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

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Abstract

Concerns about risks of money laundering (ML) and terrorist financing (TF) to the stability of the international financial system have resurfaced in the context of the liquidity problems faced by financial institutions resulting from the recent credit crisis (2007). Because of their constantly evolving nature linked with new criminal activities and methodologies, ML and TF present threats of a systemic nature to the stability of the financial system. Addressing those changing faces of ML/TF and associated risks requires the design of 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 FATF’s AML/CFT international standards. The origins of the AML/CFT regime are located in the dual consequences of globalization, associated not only with rapid economic growth resulting from increasing financial and capital liberalization and negative externalities undermining the financial system, but also changing patterns in global governance with 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, based on 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, and relying on a mixed analytical-empirical methodology using selected variables, including the soft law nature of the AML/CFT regime and its normative structure, institutional design, monitoring process, sanctions mechanisms, and legitimacy, 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.
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Navin Beekarry†

1. 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 liquidity problems,3 apparently led some banks to rely on interbank 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 all regions.5 ML/TF threats are often explained in terms of negative externalities associated with the increasing movement of capital across borders resulting from 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, with new, softer and more flexible, forms of international

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


4 Mark Heinrich, INTERVIEW-Reuters, 2009-02-09, http://www.reuters.com/article/topNews/idUSTRE52A44I20090311; Antonio Maria Costa, Executive Director of the U.N. Office on Drugs and Crime, warns that "cash-rich mafia groups have been channeling funds into banks desperate to survive the global credit crisis: -Ample signs of mafia millions buying banks--; Boris Groendahl, Austrian weekly Profil. Global Research, March 15, 2009, http://www.globalresearch.ca/index.php?context=va&aid=12718; Interview of Maria Costa, Executive Director of United Nations Office of Drugs and Crime, Vienna, The United Nations claims that it has enough indication that in the second half of the 2008 crisis liquidity was the banking system's main problem and that illicit money has been used to keep banks afloat in the global financial crisis. “There were signs that some banks were rescued in that through "interbank loans funded by money that originated from drug trade and other illegal activities." (reporting by, editing by Charles Dick, ).

5 Ibid, “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. “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.” Id.


regulation and institutions designed to address such negative externalities,\(^8\) in the search for an “ordered world.”\(^9\) Those changing 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 strategy,\(^10\) a set of soft rules associated with international financial regulation,\(^11\) to address or pre-empt potential damage to the stability of the international financial system.\(^12\) The constantly evolving ML/FT 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 of the changing faces of ML/FT. 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, been marked by critical normative and institutional initiatives, adapted to meet those challenges. Seemingly isolated, those initiatives interconnect in a regulatory ensemble forming the global AML/CFT regime\(^14\) that has, directly or indirectly, generated greater compliance impulse with the FATF international 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

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\(^12\) Paris G7/G8 Summit, *supra* note 10 (adopting the FATF 40 Recommendations against money laundering for the first time).

\(^13\) The Designated Non-Financial Businesses and Professions (DNFBPs), which embrace all non-bank financial institutions and categories of professionals such as accountants, lawyers and notaries, FATF Recommendation 12.


\(^15\) *Ibid*

shaped the AML/CFT process into a more specific regime which continues to bind many states.\textsuperscript{17} Since its inception, the AML/CFT strategy has gradually evolved into a powerful, flexible and adaptable, international regime that has been critical in generating compliance with the AML/CFT standards.\textsuperscript{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, although the latter presents challenges in a complex environment with risks of losing their weight and impact on compliance.\textsuperscript{19} However, because of the wide variety of theories using different variables to examine compliance, there is bound to be multitude overlap regarding the use, definition and impact of the different variables across disciplines,\textsuperscript{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, relying on the intrinsically soft law qualities of its normative and institutional structure, in shaping the policies and laws of many countries, forcing recognition of the ML threat.\textsuperscript{21} The AML/CFT discourse, embodied in the strength of its obligations\textsuperscript{22} and admissible exceptions,\textsuperscript{23} history, purpose and textual content, demonstrates sufficient legal characteristics of “public international law as the aggregate of legal norms governing international relations” and its specific functions.\textsuperscript{24} In a rapprochement to hard-type norms, the FATF Recommendations reflect legal norms with prescriptive and prohibitive obligations for its targets,\textsuperscript{25} providing a normative order of sufficiently “good quality”, resulting from the substantive nature and strength of its norms. Supported by an effective institutional setup,\textsuperscript{26} the cohabitation of both soft and hard norms,\textsuperscript{27} procedures and rules that shape and

\textsuperscript{17} Several countries have now adopted AML/CFT legislation and institutions such as Financial Intelligence Units (FIUs) in accordance with the FATF Recommendations. Financial Action Task Force [FATF], Annual Report 2008-09, at 30, available at http://www.fatf-gafi.org/dataoecd/11/58/43384540.pdf.
\textsuperscript{19} Kal Raustiala & Anne-Marie Slaughter, International Law, International Relations and Compliance, surveying studies of compliance in international law and international relations literature, in HANDBOOK OF INTERNATIONAL RELATIONS 553 (2002).
\textsuperscript{20} Beth Simmons, Compliance with International Agreements, 1998 ANN. REV. POL. SCI. 75-93.
\textsuperscript{21} ALEXANDER, DHUMALE & EATWELL, supra note 6..
\textsuperscript{22} FATF METHODOLOGY 2004, on the mandatory obligations contained in the Recommendations.
\textsuperscript{23} FATF Methodology 2003, as amended, FATF Recommendation 1, on exceptions such as “self-laundering”.
\textsuperscript{25} Shelton, COMMITMENT AND COMPLIANCE, supra note 9 at 16 (Identifying targets of norms as one of the factors that can influence compliance, 16, targets include non 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 Recommendation 5: preventive measures which target directly financial institutions, and Recommendation 12 which targets non-bank financial institutions.
\textsuperscript{26} The Financial Action Task Force (FATF) is the standard-setter in matters related to AML/CFT and has been the driving force in developing and promoting the AML/CFT 40 +9 AML/CFT Recommendations, http://www.fatf-gafi.org/pages/0,2987,32250379-32235720-1_1_1_1_1_00.html.
constraint states’ behavior, a compliance assessment mechanism, under threat of sanctions through a ‘name and shame’ procedure, the international AML/CFT system created a limited international legal regime that has potentially been transformed into a comprehensive international framework to control financial crime. The flexibility of the FATF AML/CFT normative structure to constantly adapt to new, and changing, ML/TF environments and activities provides compliance recipients and drivers with adaptable and flexible tools to deal with an evolving criminal behavior. Initially linked with the concern to address transnational illicit money generated by drug-trafficking, and organized criminal activities, the AML regime later stretched its reach to capture TF and new ML techniques. In addition, the cumulative effect on compliance, of cooperation among the vast regional and international network developed around the FATF to promote and spread the FATF AML/CFT message across the globe, albeit serious economic and other constraints, has been far from negligible. The landmark achievement of the FATF regime, however, has been its comprehensive compliance monitoring process and mechanism, integrating compliance, implementation and effectiveness in its compliance assessment methodology. The monitoring process, designed to evaluate countries’ behavior, or misbehavior, towards their international obligations, acts as significant inducement for compliance. The availability of sanctions, through a system of blacklisting countries

27 The FATF AML/CFT international standards rely on the provisions of the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna, 20 December, 1988); 150 have ratified the UN Convention on Transnational Organized Crime (15 November 2000); and 169 countries have ratified the UN Convention on the Suppression of the Financing of Terrorism (9 December 1999).
29 FATF, METHODOLOGY FOR ASSESSING COMPLIANCE WITH THE FATF 40+9 RECOMMENDATIONS, 27 February 2004 (updated as of February 2009), http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html
30 The Non Cooperative Countries and Territories (NCCT) List fulfills the same functions 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.
34 Article 3 of the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988, and Article 6 of the UN Convention Against Transnational Organized Crime, 2000.
35 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).
36 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).
38 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 sing the same the FATF 40+9 Recommendations and its 2004 Methodology and other documents.
39 The concept of sanction in this context is distinguished from the reference to sanctions for violation of specific recommendations as provided for in Recommendation 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) whereas Recommendation 17 is construed as sanctions applicable for supervisory and regulatory breaches.
accompanied by countermeasures, as a channel 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 NCCT sanctions process, the FATF peer review mechanism developed into a credible compliance assessment process, of both members and non-members’ compliance with its standards and, albeit the soft nature of its norms, acts as a disincentive to non-compliance, yielding positive results. Its 3rd round of evaluation of countries, which started in 2005, illustrates a level of performance not reached in the past, integrating past experience of the two previous rounds. Mutual evaluation by FATF countries gives increased credibility to its AML/CFT mechanisms, forcing participation and involvement and countries to become more proactive in enforcement. A good indication of countries’ changing behavior is their participation in the global AML/CFT initiatives and their willingness to adopt legislation. From 2004 to 2009, 145 jurisdictions, being either a member of FATF or a FSRB, have been assessed by the FATF and other regional and international organizations, using the revised 2004 Methodology, significantly higher than the 103 countries have been assessed, on the previous Methodology, from 1995-2003. 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. Together with its 8 FSRBs, some of which have recently graduated to associate membership, covering more than 170 countries and 22 observer organizations and bodies, the FATF is able to address a wider geographical network providing greater scope for more effective coverage and implementation of the standards.

Assessing compliance with the FATF international obligations, however, requires an appropriate theoretical framework that captures the impact, on states’ behavior, of the interaction...
between the different components underpinning the international AML/CFT regime, without unduly relying on a rigid dichotomy between hard and soft types of norms. Compliance theory is often defined as one of the pathways to international law issues, which entails seeking answers to its functions and effectiveness, through international instruments and institutions, addressing specific concerns. Numerous theories have offered varying and divergent explanations about states’ compliance and its related complexities, captured in a corpus of literature defined as “Legal International Compliance”, although these have remained largely dominated by disagreements among scholars about states’ motivations. Perspectives on compliance are, however, not mutually exclusive, and most theories rely on a common set of variables that characterize states’ behavior. 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. Soft law, a regular topic in recent international law and international relations discourse, occupies

