrates further benefits of a flexible and adaptable AML/CFT normative system facilitating effective compliance guided by ML/FT risk assessments. Two decades of implementation using a rule-based system led operators who are responsible to screen their clients according to certain risk factors to conclude that a risk-based approach constitutes a vital framework to identify ML/TF risks and vulnerabilities that can facilitate the design of appropriate AML/CFT systems ensuring more effective compliance. Although the language of the FATF Recommendations and 2004 Methodology already allowed countries and financial institutions the flexibility in adopting a risk-based approach,²⁰¹ these provisions had not previously been systematically used as a basis for determining levels of sector or country risks in determining a

¹⁹⁴ Thony, *supra* note 139, at 1, 4–5.

¹⁹⁵ Gilles Favarel-Garrigues, *supra* note 191.

¹⁹⁶ Barry A.K. Rider, *Recovering the Proceeds of Corruption*, 10 J. MONEY LAUNDERING CONTROL 5, 6–7 (2007).

¹⁹⁷ *Id.* at 6–7.

¹⁹⁸ *Id.*

¹⁹⁹ Stefan D. Cassella, *Reverse Money Laundering*, 7 J. MONEY LAUNDERING CONTROL 92, 92 (2003).

²⁰⁰ FINANCIAL ACTION TASK FORCE, GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING (2007), <http://www.fatf-gafi.org/dataoecd/43/46/38960576.pdf> [hereinafter FATF GUIDANCE].

²⁰¹ FATF METHODOLOGY, *supra* note 22, ¶ 23–25, at 8–9; *see also id.* Recommendation 5, Essential Criteria 5.8–5.12, at 17–18 (dealing with risk assessment in financial sector's application of the preventive measures).

country's implementation. The establishment of an Electronic Advisory Group on the risk-based approach in 2006 as a sub-group of the FATF's Working Group on Evaluations and Implementation (WGEI)²⁰² and as part of FATF's outreach to the private sector²⁰³ illustrates the FATF's concern that the AML/CFT compliance strategy should be risk driven. The risk-based approach confirms the evolution of the FATF's normative system from a "one-size-fits-all" to a more embracing approach grounded in an appreciation of country and sector specificities—where both the public and private sectors play an important role. Identifying the types of ML/TF risks depends on the level of development of the country's economy and financial sector. Assessing the level of ML/TF risks, therefore, requires a methodology that integrates these country and sector risk elements. This approach in turn provides a more accurate level of the country's compliance with the AML/CFT standards. This approach raises four critical challenges. First, integrating risks into a compliance framework should be approached with caution as such an approach could hamper the creation of a level playing field with comparisons among assessment results potentially undermining the AML/CFT strategy. Second, it is crucial to determine the advent of the risk-based approach signals, the end of the rule-based approach. Third, it makes more sense to develop a combined approach relying on both rules and risks, avoiding, however, a perception that a risk-based approach leans more from state-focused towards non-state influence, and undermining the rule-based approach. Finally, the implications of the risk-based approach raise intricate issues of policy for existing assessments conducted that have so far been conducted on a rule-based approach and should be examined further.

The cohabitation of hard and soft AML/CFT norms has significantly influenced the AML/CFT normative structure, which illustrates the impact on compliance of integrating hard law standards into soft type rules and building confidence among parties. The complementary character of the two types of norms has frequently been underlined and preferred to an approach based on rigid segregation. In fact, soft law rarely stands in isolation; instead, although it is used most frequently either as a supplement to a hard-law instrument or as a precursor leading to an accreditation of hard law,²⁰⁴ it is described as "way-stations on the road to the conclusion of a treaty."²⁰⁵ Three aspects of the FATF 40 + 9 Recommendations are closer

²⁰² FATF REVISED MANDATE 2008-2012, *supra* note 46, at 4; FINANCIAL ACTION TASK FORCE, THE FATF WORKING GROUP ON EVALUATIONS AND IMPLEMENTATION 4 (2008); FATF GUIDANCE, *supra* note 200, at 1.

²⁰³ FATF GUIDANCE, *supra* note 200, at 1; *see also* FINANCIAL ACTION TASK FORCE, FATF MONEY LAUNDERING AND TERRORIST FINANCING RISK ASSESSMENT STRATEGIES 2 (2008), <http://www.fatf-gafi.org/dataoecd/46/24/40978997.pdf> [hereinafter FATF RISK ASSESSMENT STRATEGIES].

²⁰⁴ Shelton, *supra* note 54, at 320; *see also* Sindico, *supra* note 69, at 829.

²⁰⁵ Giovanoli, *supra* note 32, at 5.

to hard law qualification: the dependence for the criminalization of ML/TF offences on the definition provided for in the UN Convention; the obligation to ratify the relevant instruments on Terrorism; and the provisions of the UNSC Resolutions 1373 and 1267 on the financing of terrorism. Criminalization of the ML offense pursuant to FATF Recommendation I has its origin in, and depends on, the definition of the ML offence in the 1988 UN Vienna Convention on Drugs and the 2000 Palermo UN Convention on Organized Crime. The cross-reference to the UN Conventions in designing and implementing the FATF ML offense provides a good illustration of the interaction between a hard law (UN Conventions) and a soft law instrument (FATF Recommendations).²⁰⁶ From an implementation perspective, added impetus is gained by countries ensuring their obligation to ratify and incorporate these two UN Conventions or the offenses into their domestic legal systems. Similarly, criminalization of the TF offense under FATF Special Recommendation II is conditioned by the UN Convention on the Suppression of the Financing of Terrorism 1999 provisions,²⁰⁷ which dictates that countries “should sign, ratify, or otherwise become a party to, and fully implement” pursuant to SR I. Another TF related example of this interaction between soft and hard law norms is illustrated in the obligation that countries “should fully implement the United Nations Security Council Resolutions relating to the prevention and suppression of FT,” including S/RES/1267(1999) and its successor resolutions and S/RES/1373 (2001).²⁰⁸ These provisions are, in turn, supported by a more general reference in Recommendation 35 that countries should take immediate steps to become party to and implement fully the Vienna Convention, the Palermo Convention, and the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism, reinforcing the validity and applicability of such cohabitation of hard and soft law provisions in the context of the AML/CFT implementation. The ratification by a large number of countries of those treaties should provide a stronger basis for complying with those FATF Recommendations that are related to provisions in those treaties.²⁰⁹ This

²⁰⁶ The obligation that “countries should criminalize money laundering on the basis of [Article 3(1)(b) & (c) of] the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the Vienna Convention) and [Article 6 (1) of] the United Nations Convention against Transnational Organized Crime, 2000 (the Palermo Convention)” indicates the interplay of soft and hard law. FATF 40 RECOMMENDATIONS, *supra* note 13, Recommendation 1, at 3.

²⁰⁷ Special Recommendation II expressly creates the obligation that Terrorist Financing should be criminalized and is consistent with Article 2 of the Terrorist Financing Convention. FINANCIAL ACTION TASK FORCE, FATF IX SPECIAL RECOMMENDATIONS 2 (2001), available at <http://www.fatf-gafi.org/dataoecd/8/17/34849466.pdf>.

²⁰⁸ See S.C. Res. 1267, U.N. Doc. S/RES/1267 (Oct. 15, 1999); see also S.C. Res. 1373, U.N. Doc. S/RES/1373 (Sept. 28, 2001).

²⁰⁹ One hundred eighty-one countries have ratified the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 150 have ratified the UN

cohabitation of soft and hard law strengthens the normative value of the AML/CFT standards, and thereby their accompanying legalization, and has therefore been integral in building consensus for compliance among countries.

B. The FATF Institutional Framework: International and Regional Cooperation

The FATF represents an instrument of international cooperation created and operated by states to ensure world order by carrying out specific functions,²¹⁰ where its AML/CFT standards constitute the “persistent and connected sets of rules that prescribe behavioral roles, constrain activity and shape compliance expectations.”²¹¹ The failure and inefficiency of unilateral actions by states to address ML/FT concerns effectively²¹² led to the design of a concerted multilateral initiative²¹³ driven by the FATF, which provided greater dynamism and impulse, shaping up a stronger international AML/CFT regime. Associated with the growing use of soft power regulating international finance²¹⁴ and issues of international interest²¹⁵ such as ML/TF, the AML/CFT normative instruments²¹⁶ became a focal point for maximizing compliance. The AML/CFT system helps

Convention on Transnational Organized Crime, and 169 countries have ratified the UN Convention on the Suppression of the Financing of Terrorism (9 December 1999). FATF ANNUAL REPORT 2008-2009, *supra* note 17.

²¹⁰ Gayl D. Ness & Steven R. Brechin, *Bridging the Gap: International Organizations as Organizations*, 42 INT’L ORG. 245, 246 (1988); Harold K. Jacobson, William M. Reisinger & Todd Mathers, *National Entanglements and International Government Organizations*, 80 AM. POL. SCI. REV. 141, 142, 149, 152 (1986).

²¹¹ ROBERT O. KEOHANE, INTERNATIONAL INSTITUTIONS AND STATE POWER: ESSAYS IN INTERNATIONAL THEORY 3 (1989).

²¹² WILLIAM C. GILMORE, DIRTY MONEY: THE EVOLUTION OF MONEY LAUNDERING COUNTER-MEASURES 23 (1995).

²¹³ Phyllis Solomon, *Are Money Launderers All Washed Up in the Western Hemisphere? The OAS Model Regulations*, 17 HASTINGS INT’L & COMP. L. REV. 433, 441, 454 (1994).

²¹⁴ Reinicke & Witte, *supra* note 78, at 76.

²¹⁵ INSTITUTIONS FOR THE EARTH: SOURCES OF EFFECTIVE INTERNATIONAL ENVIRONMENTAL PROTECTION (Peter M. Haas, Robert O. Keohane & Marc A. Levy eds., 1993); James G. March & Johan P. Olsen, *The Institutional Dynamics of International Political Orders*, 52 INT’L ORG. 943, 948 (1998).

²¹⁶ FATF ANNUAL REPORT 2008-2009, *supra* note 17, at 6.

The four key objectives of [the FATF 2004-2012] mandate are to:

- Revise and clarify the global standards and measures for combating money laundering and terrorist financing.
- Promote global implementation of the [FATF] standards.
- Identify and respond to new money laundering and terrorist financing threats.
- Engage with stakeholders and partners throughout the world.

Id. See generally FATF REVISED MANDATE 2008-2012, *supra* note 46.

reduce likelihood of defection²¹⁷ by resolving ambiguity or indeterminacy of norms, supervising the instruments that create them, and assisting regulatory targets in overcoming capacity deficits to comply through technical assistance.²¹⁸ Established in 1989, the FATF is today well known as the recognized standard-setter in the fight against ML/FT²¹⁹ and has emerged as a powerful force shaping the international AML/CFT norms.²²⁰ It distills through institutional networks information to its members in the form of best practices on ML/FT, seeking to maximize compliance.²²¹ The identity-forming organizational changes undergone by the FATF—inevitable for its survival as an international organization—define and upgrade its organizational goals and regulate behaviors of its members and the organization itself.²²² The history and purpose, legalized system, reinforced monitoring and sanctions mechanisms, and regional setups strengthened the FATF's identity and perception as a pillar entity spearheading the international AML/CFT standards²²³ and generating compliance impulse.

