

# THE FATF AND ITS INSTITUTIONAL PARTNERS: IMPROVING THE EFFECTIVENESS AND ACCOUNTABILITY OF TRANSGOVERNMENTAL NETWORKS

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## I. INTRODUCTION

As problems requiring effective state regulation extend across national borders, so do government efforts to respond to those problems. With increasing frequency, national regulators and officials are working with their foreign counterparts to build collaborative responses to shared problems.<sup>1</sup> Often, these national officials organize informal networks to advance this collaboration. The Financial Action Task Force (“FATF”), the international transgovernmental network charged with designing an effective regime of anti-money laundering and combating the financing of terrorism (“AML/CFT”) policies, follows this trend.

Transgovernmental networks have become a regular form of international collaboration utilized to address cross-border problems, especially among the major Western powers. These networks are hailed for the functional advantages they provide: they are flexible, highly responsive, fluent in the technical details of regulation and they create opportunities for government officials to work together in analyzing international problems and crafting creative policy solutions. Yet while the advocates of transgovernmental networks tout their functional advantages, critics assail transgovernmental networks for their lack of accountability. One of the primary accountability criticisms argues that these

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1. Direct international interaction and collaboration between national bureaucrats seeking to effectively regulate certain transnational economic and social areas was first noted in 1974 by Robert Keohane and Joseph Nye. See Robert O. Keohane & Joseph S. Nye, *Transgovernmental Relations and International Organizations*, 27 *WORLD POL.* 39 (1974). Over twenty years later, other scholars began to expand on this concept. See THOMAS RISSE-KAPPEN, *COOPERATION AMONG DEMOCRACIES* 38 (1995). Anne-Marie Slaughter greatly expanded upon this initial observation with her work on transgovernmental networks. See ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* (1st ed. 2004). Other scholars have built off of Slaughter’s work in describing the contribution of networks to international organization and the development of international law. See David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 *CHI. J. INT’L L.* 547 (2005); Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 *VA. J. INT’L L.* 1 (2002).

networks are exclusive institutions that lack transparency, shun broad participation, and are accountable to very few of the states whose policies they influence.<sup>2</sup> In short, transgovernmental networks suffer from a North-South democratic deficit.

Through a case study of the FATF, this Article examines the views of both functional proponents and accountability critics of transgovernmental networks. The FATF provides evidence that although networks can be very effective in addressing certain features of international problems, the advocates of networks may overstate their functional advantages. At least in addressing some types of problems, such as AML/CFT, transgovernmental networks will not be very effective on their own. The small and exclusive nature of the FATF prohibits it from providing a policy response that can be implemented across the globe. In order to overcome this limitation, the FATF has partnered with other international institutions that can provide the functional advantages that the FATF lacks. In the end, despite the FATF's own functional restrictions, it plays the central role in the multi-institutional response to money laundering and the financing of terrorism.

These institutional partnerships also shed light on the North-South accountability issues surrounding transgovernmental networks. At least in the case of the FATF, the critics of the network approach have also overstated their case. As the FATF has formed partnerships with other institutions, the FATF and its partners have resolved many of its accountability flaws.

If the FATF's own evolution reflects the developments in store for other transgovernmental networks, then it is good news for both the proponents and the critics of the network approach. For the proponents, the FATF's example suggests that even though transgovernmental networks face some functional limitations, they are well-suited to overcome these limitations by forming institutional partnerships. In this way, such networks maintain their ability to provide effective policy solutions to pressing international problems. For the critics of transgovernmental networks, the FATF's evolution suggests that the need for some networks to build institutional partnerships creates an opportunity to exact significant accountability reforms. As the network extends its functional reach, it must enhance its accountability.

The remainder of this Article is divided into five parts. Part I provides a brief introduction to money laundering and the financing of terrorism. This part argues that an effective institutional response to money laundering and the financing of terrorism must consist of three elements: an international institution designed to create an effective AML/CFT regime must be flexible, must be able to facilitate effective regulation, and must be implemented across all states. Part II explores the FATF and its institutional response to the money laundering and terrorist financing problems. It argues that the FATF meets the first two elements of an effective AML/CFT institution, but cannot achieve universal implementation of AML/CFT measures on its own. Part III describes the institutional partnerships

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2. Other common accountability criticisms of networks are that they lack accountability to the democratic constituents of member states and that they circumvent constitutional processes for regulating behavior. This Article does not focus on these particular accountability criticisms. These aspects of accountability have been discussed elsewhere. *See, e.g.,* Anne-Marie Slaughter, *The Accountability of Government Networks*, 8 *IND. J. GLOBAL LEGAL STUD.* 347, 363 (2001).

that the FATF has built to overcome this critical limitation. In particular, it describes the FATF's relationship with the FATF-Style Regional Bodies ("Regional Bodies"), the International Monetary Fund (IMF), the World Bank, and the United Nations (U.N.). Part IV describes the accountability problems that initially characterized the work of the FATF and how the formation of the FATF's institutional partnerships managed to resolve those problems. Finally, Part V highlights some factors that may influence the ability of other international regimes to emulate the FATF's balancing of its functional and accountability demands.

## II. MONEY LAUNDERING AND THE FINANCING OF TERRORISM

The similarities between money laundering and the financing of terrorism justify a common international institutional response. In order to be effective, such a response must operate with a high degree of flexibility, facilitate the implementation of national regulation, and attain universal application.

Money laundering is an attempt to conceal the origin of illegally-obtained funds in order to reintegrate them into the legitimate economy.<sup>3</sup> The financing of terrorism in effect reverses the order of money laundering: terrorist financiers seek to direct funds to illegal and violent ends; however, terrorist funds are not necessarily obtained illegally.<sup>4</sup>

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3. NICK KOCHAN, *THE WASHING MACHINE* viii (2005).