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49 ibid, Kal Raustiala
50 KU & DITLH., supra note 16. 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 occupy a pillar role in this theoretical framework as the main drivers of the compliance process, providing a platform or forum for problem-solving. Lack of administrative or financial capacity, inconsistency or ambiguity in treaty interpretation, have serious effect on compliance (Chayes, Abram & Chayes, Antonia Handler, *The New Sovereignty: Compliance with International Regulatory Agreements*, (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 solution dimension defines other variables including the rules standards and creation of institutions, sanctions, settlement of disputes mechanisms, 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 norm-driven theories, it is the power of the norms that determines the extent of compliance, often characterized by the focus on the nature and inherent quality of the international norm, whose power to influence compliance depends on these qualities. Central to compliance in the norm 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 norm-driven 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 activates and facilitate the internalization process. The nature and hardness of the norm is another contributing factor in the norm-driven theory where the very fact of the norm being law has a positive impact on the norm. This is only a fraction of the numerous theories and themes developed in relation to compliance, see Bradford below at 7; see Simmons, *Compliance with International Agreements*, supra note 20 for an examination of four theoretical approaches to compliance; Abram Chayes & Antonia Handler Chayes, *On Compliance*, 47 INT’L. ORG. 175 (1993); George W. Downs, David M. Rocke & Peter N. Barsoom, *Is the good news about compliance good news about cooperation?*, 50 INT’L. ORG. 379-406 (1996); Andrew T. Guzman, *A Compliance-Based Theory of International Law*, 90 CAL. L. REV. 1823 (2002).
52 Simmons, *Compliance with International Agreements*, supra note 20.
55 Ignaz Seidl-Hohenfeldern, *General Course on Public International Law*, 198 Recueil des Cours (1986,iii), 21-261, 61-71; Shelton, *Normative Hierarchy in International Law*, supra note 56 at 319, “There is no set definition of “soft law” and common definitions include reference to “any international instrument other than a treaty that contain principles, norms and standards, or other statements of expected behavior.”; Sztucki 1990, Chinkin 2000, “a set of rules created by a group of interested states, outside the treaty-based framework, with a
an important part in the international legal system, due to its normative features giving rise to compliance expectations.\textsuperscript{57} Although opinions differ as to the legal validity and desirability of these norms,\textsuperscript{58} focused essentially on the ‘binding and non-binding effect’ argument which, at any rate, offers limited insights into soft law and its relationship with compliance\textsuperscript{59}, scholars concur that legal norms are not monolithic\textsuperscript{60} and that the dichotomy approach does not diminish their relevance for compliance.\textsuperscript{61} Deeper understanding of compliance with AML/CFT soft law, therefore, requires a paradigm shift, moving away from an over-emphasis on the binding-nonbinding dichotomy,\textsuperscript{62} to an approach that captures the increasing legalization of soft law’s normative structure, relying on content, precision, delegation, monitoring and sanctions,\textsuperscript{63} 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 bindingness and legal force, once incorporated into domestic legal systems, assuming the status of internally binding legal
obligations. 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 binding or non-binding nature, where the soft norms, in cohabitation with harder norms, can positively influence compliance behavior. In addition, claims that soft law lack preordained penalties for failures to comply, unambiguous language imposing obligations, or precision, stand contradicted by the AML/CFT compliance performance, and are often misguided, as even hard law often suffers from lack of such indicators and instances of soft law with specific and detailed rules exist. Far from being mere voluntary cooperative codes of non-binding norms, the AML/CFT legal and preventive measures, are mandatory obligations for countries to adopt in their domestic legal system, and 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.

Inspired by regime approach to international affairs, where intergovernmental 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’ behavior, 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 on their own but more often with greater impulse arising out of their interaction. After introducing globalization followed by a brief expose of negative externalities associated with ML/FT on the stability of the international financial system, the paper critically

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64 Giovanoli, supra note 31 at 72.
65 JOSEPH GOLD, INTERPRETATION: THE IMF AND INTERNATIONAL LAW 302 (1996). Lex imperfect creates an obligation but fails to establish a clear penalty or even any penalty at all for breach of the obligation.
66 Ulrika Morth, Introduction, in SOFT LAW IN GOVERNANCE AND REGULATION, supra note 63 at 6..
68 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.
69 FATF METHODOLOGY, supra note 29 at 3-10.
71 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, Why collaborate? Issue-Linkage and International Regimes supra note 18 at 358; TRANSNATIONAL RELATIONS AND WORLD POLITICS (Robert O. Keohane & Joseph S. Nye, Jr., eds. 1973); Alexander, The International Anti-Money Laundering Regime: The Role of the Financial Action Task Force supra note 14.
analyses how the interplay among those selected variables, has, over the years, converged into a formidable international AML/CFT regime, maximizing influence compliance with the FATF standards. Existing theories about compliance are, however, underpinned by an absence of empirical studies,\(^{72}\) symbolic of a deeper concern about a one-sided approach to international law and largely fail to provide adequate narratives as to how compliance theory moulds itself in the interaction with specific environments which provide 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 best\(^ {73}\) and that estimates of compliance are overstated\(^{74}\).

II. Globalization and the Money Laundering and Terrorist Financing Challenges

Globalization produced rapid economic growth\(^ {75}\) and financial development, beneficial for both industrial and developing economies,\(^ {76}\) as well as changing patterns in global governance.\(^ {77}\) Such developments presented the global community with new challenges in controlling activities generated by forces of globalization.\(^ {78}\) This ‘quantitative’ and ‘qualitative’ transformation\(^ {79}\) gave a new outlook to business generally identified with rapid and growing movement of capital, information, trade and individuals across borders\(^ {80}\) where “all is about competing with everyone from everywhere for everything.”\(^ {81}\) The three forces\(^ {82}\) of technical

\(^{72}\) Beth Simmons, Compliance with International Agreements, in INTERNATIONAL LAW, CLASSIC AND CONTEMPORARY READINGS, supra note 16 at 156; Peter M. Haas, Why Comply, or Some Hypotheses in Search of an Analyst, in INTERNATIONAL COMPLIANCE WITH NON-BINDING ACCORDS 9 (Edith B. Weiss, ed. 1997); Chayes & Chayes, On Compliance, supra note 50 at 176.

\(^{73}\) Peter M. Haas, Choosing to Comply: Theorizing from International Relations and Comparative Politics, in COMMITMENT AND COMPLIANCE, supra note 9 at 44; Raustiala & Slaughter, International Law, International Relations and Compliance, 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. 819-35 (2000); Kal Raustiala, Compliance & Effectiveness in International Regulatory Cooperation, 32 CASE W. RES. J. INT’L L. 387, 391 (2000).


\(^{76}\) Ibid, M. Ayhan Kose, Eswar Prasad, Kenneth Rogoff & Shang-Jin Wei, Beyond the Blame Game: The Two Faces of Globalization in Financial Globalization- The impact on trade, policy, labor and capital flows 19; Kose, Prasad, Rogoff & Wei, supra note 75 at 9; A bigger world, THE ECONOMIST, supra note 7; Vaithilingam, supra note 75 at 352.

\(^{77}\) Supra 6, Kern Alexander, Rahul Dhumale & John Eatwell; 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, and the I AIS.

\(^{78}\) O’Connell, supra note 9 at 100.

\(^{79}\) Wolfgang H. Reinicke & Jan M. Witte, Challenges to the International Legal System, Independence, Globalization, and Sovereignty: The Role of Non-binding International Legal Accords, in COMMITMENT AND COMPLIANCE, supra note 9 at 76; Alexander, Dhumale & Eatwell, supra note 6 at 14.

\(^{80}\) Globalization-The Story Behind the Numbers, in Financial Globalization: The impact on trade, policy, labor, and capital flows (2007).

\(^{81}\) Harold L. Sirkin, James W. Hemerling & Arindam K. Bhattacharyya, Globality: Competing with everyone from everywhere for everything, BOSTON CONSULTING GROUP (BCC) (2008).

\(^{82}\) Raghuram Rajan, Risky Business-Skewed Incentives for investment managers may be adding to global financial risk FIN. & DEV. 54, (2005) 54; Gerdt Hausler, The Globalization of Finance, in FINANCIAL GLOBALIZATION-The impact on trade, policy, labor, and capital flows 44(2007).
change, due to radical reduction in communication costs and information acquisition;\textsuperscript{83} deregulation which facilitated international trade and finance by removing barriers to competition, leading to penetration of foreign firms and opening up of capital accounts easing restrictions on capital flows;\textsuperscript{84} and institutional change, with the emergence of new financial instruments together with new political, regulatory and legal arrangements, led to increasing interconnection which expanded and deepened international financial markets.\textsuperscript{85} The explosion of private capital flows due to intense financial activities,\textsuperscript{86} from 1990s onwards,\textsuperscript{87} catalyzed the world economy leading not only to maximization of profits, but also risks and vulnerabilities of a systemic nature seriously impacting international financial stability.\textsuperscript{88} 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 border.\textsuperscript{89} Rapid movement of massive international capital flows inadvertently provided assistance to criminals resulting in increasing cross-border criminality, facilitating ML/FT,\textsuperscript{90} with potential risks to the stability of the international financial system.\textsuperscript{91} Money launderers, terrorists, drug dealers,\textsuperscript{92} human traffickers, all operate within the global networks\textsuperscript{93}


\textsuperscript{84} Id. at 18. SCHINASI, supra note 9 at 7; DAN RODRIG, HAS GLOBALIZATION GONE TOO FAR? 9 (1997).


\textsuperscript{86} Ceyla Pazarbaşioğlu, Mangal Goswami & Jack Ree, The Changing Face of Investors, FIN. & DEV. (2007); Beth Simmons, International Efforts against Money Laundering, in COMMITMENT AND COMPLIANCE, supra note 9 at 244.

\textsuperscript{87} Pazarbaşioğlu, Goswami & Ree, supra note 86. (“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, International Efforts against Money Laundering, in COMMITMENT AND COMPLIANCE, supra note 9 at 244.

\textsuperscript{88} ALEXANDER, DHUMALE & EATWELL, supra note 6 at 14; Pazarbaşioğlu, Goswami & Ree, supra note 86 at 31.

\textsuperscript{89} O’Connell, supra note 9 at 103-104; McFarlane, supra note 36 at 301.

\textsuperscript{90} Supra 7, A bigger world, a special report on globalization, THE ECONOMIST, Sept. 20, 2008

\textsuperscript{91} Remy Davison, ‘Soft Law’ Regimes and European Organizations’ Fight Against Terrorist Financing and Money Laundering, in TERRORISM, ORGANIZED CRIME AND CORRUPT.

\textsuperscript{92} Remy Davison, ‘Soft Law’ Regimes and European Organizations’ ‘ION :NETWORKS AND LINKAGES 60 (Leslie Holmes ed., 2007); Jean-Francois 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], 200 (in Ten Years of Fight Against Money Laundering in Belgium, 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).