The history of the FATF provides background information about its identity.²²⁴ Its formation and continuing evolution from April 1989 to the present is inextricably tied up with the G7's concerns²²⁵ about the negative impact of evolving global criminal activities and the movement of illicit funds across the globe.²²⁶ The G7's call for member states and nonmember states "to participate in the fight against money laundering and to fully implement all the FATF recommendations without delay"²²⁷ has been critical in the FATF's development and policy-making functions.²²⁸ Following the establishment of the FATF as a task force by the G7, its continued existence as the leading institutional framework on AML/CFT is confirmed in the continuous renewal of its mandate, initially for a period of

²¹⁷ Kenneth W. Abbott, *Modern International Relations Theory: A Prospectus for International Lawyers*, 14 YALE J. INT'L L. 335, 354–55 (1989).

²¹⁸ Shelton, *Introduction*, *supra* note 25, at 2.

²¹⁹ Alexander, *supra* note 14, at 67.

²²⁰ *Id.* at 72; Johnson & Lim, *supra* note 40, at 12, 18.

²²¹ See generally JOSE E. ALVAREZ, *INTERNATIONAL ORGANIZATIONS AS LAW-MAKERS* (2006).

²²² Ness & Brechin, *supra* note 210, at 246; Jacobson, Reisinger & Mathers, *supra* note 210.

²²³ Johnson & Lim, *supra* note 40, at 9.

²²⁴ FINANCIAL ACTION TASK FORCE, *TWENTY YEARS OF THE FATF RECOMMENDATIONS, 1990-2010* (2010), available at <http://www.fatf-gafi.org/dataoecd/39/16/45556642.pdf>.

²²⁵ The decisions of different G7 Summit Meetings can be accessed through the G7's website: <http://www.g7.utoronto.ca/summit/index.htm> [hereinafter *Decisions of G7 Meetings*].

²²⁶ See *id.* (explaining the G7's concerns about the negative effects of money laundering).

²²⁷ Houston Economic Declaration, *supra* note 10.

²²⁸ See generally *Decisions of G7 Meetings*, *supra* note 225.

two years²²⁹ and subsequently for a continuous period of eight years.²³⁰ The G7 1991 London Summit's endorsement of the FATF as a permanent institution with a secretariat supplied by the OECD²³¹ and its AML Recommendations provided legitimacy and formalization to the FATF process as the international standard-setter of ML norms. Since then, the FATF history has been characterized by critical junctures in its organizational development, reflected in the constant changes shaping up its normative and institutional permanency with its own internal dynamics and external working relations. The organization gradually started to exert an identity of its own upon member countries, and as the process deepened, its identity prevailed upon even powerful states' interests and preferences. The growing institutionalization of the FATF as a distinct entity confirms the permanence of its operations in the area of international ML/FT. This distinctiveness is reflected in its specific "technology," defined in terms of its capacity to achieve its goals through its discourses ('software'), operational apparatus ('hardware'),²³² its membership, Ministerial Meeting, Plenary meetings, Working Groups and Committees, and the FATF Secretariat and staff ('humanware'). This "technology" which characterizes its dynamic process of identity formation and continued survival rests on the range of its products and services, including conducting country assessments, outreach, developing and adapting its norms, and carrying out typologies work on ML/FT trends. Its institutional setup continues to develop with a gradually growing membership and a full-fledged bureaucracy informed by the FATF's bi-annual accountability to the Finance Ministers' Plenary Meetings.²³³ This has led to the FATF's creation of norms and social knowledge as opposed to it being a mere passive machinery of its creators.²³⁴ Its institutional structure and functions have also been significantly enhanced by highly successful compliance monitoring²³⁵ and sanction mechanism and typologies studies on ML/FT trends. This transformative process defined as "organizational learning"—a purposeful behavior to increase IOs' problem-solving capacities to achieve

²²⁹ Economic Declaration of the Summit of the Arch, *supra* note 10, ¶ 53; Houston Economic Declaration, *supra* note 10, ¶ 78.

²³⁰ FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 2003-2004 1 (2004), available at <http://www.fatf-gafi.org/dataoecd/12/44/33622501.PDF>; London Economic Summit, London, Eng., July 15-17, 1991, *Economic Declaration: Building World Partnership*, ¶ 61, available at <http://www.g7.utoronto.ca/summit/1991london/communique/drug.html>; FATF REVISED MANDATE 2008-2012, *supra* note 46, at 2-3 (elaborating on the history of the FATF since its creation as well as its achievements).

²³¹ See London Economic Summit, London, Eng., July 15-17, 1991, available at <http://www.g7.utoronto.ca/summit/1991london/index.html>.

²³² Cho, *supra* note 32, at 19-20.

²³³ FATF REVISED MANDATE 2008-2012, *supra* note 46, at 5.

²³⁴ Michael N. Barnett & Martha Finnemore, *The Politics, Power, and Pathologies of International Organizations*, 53 INT'L ORG. 699, 699, 700, 704-06 (1999).

²³⁵ FATF METHODOLOGY, *supra* note 22.

certain institutional goals—has been critical in shaping up FATF members' and nonmembers' behavior with the AML/CFT standards. Moving beyond conventional theory which limits analytical focus of IO to the establishment process, the FATF institutional set up has now evolved into a separate and autonomous organic entity, molding itself as it interacts with the environment in which it is located.²³⁶ It no longer fits the traditional description of a mere "ad hoc grouping of governments and others with a complex single issue agenda,"²³⁷ but it resembles more of a permanent and fully functional international organization managing a set of legally, albeit non-binding norms. Although the FATF has developed some level of autonomy in its operations and management, its initial 'programmed purpose' allows it to maintain the link with the states that created it. It is now recognized as one, if not the most, influential international organization in the international campaign against both ML and FT.

The constantly evolving normative structure of the FATF system,²³⁸ which leads to greater institutionalization, has enhanced and provided more sustainability to its identity formation. Confronted with changing demands resulting from testing situations,²³⁹ it has regularly reconfigured its institutional setting²⁴⁰ (through regular reviews of its norms)²⁴¹ and adapted itself into a more dynamic institutional framework enabling it to perform its functions²⁴² and confirm its relevance as a permanent forum. This expansion of its role and functions to address TF issues on a global scale, providing a platform and process to identify jurisdictions that facilitate TF²⁴³ and strengthening cooperation networks, significantly reinforced the FATF setup and its compliance role.²⁴⁴ The increased "legalization" and "judicialization" of the FATF process with the mandatory obligations, compliance monitoring mechanism, and sanctions, contributed greatly to its institutionalization, ensuring greater compliance. Although it does not have a treaty-based formation, it nevertheless enjoys sufficient legal authority over the creation of the norms and their implementation across the world.

²³⁶ Cho, *supra* note 32, at 2, 12–15.

²³⁷ R.M. Pecchioli, *The Financial Action Task Force* (Paper presented at the Council of Europe Money Laundering Conference, Strasbourg, 28-30 September, 1992), in WILLIAM C. GILMORE, *DIRTY MONEY, THE EVOLUTION OF MONEY LAUNDERING COUNTERMEASURES* 92 (Council of Eur. Publ'g ed., 1999).

²³⁸ FATF REVISED MANDATE 2008-2012, *supra* note 46, at 2.

²³⁹ The clearest example of a testing situation has been the integration of the TF international standards into the existing AML normative and institutional structure.

²⁴⁰ FATF REVISED MANDATE 2008-2012, *supra* note 46, at 2, 4.

²⁴¹ *Id.* at 2.

²⁴² *Id.* at 3–4.

²⁴³ G8 Finance Ministers' Meeting, Statement of the G7 Finance Ministers and Central Bank Governors (Oct. 6, 2001), available at <http://www.g7.utoronto.ca/finance/fm100601.htm>.

²⁴⁴ G8 Finance Ministers' Meeting, Statement of G7 Ministers of Finance (Sept. 25, 2001), available at <http://www.g7.utoronto.ca/finance/fm010925.htm>.

Production of noticeable juridical products in the form of international quality guidelines or Best Practices and Interpretative Notes, arising out of socialization among networks of public and private sector actors,²⁴⁵ illustrates the evolving nature of the FATF institutional setup.

Integrating the AML/CFT strategy as part of other international and regional organizations' work further consolidated the FATF institutional system and provided an expanded platform for the implementation of the standards globally. The assumption is that nation states prefer cooperation to confrontation and participate in a variety of forums "contributing to the net welfare of the global community."²⁴⁶ The international reach of the AML/CFT regime is borne out by the engagement of different institutions in promoting the FATF standards, including the United Nations and its three Conventions criminalizing ML and TF offences,²⁴⁷ the International Monetary Fund (IMF) and the World Bank (WB),²⁴⁸ the Council of Europe's different instruments against ML,²⁴⁹ and the Egmont Group,²⁵⁰ which provide a forum for discussing issues related to suspicious reporting transactions with its 116 FIUs from countries.²⁵¹ In addition, private

²⁴⁵ See SLAUGHTER, *supra* note 92, at 3–6, 10.

²⁴⁶ William E. Holder, *The International Monetary Fund's Involvement in Combating Money Laundering and the Financing of Terrorism*, 6 J. MONEY LAUNDERING CONTROL 383, 387 (2003).

²⁴⁷ United Nations Convention against Illicit Traffic in Narcotics Drugs and Psychotropic Substances, ("The Vienna Convention" 1988); United Nations Convention against Transnational Organized Crime; G.A. Res. 55/25, U.N. Doc. A/RES/55/25 (Nov. 15, 2000) ("The Palermo Convention" 2000); International Convention for the Suppression of the Financing of Terrorism, G.A. Res. 54/109 A/RES/54/109 (Dec. 9, 1999).

²⁴⁸ The IMF and WB assist their member countries by conducting assessments and providing technical assistance focused on legal, regulatory, and supervisory frameworks. INT'L MONETARY FUND, THE IMF AND THE FIGHT AGAINST MONEY LAUNDERING AND THE FINANCING OF TERRORISM (2010), <http://www.imf.org/external/np/exr/facts/aml.htm>; Summing Up by the Acting Chair—Anti-Money Laundering and Combating the Financing of Terrorism—Proposals to Assess a Global Standard and to Prepare ROSCs, Executive Board Meeting 02/80, July 26, 2002, in 34 SELECTED DECISIONS AND SELECTED DOCUMENTS OF THE INTERNATIONAL MONETARY FUND (2009) at 133, available at http://www.imf.org/external/pubs/ft/sd/2010/Selected_decisions_and_selected_documents_of_the_International_Monetary_Fund_Thirty-fourth.pdf.