4. U.N. Counter-Terrorism Comm., Note by the President of the Security Council, at 5, U.N. Doc. S/2004/70 (Jan. 26, 2004). The money that supports terrorist activity comes from diverse sources. Voluntary contributions make up a large portion of terrorist operational funds. COUNCIL ON FOREIGN RELATIONS, *TERRORIST FINANCING* 7-8 (2002) [hereinafter COUNCIL ON FOREIGN RELATIONS]. Al-Qaeda, the backbone of the radical Islamic terrorist movement, relies on a fundraising network of wealthy donors primarily from Saudi Arabia for its own funds and those that financed the attacks of September 11th, 2001. NAT'L COMM'N ON TERRORIST ATTACKS UPON THE U.S., *THE 9-11 COMMISSION REPORT* 170 (2004) [hereinafter 9-11 COMMISSION REPORT]. Alms giving, or *zakat*, is one of the five pillars of Islam and an obligation incumbent upon all Muslims. Observance of *zakat* generates a tremendous flow of money among Muslim communities each year. As an indication of the magnitude of funds generated each year by *zakat*, the Saudi Royal Family alone contributes a *zakat* of \$12 billion annually. John D.G. Waszak, *The Obstacles to Suppressing Radical Islamic Terrorist Financing*, 36 CASE W. RES. J. INT'L L. 673, 697-98 (2004). Some portion of this money consistently finds its way into the hands of terrorists. Some donors may willingly donate their funds to terrorist organizations. Others may be duped into donating to phony charities run by terrorist financiers. For others still, the funds are simply diverted from legitimate charities to terrorists by corrupt employees. 9-11 COMMISSION REPORT, *supra*, at 170-71.

Terrorist groups also generate funds through the revenues of legitimate businesses. COUNCIL ON FOREIGN RELATIONS, *supra*, at 6. For a time, al-Qaeda was at least partially funded by legitimate businesses run by Osama Bin Laden in Sudan. *Id.* Some terrorist funding may come from official sources within governments that are unfriendly to the West. The Taliban in Afghanistan provided some support to Bin Laden upon his arrival from Sudan in 1996. 9-11 COMMISSION REPORT, *supra*, at 170. Similarly, there have long been allegations that senior officials in the Saudi government provide financial support to terrorist organizations. *Id.* at 171. Interestingly, this relationship has often worked in reverse as well in the case of al-Qaeda; Bin Laden gave financial support to governments of both Sudan and Afghanistan in return for hosting the hub of

Although money laundering and the financing of terrorism do exhibit some important distinctions,<sup>5</sup> they share key operational similarities that facilitate a common response by national authorities. Most obviously, terrorist financing and money laundering often occur through similar types of banking institutions, nonbank financial institutions, and nonfinancial businesses and professionals.<sup>6</sup> In addition, both money launderers and terrorist financiers seek to conduct their financial operations in relative secrecy to evade official detection. They value relationships with banks, businesses, money transfer agencies, or lawyers that ask few questions of their customers and require minimal disclosures. For instance, loosely-regulated offshore financial centers are potentially attractive jurisdictions for money launderers and terrorist financiers.<sup>7</sup> Due to these operational similarities, national governments usually assign jurisdiction over money

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al-Qaeda's network. COUNCIL ON FOREIGN RELATIONS, *supra*, at 5. Finally, some terrorist organizations may generate income through illegal activities, completing the circle between money laundering and terrorism financing. For instance, there is strong evidence that the Taliban benefited heavily from the heroin trade in Afghanistan; some have alleged that al-Qaeda collaborated in these projects. COUNCIL ON FOREIGN RELATIONS, *supra*, at 7. *But see* 9-11 COMMISSION REPORT, *supra* note 4, at 172 (acknowledging the existence of these allegations but finding no evidence that al-Qaeda benefited from the drug trade).

5. Three features of the terrorism financing problem make it slightly more difficult to detect or regulate than money laundering. First, terrorism financing need not cross into the formal economy. This informal feature can pose challenges for national regulators. For instance, much of the financial flow in the Arab world occurs through the *hawala* system, a global underground banking and money transfer system run on a network of trust. Terrorist groups are able to exploit the informal and often anonymous character of the *hawala* system. As one independent task force wrote, "[The *hawala* system's] nature . . . makes it particularly susceptible to abuse by terrorists and other criminals. Indeed, the *hawala* system . . . appears custom-made for al-Qaeda." COUNCIL ON FOREIGN RELATIONS, *supra* note 4, at 10. Second, terrorist plots can be executed using relatively small sums of money. The September 11th attacks themselves were fairly inexpensive projects. According to the 9-11 Commission Report, the perpetrators spent approximately \$400,000 to \$500,000 to plan and execute the attacks. Other potential terrorist attacks could be executed for less than that amount. 9-11 COMMISSION REPORT, *supra* note 4, at 169. Aside from individual attacks, however, it is certain that other ongoing operational needs of terrorist organizations, such as training camps and weapons, can be more costly. Al-Qaeda's annual budget leading up to the September 11th attacks was likely about \$30 million. *Id.* at 170. Without a doubt, al-Qaeda is a well-financed operation. Third, the financing of terrorism frequently runs through nonprofit organizations, including religious, charitable, and political organizations that serve as fronts for terrorist networks. *Id.* at 171. Government oversight of such institutions can raise additional political challenges. *See* U.N. Counter-Terrorism Comm., *supra* note 4.

6. INT'L MONETARY FUND & THE WORLD BANK, *Financial Sector Assessment: A Handbook* 208 (2005) [hereinafter *Handbook*]; COUNCIL ON FOREIGN RELATIONS, *supra* note 4, at 8-9.

7. While al-Qaeda has utilized the same offshore banking systems that money launderers traditionally target, such as Liechtenstein and the Bahamas, it has also exploited the lax banking regulations throughout the Middle East. COUNCIL ON FOREIGN RELATIONS, *supra* note 4, at 9.

laundering and the financing of terrorism to the same offices or administrative bodies.<sup>8</sup>

In light of the nature of money laundering and terrorist financing activities, any international institutional response to these problems must address three critical elements. First, any international institution must be flexible enough to respond to new developments in the techniques and tactics of money laundering and terrorist financing. Second, any international effort to stamp out money laundering and terrorism financing must engage and facilitate an effective regulatory response. Third, all states must universally implement the response. These elements and the critical role they play in advancing AML/CFT efforts are considered below.