\textsuperscript{93} On the trail of Traffickers, Briefing Dealing with Drugs, THE ECONOMIST, March 17, 2009 (The production of more than 90 per cent of the world’s opium by Afghanistan and narcotics trade facilitated by the Taliban, p30; and recent events in Mexico are indicative of the security risks and vulnerabilities associated with organized crime and terrorist risks and their pervasive nature on society).
making it as sinister as it is ubiquitous. The 2008 financial crisis exemplifies further recent concerns about the continuous threat of ML and TF to the stability of the international financial system, with financial institutions faced with serious liquidity problems, seeking to rely on illicit funds to survive the crisis. As the rest of the world tightens its belt in the global recession, money launderers seek to profit the situation by lending and investing what’s become a scarce commodity these days: a growing hoard of cash. The Madoff massive scam, the Stanford fraud, and the collapse of Bear and Stearns hedge funds, have all revealed suspected criminal activities associated with the recent crisis. Although measuring precisely the amount of ML means the impossible, due to their secretive nature, its quantification is relevant for purposes of understanding its impact and levels of risks, and the threat to national and international security, where systemic risks in financial markets often originate in one country but affect other countries (contagion). The main types of risks associated with ML/FT are reputational, concentration and operational risks, adverse macroeconomic consequences, 

93 ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER 1 (2004).
94 A Note from the President, FATF E-NEWS, supra note 2.
95 Mauro & Yafeh, supra note 3; Chan, et. al, supra note 3; Hugo Cox, Hedge fund administration: lifting the veil, ALPHA MAGAZINE (April 2009).
96 Supra 4, Mark Heinrich, INTERVIEW-Reuters, 2009-02-09
97 Steve Scherer & Vernon Silver, Mafia Cash Increases Grip on Sinking Italy Defying Berlusconi, BLOOMBERG, May 26, 2009, http://www.bloomberg.com/apps/news?id=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.’”)
98 Cox, supra note 95, “The Bear and Stearns funds collapsed as billions of dollars of bets made on mortgage-backed bonds and collateralized debt obligations (CDOs) unraveled, and no one wanted to buy them when the time came to try to sell some of the funds’ sub-prime mortgages”;
100 Johnson & Lim, supra note 41; Different estimates of the volume of illicit money moving across the globe include (i) Kochan’s who suggests that US $ 2.5 trillion per year would not be too far, NICK KOCHAN, THE WASHING MACHINE: MONEY, CRIME & TERROR IN THE OFFSHORE SYSTEM xxxiv (2006); (ii) Robinson suggests that at any given time, an estimated $600-$700 billion dirty money moves around the globe looking to get cleaned at around 2000, a jump from around $100-$300 billion in the 1990s and that this figure represents only 10% of the wealth hidden in offshore centers which leads to an estimate of about $6-$7 trillion moving through the offshore world (ROBINSON, THE SINK, supra note 9); (iii) Baker came up with US$ 230 billion per year; Schneider has suggested for OECD alone an amount of US$1 trillion per year; (iv) Walker has come up with US$ 2.8 trillion annually; It estimated that drug use alone accounts for 5% of the global domestic product of some $ 33 trillion, equivalent to around the estimated the volume to be around US$ 640 billion and 1.6 trillion representing around 2-5 % of the world’s GDP, 1998; (v) the UN’s estimates that the illegal drug industry alone is worth US $ 320 billion a year, How to stop the drug wars, THE ECONOMIST, March 17, 2009 at 15; the most recent year of the GFI study, developing countries lost an estimated $858.6 billion – $1.06 trillion in illicit financial outflows; (vi) the IMF approximates the yearly volume of illicit money to around US$ 590 billion to US$ 1.5 trillion (Vito Tanzi, Money Laundering and the International Finance System (IMF Working Paper No. 96/55, May 1996) 3-4; see Rowan Bosworth-Davies, Money-Laundering-chapter five: The Implications of global money laundering laws, 10 J. MONEY LAUNDERING CONTROL (2007) for an estimate of insurance payments for burglary losers, which amounted to $568million in 2001, and $424 million of credit card losses, in total $992 million which provide the highest degree of likelihood of producing cash assset with the capability of being laundered, 191; Goodhart, Some new directions in Financial Stability, Bank for International Settlements Per Jacobson Foundation, 2004
102 REFERENCE GUIDE TO ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM, 1-6 (2d ed., 2006).
103 Supra 86, 266
105 supra 80, 22.
106 Peter J. Quirk, Macroeconomic Implications of Money Laundering, 2 TRENDS IN ORGANIZED CRIME 10-14 (19977); Donato Masciandaro, Money Laundering: The Economics of Regulation, 7 EUR. J. L. & ECON. 225-40 (1999).
and damages caused to financial institutions by destabilizing customer trust, distorting allocation of resources, and facilitating crime.\textsuperscript{105} Arguments suggesting adverse macroeconomic effects of ML have, however, been challenged as unconvincing based on ML’s fundamentally crime prevention nature as opposed to being of macroeconomic relevance.\textsuperscript{106} On the other hand, the “terror of 11\textsuperscript{th} September, 2001 fractured globalization”,\textsuperscript{107} made obvious the multiple implications, including macroeconomic relevance, of terrorist financing, for the stability of the financial markets,\textsuperscript{108} where terrorists use the financial system to finance their illegal activities.\textsuperscript{109} Terrorists depend on criminal business to finance their terrorist operations.\textsuperscript{110} The impact of terrorism on financial institutions can take different forms- either as victim, perpetrator, or instrumentality,\textsuperscript{111} directly targeting financial centers as well as making indirect victims. In addition, terrorism can also benefit from financial institutions specially set up to finance its operations. The third implication for financial institutions of TF is their use, unknowingly, to channel terrorist funding.\textsuperscript{112} Concerns for the financial system stability, of the global reach of ML/FT,\textsuperscript{113} raised questions about the adequacy of prevailing regulatory frameworks to address challenges associated with managing globalization and its negative externalities,\textsuperscript{114} which undermine the financial system’s ability to allocate funds efficiently.\textsuperscript{115} The spread of financial instability associated (“financial contagion”) became a global public bad and avoiding it, a global


\textsuperscript{106} Richard Gordon, Anti-Money Laundering Policies-Selected Legal, Political, and Economic Issues, in CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW, VOLUME 1, 410-411.


\textsuperscript{109} Araujo, supra note 99.


\textsuperscript{111} Ibid. at 100.

\textsuperscript{112} Supra 110.


\textsuperscript{114} Ibid 26; SCHINASI, supra note 9 at 48 for a definition of “externalities” which arise when a financial activity imposes benefits or costs on third parties that are not directly involved in the activity.

public good.\textsuperscript{116} Justification of financial regulation to address such externalities\textsuperscript{117} thereby became an increasingly dominant feature of globalized economic policy-making.\textsuperscript{118}

The qualitative change brought about by globalization, distinct from the over-emphasized quantitative approach often misrepresenting globalization as a global phenomenon,\textsuperscript{119} laid the foundation for a new approach to address international ML/TF concerns, premised on new economic, financial and social interconnectedness.\textsuperscript{120} 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, mandate and specialized focus,\textsuperscript{121} ready to service the globally expanding markets.\textsuperscript{122} 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.\textsuperscript{123} This new form of ‘transnational legal process’;\textsuperscript{124} with their rules, institutions and networks, easily adapted as control mechanisms,\textsuperscript{125} and rooted in society’s crave for order and stability, offer a new approach to deal with global problems.\textsuperscript{126} 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)\textsuperscript{127} identified with the reforms of the existing rules paving the way for “best practices” and “principles” and the proliferation of several international

\begin{thebibliography}{99}
\bibitem{Jackson} Jackson, The Selective Incorporation of Foreign Legal Systems to Promote Nepal as an International Financial Services Center supra note 8 at 16-25.
\bibitem{Supra 5} Supra 5, 1, p.3-11
\bibitem{Wolfgang H. Reinicke & Jan Martin Witte} 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 75, supra note 9; O’Connell, supra note 9.
\bibitem{Ibid 54} Ibid 54; Steven Bernstein & Benjamin Cashore, Globalization: Four Paths of Internationalization and Domestic Policy Change: The Case of Eco Forestry in British Columbia, Canada, 33 CAN. J. POL. SCI. 67, 67-69 (2000).
\bibitem{supra 50} supra 50, Ku and Diehl.
\bibitem{Supra 50} Supra 50, Ku and Diehl.
\bibitem{supra 50} supra 50, Ku and Diehl.
\bibitem{Specialized standard setting bodies} Specialized standard setting bodies such as the International Organization of Securities Commissions (IOSCO, the grouping of securities regulators), \url{http://www.iosco.org/}; International Association of Insurance Supervisors (IAIS), \url{http://www.iaisweb.org/}; Financial Stability Forum/Bank for International Settlement (FSF/BIS), representing finance ministers, central banks, and regulatory agencies \url{http://www.bis.org/press/p090312b.htm} ; Basel Committee on Banking Supervision, \url{http://www.bis.org/bcbs/}; see also Curzio Giannini, Promoting Financial Stability in Emerging Market Countries: The Soft Law Approach and Beyond COMP. ECON. STUD. 12 (2002).
\end{thebibliography}
bodies, including the Financial Actions Task Force, all set up to address potential financial instability that may result from globalization. The multilateral AML/CFT regulatory framework, spearheaded by the international community, and providing global public goods, was born in this context, based on the need for a common legal framework to be designed, interpreted and enforced in a consistent, coherent, and predictable manner within nation states and across transnational borders. Two issues are critical to this form of global governance approach to address global problems: capacity to create effective global regulations and compliance—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, although the AML international regulation had been in place since the late 1980s and the FATF established in 1989, perhaps due to the absence of a catalyzing factor to drive ML on the international agenda. Or perhaps, and more important still, is the soft-law nature of the AML/CFT international regulatory framework which raises concerns about the effectiveness of legally ‘non-binding’ instruments, although soft law norms have been implemented and complied with on their own merit. Compliance with the FATF AML/CFT norms is inextricably linked with its soft law nature and origin, located in increasing legalization, of international [financial] regulation. Regulating ML/FT, therefore, needs to be addressed in the context of the international legal system and domestic forces, where law is regarded as the necessary basis for ordering behavior and, in its normative nature and legal language, creates expectations of compliance. The basic tenet of the rule of law principle entails an expectation that necessary

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128 Ramses A. Wessel & Jan Wouters, The Phenomenon of Multilevel Regulation: Interactions between Global, EU and National Normative Process, 4 INT’L ORG., L. REV., 260 (2007); examples of soft international institutions created in the context of international financial regulation include the Basel Committee on Banking, in which central bank directors of a limited number of countries harmonize their policies as to amount to regulation of capital markets, the International Organization of Securities Commission (IOSCO), dealing with the transnationalization of securities markets and attempts to provide a regulatory framework for them, the IAIS, FATF.


131 Following the September 11, 2001 attacks on the World Trade Center, the 8 Special Recommendations on the Financing of Terrorism were integrated into the existing FATF AML system.

132 Donald Rothwell, The General Assembly Ban on Driftnet Fishing, in COMMITMENT AND COMPLIANCE, supra note 9 at 123.

133 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; SOFT LAW IN GOVERNANCE AND REGULATION, supra note 63 at 1.