²⁴⁹ Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Nov. 8, 1990, ETS No. 141, Council Directive 91/30/EEC; Council Directive 91/308/EEC, 1991 O.J. (L 166) 77; Council Directive 05/60/EC, 2005 O.J. (L 309) 15; see also FIN. SERVS. AUTH., THE MONEY LAUNDERING REGULATIONS 2007 (2007), http://www.fsa.gov.uk/Pages/About/What/financial_crime/money_laundering/3mld/index.shtml.

²⁵⁰ The Egmont Group is an international organization made up of national Financial Intelligence Units (FIUs) and is responsible for receiving, analyzing, and disseminating to competent authorities disclosures received from the respective financial and non-financial sectors. *About the Egmont Group*, THE EGMONT GROUP (2009), <http://www.egmontgroup.org/about>.

²⁵¹ FATF Recommendation 26 requires countries to "establish a FIU that serves as a

AML/CFT initiatives provided an extended reach to non-state actors through financial and non-financial organizations.²⁵² The cumulative effect of cooperation among those agencies led to greater compliance by both state and non-state actors. Their role and participation in promoting the AML/CFT standards has been far from marginal, albeit at times frustrating, at the same time addressing legitimacy concerns arising from the FATF's limited geographical coverage.²⁵³ The G7 constant calls²⁵⁴ on the IMF and WB to endorse the FATF 40+9 Recommendations as the appropriate international standards and to complete their collaborative work for assessing countries compliance with the standards led to the endorsement and incorporation of a ROSC module on AML/CFT as part of their Financial Sector Assessment Program (FSAP). This highlights the link between ML/FT and financial sector stability.²⁵⁵ The IMF's AML/CFT mandate is encapsulated in the Board's decisions²⁵⁶ which emphasize the

national center for the receiving . . . analysis and dissemination" of suspicious transactions "regarding potential money laundering or terrorist financing." FATF 40 RECOMMENDATIONS, *supra* note 13, at 10–11.

²⁵² These include the Basel Committee on Banking Regulation and Supervisory Practices, the IOSCO, and the IAIS.

²⁵³ McFarlane, *supra* note 36, at 301–02, 307.

²⁵⁴ G8 Finance Ministers' Meeting, Strengthening the International Financial System and the Multilateral Development Banks (July 7, 2001), *available at* <http://www.g7.utoronto.ca/finance/fm010707.htm>; G8 Finance Ministers' Meeting, Statement of G-7 Finance Ministers and Central Bank Governors (Feb. 9, 2002), *available at* <http://www.g7.utoronto.ca/finance/fm020902.htm>; G8 Finance Ministers' Meeting, Statement of G-7 Finance Ministers and Central Bank Governors (Apr. 20, 2002), *available at* <http://www.g7.utoronto.ca/finance/fm022004.htm>; Report from G7 Finance Ministers to the Heads of State and Government, Actions Against Abuse of the Global Financial System (July 21, 2000), *available at* <http://www.g7.utoronto.ca/summit/2000okinawa/abuse.htm>.

²⁵⁵ Public Information Notice No. 04/33, Int'l Monetary Fund, IMF Executive Board Reviews and Enhances Efforts for Anti-Money Laundering and Combating the Financing of Terrorism (Apr. 2, 2004), *available at* <http://www.imf.org/external/np/sec/pn/2004/pn0433.htm>; Press Release No. 02/52, Int'l Monetary Fund, IMF Executive Board Approves 12-Month Anti-Money Laundering Pilot Project (Nov. 22, 2002), *available at* <http://www.imf.org/external/np/sec/pr/2002/pr0252.htm>.

²⁵⁶ Public Information Notice No. 01/41, Int'l Monetary Fund, IMF Executive Board Discusses Money Laundering (Apr. 29, 2001), *available at* <http://www.imf.org/external/np/sec/pn/2001/pn0141.htm>; Int'l Monetary Fund, Monetary and Exch. Affairs & Pol'y Dev. and Review Dep'ts, Financial System Abuse, Financial Crime and Money Laundering (Background Paper SM/01/46, 2001); Int'l Monetary Fund & World Bank, Enhancing Contributions to Combating Money Laundering, (Policy Paper SM/01/103, 2001); Press Release No. 01/47, Int'l Monetary Fund, Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund (Nov. 17, 2001) *available at* <http://www.imf.org/external/np/sec/pr/2001/pr0147.htm>; Int'l Monetary Fund, Monetary & Exch. Affairs Dep't, Offshore Financial Centers—The Role of the IMF (June 23, 2000), *available at* <http://www.imf.org/external/np/mae/oshore/2000/eng/role.htm>; Int'l Monetary Fund & World Bank, Financial Sector Assessment Program (FSAP)—A Review: Lessons from the Pilot and Issues Going Forward (Nov. 27, 2000), *available at* <http://www.imf.org/external/np/fsap/2001/review.htm>; Int'l Monetary Fund,

IMF's contribution as part of its core Article IV surveillance mandate based on the macroeconomic relevance of ML/TF argument. AML/CFT assessments continue to be included in all FSAPs and OFC Programs²⁵⁷ if it is a WB or IMF assessment or an FSRB mutual evaluation.²⁵⁸ Since then, the IMF's involvement in AML/CFT has been "fast-moving, intensive, and consequential for the international community" and has "permeated its work program."²⁵⁹

The establishment of several regional bodies as Associate Members and FATF-Styled Regional Bodies (FSRBs) with the shared objectives of promoting cooperation among their respective regions in matters relating to the AML/CFT international standards provides an invaluable regional outreach platform to FATF by adding greater impulse to compliance.²⁶⁰ With a membership accounting for over two-thirds of the UN member states, these regional organizations constitute an additional force ensuring wider coverage of the AML/CFT standards across the globe.²⁶¹ Mandated to promote the AML/CFT standards in the region and evaluate countries' compliance, undertake ML/TF typologies, and build capacity,²⁶² the regional organizations are the primary partners of the FATF and have important leadership roles in their regions.²⁶³ Mutual participation in their plenary meetings²⁶⁴ allows for closer coordination and monitoring of the AML/CFT activities. This interaction between the FATF, FSRBs, and other international organizations allows for greater coordination in ensuring compliance among member countries and identifying patterns and inconsistencies in countries' mutual evaluation in the assessments being carried out by the FSRBs, IMF, and WB, as opposed to those carried out by

Monetary & Exch. Affairs Dep't, Experience with Basel Core Principles Assessments (Apr. 12, 2000), available at <http://www.imf.org/external/np/mae/bcore/exp.htm>.

²⁵⁷ See Public Information Notice No. 04/33, Int'l Monetary Fund, IMF Executive Board Reviews and Enhances Efforts for Anti-Money Laundering and Combating the Financing of Terrorism (Apr. 2, 2004), available at <http://www.imf.org/external/np/sec/pn/2004/pn0433.htm>.

²⁵⁸ INT'L MONETARY FUND & WORLD BANK, TWELVE-MONTH PILOT PROGRAM OF ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT) ASSESSMENTS (2004), available at <http://www.imf.org/external/np/aml/eng/2004/031604.pdf>.

²⁵⁹ Holder, *supra* note 246, at 387.

²⁶⁰ *Id.*; see also *Members and Observers*, FATF, http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236869_1_1_1_1_1,00.html (last visited Jan. 21, 2011).

²⁶¹ See FATF ANNUAL REPORT 2008-2009, *supra* note 17, at 6, 13-15 & Annexes 3 & 4 at 30-36.

²⁶² See, e.g., GIABA, ANNUAL REPORT 2007 OF THE INTER-GOVERNMENTAL ACTION GROUP AGAINST MONEY LAUNDERING AND THE FINANCING OF TERRORISM IN WEST AFRICA (2008).

²⁶³ FATF REVISED MANDATE 2008-2012, *supra* note 46, at 3.

²⁶⁴ The FSRBs are recognized as associate members of FATF and participate in its plenary meeting while the FATF is represented in the FSRBs' meetings.

the FATF. Variances in the manner and substance of assessments provide valuable indicators about compliance levels. While not always perfect, cooperation and collaboration among those institutions has not only strengthened the FATF system but has played an important part in mobilizing support for the standards. Such cooperation is an important determinant of compliance with the international AML/CFT standards and often drives the compliance process forward by generating a compliance impetus. However, the international strategy and cooperation against ML/FT remains fragmented and often suffers from a lack of coherence, cohesion, and sustained coordination. There is also considerable overlap and duplication in activities carried out by those international and regional organizations.

C. Compliance Monitoring Mechanisms: The FATF Mutual Evaluation Process

The landmark achievement of the FATF regime has been its comprehensive monitoring process of countries' compliance with the AML/CFT standards. For this process, FATF relies on international law and international relations concepts such as compliance, implementation, and effectiveness. Compliance, implementation, and effectiveness constitute three critical stages in the FATF methodology to assess countries' implementation of the AML/CFT standards. The monitoring process,²⁶⁵ designed to evaluate countries' behavior or misbehavior towards their international obligations, acts as significant inducement for compliance. Relying on information disclosed about countries' existing AML/CFT systems,²⁶⁶ it provides early warning of violations (reducing fear of free-riding), confirms countries' reputations, and indirectly deters non-compliance by increasing the likelihood of detection.²⁶⁷ Supported by a delegation of its assessment mandate to regional groupings (FSRBs) and the NCCT sanctions process, the FATF peer review mechanism developed into a credible compliance assessment process of both members and nonmembers' compliance with its standards and despite the soft nature of its norms, acts as a disincentive to non-compliance, yielding positive results. Its performance and achievements are captured in countries' adoption of legislation and their participation in the assessment process. Mutual evaluation of countries by FATF and other regional and international organizations using the FATF Methodology 2004 strengthened

²⁶⁵ References to the FATF AML/CFT assessment process in this paper should be read as including AML/CFT assessments conducted by the International Monetary Fund, World Bank, and FATF-Styled Regional Bodies, which carry out their evaluation using the same the FATF 40+9 Recommendations and its 2004 Methodology and other documents.

²⁶⁶ The onus of providing relevant information is on the country.

²⁶⁷ The NCCT process acts as a surveillance mechanism overseeing whether countries are complying with their obligations.

the credibility of its norms and process, forcing participation and involvement where countries become more proactive in enforcement.²⁶⁸ Greater participation in the process is illustrated by the growing number of countries that have subjected themselves to the mutual evaluation process and having either adopted AML/CFT legislation or made commitments to that effect.²⁶⁹ FATF's multiple rounds of countries' evaluations²⁷⁰ has now reached a level of performance not reached in the past. The number of countries assessed using the 2004 Methodology grew to 145 during 2004-2009, of which 123 assessment reports have been published.²⁷¹ Mutual evaluation reports are now public, enabling a better appreciation of achievements and ensuring greater transparency.²⁷² In addition, the direct endorsement of the FATF standards by 180 jurisdictions, representing more than 85% of the world, confirms the long and effective reach of its compliance arm.²⁷³ Its international and regional network collaborates with other organizations,²⁷⁴ providing the FATF a wider geographical network with a greater scope for more effective coverage and implementation of the standards.²⁷⁵

This growing "judicialization" of the FATF process is best understood in the context of the impact of law and legalization on states' behavior and based on the presumption that legal rules generate an expectation of compliance.²⁷⁶ Two aspects of the FATF assessment process are critical to understanding the impulse it generated for compliance with its AML/CFT norms. First, the participatory nature and transparency associated with its detailed and comprehensive mutual evaluation procedures and processes have encouraged and facilitated countries' involvement in the process. Second, and most important, is its distinctiveness, characterized by reliance on the three fundamental concepts of compliance, implementation and effectiveness,²⁷⁷ which enables a comprehensive assessment of countries' compliance with their AML/CFT obligations.²⁷⁸ Although, theoretically, a

²⁶⁸ Johnson & Lim, *supra* note 40, at 18.