#### ***A. Institutional Response Must be Flexible***

The AML/CFT international response must be flexible enough to keep pace with the continually evolving nature of money laundering and the financing of terrorism. Criminals and terrorists engaged in money laundering and terrorist financing maintain their illegal operations through ingenuity and creativity. The successful money launderer is able to manipulate financial instruments and organizations in order to create novel and clever ways of evading official detection.<sup>9</sup> As AML/CFT officials close down one avenue of illegal funds transfer, criminals and terrorists seek to develop new means of accomplishing the same goal.<sup>10</sup>

As new forms of financial technologies outpace regulation, they may become particularly susceptible to criminal exploitation. For instance, AML/CFT experts have identified wire transfers as a financial tool that requires greater regulation and oversight in order to prevent its use for money laundering and terrorism financing.<sup>11</sup> Other money launderers or terrorist financiers may look in the opposite direction and evade technology altogether, making use of informal and rudimentary means of transferring funds. The *hawala* system, for example, is an ancient form of money transfer that terrorists recently have utilized to move operational funds.<sup>12</sup> Financial law enforcement officials struggle to find ways to prevent money launderers and terrorist financiers from utilizing this traditionally

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8. In the United States, for example, the Financial Crimes Enforcement Network (FinCEN), an office of the Department of Treasury, directs much of U.S. enforcement efforts against both money laundering and terrorist financing. See Financial Crimes Enforcement Network (FinCEN), <http://www.fincen.gov> (last visited Mar. 3, 2008).

9. See Financial Action Task Force (FATF), *Report on Non-Cooperative Countries and Territories 1* (2000), available at <http://www.fatf-gafi.org/dataoecd/57/22/33921735.pdf> [hereinafter *NCCT Review 2000*]; *Handbook*, *supra* note 6, at 208-09.

10. Al-Qaeda's financial network has been described as decentralized and flexible, like much of its organizational structure. See, e.g., COUNCIL ON FOREIGN RELATIONS, *supra* note 4, at 8-9.

11. FATF, *Report on Money Laundering Typologies 4-7* (2003-04), available at <http://www.fatf-gafi.org/dataoecd/19/11/33624379.pdf>.

12. COUNCIL ON FOREIGN RELATIONS, *supra* note 4, at 10.

unregulated system.

The criminal and the terrorist seek to stay one step ahead of the authorities, while the job of the authorities is to respond to the movement of the criminal as quickly as possible.<sup>13</sup> The first key characteristic of any institutional response to money laundering and terrorism financing is flexibility: the authorities must be as flexible as the criminals themselves, responding quickly and decisively to operational changes. Laws and regulations designed to stamp out money laundering and the financing of terrorism must be easily amended, expanded, or refocused.

Flexibility, however, cannot be achieved by settling for weak agreements. Putting an end to money laundering has been a consistent foreign policy priority of major industrialized states since the war on drugs in the 1980s.<sup>14</sup> Since September 11, 2001, however, the international effort to end money laundering and terrorism financing has taken on a new sense of urgency for many of the most powerful industrialized states. For these states, the struggle against terrorism is a top national priority and the dismantling of terrorism financing is one of the most effective means of removing the threat of terrorist organizations. Yet many states are woefully under-equipped to address the problem. In light of this mismatch between international priorities and national AML/CFT systems, any institution that deals with the terrorist financing problem will need to seek meaningful and deep changes in the regulation of financial flows.

#### ***B. Institutional Response Must Facilitate Regulatory Response***

A successful effort against money laundering and the terrorism financing will be executed by national regulatory authorities exercising financial oversight, regulating financial activity, and maintaining close private-public collaboration in identifying and pursuing suspicious transactions. An international institution that seeks to effect national regulatory action must interact with national authorities differently than an institution designed to achieve other less burdensome changes in national behavior. For example, some elements of an AML/CFT institution may require that states merely take certain legal steps, such as criminalizing money laundering or ratifying the International Convention for the Suppression of the Financing of Terrorism. Other elements, however, may impose regulatory obligations that place heavier burdens on national governments. For instance, a requirement that states establish financial intelligence units (“FIUs”) capable of receiving and analyzing streams of transaction reports from financial actors, identifying suspicious activity, collecting and sharing information with foreign counterparts, and enforcing financial freezes places great demands on state

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13. FATF, *Annual Review of Non-Cooperative Countries and Territories 2005-2006*, at 2 (2006), available at <http://www.fatf-gafi.org/dataoecd/0/0/37029619.pdf> [hereinafter *NCCT Review 2006*] (describing money laundering as a “dynamic process because the criminals who launder money are continuously seeking new ways to achieve their illegal ends.”).

14. FATF, *Annual Report 1989-1990*, at 3 (1990), available at <http://www.fatf-gafi.org/dataoecd/20/16/33643019.pdf> [hereinafter *1989-1990 FATF Ann. Rep.*] (stating that the FATF was formed initially to end money laundering, in direct response to the observation that the “drug problem has reached devastating proportions.”).

resources and capabilities. In order to facilitate this sort of effective national regulation, an international institution must exercise a wider array of functions.

In the case of AML/CFT regulation, an effective international institution must inform national regulators on methods of money laundering and terrorism financing and the latest developments in those practices. Such an institution must ensure that national regulators cooperate with foreign counterparts to develop and implement effective means of regulating these problems. In addition, an international AML/CFT institutional response will have to build the capacity to implement an effective AML/CFT system in those countries with insufficient regulatory abilities. This includes policy design assistance; financial assistance; assessments of performance; and legal, regulatory, and enforcement training.