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


136 Shelton, COMMITMENT AND COMPLIANCE, supra note 9 at 7.

137 Jonathan L. Charney, Compliance with International Soft Law, in COMMITMENT AND COMPLIANCE, supra note 9 at 115.
measures are adopted to encourage compliance, and address defection caused by non-compliance which, in the long term, undermines the very principle. 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. Supported by an effective institutional setup, cohabitation of soft and hard law norms, a strong compliance assessment mechanism, under threat of sanctions for non-compliance, which are characteristics of major legal systems, the AML/CFT system has been transformed into a more comprehensive international legal regime for the control of financial crime. Its discourse including, the strength of its obligations, admissible exceptions, history, purpose and textual content, demonstrates sufficient legal characteristics of “public international law as the aggregate of the legal norms governing international relations”, capturing its functions and nature. In a rapprochement to hard-type norms, the FATF Recommendations embody legal norms with prescriptive and prohibitive obligations for its targets, 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 un compelling”, 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, as opposed to being mere ‘programmatory’, of the AML/CFT international obligations provides the strongest basis for understanding recent compliance impact. The substantive rules embodied in the FATF Recommendations constitute the minimum international mandatory standards that have shaped and constrained countries’

138 Id. at 8.
139 ALEXANDER, DHUMALE & EATWELL, supra note 6.
141 See the FATF NCCT List and Recommendation 21 which provides for sanctions for departure from the FATF Recommendations (also Chapter on NCCT).
142 Supra 6, Kern Alexander, p10
143 FATF 40+9 Recommendations; FATF METHODOLOGY, supra note 29, on the mandatory obligations contained in the Recommendations.
144 FATF METHODOLOGY 2003, as amended, FATF Recommendation 1; supra note 29 on exceptions such as “self-laundering.”
145 Weil, supra note 24 at 414-415.
146 Shelton, Introduction, in COMMITMENT AND COMPLIANCE, supra note 9 (identifying targets of norms as one of the factors that can influence compliance, 16, targets include non 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 Recommendation 5: preventive measures which target directly financial institutions, and Recommendation 12 which targets non-bank financial institutions.
147 Abbott & Snidal supra note 70 at 423; Sindicco supra note 70; see Shelton, COMMITMENT AND COMPLIANCE, supra note 9 at 12-13 (discussing the reasons that motivate countries’ choice for soft law).
148 Giovanoli, supra note 31 at 72.
regulatory practices in the fight against ML/FT\textsuperscript{149} and form the all-embracing foundations upon which all compliant countries and territories base their approach to AML/CFT. Use of the terms “should”\textsuperscript{150} or “should be required by law or regulation”\textsuperscript{151} embodies mandatory obligations “requiring countries or their competent authorities to take measures that will oblige their financial institutions or DNFBPs to comply with the recommendations”.\textsuperscript{152} On the other hand, the terms “should consider”,\textsuperscript{153} reflect mere discretionary obligations allowing countries some flexibility in respect of the matter to be regulated. Of the 40+9 AML/CFT Recommendations, only 3 are of a discretionary nature,\textsuperscript{154} while the remaining 46 Recommendations illustrate precise and specific obligations which, although do not create legally enforceable rights (in the conventional sense), nevertheless create commitments and expectations in 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.\textsuperscript{155}

Contrary to claims about soft norms being of mere “hortatory or promotional language”\textsuperscript{156}, the FATF standards represent the hardest type of soft norms with more defined language\textsuperscript{157} 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 Elements\textsuperscript{158} 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. “They are those elements that should be present in order to demonstrate full compliance with the mandatory elements of each of the Recommendations.”\textsuperscript{159} The E.Cs are determinate and relate to one another in a non-contradictory way, creating a framework of

\textsuperscript{149} ALEXANDER, DHUMALE & EATWELL, supra note 6; FATF METHODOLOGY, supra note 29 at 5, ¶ 9 (“The Recommendations… are applicable to all countries.”); Giovano, supra note 31 at 12.

\textsuperscript{150} The word ‘should’ has the same meaning as ‘must’ for purposes of assessing compliance.”

\textsuperscript{151} FATF METHODOLOGY, supra note 29 at 9 ¶ 23; definition of “should” and “consider” in the Glossary to the Methodology, Annex.1, 63.

\textsuperscript{152} FATF METHODOLOGY, supra note 29 at 9, ¶ 26-27.

\textsuperscript{153} Definition of “consider” in the FATF 2004 (2009) Glossary.

\textsuperscript{154} FATF Recommendations 9, 19 and 20; FATF METHODOLOGY, supra note 29.


\textsuperscript{156} Chinkin, The Challenge of Soft Law: Development and Change in International Law, supra note 32 at 850; Kal Raustiala, Form and Substance in International Agreements, 99 Am. J. Int’l L. 588.

\textsuperscript{157} Ross Delston & Stephen 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. 92 (2009).

\textsuperscript{158} FATF METHODOLOGY, supra note 29; for each Recommendation, there is a set of EC which guides the country as regards the elements of the Recommendation that are required to be complied with in order to ensure conformity with the respective Recommendation, http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf

\textsuperscript{159} FATF METHODOLOGY, supra note 29 at 6, ¶10.
coherence,\textsuperscript{160} spelling out prescribed or proscribed behavior 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.\textsuperscript{161} At the same time, the Recommendations create exceptions based on countries’ national constitutional provisions or fundamental principles of their legal system\textsuperscript{162} as in the case of the ‘self-laundering’ offence.\textsuperscript{163} Countries are also allowed to limit the application of certain Recommendations, under specific conditions, based on levels of risks and vulnerabilities.\textsuperscript{164}

Delegation by the G7 to the FATF in 1989,\textsuperscript{165} of the mandate to develop and implement the international AML/CFT standards across the world, posits the FATF AML/CFT institutional system as a dynamic and fluid phenomenon with sufficient degree of legalization.\textsuperscript{166} The mandate to develop and monitor implementation of the norms,\textsuperscript{167} its dispute settlement-like sanction process,\textsuperscript{168} and its mechanisms (Working Groups and Plenary) to interpret the Recommendations and the E.C.s, in order to remove uncertainty and inconsistency and ensure coherence, conforms to the ‘broad authority of a neutral entity to implement the agreed rules, including their interpretation and adaptation as circumstances unfold.’\textsuperscript{169} The rules can be made precise through ‘adjudication’, via its Working Groups and Plenary, or the issuance of

\textsuperscript{160} Thomas Franck, The Power of Legitimacy among Nations (1990); Thomas Franck, Fairness in International Law and Institutions (1998).

\textsuperscript{161} 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 \textit{de minimis} provision; extraterritoriality of the predicate offence; and self-laundering guided by the fundamental principles of countries’ domestic law.

\textsuperscript{162} See FATF Recommendation 1 and EC.1.1.6, which provides 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 Recommendation on Money Laundering, http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html

\textsuperscript{167} Houston Economic Declaration, supra note 10. 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, http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf


\textsuperscript{169} FATF Methodology, supra note 29 at ¶ 23-25. 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, http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf

\textsuperscript{166} Houston Economic Declaration, supra note 10. The G7 endorsed the report of the Financial Action Task Force (FATF) and commit countries to a full implementation of all its recommendations. The FATF shall be reconvened for a second year, chaired by France, to assess and facilitate the implementation of these standards http://www.g7.utoronto.ca/summit/1990houston/declaration.html#drug; G7 Summit, Paris, Summit of the Arch, July 14-16, 1989, convening a financial action task force from Summit participants, http://www.g7.utoronto.ca/summit/1989paris/communique/dng.html

\textsuperscript{165} Delegation, being 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, The Concept of Legalization, supra note 63 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, supra note 63 at 62.

\textsuperscript{169} Houston Economic Declaration, supra note 10.


\textsuperscript{161} FATF Annual Report, 2006-2007, 2.
Interpretation of “horizontal issues”\textsuperscript{171}-those 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”\textsuperscript{172}, facilitating countries’ compliance.\textsuperscript{173} However, grey areas still exist in the norms, as illustrated by the lack of clarity in purpose between the Recommendation and the E.Cs.\textsuperscript{174} Whether the EC 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, undermining compliance. Criminalization of TF has also given rise to intricate legal issues arising out of the implementation of the SR II, in the context of the 1999 Convention and UN SCR Resolutions on TF.\textsuperscript{175} 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, building up its unique ‘software’, leading to more institutional equilibrium through teleological interpretation, where norms are strengthened by constructive interpretation through more jurisprudential approach.

The flexibility of the FATF AML/CFT normative structure to constantly adapt to new, and changing, ML/TF environments and activities,\textsuperscript{176} provides compliance recipients and drivers with adaptable and flexible tools to deal with an evolving criminal behavior. With ML/TF


\textsuperscript{171}FINANCIAL ACTION TASK FORCE [FATF], THIRD ROUND OF AML/CFT MUTUAL EVALUATION: PROCESS AND PROCEDURES (FATF Reference Document) (2009) at 9, ¶ 25. 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), R.32 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, http://www.fatf-gafi.org/dataoecd/20/14/41563294.pdf

\textsuperscript{172}See FATF METHODOLOGY, supra note 29 at 9, ¶ 27. The concept of “other enforceable means” have given rise to serious debate among countries, the issue being what is the exact meaning of the concept.

\textsuperscript{173}Recommendations that are supplemented by Interpretative Notes include 5, 6, 9, 10 to 16, 19, 23, 25 to 27, 38, and 40. TF Recommendations are supplemented by IN to SR III relating to freezing and confiscating terrorist assets and IN to SR 8 related to Alternative Remittance Systems (unpublished).

\textsuperscript{174}An analysis I carried out recently reveals several areas of inconsistency exist between the Recommendations and the E.Cs (unpublished).

\textsuperscript{175}Based on an analysis of the cross-reference to the offence of TF in SR II, E.C II.1 to Article 2 of the UN International Convention for the Suppression of Terrorism 1999 Convention and the definition of terrorist act under the Convention, which appears to create some inconsistency.

\textsuperscript{176}Chinkin, The Challenge of Soft Law: Development and Change In International Law, supra note 32 at 852; Giovanoli, supra note 31 at 12.
methods continuously evolving and ML/FT channels becoming targets of law enforcement and regulatory bodies, perpetrators search for new methods and channels of laundering their illicit money. Evolution in ML/TF techniques witnessed a transformation where illicit money is diverted from the financial system through jurisdictions with weak regulations, such as Offshore Financial Centers (OFCs), informal transfer systems, 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; the cohabitation of hard and soft AML/CFT standards, generates greater compliance impulse. The FATF’s typological studies on ML/FT trends and patterns, informed by changing circumstances, are highly valuable in ensuring normative adjustment, 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, and “gatekeepers’ such as lawyers, notaries, accountants, often referred to as “DNFBPs (Designated Non-Financial Businesses and Professions). The fundamental change in approach developed as a result of money launderers moving away from the financial sectors to the more real economy sectors. New and cutting edge money laundering methodologies represent tremendous challenge for the financial, regulatory, legal, intelligence, and the law enforcement community. The explosion of the internet drastically changed the environment for doing business allowing hackers and fraudsters to exploit criminal opportunities presented by cyberspace, and have since been joined by cyber- launderers eager to wash the proceeds of both virtual and real-life crimes. The FATF addresses new challenges posed by e-cash, online auctioneering, internet gambling, telemarketing fraud, and cyber terrorism and, more recently, the football sector’s vulnerabilities, by regularly upgrading its norms and strategies. The flexible nature of the