²⁶⁹ FATF ANNUAL REPORT, 2008-2009, *supra* note 17, Annexes 3 & 4, at 30-36.

²⁷⁰ *A Note from the President*, *supra* note 2, at 1.

²⁷¹ FATF ANNUAL REPORT 2008-2009, *supra* note 17, Annex 4.

²⁷² See Jackie Johnson, *Is the Global Financial System AML/CFT Prepared?*, 15 J. FIN. CRIME 7, 8-9 (2008).

²⁷³ FATF ANNUAL REPORT 2007-2008, *supra* note 45, at ii.

²⁷⁴ FATF REVISED MANDATE 2008-2012, *supra* note 46, at 2-3; FATF Annual Report 2007-2008, *supra* note 45, at i.

²⁷⁵ For a detailed list of regional organizations, see note 47.

²⁷⁶ Raustiala & Slaughter, *supra* note 19, at 538.

²⁷⁷ For a detailed analysis of these three concepts in compliance theory, see *id.*; see also Jose E. Alvarez, *Foreword: Why Nations Behave*, 19 MICH. J. INT'L. L. 303 (1998); Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 387-439; see also Benedict Kingsbury, *The Concept of Compliance as a Function of Competing Conceptions of International Law*, 19 MICH. J. INT'L. L. 345 (1998).

²⁷⁸ A parenthesis is required at the outset to distinguish between "compliance" as a

disjunctive application of these concepts to determine a country's compliance is possible, the FATF approach illustrates that recourse to a methodology integrating all three concepts offers greater expectations of compliance. However, any overlap or inconsistency in the interpretation and use of these concepts, their linkages and interchangeability, and their influence on the various determinants present complexities, which often blur compliance analysis and conclusions.²⁷⁹

Replacing the previous self-assessment process, which relied on countries' own assessments²⁸⁰ and were riddled with reliability and credibility concerns,²⁸¹ the FATF's new third-party mutual evaluation process fulfills two main functions. Based on assessment by independent experts, it seeks to identify whether countries' regulatory, supervisory, and institutional systems are in conformity with the FATF AML/CFT Recommendations²⁸² and serves to highlight weaknesses accompanied by appropriate recommendations.²⁸³ Greater involvement of countries in the process is ensured by the depth of the FATF compliance assessment process, illustrated by the three-step procedure²⁸⁴ with specific timeframes: the FATF's basic instruments for conducting assessment, including the 40+9 AML/CFT Recommendations, the FATF Methodology, comprised of 215 Essential Criteria²⁸⁵ and 37 Additional Elements.²⁸⁶ Countries' responsibilities to provide relevant information and data necessary to complete the detailed questionnaire, to organize meetings and participate in the on-site visit of experts, and to provide comments on the draft report guarantee fairness and transparency on procedural and substantive issues and allow greater involvement.²⁸⁷ Countries' ownership of the compliance assessment process is a critical element in motivating greater compliance.

generic term, commonly used in theoretical debates to describe overall conformity with international obligations, distinct from "compliance" as a specific step in the three-tier process of ensuring conformity.

²⁷⁹ Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 404.

²⁸⁰ FATF ANNUAL REPORT 2003-2004, *supra* note 230, at 8–10.

²⁸¹ See Johnson & Lim, *supra* note 40, at 9.

²⁸² FATF METHODOLOGY, *supra* note 22, at 3–5.

²⁸³ *Id.* at 3–6.

²⁸⁴ See FINANCIAL ACTION TASK FORCE, AML/CFT EVALUATIONS AND ASSESSMENTS: HANDBOOK FOR COUNTRIES AND ASSESSORS 13–14 (2009), available at <http://www.fatf-gafi.org/dataoecd/7/42/38896285.pdf> [hereinafter FATF HANDBOOK].

²⁸⁵ See FATF METHODOLOGY, *supra* 22, for the Essential Criteria for each Recommendation.

²⁸⁶ *Id.* at 7. The additional elements are options that can further strengthen the AML/CFT system and may be desirable. They are derived from the non-mandatory elements in the FATF Recommendations or from Best Practice and other guidance issued by the FATF. Although they form part of the overall assessment, they are not mandatory and are not assessed for compliance purposes.

²⁸⁷ FATF HANDBOOK, *supra* note 284, at 7–9.

Their power to challenge experts' conclusions regarding their performance and ratings,²⁸⁸ after taking cognizance of the draft assessment report and their right to determine publication of the report, provides such a sense of ownership. The expectation is for a level playing field with the production of an objective and consistent report based on shared understanding of the country's onus to provide relevant and accurate information and for the assessors to exercise judicious judgment in reaching their conclusions about levels of compliance.²⁸⁹ On a more substantive level, however, it is the comprehensive approach adopted by the FATF monitoring mechanism that has been highly instrumental in providing greater dynamism to countries' compliance.

The distinctive feature of the FATF assessment monitoring process, however, remains its comprehensive approach integrating compliance, implementation, and effectiveness as three distinct but interrelated concepts.²⁹⁰ Pioneered by Professor Jacobson and Weiss,²⁹¹ these concepts expanded academic perspectives on compliance²⁹² and provided a new approach to the debate about how nations behave²⁹³ and allowing different perspectives for academic and policy dialogues.²⁹⁴ Implementation is

²⁸⁸ Ratings are allocated according to four categories including: Compliant (C), Largely Compliant (LC), Partially Compliant (PC) and Non-Compliant (NC). NC: there are major shortcomings with a large majority of the essential criteria not being met; PC: some substantive action has been taken, and there is compliance with some of the essential criteria; LC: only minor shortcomings with a large majority of the essential criteria being fully met; C: the Recommendation is fully observed with respect to all its essential criteria.

²⁸⁹ FATF HANDBOOK, *supra* note 284, at 12.

²⁹⁰ The FATF Methodology states:

It is essential that all the FATF Recommendations are effectively implemented, and that assessments or evaluations address this issue and reflect it in the rating. The fundamental point . . . is that reports will not only assess formal compliance with the FATF Recommendations, but will also assess compliance having regard to whether the Recommendations have been implemented effectively.

FATF METHODOLOGY, *supra* note 22, at 7. The Methodology constitutes the cornerstone of the FATF monitoring mechanism whereby countries' compliance and implementation of the AML/CFT is assessed.

²⁹¹ For more background, see generally Harold K. Jacobson & Edith Brown Weiss, *Strengthening Compliance with International Environmental Accords: Preliminary Observations from a Collaborative Project*, 1 GLOBAL GOVERNANCE 119 (1995) and ENGAGING COUNTRIES: STRENGTHENING COMPLIANCE WITH INTERNATIONAL ENVIRONMENTAL ACCORDS (Edith B. Weiss & Harold K. Jacobson eds., 1998).

²⁹² See *supra* note 277 (citing authors Kal Raustiala, Anne-Marie Slaughter, Jose E. Alvarez, and Benedict Kingsbury). See also Shelton, *Introduction*, *supra* note 25, at 5; Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 392.

²⁹³ Alvarez, *supra* note 277, at 303–04; Daniel E. Ho, *Compliance and International Soft Law: Why Do Countries Implement the Basel Accord?*, 5 J. INT'L ECON. L. 647, 649 (2002).

²⁹⁴ Jacobson & Weiss, *supra* note 291, at 123–25.

distinguishable from compliance²⁹⁵ and refers to the transposition into the domestic legal system, through legislation, of acceptable rules that reflect countries' international obligations.²⁹⁶ Compliance, which includes implementation, is the behavior of an actor with a specified rule²⁹⁷ and provides one of the pathways through which legal rules and institutions impact states' behavior in relation to their commitments.²⁹⁸ Compliance is assessed by ascertaining whether the country in fact adheres to the provisions of the accord and adheres to implementing measures that need to be instituted.²⁹⁹ Effectiveness, on the other hand, looks at whether the policy objectives are achieved or not. It involves a process of evaluating the goals integrated in the norms and represents the yardstick to measure the impact of a legal rule or standard in inducing changes in behavior.³⁰⁰

Reliance on these three concepts as part of the FATF assessment framework has been instrumental in providing countries with a more complete picture of their role in the process and their performance with the AML/CFT standards. The FATF Methodology 2004—the backbone of the FATF assessment framework—integrates these concepts as critical steps for a full evaluation of the country's compliance performance with the international AML/CFT standards.³⁰¹ Countries not only have the obligation to ensure that they have adopted the relevant laws and institutional framework that incorporate the AML/CFT Recommendations into their domestic legislation (implementation)³⁰² but to ensure that the laws or measures adopted are in conformity with the standards (compliance).³⁰³

Compliance requires that the norm has been transposed according to the exact requirements of the Recommendations and considers whether there has been any major deviation. Compliance is defined by reference to conformity of domestic legislation or measures with the specific Essential Criteria³⁰⁴ and is rated either largely compliant with all ECs (C), partially

²⁹⁵ Simmons, *supra* note 20, at 77–78.

²⁹⁶ Jacobson & Weiss, *supra* note 291, at 123.

²⁹⁷ Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 392–93; *see also* Kingsbury, *supra* note 277, at 368–72.

²⁹⁸ Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 388; Ronald B. Mitchell, *Regime Design Matters: International Oil Pollution and Treaty Compliance* 48 INT'L ORG. 425 (1994).

²⁹⁹ Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 391.

³⁰⁰ Raustiala, *Form and Substance in International Agreements*, *supra* note 155, at 610.

³⁰¹ FATF METHODOLOGY, *supra* note 22, at 3–7; *see also* FATF HANDBOOK, *supra* note 284, at 3–12 (making continuous reference to the assessment of a country's compliance with international standards and the effectiveness of the implementation of these standards).

³⁰² FATF METHODOLOGY, *supra* note 22, ¶ 6, at 4.

³⁰³ *Id.* at 4.