### ***C. Implementation of Rules Must Have Universal Participation***

Money laundering and the financing of terrorism gravitate toward jurisdictions with the weakest oversight and disclosure regulations. If one jurisdiction strengthens regulation, money launderers and terrorism financiers are able to move their operations quickly to a jurisdiction that is more lax and conducive to their clandestine operations.<sup>15</sup>

Stiffer regulations and policies on bank secrecy or client identification in one jurisdiction contribute little to resolving the AML/CFT problem if criminals and terrorists are free to continue their activities in less demanding jurisdictions. The global system against money laundering and the financing of terrorism is only as strong as its weakest link. As a result, an effective AML/CFT regime requires that AML/CFT systems are implemented universally in all states. Beth Simmons notes this feature of the AML/CFT problem when she explains that in order “[t]o yield significant benefits, near-global cooperation is a virtual necessity.”<sup>16</sup>

An effective international institutional response to money laundering and the financing of terrorism must account for each of these three features: flexibility, regulatory response facilitation, and universal implementation. The following section explores how the FATF tries to meet these three objectives. As the discussion demonstrates, the FATF is particularly well-suited for pursuing the first two elements: flexibility and facilitation of regulatory responses among its membership; however, it does not lend itself to universal participation. The

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15. The FATF states that “high mobility of funds,” a key characteristic of global finances, demands an international response to money laundering and terrorism financing. *NCCT Review 2000*, *supra* note 9, at 1. See also Beth Simmons, *International Efforts against Money Laundering*, in COMMITMENT AND COMPLIANCE 244, 246 (Dinah Shelton ed., 2000) (2003); Int’l Monetary Fund, *A Factsheet: The IMF and the Fight Against Money Laundering and the Financing of Terrorism* (2007), <http://www.imf.org/external/np/exr/facts/aml.htm> [hereinafter *IMF Factsheet*].

16. Simmons, *supra* note 15, at 247.

challenge for the FATF is how to achieve universal participation without losing its flexibility and facilitation advantages.

### III. THE INSTITUTIONAL RESPONSE

The FATF is the primary international institution addressing money laundering and the financing of terrorism. This section examines the FATF and the FATF Recommendations, the FATF's international AML/CFT standards. I assess the FATF according to the three criteria described above: flexibility, regulatory response facilitation, and universality. While the FATF meets the first two criteria, it has not succeeded in achieving universal implementation of effective AML/CFT measures. I describe how the FATF's two primary strategies for advancing implementation of the FATF Recommendations—persuasion and coercion—have failed to provide a solution to this fatal shortcoming.

#### A. FATF: The Network Response

The FATF is a transgovernmental network of national AML/CFT officials dedicated to creating an effective international response to money laundering and the financing of terrorism.<sup>17</sup> Although the members of the FATF are states, the actual participants are officials, experts, and technocrats from various domestic criminal, judicial, and financial agencies. This subnational participation, exercised independently of national foreign ministries, gives the FATF its transgovernmental character. The FATF participants are experts in the field of AML/CFT with practical and technical knowledge about their respective national systems.

The current membership of the FATF consists of thirty-three states and two regional organizations.<sup>18</sup> The members of the FATF share a deep political commitment to preventing money laundering and terrorism financing operations.<sup>19</sup>

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17. Several scholars have recognized the FATF as a transgovernmental network. See SLAUGHTER, *supra* note 1, at 6. It is noteworthy, however, that the FATF does not refer to itself as a transgovernmental network. Rather, the FATF describes itself as a “task force” with a temporary and specific mandate. The FATF does not consider itself a “formal international organization.” The FATF was initially created in 1989 by a group of industrialized states that were determined to organize an “urgent and decisive” international response to money laundering. *1989-1990 FATF Ann. Rep.*, *supra* note 14, at 3. After the terrorist attacks of September 11th, the FATF expanded its mandate to include terrorism financing as well. Press Release, FATF, FATF Cracks Down on Terrorist Financing, (Oct. 31, 2001), <http://www.fatf-gafi.org/dataoecd/45/48/34269864.pdf>.

18. The member states of the FATF consist of: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; Finland; France; Germany; Greece; Hong Kong, China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States. The regional organizations are the European Commission and the Gulf Cooperation Council. FATF Members and Observers, <http://www.fatf-gafi.org> (follow “About the FATF” hyperlink; then follow “Members & Observers” hyperlink).

19. Current membership eligibility requires that members be “fully committed at the political level: (i) to implement the FATF Recommendations, and (ii) to undergo regular mutual evaluations.” FATF, *Annual Report 2003-2004*, at 12 (2004), available at <http://www.fatf-gafi.org/dataoecd/12/44/33622501.pdf> [hereinafter *2003-2004 FATF Ann. Rep.*].

Most members of the FATF are powerful industrialized nations that govern large financial centers. A smaller group of more recent FATF members consists of developing nations that are deemed “strategically important” by the other FATF members.<sup>20</sup>

As with other transgovernmental networks, the FATF is run by a small permanent administrative body consisting of a President and a Secretariat.<sup>21</sup> The real work of the FATF is carried out by the network of national AML/CFT regulators that represent its member states. FATF decisions are made by consensus among the member states.<sup>22</sup>

The primary responsibility of the FATF is to draft and update a comprehensive set of governmental policies aimed at reducing the ability of individuals to launder money and finance terrorism.<sup>23</sup> To this end, the FATF has issued the Forty Recommendations of the FATF on Money Laundering (the “Forty Recommendations”) and the Nine Special Recommendations on Terrorist Financing (the “Special Recommendations”) (collectively called the “Recommendations”).<sup>24</sup> The FATF also issues interpretive notes that further detail the proper implementation of the Recommendations, including the objectives and general principles of each Recommendation.<sup>25</sup> In addition, each of the Special

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20. *Id.* at 11. The FATF members periodically vote to extend the FATF’s mandate. The most recent extension occurred on May 14, 2004, when FATF members renewed the FATF’s mandate for another eight years. *Id.* at 4-5.

21. Occupancy of the Office of the FATF President rotates among the FATF members annually. The President guides the FATF’s policies and serves as its public spokesperson. The Secretariat, housed at the OECD in Paris, France, serves to support the work of the FATF President and the FATF. FATF Presidency and Secretariat, <http://www.fatf-gafi.org> (follow “About the FATF” hyperlink; then follow “Presidency & Secretariat” hyperlink)

22. FATF Brochure (Sept. 6, 2002), available at <http://www.fatf-gafi.org/dataoecd/32/31/34048008.pdf> (“The decision making process within the FATF is based on consensus and thus all members actively work to reach agreement on the many issues with which they have to deal.”)