179 See Chapter III, Compliance Determinants, at page 21.
182 G7/8 Summit Meeting, London, 9 May 1998 This was reaffirmed by the typologies experts in the report issued in February 2002 in the light of which, four recommendations (12, 16, 24 and 25) were created incorporating the 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, under AML/CFT regulation; as a result of the conclusions of the G7 expert working group on the involvement of professionals such as lawyers and accountants in money laundering, as part of its “Actions against the Abuse of the Global Financial System”.
184 Id.; previous FATF Annual Reports 2005, 2006, 2007
185 KOCHAN, THE WASHING MACHINE, supra note 99.
186 Trehan, supra note 114.
187 FATF Annual Report, 2008-2009, http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html
188 Id.
Recommendations also enables participation and integration of all interested parties including non-state actors in the process of transnational law-making,\(^{189}\) associated with increased openness which allows for more transparency, enhances agenda setting, and facilitates diffusion of knowledge.\(^{190}\) In addition, inbuilt normative flexibility enables the FATF’s to review, every seven years, the overall substance and framework of the principles and practices that underpin its Recommendations, ensuring that the lessons from compliance assessments are captured.\(^{191}\)

Flexibility is also demonstrated through the integration of the 8 FT SRs,\(^{192}\) following the September 11, 2001 attacks, into the already existing AML normative structure, providing greater impetus to the AML compliance framework. It has been suggested that it was the 11\(^{th}\) September 2001 that changed the face of ML\(^{193}\), by providing greater impulse to the existing AML framework, comparable to when growing drug trafficking, as opposed to money laundering itself, that first drove the AML movement. The 9/11 event elevated ML to the rank of a serious threat by virtue of the inextricable link between the financing of terrorism and ML\(^{194}\) 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 illicit money, driven by similar criminal sources and methodologies, both relying on illicit assets to carry out their activities.\(^{195}\) Despite divergent views about the benefits of such linkages, based on legitimacy concerns,\(^{196}\) 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 experience of 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 wealth,\(^{197}\) and applied through the banking system to interdict criminal assets, was now being used against the terrorists.\(^{198}\) The integration of TF into the already existing ML

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189 Reinicke & Witte, Challenges to the International Legal System, Interdependence, Globalization, and Sovereignty: The Role of Non-Binding International Legal Accords, in COMMITMENT AND COMPLIANCE, supra note 9.
190 Supra 176, p11,12
194 Ibid. at 9-11.
195 THONY, MONEY LAUNDERING AND TERRORISM FINANCING: AN OVERVIEW, supra note 140 at 244.
196 Gilles Favarel-Garrigues supra note 192.
198 Ibid.
process and framework exerted a greater compliance pull 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 differences between property linked to ML and terrorist property,\textsuperscript{199} where the predicate offence is a concept defined in respect of a past event. Moreover, the source of terrorist funds, which may, at the point of inception, be clean, but still being used for a criminal act, is another issue of some complexity.\textsuperscript{200}

FATF’s recent shift, from the traditional rule-based system to a more risk-based approach,\textsuperscript{201} 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 with the flexibility in adopting a risk-based approach,\textsuperscript{202} these provisions had not previously been exhausted and systematically used as a basis for determining levels of sector or country risks in determining a 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)\textsuperscript{203} and, as part of FATF’s outreach to the private sector,\textsuperscript{204} 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 normative system from a “one-size-fits-all” to a more embracing approach grounded in an appreciation of country and sector specificities interaction where both the public and private sectors play an important role. Risks vary according to countries’ and sectors’ specificities and identifying risks

\textsuperscript{199} Ibid.
\textsuperscript{202} FATF Recommendation and Methodology, 2004 (updated February 2009), 9 at ¶ 23-25, \textit{see also} Recommendation 5, Essential Criteria 5.8-5.12, dealing with risk assessment in financial sector’s application of the preventive measures; Note that the ECs 5.8-5.12 also apply to the DNFBPs under Recommendation 12 (EC 12.1: DNFBPs should be required to comply with the requirements set out in Recommendation 5 (Criteria 5.1-5.18), p23, \textit{http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf}
\textsuperscript{203} FATF Revised Mandate 2008-2012, \textit{supra} note 47 at 4; The FATF Working Group on Evaluations and Implementation.
\textsuperscript{204} FATF, \textit{GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING}, \textit{supra} note 20; \textit{see also}, FATF Money Laundering and Terrorist Financing Risk Assessment Strategies, 18 June 2008, \textit{http://www.fatf-gafi.org/dataoecd/46/24/40978997.pdf}
and vulnerabilities accordingly, and adopting a methodology and assessment that integrates these risks elements provides a real-time measure of the country’s compliance situation. This approach raises four critical challenges. First, integrating risks into a compliance framework should, however, be approached with caution as such an approach could hamper the creation of a level playing field, with comparisons among assessments 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, and of some complexities, 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, undermining the rule-based approach. Finally, the implications of the risk-based approach, however, raises 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, 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, described as ‘way-stations on the road to the conclusion of a treaty’. Three aspects of the FATF 40+9 Recommendations are closer 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 offence pursuant to Recommendation I originated with, and is conditional upon, the definition of the ML offence provided for in both the 1988 UN Vienna Convention on drugs, and the 2000 Palermo Convention on organized crime, illustrates the influence of a hard law provision (UN Conventions) on, and its interaction with, a soft law instrument (FATF Recommendations). From an implementation perspective, added impetus is

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205 Shelton, Normative Hierarchy in International Law supra note 56 at 320; Sindico supra note 70.
206 Giovanoli, supra note 31 at 91.
207 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) indicate the interplay of soft and hard law.
gained by countries ensuring their obligation to ratify and incorporate these two UN Conventions, or the offences, into their domestic legal systems. Similarly, criminalization of the TF offence, under FATF Special Recommendation II, is conditioned by the UN Convention on the Suppression of the Financing of terrorism 1999 provisions, which obliges 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 TF”, including S/RES/1267(1999) and its successor resolutions and S/RES/1373 (2001). 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. This cohabitation of soft and hard law strengthens the normative value of the AML/CFT standards strengthening their legalization and has been significant in building consensus for compliance among countries.

B. The FATF Institutional Framework- International and Regional Cooperation

The FATF represents an institutional instrument of international cooperation, created and operated by states, to ensure world order by carrying out specific functions, where its AML/CFT standards constitute the ‘persistent and connected sets of rules that prescribe behavioral roles, constrain activity and shape compliance expectations’. Failure and inefficiency of unilateral actions by states to address ML/FT concerns effectively, led to the design of a concerted multilateral initiative, driven by the FATF, which provided greater

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208Special Recommendation II which expressly creates the obligation that Terrorist Financing should be criminalized consistent with Article 2 of the Terrorist Financing Convention.  
210 181 countries have ratified the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna, 20 December, 1988); 150 have ratified the UN Convention on Transnational Organized Crime (15 November 2000); 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.  
212 ROBERT O. KEOHANE, INTERNATIONAL INSTITUTIONS AND STATE POWER, ESSAYS IN INTERNATIONAL THEORY. (1989), 3  
dynamism and impulse, shaping up a stronger international AML/CFT regime. Associated with the growing use of soft power regulating international finance and issues of international interest, such as ML/TF, the AML/CFT normative instruments became a focal point for maximizing compliance. The AML/CFT system helps reduce likelihood of defection by resolving ambiguity or indeterminacy of norms, supervising the instrument that created them, and assisting regulatory targets overcome capacity deficits to comply through technical assistance. Established in 1989, the FATF is today well known as the recognized standard-setter in the fight against ML/TF and has emerged as a powerful force shaping the international AML/CFT norms. It distils, through institutional networks, information to its members in the form of best practices on ML/FT, seeking to maximize compliance. 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. 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 standards and generating compliance impulse.

By frontloading its character and rationale, the history of FATF provides a basis to its identity and the initial influence which shaped up its future. Its formation and continuing evolution, from 1989 to the present, is inextricably tied up with the G7’s concern about the devastating proportions of the evolving global criminal activities and the movement of illicit

215 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, supra note 9 at 76.
217 Its four essential functions are (i) to revise and clarify the global standards and measures for combating money laundering and the financing of terrorism; (ii) promote global implementation of the standards; (iii) identify and respond to new money laundering and terrorist financing threats; and (iv) engage with stakeholders and partners throughout the world, FATF Annual Report, 2007-2008, supra note 46 at 1.
219 SHELTON, COMMITMENT AND COMPLIANCE, supra note 9 at 2.
223 Ness & Brechin, supra note 21 at 246; Jacobson et al., supra note 211; Keohane, International Institutions and State Power, supra note 212.

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funds across the globe.\textsuperscript{227} The G7’s call for member states and non-member states “to participate in the fight against money laundering and to fully implement all the FATF recommendations without delay”\textsuperscript{228} has been critical in FATF’s development and policy-making functions.\textsuperscript{229} The continued existence of the FATF institutional framework is confirmed in the renewal of its mandate, initially for five years\textsuperscript{230}, and subsequently for continuous periods of five years.\textsuperscript{231} The G7 1991 London Summit’s endorsement of the FATF as a permanent institution with a secretariat supplied by the OECD,\textsuperscript{232} and its AML Recommendations, provided legitimacy and formalization to the FATF process as the pillar 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\textsuperscript{233} and institutional permanency, with its own internal dynamics and external working relations. This gradually started to exert an identity of its own upon member countries and, as the process deepened, its identity prevailed upon even powerful states’ interest and preferences. Permanency in the FATF institutional framework is reflected in its growing institutionalization as a distinct entity with its specific “technology”, defined in terms of the functional capability to achieve its goals through its discourses (‘software’), operational apparatus (‘hardware’),\textsuperscript{234} with its membership, Ministerial Meeting, Plenary meetings, Working Groups and Committees, and ‘human-ware’, namely, the FATF Secretariat and staff. This “technology”, which characterizes its dynamic process of identity formation and continued survival, rests on the range of its products and services, including conducting countries’ 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, a full-fledge FATF bureaucracy informed by the FATF bi-annual accountability to the Finance Ministers’ Plenary Meetings,\textsuperscript{235} creating norms and social knowledge, as opposed to being a mere passive machinery of their creators.\textsuperscript{236} Its institutional structure and functions have also been significantly enhanced by the highly

\textsuperscript{227} ibid 211.
\textsuperscript{228} Houston Economic Declaration, supra note 10.
\textsuperscript{229} G7 Meetings, supra note 226.
\textsuperscript{231} FATF Revised Mandate 2008-2012, supra note 47 (elaborating on the history of the FATF since its creation and its achievements).
\textsuperscript{233} See chapter III. A above, on Normative Structure , page 14.
\textsuperscript{234} Cho, supra note 32.
\textsuperscript{235} FATF Revised Mandate 2008-2012, supra note 47 at 5.
successful compliance monitoring\textsuperscript{237} 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 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 separate and autonomous organic entity molding itself as it interacts with the environment in which it is located.\textsuperscript{238} It is no longer a mere “ad hoc grouping of governments and others with a complex single issue agenda”, and resembles more “a permanent international organization, and a body managing a set of legally, non-binding norms.\textsuperscript{239} Although it has developed some independence, mostly for operational and management purposes, which facilitates achieving its objectives more effectively, it has, nevertheless, retained the initial ‘programmed purpose’ which remains the main 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/FT.