³⁰⁴ *Id.* ¶ 10, at 5 (“The essential criteria are those elements that should be present in order to demonstrate full compliance with the mandatory elements of each of the

compliant with the ECs of each recommendation (PC), or non-compliant (NC).³⁰⁵ Any departure from the obligation is sanctioned and reflected in the rating as part of the assessment process. In addition, the system has to be “effectively implemented.”³⁰⁶ The compliance assessment process, relying on these three concepts and the overall ratings on all the Recommendations, captures the level of a country’s conformity with its international AML/CFT obligations. It also indicates the effectiveness of the country’s AML/CFT system, the end result of which is to ascertain whether the goals of the norms have been met.³⁰⁷

Guided by the quest for order and stability achievable through policy-making and the rule of law,³⁰⁸ effectiveness forms the cornerstone of the FATF assessment mechanism. Incorporation of effectiveness as an indicator of compliance performance was only addressed in the 2003 revised version of the FATF Methodology—not an issue in the 1996 version. It illustrates the FATF’s concern for effectiveness of the AML/CFT domestic system, shifting compliance assessment beyond mere formal implementation and compliance. Effectiveness is critical as it relates directly to the core purpose of the entire AML/CFT strategy, which is to undermine ML/FT and safeguard the integrity of the international financial system from abuse by the criminals. Assessing effectiveness of the AML/CFT system, therefore, acts as an indicator to changes in ML/FT patterns and evolution.

Measuring effectiveness, however, is fraught with serious difficulties both conceptually and practically, and depends on availability of quality and quantitative data from various sectors including enforcement, regulators and private sector. While the number of ML/FT investigations, prosecutions, convictions, and suspicious transactions reports (STRs) may provide some indication of the level of effectiveness, these remain highly elusive concepts and indicators, which may eventually provide a distorted picture. In addition, behavior of actors is often not uniform or consistent—they are often ambiguous, dilatory, or confusing and frequently take place under conditions which makes compliance verification difficult. In an attempt to address growing concerns about how to measure effectiveness, the FATF revised its Methodology and Handbook for Assessors in 2007 to include a methodology based on listing indicators relevant for assessing effectiveness of individual recommendations.³⁰⁹

However, two aspects of the FATF assessment framework are worth considering for their relevance to ensuring effective compliance. First, the

Recommendations.”).

³⁰⁵ *Id.* ¶ 11, at 6.

³⁰⁶ *Id.* ¶ 6, at 4.

³⁰⁷ Shelton, *Introduction*, *supra* note 25, at 9, 17.

³⁰⁸ *See* O’Connell, *supra* note 9, at 100–01.

³⁰⁹ FATF HANDBOOK, *supra* note 284, Annex 3, at 96–98.

FATF assessment process illustrates that compliance is more a function of the inextricable interconnection between these three concepts, providing more in-depth insights into a country's AML/CFT system, its compliance with, and implementation of, the standards as well as their effectiveness. As such, the FATF compliance experience tends to disprove attempts to identify compliance, implementation, and effectiveness as autonomous and unrelated phases in monitoring states' behavior with their international obligations. These concepts condition one another and cannot on their own provide a full picture of a country's level of compliance. In fact, assessing compliance using a disjunctive approach relying on only one or the other of these three concepts distorts the performance picture of states' behavior with their international obligations. Compliance depends on implementation, and effectiveness is directly related to both the level of implementation and conformity with the Recommendations. Second, perhaps arising out of translation of the English version from the French version of the Methodology, the FATF interpretation of the three components is characterized by a conceptual distinction where implementation is interpreted as ensuring conformity with the AML/CFT obligations, whereas compliance is the formal adoption of legislation and measures to adopt the Recommendations. Theoretical interpretation of these concepts differs from the FATF's interpretation.³¹⁰ Although this does not appear to have been of any serious consequence for the assessment of countries, the distinction in meaning can nevertheless potentially be of considerable significance and implications for ratings.

D. The FATF NCCT Sanctions Process: The Reputational Factor

Whatever forms of sanction or penalty that violations of responsibilities may entail,³¹¹ they are critical for ensuring compliance. The availability of sanctions³¹² through a system of blacklisting countries accompanied by countermeasures as a channel to address non-compliance with the FATF Recommendations has been critical in enhancing compliance with the FATF standards. The FATF AML/CFT regime with its assessment monitoring mechanism³¹³ is of considerable international

³¹⁰ See Shelton, *Introduction*, *supra* note 25, at 5; see also Raustiala & Slaughter, *supra* note 19, at 538–39; see also Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, *supra* note 47, at 387; see also Alvarez, *supra* note 277, at 303–05.

³¹¹ Gold, *supra* note 54, at 465.

³¹² The concept of sanction in this context is distinguished from the reference to sanctions for violation of specific recommendations as provided for in Recommendations 2 and 17 of the FATF Recommendations, which specifically relate to enforcement following implementation and compliance at domestic level. Recommendation 2 provides for penal sanctions for violation of Recommendation 1 (the offence of money laundering). Recommendation 17 is construed as sanctions applicable regulatory breaches. See FATF 40 RECOMMENDATIONS, *supra* note 13, at 3–4, 9.

³¹³ FATF METHODOLOGY, *supra* note 22, at 3–11.

significance and moral suasion. Failure to subscribe to its standards can result in significant downsides for those countries that fail their review.³¹⁴ Three issues provide valuable insights into the FATF sanction mechanism and how it drives the assessment process and compliance. First, acting as a deterrent to non-compliance,³¹⁵ the FATF sanction process, which comprises its List of Non Cooperative Countries and Territories (NCCT List)³¹⁶ and countermeasures, is a non-confrontational and collective form of managing non-conformity,³¹⁷ and it is crucial for the credibility of its compliance monitoring process. Albeit a softer form of enforcement mechanism,³¹⁸ operating outside the boundaries of formal treaty law,³¹⁹ it generated a greater compliance impulse among countries, explained in terms of reputational considerations and fear factor.³²⁰ Second, the NCCT process strengthens the “judicialization” of the AML/CFT standards, violation of which is reprimanded from being mere policy recommendations. Finally, the effectiveness of the sanction system, confirmed by the speed of corrective measures adopted, acts as a pressure point in the compliance process with significant impacts to countries’ behavior.

Initially developed in 1998 at a time when many countries around the world did not have adequate AML measures in place, the objective of the NCCT List was to “secure the adoption by all financial centres of international standards to prevent, detect and punish money laundering, and

³¹⁴ Jackie Johnson, *Repairing Legitimacy after Blacklisting by the Financial Action Task Force*, 7 J. MONEY LAUNDERING CONTROL 38, 38, 40, 42 (2003).

³¹⁵ See George W. Downs, *Enforcement and the Evolution of Cooperation*, 19 MICH. J. INT’L L. 319 (1998) (describing enforcement and different interpretations based on various theories as a deterrence strategy designed to maintain cooperation by preventing noncompliance). The broader view is that “[a]ny threatened action or combination of actions that the designers of an enforcement strategy believe will operate to offset the net benefit that a potential violator could gain from noncompliance qualifies as a punishment strategy.” Downs, *supra*, at 321. See CHAYES & CHAYES, *supra* note 49, at 152–53 (explaining the distinction between an action that inflicts a cost (a fine or sanction) and an action that withdraws a benefit (reciprocal noncompliance)).

³¹⁶ FINANCIAL ACTION TASK FORCE, ANNUAL REVIEW OF NON-COOPERATIVE COUNTRIES AND TERRITORIES 2006-2007: EIGHTH NCCT REVIEW (2007) [hereinafter FATF ANNUAL LIST OF NCCTs 2006-2007].

³¹⁷ See Abram Chayes & Antonia Chayes, *Adjustment and Compliance in International Regulatory Regimes*, in PRESERVING THE GLOBAL ENVIRONMENT: THE CHALLENGE OF SHARED LEADERSHIP 280–308 (Jessica Tuchman Mathews ed., 1991).

³¹⁸ See ROBERT O. KEOHANE, *AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* 105–08 (1984).

³¹⁹ See George W. Downs & Michael A. Jones, *Reputation, Compliance, and International Law*, 31 J. LEGAL STUD. 95 (2002) (providing a detailed analysis of the concept of reputation as a factor influencing compliance outside the formal treaty system).

³²⁰ J. C. SHARMAN & PERCY S. MISTRY, *CONSIDERING THE CONSEQUENCES: THE DEVELOPMENT IMPLICATIONS OF RECENT INTERNATIONAL TAXATION AND ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM INITIATIVES* (2008).

thereby effectively co-operate internationally in the global fight against money laundering.”³²¹ It also became apparent at the time that most ML transactions ended up in or through offshore tax havens, which the FATF could not ignore.³²² Based on its twenty-five criteria,³²³ the NCCT process is an extensive assessment of a country’s financial and non-financial environment, identifying loopholes in regulations, institutions and supervision, and practices that hinder cooperation in the fight against ML.³²⁴ It constitutes the central framework according to which “countries should be able to apply appropriate counter-measures” where “a country continues not to apply or insufficiently applies the FATF Recommendations.”³²⁵ Failure to comply leads to blacklisting under the NCCT procedure, which raises concerns about the country’s legitimacy to conduct business in the global environment.³²⁶ Fairness and transparency are embodied in the process where identified countries have sufficient opportunities to adopt measures required by the FATF to be put in place to ensure conformity. Blacklisted members are monitored until they achieve levels of compliance acceptable by the FATF, leading to their removal from the list.³²⁷ More serious measures include invocation of Recommendation 21, authorizing the FATF to urge financial institutions worldwide to closely scrutinize business relations and transactions with persons, companies, and financial institutions domiciled in the subject country. The ultimate sanction is expulsion from membership in the organization.³²⁸

This policy of classifying NCCTs pursuant to Recommendation 21 is basically a name and shame procedure, which affects the countries’

³²¹ FATF ANNUAL LIST OF NCCTs 2006-2007, *supra* note 316, at 2.

³²² JEAN-FRANÇOIS THONY & CATHERINE DUJOLS-THONY, QUINZE ANS DE LA DYNAMIQUE INTERNATIONALE DE LA LUTTE CONTRE LE BLANCHIMENT “OFFSHORE”, LA FACE CACHEE DE LA FINANCE: LES ENJEUX ETHIQUES, RAPPORT MORAL SUR L’ARGENT DANS LE MONDE (2005).

³²³ FINANCIAL ACTION TASK FORCE, REPORT ON NON-COOPERATIVE COUNTRIES AND TERRITORIES Annex 10 (2000) [hereinafter FATF REPORT ON NON-COOPERATIVE COUNTRIES AND TERRITORIES].

³²⁴ Wassim N. Shahin, *De-Listing from NCCTs and Money Laundering Control Measures: A Banking Regulation Perspective*, 8 J. MONEY LAUNDERING CONTROL 320, 320-21 (2005).

³²⁵ FATF METHODOLOGY, *supra* note 22, Essential Criteria 21.3, at 30 (providing that “Where a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate counter-measures”).

³²⁶ Johnson, *supra* note 314, at 38.

³²⁷ See FATF REPORT ON NON-COOPERATIVE COUNTRIES AND TERRITORIES, *supra* note 323, at 7–9 (providing a detailed description of the process involved in the FATF sanctions process).