23. The FATF refers to the recommendation-making function as its *raison d’être*. 2003-2004 FATF Ann. Rep., *supra* note 19, at 4.

24. The Recommendations cover three broad areas. First, several Recommendations suggest that states take certain legal measures. Recommendation 1 states the countries should criminalize money laundering in keeping with the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention) and the 2000 United Nations Convention against Transnational Organized Crime, (the Palermo Convention). Second, other Recommendations urge states to adopt certain institutional measures to facilitate national and international regulation of financial flows. For example, Recommendations 4-12 deal with the implementation of effective due diligence and record keeping measures. Recommendation 26 states that countries should establish a Financial Intelligence Unit (FIU), a national office for the international sharing of information on the financing of terrorism. Finally, a third category of Recommendations addresses how financial institutions should contribute to AML/CFT systems. For example, Recommendation 21 states that financial institutions should give special attention to business transactions with persons from countries not in compliance with the FATF Recommendations. FATF, *The Forty Recommendations* 1-5, 7-8 (2003), available at <http://www.fatf-gafi.org/dataoecd/7/40/34849567.pdf>.

25. For example, the FATF adopted an interpretive note clarifying the requirements of Special Recommendation VIII on non-profit organizations in February 2006. The interpretive

Recommendations is accompanied by a Study on Best Practices for Implementation.<sup>26</sup>

Like the products of other transgovernmental networks, the Recommendations do not create legal obligations. Instead, they can be viewed as soft law<sup>27</sup> or pledges by member states.<sup>28</sup> As such, each of the Recommendations describes the actions that states or financial institutions *should* take, not what actions they *must* take. However, the decision to produce nonlegal agreements does not suggest that the FATF is any less determined to achieve the implementation of AML/CFT measures. Rather, the nonlegal character of the Recommendations provides certain functional advantages that serve the FATF's institutional objectives.

In analyzing the functions of the FATF, it is useful to consider its ability to meet the three features of an effective international AML/CFT regime described above: flexibility, facilitating regulatory implementation, and universal participation. As this section describes, the FATF is well-equipped to meet the first two of these objectives. The FATF's exclusive and small structure, however, does not provide a basis for universal participation.

### ***B. FATF Provides for Flexible Decision-Making***

Transgovernmental networks and the pledges they produce are often noted for providing policymakers with a flexible means of addressing international problems.<sup>29</sup> The FATF in particular is a highly flexible institution capable of producing quick policy changes and responding to the ever-evolving practices of money launderers and terrorist financiers. The informality of the FATF is the key

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note describes four measures that should be taken to protect nonprofit organizations from abuse by terrorism financiers: (i) outreach to the nonprofit sector; (ii) supervision and/or monitoring of the non-profit sector; (iii) investigation and information gathering, and (iv) establishment of effective mechanisms for international cooperation in addressing the challenges of terrorist use of non-profits. FATF, *Interpretive Note to Special Recommendation VIII: Non-Profit Organisations* 3-4 (2006), available at <http://www.fatf-gafi.org/dataoecd/43/5/38816530.pdf>.

26. For example, in October 2002, the FATF adopted a Best Practices Paper for Special Recommendation VIII on non-profit organizations including financial transparency and verification of program activities. FATF, *Combating the Abuse of Non-Profit Organisations* (2002), available at <http://www.fatf-gafi.org/dataoecd/39/19/34033761.pdf>.

27. Kenneth Abbot and Duncan Snidal offer a useful conception of soft law as weaker than hard law in terms of obligation, precision, and delegation. See Kenneth W. Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421, 422 (2000).

28. Kal Raustiala advances the concept of pledges as a useful way of analyzing international agreements such as the FATF Recommendations. Raustiala rejects the traditional soft law/hard law dichotomy for a more discerning analysis that describes agreements along three elements: legality, substance, and structure. Legality describes whether an agreement imposes a legal obligation. Agreements that impose such obligations are contracts. Agreements that do not impose legal obligations are pledges. Substance describes the level of commitment that a particular agreement aims to achieve. Agreements of deep substance require large deviations from status quo behavior. Agreements of shallow substance require little deviation from the status quo. Finally, structure describes the extent to which an agreement contains mechanisms for monitoring and enforcing an agreement on individual states. See Kal Raustiala, *Form and Substance in International Agreements*, 99 AM. J. INT'L L. 581, 581-85 (2005).

29. SLAUGHTER, *supra* note 1, at 4; Zaring, *supra* note 1, at 596.

feature providing this flexibility. The lack of any ratification process or other formal procedures lowers the transaction costs associated with adoption or revision of the Recommendations and facilitates quick policy responses.<sup>30</sup> Three additional features of the FATF assure that its ability to reach rapid consensus on the Recommendations does not come at the cost of substantively shallow agreements.<sup>31</sup>

First, the FATF has a small and relatively homogeneous membership deeply dedicated to creating an effective international AML/CFT regime. The FATF's setup has been described as the "coalition of the willing" approach to money laundering and the financing of terrorism.<sup>32</sup> Among the original fifteen members of the FATF, the United States, Canada, and Japan are the only non-Western European states. Many of the member states consider organized crime, the illicit drug trade, and the threat of terrorism to rank among their top national priorities.

Second, as a transgovernmental network, the FATF is run by like-minded experts able to filter divergent national interests through shared professional expertise.<sup>33</sup> Advocates of the network approach suggest that national regulatory officials participating in transgovernmental cooperation are able to provide policy solutions that combine both national interests and commonly recognized best practices within their area of expertise. Indeed, at least one scholar argues that in the highly technical areas of financial regulation, states do not have any particular interest aside from effective regulation.<sup>34</sup> At the least, national regulators from the homogeneous FATF member states can relax the minimal differences between the interests of their respective national governments in order to achieve the larger objective of developing an effective AML/CFT system. Third, the nonlegal character of the FATF Recommendations facilitates agreement even when

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30. Abbott & Snidal, *supra* note 27, at 434 (noting that the low contract costs of soft law produce this flexibility). *But see* Raustiala, *supra* note 28, at 586-91.