The constantly evolving normative structure of the FATF system,\textsuperscript{240} leading to greater institutionalization, contributed to enhance and provide more sustainability to its identity formation. Confronted with changing demands resulting from testing situations,\textsuperscript{241} it has regularly reconfigured its institutional setting\textsuperscript{242} illustrated in the numerous normative reviews,\textsuperscript{243} adapting itself into a more dynamic institutional framework to enable it achieve its functions,\textsuperscript{244} confirming 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 TF\textsuperscript{245}, and strengthening cooperation networks, significantly reinforced the FATF setup and its compliance role.\textsuperscript{246} The increased “legalization” and “judicialization” of the FATF process, with the mandatory obligations and its compliance monitoring mechanism and its

\footnotesize{\textsuperscript{237} FATF METHODOLOGY, supra note 29.\textsuperscript{238} Sungjoon Cho, An Identity Crisis of International Organizations, presentation made at the Harvard Law School Graduate Forum held in Cambridge, Massachusetts on February 26, 2009, http://works.bepress.com/cgi/viewcontent.cgi?article=1048&context=sungjoon_cho\textsuperscript{239} R.M. Pecchioli, The Financial Action Task Force, (Paper presented at the Council of Europe Money Laundering Conference, Strasbourg, 28-30 September, 1992).\textsuperscript{240} See chapter III.A above, on Normative Structure, p. 14 onwards\textsuperscript{241} The clearest example of a testing situation has been the integration of the TF international standards into the existing AML normative and institutional structure.\textsuperscript{242} Supra, 233\textsuperscript{243} supra, Chapter III.A above, p.14 onwards\textsuperscript{244} See Chapter III.A above, p.14 onwards\textsuperscript{245} G7 Finance Ministers and Central Bank Governors (October 6, 2001).\textsuperscript{246} Statement of G7 Finance Ministers, September 2001, Canada.}
sanctions, contributed greatly to its institutionalization, ensuring greater compliance pull. Although it does not have a treaty-based formation, it nevertheless enjoys sufficient legal authority over the creation of the norms and its implementation across the world as an acknowledgement of its distinguishable mission. Production of noticeable juridical products in the form of international quality guidelines or Best Practices and Interpretative Notes developed by the FATF, arising out of socialization among networks, integrating both governmental officials and private sector and trans-governmental networks of actors and regulators, 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, providing 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 forum, contributing to the net welfare of the global community.”

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, the International Monetary Fund (IMF) and the World Bank, the Council of Europe’s different instruments against ML, and the Egmont Group, which provide a forum for discussing issues related to suspicious reporting transactions, with its 116 FIUs from countries. In addition, private AML/CFT initiatives provided an extended reach to non-state actors, through financial and non-financial organizations. The cumulative effect of cooperation among those agencies generated an impulse that ensured greater compliance by both state and non-state actors. Their role and participation in promoting the AML/CFT standards has been far from marginal, at the same time,

247 Slaughter, A New World Order, supra note 93.
252 The Egmont Group is an international organization made up of national Financial Intelligence Units (FIUs), responsible for receiving, analyzing, and disseminating to competent authorities, disclosures received from the respective financial and non-financial sectors. The Egmont Group, http://www.egmontgroup.org/.
254 These include the Basel Committee on Banking Regulation and Supervisory Practices, the IOSCO and the IAIS.
addressing legitimacy concerns arising of the FATF’s limited geographical coverage. The G7 constant calls, 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), highlighting the link between ML/FT and financial sector stability. The IMF’s AML/CFT mandate is encapsulated in the Board’s decisions which emphasize the Fund’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 Programs either if it is a Bank/Fund assessment or an FSRB mutual evaluation. 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.”

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 adding greater impulse to compliance. With their membership accounting for over two-third of the UN member states covering a range of about 100 member, these regional organizations constitute an additional force ensuring wider coverage of the AML/CFT standards across the globe. Mandated to evaluate member’s compliance, promote the AML/CFT standards across its members, undertake ML/FT typologies

255 McFarlane, supra note 36.
262 Holder supra note 261; see FATF Members and Observers, http://www.fatf-gafi.org/pages/03.3417_en_32250379_32236869_1_1_1_1_1_00.html
263 Supra 40, See FATF Annual Report 2008-2009, supra note 17 for a list of all Associate Members and FSRBs.
exercises, and build capacity, they are the primary partners of the FATF, with and an important leadership role in their regions. Mutual participation in their plenary meetings allow 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 identify patterns and lessons, or inconsistencies, in countries’ mutual evaluation in the assessments being carried out by the FSRBs, IMF, WB, as opposed to those carried out by the FATF. Variances in the manner and substance of such assessment provide valuable indicators about compliance levels. Cooperation and collaboration, among those institutions, albeit not always perfect, has not only strengthened the FATF system but 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 has often generated compliance impetus, driving the compliance process forward. However, the international strategy and cooperation against ML/FT remains fragmented and often suffers from lack of coherence, cohesion and sustained coordination, with 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 compliance monitoring process, of countries’ compliance with, the AML/CFT standards, integrating compliance, implementation and effectiveness as crucial stages in its assessment methodology. The monitoring process, 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, it provides early warning of violations reducing fear of free-riding, confirms countries’ reputation, and indirectly deters non-compliance by increasing the likelihood of detection. 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

265 FATF Revised Mandate 2008-2012, supra note 47 at 3.
266 The FSRBs are recognized as associate members of FATF and participate in its Plenary meeting while the FATF is represented in the FSRBs’ meetings.
267 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 sing the same the FATF 40+9 Recommendations and its 2004 Methodology and other documents.
268 The onus of providing the relevant information is on the country.
269 The NCCT process acts as a surveillance mechanism overseeing whether countries are complying with their obligations.
members and non-members’ compliance with its standards and, albeit 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 credibility of its norms and process, forcing participation and involvement where countries become more proactive in enforcement.270 Greater participation of countries in the process is illustrated by the growing number of countries that have subjected themselves to the mutual evaluation process and have either adopted AML/CFT legislation or made commitments to that effect. FATF’s 3rd round of evaluation of countries which started in 2005 (it is now preparing work for the 4th round of evaluations),271 has now reached a level of performance not reached in the past. The number of countries assessed grew to one hundred and forty-five (145) from 2004-2009, using the 2004 Methodology,272 of which one hundred and twenty-three (123) assessment reports have been published.273 Mutual Evaluation reports are now public enabling a better appreciation of achievements and ensuring greater transparency.274 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.275 Its international and regional network collaborating with other organizations,276 provides the FATF a wider geographical network providing greater scope for more effective coverage and implementation of the standards.277

This growing ‘judicialization’ of the FATF process is best understood in the context of the impact of law and legalization on states’ behavior based on the presumption that legal rules generate an expectation of compliance.278 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

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270 Johnson & Lim supra note 41.
271 A Note from the President FATF E-NEWS, supra note 2.
272 Based on statistics provided by the FATF Executive Secretariat and its Annual Reports about countries that have accepted to publish the mutual evaluation.
276 FATF Revised Mandate 2008-2012, supra note 47; FATF Annual Report, 2007-2008, supra note 46 at Foreword by the FATF President.
277 Supra 47 and pages 5-6 for a detailed list of regional organizations.
the process. Second, and most important, is its distinctiveness, characterized by reliance on the three fundamental concepts of compliance, implementation and effectiveness, enabling a comprehensive assessment of countries’ compliance with their AML/CFT obligations. Although theoretically 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.

Replacing the previous self-assessment process relying on countries’ own assessment, riddled with reliability and credibility concerns, the FATF 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 Recommendations, and serves to highlight weaknesses accompanied by appropriate recommendations. The depth of the FATF compliance assessment process, illustrated by the three-step procedure within specific timeframes; its basic instruments for conducting assessment, including the 40+9 AML/CFT Recommendations, the FATF Methodology, comprised of two hundred and fifty (215) Essential Criteria and 37 Additional Elements, ensure greater involvement of countries in the process. 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, guarantees fairness and transparency on procedural and substantive issues, allowing greater involvement. The power of countries, after taking cognizance of the draft assessment

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280 A parenthesis is required at the outset to distinguish between ‘compliance’ as a 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.

281 Supra 278, Raustiala, 304.


283 Johnson & Lim, supra note 41.

284 Supra 284, FATF METHODOLOGY, supra note 29 at 3-5.

285 Id. at 3-6.


287 Supra 284, the E.Cs are found under each Recommendation, in the FATF 2004 Methodology.

288 Supra 284, 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.

report, to challenge whatever conclusions reached by the experts regarding compliance performance and ratings, and their decision to allow publication of the report, or not, promotes ownership of the process and the final report, all vital elements for motivating compliance. 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 providing relevant and accurate information and for the assessors to exercise judicious judgment in reaching their conclusions about levels of compliance. 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, albeit distinct but interrelated, concepts, critical for ensuring a complete assessment of a country’s compliance. Pioneered by Professor Jacobson and Weiss, these concepts led to additional perspectives in academic debates, providing a new approach looking beyond the debate about how nations behave to why behave, with different perspectives for academic and policy dialogues. Implementation, distinguishable from compliance, refers to the transposition, by adoption of domestic legislation or other process, as acceptable rules into their domestic legal systems, of countries’ international obligations. Compliance, which includes implementation, is the behavior of an actor with a specified rule, providing one of the pathways through which legal rules and institutions impact states’ behavior in relation to their

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290 Ratings are allocated under four categories including Compliant (C), Largely Compliant (LC), Partially Compliant (PC) and Non-Compliant (NC). NC- there is 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.
291 supra, 290, FATF Handbook, p3
292 It is essential that all the FATF Recommendations are effectively implemented and that assessments or evaluations address this issue and reflect it in writing. 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 effectively implemented.” FATF METHODOLOGY, supra note 29. The Methodology constitutes the cornerstone of the FATF monitoring mechanism whereby countries’ compliance and implementation of the AML/CFT is assessed.
294 Raustiala, Kal and Slaughter, Anne-Marie; Kal Raustiala; Alvarez, E.Jose; Kingsbury, supra note 279; Shelton, COMMITMENT AND COMPLIANCE, supra note 9 at 5; Raustiala, Compliance & Effectiveness in International Regulatory Cooperation, supra note 74 at 392.
296 WEISS & JACOBSON, supra note 293.
297 Simmons, Compliance with International Agreements, supra note 20.
298 Jacobson & Weiss, supra note 293.
299 Kal Raustiala, , supra note 294; Kingsbury, supra note 279.
commitments. It is assessed by ascertaining whether the country in fact adheres to the provisions of the accord and to implementing measures that need to be instituted, often associated with factual matching of the state behavior with the norms. Effectiveness, on the other hand, looks at whether the policy objectives are achieved or not and involves a process of evaluating the goals integrated in the norms and represents the yardstick to measure the “degree to which a legal rule or standard induces changes in behavior.”