³²⁸ FATF 40 RECOMMENDATIONS, *supra* note 13, Recommendation 21, at 9 (outlining the obligation on financial institutions to give special attention to business relationships and transactions with persons, including companies and financial institutions from countries which do not or insufficiently apply the FATF Recommendations); FATF METHODOLOGY, *supra* note 22, Essential Criteria 21.3, at 30 (detailing the different countermeasures available in cases of failure to apply or insufficient application of the Recommendations).

reputations. The process relies upon the assumption that countries will eventually prefer to comply with the FATF rather than risk shame at the international level. Reputation, identified with transparency, acts as a central consideration in the sanction process where actors are concerned about their reputation in international commitments and rely on compliance as a means of ensuring credibility gains.³²⁹ The NCCT List, as an instrument to ensure compliance with FATF standards, illustrates that the weight of reputational consideration associated with sanctions should not be underestimated. The “single most important factor explaining the adoption of the AML/CFT international standards in all countries has been fear of the consequences of being blacklisted by international organizations in the event of non-compliance.”³³⁰ Many of those countries view compliance with the international standards as a no-choice of “death by blacklisting”³³¹ with “a gun to their head” in instituting a comprehensive AML/CFT system. Expensive compliance is preferred to non-compliance followed by blacklisting. Out of the fifteen NCCTs in the first 2000 NCCT list³³² that had been threatened with sanctions for failure to adopt appropriate AML/CFT measures, four countries were removed from the list in June 2001³³³ because they had adopted the necessary legislation and implementation measures. New countries are added and removed from the list on an annual basis, and the publication of regular annual NCCT

³²⁹ International legal theorists normally refer to reputation as “(1) the extent to which a state is considered to be an honorable member of the international community and (2) the degree to which a state reliably upholds its international commitments.” Downs & Jones, *supra* note 319, at 96 n.2. Main proponents of reputation as a critical factor affecting compliance include: KEOHANE, *supra* note 318 (arguing that reputation operates outside the boundaries of formal treaty law as well); ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* (1984); Paul R. Milgrom, Douglass C. North & Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and Champagne Fairs*, 2 *ECON. & POL.* 1 (1990); Simmons, *supra* note 72; Guzman, *supra* note 49; CHAYES & CHAYES, *supra* note 49, at 273 (agreeing that the power of reputational concerns to promote compliance is considerable and rivals the deterrent expectations about reciprocal defection).

³³⁰ SHARMAN & MISTRY, *supra* note 320, at 47–48, 118. *See also* Mark Pieth & Gemma Aiolfi, *Anti-Money Laundering: Levelling the Playing Field*, BASIL INST. GOVERNANCE, available at http://www.baselgovernance.org/old/fileadmin/docs/pdfs/Publications/Money_Laundering_Levelling.pdf.

³³¹ SHARMAN & MISTRY, *supra* note 330, at 344.

³³² FINANCIAL ACTION TASK FORCE, *REVIEW TO IDENTIFY NON-COOPERATIVE COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES 2–10 (2000)* (countries identified as NCCTs include Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts and Nevis, St. Vincent, and the Grenadines).

³³³ FINANCIAL ACTION TASK FORCE, *REVIEW TO IDENTIFY NON-COOPERATIVE COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES 3 (2001)* (countries removed are Bahamas, Cayman Islands, Liechtenstein, and Panama).

reviews³³⁴ indicate the constant monitoring of the FATF of non-cooperative countries. Given pressure arising out of the FATF blacklisting process, which questions the legitimacy of the country or jurisdiction identified as a rogue state and its right to conduct financial business in the global environment,³³⁵ countries prefer to comply with the FATF requirements motivated by concerns about gaining legitimacy of their financial systems and transactions in the global world. Others have argued, however, that the actual effects of reputation are weaker and more complex.³³⁶

Although of a soft law enforcement type, the FATF NCCT process generates a perception of legality that exhibits characteristics of a legal obligation where countries have a right to invoke countermeasures in cases of persistent non-compliance or insufficient compliance by countries. The right to apply sanctions and countermeasures is exercisable in instances amounting to breaches or violations of the obligations under the Recommendations. However, the NCCT List process and mechanism operates outside any express provision of the FATF and, as such, lacks a strong legal basis, although as the enforcing agency, the FATF is implicitly empowered to design any ancillary process necessary for the enforcement of its obligations. In addition, the implementation of Recommendation 21 requires that specific procedures be defined before any countermeasures are triggered as a last resort. The FATF's power to invoke its countermeasures to member countries for failure to comply with their AML/CFT obligations remains a problematic area. Arguably, such power exercised through the NCCT process operates on the basis of agency rules where it acts on behalf of its members. The agency argument is, however, weakened in the case where sanctions and countermeasures are imposed on nonmember countries, as it is devoid of any legal basis. While the argument is not devoid of challenges, it no doubt represents a higher level of rapprochement to hard law obligations.

Indicators of the force and effectiveness of the FATF NCCT and countermeasure mechanism are reflected in the continued application of the

³³⁴ Since 2000, except for the year 2005-2006, there have been regular annual NCCT Reviews to outline progress on existing NCCTs, including delisting and continued monitoring, as well as adding new NCCTs. FATF ANNUAL LIST OF NCCTs 2006-2007, *supra* note 316; FINANCIAL ACTION TASK FORCE, REVIEW TO IDENTIFY NON-COOPERATIVE COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES (2002) [hereinafter FATF ANNUAL LIST OF NCCTs 2002]; FINANCIAL ACTION TASK FORCE, ANNUAL REVIEW OF NON-COOPERATIVE COUNTRIES OR TERRITORIES (2003) [hereinafter FATF ANNUAL LIST OF NCCTs 2003]; FINANCIAL ACTION TASK FORCE, ANNUAL REVIEW OF NON-COOPERATIVE COUNTRIES OR TERRITORIES (2004) [hereinafter FATF ANNUAL LIST OF NCCTs 2004]; FINANCIAL ACTION TASK FORCE, ANNUAL AND OVERALL REVIEW OF NON-COOPERATIVE COUNTRIES OR TERRITORIES (2005) [hereinafter FATF ANNUAL LIST OF NCCTs 2005], available at http://www.fatf-gafi.org/document/51/0,3746,en_32250379_32236992_33916403_1_1_1_1,00.html.

³³⁵ Johnson, *supra* note 314, at 40, 42.

³³⁶ Downs & Jones, *supra* note 319, at 95.

process and the speed at which countries respond to adopt corrective measures acceptable to the FATF out of concern for their reputation and in order to be removed from the blacklist. As of 2009, twenty-eight countries have been placed on the NCCT list.³³⁷ Out of the initial forty-seven jurisdictions referred to the NCCTs process³³⁸ and reviewed in two rounds (thirty-one in 2001 and sixteen in 2002), a total of twenty-three jurisdictions were identified as NCCTs (fifteen in 2000 and eight in 2001). The removal of twenty-three countries, having adopted necessary actions to meet the requirements of the FATF and remedy any shortcomings in their AML/CFT systems, illustrates compliance impact of the sanctions system. Countermeasures, which include enhanced surveillance and other stringent relevant actions,³³⁹ have been applied to Myanmar, Nauru, Nigeria, Ukraine, and Philippines for failure to enact appropriate legislative measures and the existence of numerous shell banks. However, there has never been any case of expulsion, although Recommendation 21 has at times been invoked. A study carried out mapping the twenty-three countries against the twenty-five criteria³⁴⁰ illustrates the level of progress that was achieved by the countries in response to the implementation plan designed to ensure implementation and compliance. Although progress

³³⁷ This includes the twenty-three countries listed initially with the five countries listed in 2006: namely, Iran, Pakistan, Uzbekistan, Turkmenistan, and Sao Tome & Principe. FINANCIA ACTION TASK FORCE, ANNUAL REVIEW OF NON-COOPERATIVE COUNTRIES AND TERRITORIES 2006-2007: EIGHTH NCCT REVIEW 2 (2007), *available at* <http://www.fatf-gafi.org/dataoecd/14/11/39552632.pdf>; FINANCIA ACTION TASK FORCE, FATF STATEMENT 16 OCTOBER 2008 1-2 (2008), *available at* <http://www.fatf-gafi.org/dataoecd/25/17/41508956.pdf>.

³³⁸ The initial forty-seven countries are: Antigua & Barbuda, Bahamas, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Guernsey, Isle of Man, Israel, Jersey, Lebanon, Liechtenstein, Malta, Marshall Islands, Mauritius, Monaco, Nauru, Niue, Panama, Philippines, Russia, Samoa, Seychelles, St. Kitts & Nevis, St. Lucia, St. Vincent & the Grenadines, Vanuatu, Costa Rica, Czech Republic, Egypt, Grenada, Guatemala, Hungary, Indonesia, Myanmar, Nigeria, Palau, Poland, Slovakia, Turks & Caicos Islands, United Arab Emirates, Ukraine, and Uruguay. FATF ANNUAL LIST OF NCCTs 2006-2007, *supra* note 316, at 2.

³³⁹ See FATF METHODOLOGY, *supra* note 22, Essential Criteria 21.3, at 30 (providing a complete indication of the countermeasures available for failure or insufficient application of the FATF AML/CFT standards).

³⁴⁰ Wassim N. Shahin, *Monetary Implications of FATF Regulation of Secret Bank Accounts to Combat Money Laundering*, 9 J. MONEY LAUNDERING CONTROL 214 (2006) (providing a comparative analysis of the twenty-three countries' responses against the twenty-five criteria, which illustrated that many of the countries do not meet half of the criteria. Four countries, or over 60%, do not fully meet at least fourteen of the criteria, which represents 56% of the criteria. Out of the twenty-three countries initially listed, eleven do not fully meet at least five of the seven requirements directly relevant to the regulation of banks and financial institutions. Nineteen countries out of the twenty-three listed countries, or 83%, do not meet at least three of those seven criteria earlier, or 43%. Fifteen countries, or 63% of the listed countries, do not meet at least half of the criteria or four, amounting to 57%).

does not reflect complete harmony or conformity with the AML/CFT requirements, it signifies the strength and flexibility of the NCCT system allowing the country to make the necessary efforts to be delisted, the end result of which is compliance, albeit not full conformity. The process has demonstrated the willingness and commitment of countries to improve their AML regimes, as most NCCTs immediately began addressing shortcomings after being listed.

The timeline from being listed as a NCCT to being delisted (Table 1) indicates the speed at which countries concerned with being blacklisted³⁴¹ prefer to act expeditiously in order to be delisted by complying with the FATF requirements, confirming the effectiveness of the system. Out of the initial twenty-three countries listed between 2000 and 2001 (fifteen in 2000 and eight additions in 2001), four countries were delisted after one year (2001)³⁴² and between 2002 to 2004, eleven additional countries were removed from the list based on progress achieved.³⁴³ It took the first five countries,³⁴⁴ which indicated no objection to implementing the FATF's demands, one year to adopt compliant measures,³⁴⁵ as none of them could afford sanctions which would have damaged and isolated their financial sector.³⁴⁶ The next group of seven countries³⁴⁷ took 2-2.5 years to be delisted, four of these countries initially adopting a selective restructuring and fragmented and piecemeal approach with the hope of being delisted. However, concerned with the damage blacklisting has done to confidence in their financial systems, they eventually had no choice but to make adequate changes to meet the FATF requirements.³⁴⁸ The third group of nine countries³⁴⁹ is different only in terms of the speed it took them to comply, exhibiting a similar pattern of initial denial followed by a more piecemeal approach to finally comply with the FATF requirements. The only two

³⁴¹ Johnson, *supra* note 314, at 43, 44–45, 49 (providing a more detailed empirical analysis of this initial list of countries and their responses to FATF pressure and demands).