31. The substantive depth of an agreement is the second of the three characteristics of pledges identified by Raustiala. *See* Raustiala, *supra* note 28, at 584-85.

32. Eyal Benvenisti, "Coalitions of the Willing" and the Evolution of Informal International Law 1 (Tel Aviv University Legal Working Paper Series, Tel Aviv University Law Faculty Papers, Working Paper No. 31, 2006), abstract available at <http://ssrn.com/abstract=875590>.

33. Abbott & Snidal, *supra* note 27, at 440.

34. Zaring, *supra* note 1, at 602 (stating that "[t]here is no particular American interest represented in disaggregated financial regulatory cooperation. There is instead the increasing involvement of domestic regulators in the work of international cooperation . . .").

compliance is uncertain.<sup>35</sup> Indeed, few FATF member states comply fully with the terms of the Recommendations.<sup>36</sup>

The informality, homogeneity, professional expertise, and nonlegal character of the FATF provide the network with a flexible process for designing substantive AML/CFT commitments. This flexibility permits the FATF to craft recommendations that respond to new developments and threats in money laundering and the financing of terrorism. For instance, the FATF's flexibility allowed it to react quickly to the September 11th attacks. On October 29 and 30, 2001, less than two months after the attacks on the World Trade Center and the Pentagon, the FATF met in Washington, D.C. in an extraordinary session to discuss its role in responding to the terrorist threat.<sup>37</sup> Despite previous disagreement within the FATF about its role in addressing terrorist financing,<sup>38</sup> the October 2001 meeting swiftly expanded the FATF's mandate to include the financing of terrorism and the drafting of the initial Special Recommendations as well as the development of an action plan to implement those initiatives.<sup>39</sup> By January 2002, each FATF member state had conducted a self-assessment based on the Special Recommendations and submitted a report with its findings to the FATF.<sup>40</sup>

The FATF's flexibility is also vital in maintaining up-to-date Recommendations. Indeed, the FATF Recommendations have been revised several times to keep pace with new developments and analyses in money laundering and terrorism financing.<sup>41</sup> Often, the FATF is able to refine Recommendations by editing the Interpretive Notes or Best Practices.<sup>42</sup> The FATF

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35. Raustiala, *supra* note 28, at 610 (arguing that “[b]y minimizing concerns about legal compliance, pledges may permit states to negotiate more ambitious and deeper agreements that are tied to stricter monitoring and review provisions.”). Abbot and Snidal note that the FATF Recommendations are not as “constraining” as a hard legal agreement because they lower the costs imposed on countries that endorse the Recommendations but fail to comply. *See* Abbott & Snidal, *supra* note 27, at 440. Abbot and Snidal argue that the lower “sovereignty costs” of international rules such as the FATF Recommendations facilitate international agreement. *See id.*

36. For instance, the initial round of self-assessments of the Special Recommendations in 2001 revealed that only four FATF members had fully implemented Special Recommendation I on the ratification and implementation of U.N. instruments. FATF, ANNUAL REPORT 2001-2002, at 5-6 (2002), *available at* <http://www.fatf-gafi.org/dataoecd/13/1/34328160.pdf> [hereinafter 2001-2002 FATF ANN. REP.].

37. *Id.* at 4.

38. *See id.* at 16-17.

39. *Id.* at 4.

40. *Id.* at 5.

41. The FATF has overhauled the Recommendations twice since their creation—once in 1996 and again in 2003. FATF, *Annual Report 2002-2003*, at 4 (2003), *available at* <http://www.fatf-gafi.org/dataoecd/13/0/34328221.pdf> [hereinafter 2002-2003 FATF Ann. Rep.].

42. For example, Special Recommendation VII deals with the obligation of financial authorities to collect customer information on wire transfers. In 2003, the FATF issued an interpretive note to Special Recommendation VII, creating a \$3,000 threshold before the obligation arises. After further analysis and discussion, the FATF issued a revised interpretive note in June 2005, reducing the threshold to \$1,000 and clarifying the application of the Special Recommendation with regard to “batch transfers.” FATF *Annual Report 2004-2005*, at 8 (2005), *available at* <http://www.fatf-gafi.org/dataoecd/41/25/34988062.pdf> [hereinafter 2004-2005 FATF

has also expanded the Recommendations to fill any gaps in the international AML/CFT regime.<sup>43</sup>

### *C. FATF Facilitates a Regulatory Response*

The FATF has proven to be highly effective at facilitating regulatory implementation among the national AML/CFT agencies of its member states. As with other transgovernmental networks, the national regulators and experts who participate in the FATF are the same officials who implement and oversee national AML/CFT systems. The direct participation of national officials in the FATF advances the regulatory implementation of its Recommendations in three ways.

First, the direct participation of AML/CFT experts assures that the FATF is able to provide solutions that are detailed, practical, and appropriate to the highly technical problems of money laundering and terrorism financing.<sup>44</sup> The detailed procedures outlined in the FATF Recommendations and companion documents provide clear direction for regulatory implementation.<sup>45</sup> A more traditional international agreement fashioned by diplomats with little working knowledge of AML/CFT systems would be unlikely to provide equally effective recommendations.<sup>46</sup>

Second, the direct participation of national regulatory experts creates opportunities for information exchange and shared learning that strengthen the understanding that FATF participants have of money laundering, terrorism financing, and effective regulation. Anne-Marie Slaughter argues that information sharing and the creation of ideas are among the primary functions of transgovernmental networks.<sup>47</sup> Following Robert Keohane and Joseph Nye's characterization of information as a critical source of soft power,<sup>48</sup> Slaughter

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*Ann. Rep.*].

43. For example, the FATF expanded the Special Recommendations in 2004 by adding a ninth Special Recommendation on cross-border movement of cash, along with an interpretive note and best practices for the implementation of this new recommendation. *Id.* at 7-8.