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. 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), but to ensure that the laws or measures adopted are in conformity with the standards (compliance). Compliance requires that the norm has been transposed according to the exact requirements of the Recommendations, or whether there has been any major deviation. It is defined by reference to conformity of domestic legislation or measures with the specific Essential Criteria and is rated according to any full (C), majority, partial (PC), observation of all ECs of each recommendation, or major shortcomings (NC). 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”. The cumulative effect of the three-tier approach, based on these concepts, including the overall ratings, captures country’s levels of conformity, its needs to meet the requirements of the international obligations; and the effectiveness of the country’s AML/CFT system, the end result of which is to ascertain whether

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301 Supra, 294, Raustiala
303 Raustiala, Form and Substance in International Agreements, supra note 156 at 610.
304 FATF METHODOLOGY, supra note 29 at 3-7; the handbook for Assessors, at pages 3-12, makes continuous reference to the assess a country’s compliance and implementation of the standards and their effective implementation
305 Id. at 4-13.
306 Id. at 4.
307 Id. at 4, ¶ 6. Essential Criteria: “The essential criteria are those elements that should be present in order to demonstrate full compliance with the mandatory elements of the Recommendations”.
308 Id. at 6, ¶ 11.
309 Id. at 4, ¶ 6.
the goals of the norms have been met.\textsuperscript{310} Guided by the quest for order and stability achievable through policy-making and the rule of law,\textsuperscript{311} 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, and 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 and 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\textsuperscript{312}. 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.\textsuperscript{313}

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

\textsuperscript{310} Shelton, COMMITMENT AND COMPLIANCE, supra note 9.

\textsuperscript{311} O’Connell, supra note 9 at 100.

\textsuperscript{312} YOUNG, COMPLIANCE AND PUBLIC AUTHORITY, supra note 302 at 172.

\textsuperscript{313} FATF AML/CFT Evaluations and Assessments-Handbook for Countries and Assessors, June 2007, Annex 3, 96
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. 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: Impulse from Reputational Factor.

Whatever forms of sanction or penalty that violations of responsibilities may entail, they are critical for ensuring compliance. The availability of sanctions, 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 mechanism, is of considerable international significance and moral suasion and failure to subscribe to its standards can result in significant downsides for those countries that fail their review. 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-conformity, the FATF sanction

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314 Shelton, COMMITMENT AND COMPLIANCE, supra note 9 at 5; Raustiala & Slaughter, International Law, International Relations and Compliance, supra note 19 at 538-39; Raustiala, Compliance & Effectiveness in International Regulatory Cooperation, supra note 74 at 387; Alvarez, Why Nations Behave, supra note 279 at 303-05.
316 The concept of sanction in this context is distinguished from the reference to sanctions for violation of specific recommendations as provided for in Recommendation 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) whereas Recommendation 17 is construed as sanctions applicable for supervisory and regulatory breaches.
319 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 “any 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.”); see Chayes & Chayes, THE NEW SOVEREIGNTY: COMPLIANCE WITH INTERNATIONAL REGULATORY AGREEMENTS 152-53 (1995) (distinction between an action that inflicts a cost (a fine or sanction) and an action that withdraws a benefit (reciprocal noncompliance).
process, comprising its List of Non Cooperative Countries and Territories (NCCT List), and countermeasures, a non-confrontational and collective form of managing non-conformity, is crucial for the credibility of its compliance monitoring process. Albeit a softer form of enforcement mechanism, operating outside the boundaries of formal treaty law, it generated greater compliance impulse among countries, explained in terms reputational considerations and fear factor. 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 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 centers of international standards to prevent, detect and punish money laundering, and thereby effectively co-operate internationally in the global fight against money laundering”. 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. Based on its twenty-five criteria, the NCCT process is an extensive assessment of the country’s financial and non-financial environment, identifying loopholes in regulations, institutions and supervision, and practices that hinder cooperation in the fight against ML. It constitutes the central framework according to which “countries should be able to apply appropriate counter-measures” “where a third country continues not to apply or insufficiently applies the FATF Recommendations”. 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. Fairness and

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320 The FATF List of Non-Cooperative Countries and Territories.  
323 George W. Downs & Michael A. Jones, Reputation, Compliance and International Law, 31 J. LEGAL STUD. 95 (2002).(relevant for a detailed analysis of the concept of reputation as a factor influencing compliance).  
324 See Chapter III.F above, on Legitimacy about reputation being an indicator of compliance.  
326 Jean-François THONY and Catherine DUJOLS-THONY, Quinze ans de la dynamique international de lutte contre le blanchiment “Offshore”, La face cachée de la finance : les enjeux éthiques, Rapport Moral sur l’Argent dans le Monde, 2005  
327 Financial Action Task Force, Report on Non-Cooperative Countries and Territories, 14 February 2000, the list of criteria is found at Annex 10.  
329 FATF Recommendation 21, Essential Criteria 21.3 provides that “Where a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate countermeasures”, FATF Reference Document, Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations, 27 February 2004(updated as of February 2009) http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf  
330 Johnson, supra note 318 at 38, referring to Suchman.
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. The different steps involved in the NCCT process ensure that identified members are constantly monitored until they achieve levels of compliance acceptable by the FATF, leading to removal from the list. 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.

This policy of classifying NCCTs, pursuant to Recommendation 21, is basically a ‘name and shame’ procedure which affects countries’ reputation creating expectations that countries will eventually prefer to comply rather than be shamed 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, rely on compliance as a means of ensuring credibility gains. The NCCT List as a potent instrument in the hands of the FATF to ensure compliance 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.” Many of those countries view compliance with the international standards as a no-choice of “death by blacklisting” with “a gun to their head” in instituting a comprehensive AML/CFT system. Expensive compliance is preferred to non-compliance followed by

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331 See Annual FATF Report on Non-Cooperative Countries and Territories, and Annex 10, 14 February 2000, for a detailed description of the process involved in the FATF sanctions process.
332 FATF Recommendation 21 outlines 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. The Essential Criteria 21.3 then details the different countermeasures available in cases of failure to apply or insufficient application of the Recommendations.
333 Reputation is normally referred to by international legal theorists 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, Compliance and International Law, supra note 323 at 95; Main proponents of reputation as a critical factor affecting compliance include: ROBERT O. KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN WORLD POLITICAL ECONOMY (1984) (who also argues that reputation operates outside the boundaries of formal treaty law as well); ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984), Paul R. Milgrom, Douglas C. North & Barry R. Weingast, The Role of Institutions in the Revival of Trade: The Medieval Merchant, Private Judges, and Champagne Fairs, 2 ECON. & POL. 1 (1990), Beth Simmons, International Law and State Behavior: Commitment and Compliance in International Monetary Affairs, supra note 73; Guzman, A Compliance-Based Theory of International Law, supra note 50; Chayes & Chayes, the New Sovereignty: Compliance with New Regulatory Agreements, 273, 1995 (also agree that the power of reputational concerns to promote compliance is considerable and rival the deterrent expectations about reciprocal defection).
336 Id. at 344.
blacklisting. Out the fifteen NCCTs in the first 2000 NCCT list, that had been threatened with sanctions for failure to adopt appropriate AML/CFT measures, four countries were removed from the list in June 2001, 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 reviews 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, 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.

Although of a soft law enforcement type, the FATF NCCT process generates a perception of legality exhibiting characteristics of a legal obligation where countries have a right to invoke countermeasures in cases of persistent non-compliance, or insufficient compliance, by third 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 the FATF is implicitly, as the enforcing agency, empowered to design any ancillary process necessary for the enforcement of its obligations. In addition, the implementation of R.21 requires, at any rate, that specific procedures be defined before any counter measure can be taken, and, at last resort, is triggered under that provision. A more challenging issue, however, is the ability for the FATF, as an institution, to exercise a right afforded to countries, presumably members, to invoke its countermeasure provision to countries only, although is arguable that the FATF NCCT process operates on the basis of agency rules, acting

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337 Financial Action Task Force: Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effect of Anti-Money Laundering Measures, 22 June 2000; list of 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.


340 The FATF published an Annual Review of the NCCTs which provides an indication of countries being removed from the list and new ones being added.


342 Downs & Jones, supra note 323 at 95.
on behalf of its members. The agency argument is, however, weakened in the case where sanctions and countermeasures are imposed on non-member countries, 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 continued application of the process, countries’ expeditious response to adopt corrective measures acceptable to the FATF, out of concern for their reputation, so as to be removed from the blacklist. As of 2009, 28 countries have been placed on the NCCT list. Out of the initial forty-seven jurisdictions referred to the NCCTs process and reviewed in two rounds (31 in 2001 and 16 in 2002), a total of 23 jurisdictions were identified as NCCTs (15 in 2000 and 8 in 2001). The removal of 23 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 in general enhanced surveillance and other stringent relevant actions, have been applied to Myanmar, Nauru, Nigeria and Ukraine for failure to enact appropriate legislative measures and the existence of numerous shell banks. However, there has never been any case of expulsion although R 21 has been invoked. In the case of the Philippines, no countermeasures were ever applied although it was being monitored continuously. A study carried out mapping the 23 countries against the 25 criteria 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 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

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343 This includes the 23 countries listed initially with the 5 countries listed in 2006, namely, Iran, Pakistan, Uzbekistan, Turkmenistan and Sao Tome and Principe. See *id.* at 294.

344 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 Review of NCCTs-2006-2007, 2.


346 See the study carried out by Wassim N. Shahin for a comparative analysis of the 23 countries’ response against the 25 criteria, which illustrates that not many of the delisted countries do not meet half of the criteria. 14 countries or over 60% do not fully meet at least 14 of the criteria or 56% of the 25 ones. Out of the 23 countries initially listed, 11 do not fully meet at least 5 of the seven requirements directly relevant to the regulation of banks and financial institutions. 19 countries out of the 23 listed countries, or 83% do not meet at least 3 of the 7 criteria referred earlier, or 43%. 15 countries or 63% of the listed countries do not meet at least half of the criteria or 4 amounting to 57%.
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 blacklisted, 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 23 countries listed between 2000 and 2001 (15 in 2000 and 8 additions in 2001), four countries were delisted after one year (2001) and, between 2002 to 2004, eight additional countries were removed from the list based on progress achieved. In some cases, it took the first five countries, which indicated no objection to implementing the FATF’s demands, 1 year to adopt compliant measures, as none of them could afford sanctions which would damage and isolate their financial sector. The next group of 7 countries took 2-2.5 years to be delisted, 4 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 the confidence of their financial systems they eventually had no choice than to make adequate changes to meet the FATF requirements. The third group of 9 countries is different only in terms of the speed it took them, exhibiting similar pattern of initial denial followed by more piecemeal approach, to finally comply with the FATF requirements. The only two exceptions are Nauru and Ukraine, which, in the case of Nauru, refused to adopt any ML legislation and preferred to end its offshore banking operations, revoking its 139 offshore banking licenses, with no interest in adopting any AML legislation. Ukraine seemed uninterested in attending to any AML legislation. In conclusion, response from the initial list of countries seems to have been relatively quick with those responded quickest and more thoroughly were more concerned with their developed financial sectors. The success of the process lies in the fact that the 23 jurisdictions identified in 2000 and 2002 as NCCTs process are