³⁴² Bahamas, Cayman Island, Liechtenstein and Panama were removed from the list in 2001. FATF ANNUAL LIST OF NCCTS 2001, *supra* note 334, at 3.

³⁴³ FATF ANNUAL LIST OF NCCTS 2002, *supra* note 334, at 1 (Niue and Dominica were removed from the NCCT list); FATF ANNUAL LIST OF NCCTS 2003, *supra* note 334, at 1 (providing Grenada and St. Vincent & the Grenadines were removed from the NCCT list); FATF ANNUAL LIST OF NCCTS 2004, *supra* note 334, at 1 (providing Egypt, Guatemala, and Ukraine were removed from the NCCT list although they remained on the monitoring list).

³⁴⁴ These countries were Bahamas, Cayman Islands, Liechtenstein, Panama, and Hungary.

³⁴⁵ These countries created monitors to oversee the financial sector adopted necessary changes as required by the FATF. *See generally* note 334.

³⁴⁶ Johnson, *supra* note 314, at 43.

³⁴⁷ These countries were Israel, Lebanon, St Kitts & Nevis, Dominica, Marshall Islands, Niue, and Russia.

³⁴⁸ Johnson, *supra* note 314, at 38, 40.

³⁴⁹ These countries were Cook Islands, Egypt, Grenada, Guatemala, Indonesia, Myanmar, Nigeria, Philippines, and St. Vincent & the Grenadines.

exceptions are Nauru and Ukraine which constantly refused to comply. Nauru refused to adopt any AML legislation and preferred to end its offshore banking operations, revoking its 139 offshore banking licenses, rather than adopting any AML legislation.³⁵⁰ Ukraine seemed particularly uninterested in adopting AML legislation. In conclusion, response from the initial list of countries seems to have been relatively quick, and those that responded quickest and more thoroughly were more concerned with their developed financial sectors. The success of the process lies in the fact that the twenty-three jurisdictions identified in 2000 and 2002 as NCCTs process are no longer on the NCCT list in view of the significant progress in strengthening the AML/CFT frameworks.³⁵¹

Table 1: TIMELINES OF FATF DECISIONS ON NCCTS—
JURISDICTIONS LISTED AND MONITORED (*FATF NCCT Review 2006-2007, updated to include 2008 Listing*)

| Date | Decision |
|------------------|--|
| 14 February 2000 | Initial report on NCCTs laid out the framework and procedures. |
| 22 June 2000 | First review of NCCTs identified 15 jurisdictions as NCCTs: Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts and Nevis, and, St. Vincent & the Grenadines. |
| 22 June 2001 | Bahamas, Cayman Islands, Liechtenstein, and Panama were de-listed. |
| 7 September 2001 | Second review of NCCTs identified new NCCTs; Egypt, Guatemala, Hungary, Indonesia, Myanmar and Nigeria. |
| 5 December 2001 | Grenada and Ukraine were identified as NCCTs. FATF recommended that its members apply additional counter-measures to Nauru. |
| 21 June 2002 | Hungary, Israel, Lebanon, and St. Kitts & Nevis were de-listed. |
| 11 October 2002 | Dominica, Marshall Islands, Niue, and Russia were de-listed. |
| 20 December 2002 | FATF recommended that its members apply additional counter-measures to Ukraine. |
| 14 February 2003 | FATF withdrew counter-measures for Ukraine; however, it remains on the list. Grenada was de-listed. |
| 20 June 2003 | FATF de-listed St. Vincent & the Grenadines. |
| 3 November 2003 | FATF recommended that its members apply additional counter-measures to Myanmar. |

³⁵⁰ See generally FATF ANNUAL LIST OF NCCTs 2005, *supra* note 334.

³⁵¹ FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 14.

| | |
|------------------|---|
| 27 February 2004 | Egypt and Ukraine were de-listed. |
| 2 July 2004 | FATF de-listed Guatemala. |
| 22 October 2004 | FATF removed counter-measures for Nauru and Myanmar; however, they remained on the list. |
| 11 February 2005 | FATF de-listed Cook Islands, Indonesia, and Philippines. |
| 13 October 2005 | FATF de-listed Nauru. |
| 23 June 2006 | FATF de-listed Nigeria. |
| 13 October 2006 | FATF de-listed Myanmar. |
| 28 February 2008 | Iran, Uzbekistan, Turkmenistan, Pakistan, and Sao Tome & Principe are still monitored as NCCTs. |

The NCCT process gained greater credibility as a result of its application to both member and nonmember countries. The extent and speed by which countries' have conformed to NCCT obligations following a country's inclusion on the blacklist illustrates how much the process affects countries. In fact, noncompliance nonmember countries have on occasion been the subjects of sanctions. Although Recommendation 21 is not applicable to non-members, meaning that FATF cannot suspend a nonmember country, FATF may ask its member countries to impose restrictions on its financial institutions that operate in nonmember jurisdictions. The Seychelles is an example of the application of such measures where Seychelles had enacted a legislation facilitating ML, and FATF warning to Seychelles attracted international attention and led many member countries to advise their financial institutions to stop business with Seychelles.³⁵² Mounting pressure forced the country to repeal the legislation. This situation led the FATF to take concrete action to bring Offshore Financial Centers (OFCs) into compliance with AML/CFT³⁵³ and to ask countries with close relations with OFCs to take measures to enhance home country AML/CFT supervision. This course of action resulted in the de-listing of four OFCs in 2001.³⁵⁴

The NCCT list was apparently suspended at some point in time, perhaps as a result of concerns expressed by the IMF³⁵⁵ or due to absence of any NCCT list of countries from 2005 to 2006. It was, however, revived as part of a broader international cooperation framework known as the International Cooperation Review Group (ICRG) in 2006. This new surveillance process is vested with the same functions and objectives of identifying, examining, and engaging with vulnerable jurisdictions that fail

³⁵² ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 70.

³⁵³ Finance Ministers' Meetings, Report of G7 Finance Ministers to the Köln Economic Summit, June 18-20, 1999, available at <http://www.g7.utoronto.ca/finance/fm061999.htm>.

³⁵⁴ G7 Genova Statement (July 20, 2001), available at <http://www.g7.utoronto.ca/summit/2001genoa/g7statement.html>.

³⁵⁵ Nadim Kyriakos-Saad, *The Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards*, in 3 CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW L. 265, 267 (2005).

to implement effective AML/CFT systems. The FATF uses this process to reach out to those countries and, where appropriate, will take firm action when a country chooses not to engage with the appropriate FSRB or the FATF or to reform its systems.³⁵⁶ The ICRG is a broader monitoring international cooperation framework, which now integrates the NCCT process using the same process of listing, monitoring, and delisting with possibilities of applying countermeasures in specific cases. The importance of the sanctions process is illustrated by the listing in 2007 of five countries, namely, Iran, Uzbekistan, Turkmenistan, Pakistan, and Sao Tome and Principe.³⁵⁷ These countries had been earmarked for non-compliance arising from the lack of comprehensive AML/CFT systems. The FATF Plenary called upon those countries to address, on an urgent basis, weaknesses in their AML/CFT system.³⁵⁸ The five countries continue to be on the list while being under constant monitoring by the FATF.³⁵⁹ Although the NCCT list was suspended, the perception that remains is one of skepticism where jurisdictions are fearful of the negative consequences involved in defying international regulation.

E. Legitimacy Concerns

Although the FATF institutional structure has evolved into an effective standard-setting and compliance framework, its main challenge has been to overcome the legitimacy deficit that characterizes its normative and policy-making processes because “a law perceived as legitimate and fair is more likely to be observed than not.”³⁶⁰ Legitimacy³⁶¹ as a factor influencing compliance is an idea developed by Franck, who advocated that in a community of organized rules, compliance is directly linked to a perception

³⁵⁶ FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 20.

³⁵⁷ See Statement, Financial Action Task Force (Feb. 5, 2009), *available at* www.fatf-gafi.org/dataoecd/18/28/42242615.pdf.

³⁵⁸ FATF ANNUAL REPORT 2007-2008, *supra* note 45, at ii & 14.

³⁵⁹ *Id.*

³⁶⁰ Shelton, *Introduction*, *supra* note 25, at 8.

³⁶¹ Legitimacy, in this context, refers to an attribute conferred on it when external parties affected by the organization's outcomes endorse its goals and activities. Borrowed from organized theory, it implies that the goals and activities of those parties that are in a position to confer legitimacy are aligned with those of the organization concerned. Johnson, *supra* note 314, at 38. Another definition is “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.” Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571, 574 (1995). Legitimacy can be defined as “the aspect of governance that validates institutional decisions as emanating from right process.” Thomas M. Franck, *Democracy, Legitimacy and the Rule of Law: Linkages 1* (N.Y. Univ. Sch. of Law Pub. Law & Legal Theory Working Paper Series, Working Paper No. 2, 1999), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=201054.

of legitimacy by those who are at the receiving end.³⁶² In secularized, democratic societies, the primary source of legitimacy lies in the involvement in the decision-making process of those impacted by its decision.³⁶³ The fundamental principle underpinning the concept of legitimacy in policy-making is the recognition that subjects of international norms should have an opportunity to participate and influence the development of those norms.³⁶⁴ Observance owes more to the recognition that the existing legal rules reflect the shared values and interests of the members of the international community and are, therefore, legitimate.³⁶⁵ Similarly, soft law is legitimized on the basis that “a rule . . . is legitimate if relevant audiences accept it as appropriate . . . [and] . . . can be difficult to enforce if it does not reflect a general consensus about its legitimacy.”³⁶⁶ To that extent, the FATF’s norm-creation and diffusion process is weakened by a lack of accountability, which ensures transparent decision-making, providing clear lines of authority between decision-makers and their subjects and by legitimacy, encouraging countries’ ownership and influence in setting international standards.³⁶⁷ Consensus-building based on participation by interested parties in the standard-setting process, and the opportunity to influence the development of the norms, occur largely outside the FATF normal law-making process.³⁶⁸ However, the legitimacy deficit, perhaps more relevant in the beginning stages of its creation, has gradually been addressed, albeit in a limited manner, providing the FATF process with a perception of greater inclusiveness and transparency. In addition, compliance levels experienced across countries tend to disprove legitimacy concerns as most countries have now adopted, although not in entire conformity, some form of AML/CTT legislation and framework and have subjected themselves to the FATF assessment process.³⁶⁹

³⁶² FRANCK, FAIRNESS IN INTERNATIONAL LAW AND INSTITUTIONS, *supra* note 159, at 24–26; Franck, *supra* note 361; Ellen Gutterman, Domestic Sources of Compliance with International Law 2 & 6–8 (2008) (unpublished manuscript presented at the Int’l Studies Assoc. annual meeting, March 26–29, 2008), available at http://www.allacademic.com/meta/p_mla_apa_research_citation/2/5/0/9/3/p250939_index.html.