44. Zaring, *supra* note 1, at 596.

45. The FATF Interpretive Notes to the Special Recommendations and the International Best Practices Papers provide detailed guidance on implementation. *See, e.g.*, FATF, *Interpretive Note to Special Recommendation IX: Cash Couriers* (2004), available at <http://www.fatf-gafi.org/dataoecd/5/48/34291218.pdf>; FATF, *Detecting and Preventing the Cross-Border Transportation of Cash by Terrorists and Other Criminals* (2005), available at <http://www.fatf-gafi.org/dataoecd/50/63/34424128.pdf>.

46. Abbott and Snidal note a similar rule-making system in another highly technical area of international collaboration—nuclear nonproliferation regulations. While the major nuclear obligations are contained in the Nuclear Non-Proliferation Treaty, the International Atomic Energy Agency (IAEA) regulates many key nuclear issues through recommendations. They argue that “[r]ecommendations [of the IAEA] deal with technical matters . . . at a level of detail that would be intractable in treaty negotiations.” Abbott & Snidal, *supra* note 27, at 435. *See also* Peter M. Haas, *Introduction: Epistemic Communities and International Policy Coordination*, 46 INT’L ORG. 1, 13 (1992) (arguing that traditional nonexpert policymakers are not well-equipped to deal with policy issues with increasing technical complexities).

47. SLAUGHTER, *supra* note 1, at 52.

48. Robert O. Keohane & Joseph S. Nye, Jr., *Power and Interdependence in the*

describes how transgovernmental networks often exercise power “through their role as distillers and disseminators of credible information in a world of information overload.”<sup>49</sup>

The FATF exercises this information-sharing role primarily through its annual “typologies” exercise, where national AML/CFT regulators meet to discuss the newest “methods and trends” in money laundering and the financing of terrorism.<sup>50</sup> At the typologies meeting, experts break into working groups that focus on particular aspects of money laundering and terrorism financing.<sup>51</sup> The participants share research, brainstorm new ideas, and make recommendations for policy changes.<sup>52</sup> Each group shares its conclusions with the other working groups at the closing plenary meeting and produces a report that serves as a reference for other regulators throughout the global AML/CFT regime.<sup>53</sup> In addition to the annual typologies reports, the FATF periodically issues studies written by working groups of FATF experts on critical issues in AML/CFT that advance collective knowledge and keep national regulators on the cutting edge of effective AML/CFT regulation.<sup>54</sup>

Finally, transgovernmental networks such as the FATF can serve as the foundation for bilateral capacity-building assistance among member states.<sup>55</sup> The relationships that form among regulators within transgovernmental networks can facilitate the identification of relative strengths and weaknesses in national regulatory systems and the provision of technical assistance as needed. Improving capacity for soft law implementation can be an effective means of advancing compliance with such norms.<sup>56</sup> Although the FATF is well-equipped to play such a role among its membership, the actual amount of technical assistance flowing between members of the FATF is limited. Within transgovernmental networks, technical assistance most commonly flows along North-South lines.<sup>57</sup> The

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*Information Age*, 77 FOREIGN AFF. 81, 94 (1998).

49. SLAUGHTER, *supra* note 1, at 177.

50. FATF, *Money Laundering and Terrorist Financing Typologies 2004-2005*, at 1 (2005), available at <http://www.fatf-gafi.org/dataoecd/16/8/35003256.pdf>.

51. The working groups at the 2004-2005 typologies meeting focused on alternative remittance systems, money laundering vulnerabilities in the insurance sector, and proceeds in trafficking in human beings and illegal migration. *Id.* They also continued work on producing a methodology for compiling trends and indicators of money laundering and terrorist financing. *Id.*

52. *Id.* at 1-2.

53. *Id.* at 1.

54. For instance, the FATF issued a report in October 2006 on the misuse of corporate vehicles, including corporations, trusts, and foundations, for money laundering and terrorism financing purposes. The report provides case studies and an international survey on forms of corporate vehicles, highlighting patterns of abuse across different jurisdictions. See FATF, *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers*, at 1-2 (Oct. 13, 2006), available at <http://www.fatf-gafi.org/dataoecd/30/46/37627377.pdf>.

55. SLAUGHTER, *supra* note 1, at 57-58; Raustiala, *supra* note 1, at 28 (arguing that areas of diffuse regulatory authority create more opportunities for international capacity-building).

56. See Abram Chayes & Antonia Handler Chayes, *On Compliance*, 47 INT'L ORG. 175, 193 (1993).

57. See SLAUGHTER, *supra* note 1, at 57 (describing the international capacity building objectives of U.S. federal agencies as “working to build regulatory capacity in countries with

membership of the FATF, however, is mostly limited to large, industrialized states with strong regulatory capacity. The need for capacity-building and technical assistance lies largely outside the FATF, with those nonmember states excluded from the organization.

#### ***D. Universal Implementation of AML/CFT Measures***

An effective international AML/CFT regime must be implemented universally. The two strengths of the FATF—a flexible structure and the implementation of national regulation—cannot provide an effective international AML/CFT regime if they are not accompanied by an ability to advance universal implementation of the FATF Recommendations.

Although the solution to money laundering and terrorism financing requires a universal response, the problem does not lend itself to one. Many states do not place money laundering and combating the financing of terrorism high on their list of national priorities. In fact, many states have incentives to resist cooperation.<sup>58</sup> Implementing effective AML/CFT regulations can be very costly, especially in regards to rulemaking, monitoring financial institutions for compliance, enforcing regulations, and training officials to implement the necessary rules.<sup>59</sup> “[F]inancial reporting systems are expensive” to run.<sup>60</sup> Moreover, the implementation of a successful AML/CFT system imposes significant opportunity costs for economies that cater to clients seeking financial privacy or the low transaction costs associated with lax regulations.<sup>61</sup> For example, regulations requiring customer disclosures or other forms of deeper regulation threaten offshore banking services, a highly profitable sector and a significant source of national income in many small economies.