347 See Johnson, supra note 318 for a more detailed empirical analysis of the responses of this initial list of countries and their responses to the FATF pressure and demands.
348 Bahamas, Cayman Island, Liechtenstein and Panama were removed from the list in 2001.
349 Niue and Dominica were removed in 2002, Grenada and St Vincent and the Grenadines, 2003, and Egypt, Guatemala, and Ukraine removed in 2004 from the NCCT list although they remained on the monitoring list.
350 The Bahamas, Cayman Islands, Liechtenstein, Panama and Hungary.
351 These countries created monitors to oversee the financial sector, adopted necessary changes as required by the FATF.
352 Ibid, 309. 43
353 Israel, Lebaon, St Kitts & Nevis, Dominica, Marshall Islands, Niue, and Russia.
354 Johnson, supra note 318.
355 Cook Islands, Egypt, Grenada, Guatemala, Indonesia, Mayanmar, Nigeria, Philippines, and St Vincent & the Grenadines.
356 Supra 363, 47
no longer on the NCCT list in view of the significant progress in strengthening the AML/CFT frameworks.\textsuperscript{357}

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

<table>
<thead>
<tr>
<th>Date</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>14 February 2000</td>
<td>Initial report on NCCTs lays out the framework and procedures.  \hspace{1cm}</td>
</tr>
<tr>
<td>22 June 2000</td>
<td>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 &amp; the Grenadines.  \hspace{1cm}</td>
</tr>
<tr>
<td>22 June 2001</td>
<td>Bahamas, Cayman Islands, Liechtenstein, and Panama are de-listed. \hspace{1cm}</td>
</tr>
<tr>
<td>7 September 2001</td>
<td>Second review of NCCTs identifies new NCCTs; Egypt, Guamata, Hungary, Indonesia, Myanmar and Nigeria.  \hspace{1cm}</td>
</tr>
<tr>
<td>5 December 2001</td>
<td>Grenada and Ukraine are identified as NCCTs.</td>
</tr>
<tr>
<td>21 June 2002</td>
<td>Hungary, Israel, Lebanon, and St. Kitts &amp; Nevis are de-listed. \hspace{1cm}</td>
</tr>
<tr>
<td>11 October 2002</td>
<td>Dominica, Marshall Islands, Niue, and Russia are de-listed. \hspace{1cm}</td>
</tr>
<tr>
<td>20 December 2002</td>
<td>FATF recommends that its members apply additional counter-measures to Ukraine. \hspace{1cm}</td>
</tr>
<tr>
<td>14 February 2003</td>
<td>FATF withdraws counter-measures for Ukraine; however, it remains on the list. \hspace{1cm}</td>
</tr>
<tr>
<td>20 June 2003</td>
<td>Grenada is de-listed. \hspace{1cm}</td>
</tr>
<tr>
<td>3 November 2003</td>
<td>FATF recommends that its members apply additional counter-measures to Myanmar. \hspace{1cm}</td>
</tr>
<tr>
<td>27 February 2004</td>
<td>Egypt and Ukraine are de-listed. \hspace{1cm}</td>
</tr>
<tr>
<td>2 July 2004</td>
<td>FATF de-lists Guatemala. \hspace{1cm}</td>
</tr>
<tr>
<td>22 October 2004</td>
<td>FATF removes counter-measures for Nauru and Myanmar; however, they remain on the list. \hspace{1cm}</td>
</tr>
<tr>
<td>11 February 2005</td>
<td>FATF de-lists Cook Islands, Indonesia, and Philippines. \hspace{1cm}</td>
</tr>
<tr>
<td>13 October 2005</td>
<td>FATF de-lists Nauru. \hspace{1cm}</td>
</tr>
<tr>
<td>23 June 2006</td>
<td>FATF de-lists Nigeria. \hspace{1cm}</td>
</tr>
<tr>
<td>13 October 2006</td>
<td>FATF de-lists Myanmar. \hspace{1cm}</td>
</tr>
<tr>
<td>28 February 2008</td>
<td>Iran, Uzbekistan, Turkmenistan, Pakistan, and Sao Tome &amp; Principe still monitored as NCCTs \hspace{1cm}</td>
</tr>
</tbody>
</table>

The NCCT process gained greater its credibility as a result of its application to both member and nonmember countries, and their conformity with its obligations following publication, illustrate the extent of its persuasiveness for countries to comply. In fact, noncompliance non-member countries have on occasions been the subjects of such sanctions. Although Recommendation 21 is not applicable to nonmembers, meaning that FATF cannot suspend a nonmember country, it may apply R21 and ask its member countries to impose restrictions on its financial institutions that operate in nonmember jurisdictions. The Seychelles is an indication 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\textsuperscript{358}.

\textsuperscript{357} FATF Annual Report, 2007-2008, supra note 46.
Mounting pressure forced the country to repeal the legislation. This situation led the FATF to take concrete actions to bring Offshore Financial Centers (OFCs) into compliance with AML/CFT\textsuperscript{359}, and non-cooperative jurisdictions on de-listing of 4 OFCs in 2001\textsuperscript{360}, asking countries with close relations with OFCs, to take measures to enhance home country AML/CFT supervision.

Although the NCCT list was apparently suspended at some point in time, perhaps as a result of concerns expressed by the IMF\textsuperscript{361} 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 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.\textsuperscript{362} 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 continuing importance and recourse to the sanctions process is illustrated by the listing, in 2007, of five countries, namely, Iran, Uzbekistan, Turkmenistan, Pakistan and Sao Tome and Principe,\textsuperscript{363} earmarked for lack of AML/CFT regime which represents a serious vulnerability to the international system, arising from the lack of comprehensive AML/CFT systems, with a call from the Plenary to address on an urgent basis its AML/CFT.\textsuperscript{364} The five countries continue to be on the list while being under constant monitoring by the FATF.\textsuperscript{365} 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


\textsuperscript{360} G7 Genoa Decision of July 20, 2001.


\textsuperscript{363} FATF Statement of February 5, 2009.

\textsuperscript{364} FATF Annual Report, 2007-2008, supra note 46.

\textsuperscript{365} \textit{id.}
characterizes its normative and policy-making processes. A law perceived as legitimate and fair is more likely to be observed than not.\textsuperscript{366} Legitimacy\textsuperscript{367} as a factor influencing compliance, developed with Franck, who advocated that in a community of organized rules, compliance is directly linked to a perception of legitimacy by those who are at the receiving end.\textsuperscript{368} In secularized, democratic societies, the primary source of legitimacy lies in the involvement, in the decision-making process, of those impacted by its decision.\textsuperscript{369} 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.\textsuperscript{370} 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.\textsuperscript{371} 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’.\textsuperscript{372} To that extent, the FATF’s norm-creation and diffusion process is weakened by accountability, which ensures transparent decision-making, providing clear lines of authority between decision-makers and their subjects; and legitimacy, encouraging countries’ ownership and influence in setting international standards.\textsuperscript{373} Aimed at consensus–building among countries, the ‘geographic’ factor, linked to the participation in the standard-setting process, and ‘procedural’ or ‘normative’ aspect, meaning capacity or opportunity to influence the development of the norms, occur, to a large extent, outside the FATF normal law-making

\textsuperscript{366} Shelton, COMMITMENT AND COMPLIANCE, supra note 9 at 8.

\textsuperscript{367} “Legitimacy, in this context, refers to an attribute conferred on it when external parties affected by the organization’s outcomes, endorses 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.” 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.” See also, 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” (Suchman); Legitimacy can be defined as ‘the aspect of governance that validates institutional decisions as emanating from right process’ (T. M. Franck); Frederick Van Den Berghe, Good Coffee, Bad Governance: The Legitimacy of FLO, (Center for Human Rights & Global Justice- NYU Law Sch, Working Paper No. 12, 2006), available at http://www.chrgj.org/publications/docs/wp/WPS_NYU_CHRGJ_VandenBerghe.pdf.


\textsuperscript{369} Fritz W. Scharpf, Legitimacy in the Multi-actor Polity, in ORGANIZING POLITICAL INSTITUTIONS: ESSAYS FOR JOHAN P. OLSEN 267 (M. Egeberg & P. Laegreid, eds., 1999).

\textsuperscript{370} ALEXANDER, DHUMALE & EATWELL, supra note 6.

\textsuperscript{371} Sindicco supra note 70 reviewing HARD CHOICES, SOFT LAW: VOLUNTARY STANDARDS IN GLOBAL TRADE, ENVIRONMENT AND SOCIAL GOVERNANCE, (John J. Kirton & Michale J. Trebilcock eds., 2004).

\textsuperscript{372} ALEXANDER, DHUMALE & EATWELL, supra note 6.
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 experience across countries tend to disprove legitimacy concerns as most countries have now adopted, although not in entire conformity, some form of AML/CTF legislation and framework, and have subjected themselves to the FATF assessment process.\textsuperscript{375}

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 reflected in the restricted initial membership of fifteen countries.\textsuperscript{376} 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.\textsuperscript{377} Although the FATF has now expanded from a small group of 15 industrialized countries, its present membership is still largely limited to 34 countries,\textsuperscript{378} 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.\textsuperscript{379} 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 that inclusive. Legitimacy, grounded in the degree of ownership and influence that countries have in the design and implementation of the AML/CFT rules, meant to be of an international nature and 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 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. 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. 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, 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 expected to comply with international norms but whose voices in so far as these have political, economic or financial implications, have not been heard, undermines the legitimacy of the FATF normative structure. In addition, possibilities of mismatch between the norms, developed in the context of the industrialized economies with all originally FATF member countries, and expected implementation by non-member countries with different economic environment, significantly impairs compliance drive and performance. Countries are reluctant to comply with such norms which they consider are developed without their consent but also do not reflect 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 inadaptable to their economic and financial context, illustrating instances of mismatch. These

380 Supra, 10,33.
381 ibid.
383 Supra, 10, 35.
factors reinforce lack of legitimacy for countries to comply with these same norms, which do not have their print, having been 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 and countries’ specificities, can undermine compliance, and represents an 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, enabling the FATF to reach out to most countries of the world. The second step witnessed a gradual expansion of the FATF’s membership to include some developing countries such as Mexico, South Africa and China, although it still remains highly exclusive. However, although more than 185 countries, representing 85 percent of the world, have endorsed the FATF recommendations, only 34 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. 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. The diffusion of the AML/CFT standards, not only within the frameworks of hard law international organizations but soft international institutions such as the IOSCO, BASLE, IAIS and the Egmont Group of FIUs, further legitimizing 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 and sit as

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384 FATF Money Laundering & Terrorist Financing Assessment Strategies (June 2008); FATF, GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING, supra note 201, which was developed in consultation with international banking and securities sectors.

385 See Chapter on Institutional Framework where 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, have been critical in ensuring wider recognition of the norms among countries. There are 19 observer organizations working closely with the FATF (FATF Annual report 2007-2008).


387 Id.

388 There are 8 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 278.
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 the development of the norms, and frontline role in the international and domestic fight against ML/FT, the FATF has significantly increased its engagement with the private sector, although such engagement has 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. 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 developed into a formidable international regulatory regime which has significantly influenced countries’ compliance with its standards. Its flexible and adaptable set of norms, adaptable to changing ML/FT methodologies; a strong institutional framework, supported by other international and regional organizations, engaged in promoting the AML/CFT standards among their constituents, increased its legitimacy 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 international legal regime has 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 studies.
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