³⁶³ Fritz W. Scharpf, *Legitimacy in the Multi-actor Polity*, in ORGANIZING POLITICAL INSTITUTIONS: ESSAYS FOR JOHAN P. OLSEN 261, 267–68 (Morten Egeberg & Per Laegreid eds., 1999).

³⁶⁴ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 34–35.

³⁶⁵ Sindico, *supra* note 69, at 839.

³⁶⁶ *Id.*; Steven Bernstein & Benjamin Cashore, Can Non-State Global Governance be Legitimate? A Theoretical Framework 3–6 (2007) (unpublished manuscript presented at the Int’l Studies Assoc. annual meeting, Feb. 28–Mar. 3, 2007), available at http://www.allacademic.com/meta/p_mla_apa_research_citation/1/7/9/5/0/p179504_index.html.

³⁶⁷ ALEXANDER, DHUMALE & EATWELL, *supra* note 6, at 36.

³⁶⁸ Giovanoli, *supra* note 32, at 16.

³⁶⁹ Indicators of this willingness to be part of the FATF process sees confirmation in the number of countries that have been willing to participate in the FATF AML/CFT assessment and the number of countries that have some form of AML/CFT laws and system in place,

Since its inception, the creation and diffusion of the FATF AML/CFT norms has been characterized by a serious democratic deficit identified with a limited geographical coverage and reflected in the restricted initial membership of fifteen countries.³⁷⁰ The development of the AML/CFT international standards are influenced by a small group of countries focused on issues related to advanced markets and developed economies given its establishment by, and within the context of, the G7/8 membership.³⁷¹ Although the FATF has now expanded from a small group of fifteen industrialized countries, its present membership is still largely limited to thirty-four countries,³⁷² considering that the expansion occurred over a period of twenty years. The enlargement, however, reflects an expanded regional representation, allowing for participation of a more diverse group of countries, although still subject to the rigid membership criteria.³⁷³ With such restrictive membership, the design and diffusion of the AML/CFT principles, creating expectations of a broader implementation while retaining a lot of virtues, loses its validity, being more exclusive rather than inclusive. Legitimacy, which is explained in terms of countries' ownership and the influence they can have in designing and implementing the AML/CFT rules meant to be of an international application, is lacking. Decision-making is still dominated by a small group of countries and, therefore, lacks political legitimacy and accountability because countries outside of the FATF group have no say in the development of international norms. Its constituency is not elected and its appointments are entirely in the hands of the member states who agree to accept new constituents on the basis of internal discussions. The decision to limit the admission of new members further aggravates the image of the FATF as a very exclusive club with no convention-based status and limited membership to a selected few.

Lack of transparency and accountability are additional factors that

including the number of FIUs that have been established over the last two decades.

³⁷⁰ At the time the FATF was established in July 1989 by the G-7 Summit, its membership comprised fifteen jurisdictions plus an international organization. In addition to the G-7 Summit participants (Canada, France, Germany, Italy, Japan, United Kingdom and the United States), the European Commission, Australia, Austria, Belgium, Luxembourg, the Kingdom of the Netherlands, Spain, Sweden and Switzerland were invited to join the Task Force in order to enlarge its expertise and to reflect the views of other countries particularly concerned by or having experience in the fight against money laundering. FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 1.

³⁷¹ The G7 was comprised of the US, France, Italy, Japan, UK, Germany, and Canada. Russia was later admitted in 1997 as the eighth member.

³⁷² Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, European Commission, Finland, France, Germany, Gulf Cooperation Council, Greece, Hong Kong-China, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Kingdom of the Netherlands, New Zealand, Norway, Portugal, Singapore, South Africa, Sweden, Spain, Switzerland, Turkey, People's Republic of China, Russian Federation, United Kingdom, United States. FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 2.

³⁷³ See FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 29-30.

weaken the FATF process, based on the informal and secretive nature of its decision-making process and standard setting with little or no input from the wider group of developing and emerging market countries.³⁷⁴ The deliberations of its internal working groups and their documents are entirely secret, although the publication of its country assessment report in the context of the third round of mutual evaluations is a significant progress in seeking to promote greater transparency. Its recommendations are enforced on nonparties, and given that the FATF's decisions are not subject to any oversight or appeal mechanism, these recommendations remain highly influential upon which the financial and commercial world can be held to strict account.³⁷⁵ For a long time, the final adoption of the standards or their review lay solely with member countries and did not involve nonmembers and private sector participants, although nonmember countries have to comply with them. However, the recent overture towards the private sector,³⁷⁶ engaging with them in indirect and informal consultations and seeking their views on related specific issues, reflects a positive form of indirect participation and openness.

Non-participation of countries that have an obligation to comply with international norms but whose voices, on the other hand, have not been heard, undermines the legitimacy of the FATF normative structure. In addition, the obligation of nonmember countries, often with diverse and less developed economic and financial systems, to implement norms developed in the context of industrialized economies, gives rise to possible mismatch that significantly impairs compliance. Countries are reluctant to comply with such norms which they consider developed without their consent but inconsistent with the realities of their economic and financial systems and rules. States in Africa and part of Asia have all along argued that the norms do not match their financial environment. Countries with rudimentary financial systems associated with weak banking cultures and heavy reliance on cash oriented economies are likely to find the standards inadaptably to their economic and financial context, illustrating instances of mismatch. These factors reinforce the lack of legitimacy for countries to comply with these same norms, which after all were developed within a framework with limited participation. However, the FATF's recent decision to integrate a risk-based approach as part of its normative structure and compliance assessment work illustrates its concern about how types of risks associated with different levels of economic development, countries' specificities, and financial transactions, can undermine compliance³⁷⁷ and represents an

³⁷⁴ Kenneth S. Blazejewski, *The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Transgovernmental Networks*, 22 TEMP. INT'L & COMP. L.J. 1, 23 (2008).

³⁷⁵ *Id.*

³⁷⁶ FATF ANNUAL REPORT 2008-2009, *supra* note 17, at 5.

³⁷⁷ FATF RISK ASSESSMENT STRATEGIES, *supra* note 203, at 2-3; FATF GUIDANCE, *supra*

opportunity to improve its normative legitimacy.

The legitimacy concerns have, however, been gradually addressed over the years, providing the FATF and its AML/CFT standards with perceived inclusiveness while at the same time being more transparent. The first step towards greater legitimacy, albeit indirectly, was the expanded coverage achieved by integrating the international standards within the mandate of the IMF, the WB, UNODC, and the Commonwealth membership, representing a much broader geographical framework for diffusion of the norms and enabling the FATF to reach out to most countries of the world.³⁷⁸ The second step witnessed a gradual expansion of the FATF's membership to include some developing countries such as Mexico, South Africa, and China. Admittedly it still remains highly exclusive. However, although more than 180 countries, representing 85% of the world,³⁷⁹ have endorsed the FATF recommendations, only thirty-four countries are members of the group and play a direct role in norm creation. In addition, the FATF's decision to allow regional and international organizations to participate as observers in its plenary deliberations also promotes transparency and inclusiveness.³⁸⁰ Third, the establishment of FSRBs in different parts of the world has been of considerable support to the FATF, providing a wider geographical and focused coverage in terms of countries.³⁸¹ The diffusion of the AML/CFT standards by both hard and soft-type international organizations, such as the IOSCO, BASLE, IAIS and the Egmont Group of FIUs, further legitimizes the FATF actions. However, the system still suffers some weaknesses in the sense that these regional bodies or international organizations do not enjoy full membership in the FATF, nor do they have any decision-making power. They sit as observers and participate in debates on that basis. Initiating steps to recognize the benefits of risk-based approaches in assessing countries' ML/FT vulnerabilities offers a promising option to increase its legitimacy by addressing specificities of countries and financial systems in the development of its norms.

In addition, in recognition of the non-state actors' critical role in developing and promoting the norms, the FATF has significantly increased

note 200, at 2–4 (developed in consultation with international banking and securities sectors).

³⁷⁸ See FATF RISK ASSESSMENT STRATEGIES, *supra* note 203, at 56–57 (explaining how the integration of the FATF AML/CFT Recommendations into the work of major regional and institutional organizations, including the IMF, WB, UNODC, Commonwealth Secretariat, and the Basel Committee, IOSCO, IAIS, OGBS, has been critical in ensuring wider recognition of the norms among countries). There are nineteen observer organizations working closely with the FATF. FATF ANNUAL REPORT 2007-2008, *supra* note 45, at 2–3.

³⁷⁹ FATF ANNUAL REPORT 2007-2008, *supra* note 45, at ii.

³⁸⁰ See *id.* at 2–5.

³⁸¹ There are eight FATF-Styled Regional Bodies, representing different regions across the world, which provides a regional platform to the FATF to carry out its mandate. *Id.* at 2.

its engagement with the private sector. Such engagement has, however, remained at an informal level in the production of joint analysis on issues of common concern, private sector input in typologies work, and the establishment of a new private sector consultative forum.³⁸² Adopting an all-inclusive approach would also allow its members to freely pursue their AML/CFT interests according to the specificity of their environment so long as it does not transgress the main obligations and adhere to certain basic disciplines or obligations. A desirable aspect of its identity formation, which is likely to have greater impact on its performance, is the extended reconciliation with non-state actors and participation of nonmembers or its further enlargement. More active participation of nonmember countries and non-state actors in its activities and ensuring greater quasi-harmonization of the rules across countries would have the effect of building more coherence into the norms and their application or effective implementation.

IV. CONCLUSION

The FATF AML/CFT system has developed into a formidable international regulatory regime. It has significantly influenced countries' compliance with its standards. The strength of its normative structure, its vibrant institutional framework, and support from other international and regional organizations have contributed to increase its legitimacy, thereby generated considerable compliance impulse. Those features have over the years marked the compliance performance of countries, resulting in a greater number of countries having either adopted, or made commitments to adopt, AML/CFT systems and subject themselves to the FATF assessment of their AML/CFT system. The AML/CFT regime could, nevertheless, benefit from further improvements in areas related to legitimacy of its norms and systems, enhanced compliance assessment ensuring more effectiveness supported by a reinforced sanctions process, reinforced international cooperation, and coordination among international organizations. However, although the international AML/CFT standards have been transformed into a comprehensive international framework generating greater compliance impulse with the standards, the biggest challenge remains whether it has been effective in controlling money laundering and the financing of terrorism. This is a matter for further study.

³⁸² FATF REVISED MANDATE 2008–2012, *supra* note 46, at 4; Financial Action Task Force, Chairman's Summary, Paris Plenary 3 (Feb. 29, 2008), *available at* <http://www.fatf-gafi.org/dataoecd/28/31/40196357.pdf>.