Solutions that require universal participation are not well-suited to problems that inspire uncooperative responses. This sort of problem—marked by asymmetrical relationships between states where one state (or group of states) has a deep interest in a particular outcome and another state (or group of states) is indifferent or prefers another outcome—is not unique in the study of international

relations or international law.<sup>62</sup> Lisa Martin has characterized this sort of problem

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poorly developed or weak legal systems”).

58. Simmons, *supra* note 15, at 247.

59. *Id.* at 248.

60. *Id.*

61. *Id.* at 245-46 (noting that the benefits of offering banking secrecy are greater than the costs of not complying with the Recommendations for many states).

62. Legal scholars tend to think of the money laundering and terrorism financing problems in the context of a state’s ability to design rules to combat these problems effectively. In this framework, money laundering and terrorism financing can be analyzed as areas where the state

as a “suasion problem.”<sup>63</sup>

The international AML/CFT effort confronts such a suasion problem: any international AML/CFT institutional response must find ways to induce states that are not overly threatened by money laundering or terrorism financing to contribute to the overall AML/CFT system. Martin notes that states facing suasion problems traditionally attempt to induce compliance in recalcitrant states through one of two approaches: coercion, the exercise of hard power, or persuasion, the use of soft power.<sup>64</sup> In seeking to attain compliance with their recommendations, the FATF has attempted both.

### ***E. Persuading Implementation: The FATF's Internal Monitoring and Compliance***

The FATF's primary tools in monitoring compliance with the Recommendations among its member states are self-assessment and mutual evaluation exercises. Through annual self-assessments, the FATF requires its member states to respond to a questionnaire that measures implementation of the FATF Recommendations. The self-assessments provide the FATF with an “annual record of FATF members' progress in implementing the Recommendations” rather than an exhaustive report on the effectiveness of any one AML/CFT system.<sup>65</sup>

The FATF's primary tool for assessing the effectiveness of each member's AML/CFT system is mutual evaluation.<sup>66</sup> Through the mutual evaluation program, teams of AML/CFT experts drawn from FATF member states conduct exhaustive evaluations of each FATF members state's AML/CFT system. The team conducts preliminary research and investigation, visits the evaluated state, interviews the state's AML/CFT experts, and produces a detailed report on the state's AML/CFT policies. At the FATF plenary meeting, each mutual evaluation report is presented to the FATF membership. The AML/CFT representatives of the evaluated

member state are required to answer questions from their FATF colleagues regarding any weaknesses or concerns with their AML/CFT systems.<sup>67</sup>

The self-assessment and mutual evaluation processes function as a means of

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can only exert what Raustiala refers to as “diffuse” regulatory power. *See* Raustiala, *supra* note 1, at 27.

63. Lisa L. Martin, *Interests, Power, and Multilateralism*, 46 INT'L ORG. 765, 777 (1992).

64. *Id.* at 778-79. The coercion and persuasion dichotomy maps nicely onto the distinction that Nye has drawn between hard and soft power. *See* JOSEPH S. NYE, JR., *SOFT POWER: THE MEANS TO SUCCESS IN WORLD POLITICS* 5-11 (2004). Networks are generally associated with a softer exercise of power. It is not surprising that, as I will demonstrate, the persuasive, or soft power, approach has proven more effective for the FATF than the coercive, hard power approach.

65. *2001-2002 FATF Ann. Rep.*, *supra* note 36, at Annex C.

66. *Id.* To date the FATF has conducted three rounds of mutual evaluations. The first round occurred from 1992-1995, the second round during 1996-1999, and the third round began in 2004. *2003-2004 FATF Ann. Rep.*, *supra* note 19, at 9.

67. *Id.*

persuading member states to comply with the Recommendations. These monitoring exercises employ “peer pressure” to induce compliance with the recommendations among the FATF members. Transgovernmental networks commonly use social pressures to influence the behavior of their members.<sup>68</sup> Scholars such as Slaughter have demonstrated that such networks socialize national regulators to induce compliance with their respective norms.<sup>69</sup> Slaughter argues that regulators and experts that participate in transgovernmental networks develop professional reputations, relationships, and trust with their counterparts from other member states.<sup>70</sup> A network creates a large peer group of regulators and experts where those with “common professional identities and substantive experience[s]”<sup>71</sup> exchange ideas, collaborate on projects, and discuss technical developments. Slaughter further describes how national regulators that participate in transgovernmental networks act so as to avoid the “social and professional opprobrium” that accompanies a bad reputation for compliance.<sup>72</sup> The mutual evaluation process plays a critical role in this socialization process. By requiring that national regulators answer questions regarding their respective states’ mutual evaluation reports, the FATF creates space for public disapproval or approval of the efficacy of each member’s AML/CFT policies. Interestingly, even being selected to participate in a mutual evaluation team may serve to reinforce an individual regulator’s loyalty to the rules against which she monitors member compliance.<sup>73</sup> In effect, FATF participants who are judged to be in violation of the “professional ethic” of the network are sanctioned with discredit by the other regulators and experts.<sup>74</sup>

Admittedly, regulators themselves do not always determine national compliance with AML/CFT standards. Key reforms often require high level executive endorsement or legislative action on the national level. The FATF is able to induce compliance even among these policymakers by selectively directing graduated sanctions at FATF member states that do not sufficiently comply with the Recommendations.<sup>75</sup> These sanctions include requiring progress reports on necessary reforms to member AML/CFT systems, sending FATF missions to

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68. SLAUGHTER, *supra* note 1, at 52. Slaughter’s observation on the power of socialization is consistent with the findings of social psychologists who have described the tendency of individual beliefs to converge on group norms. See, e.g., Turner, J.C., et. al., *Rediscovering the social group: A self-categorization theory*. Oxford: Blackwell (1987).

69. SLAUGHTER, *supra* note 1, at 52; Raustiala, *supra* note 1, at 51.

70. See generally SLAUGHTER, *supra* note 1, at 37-64.

71. *Id.* at 18.

72. *Id.* at 196.

73. Cognitive psychologists suggest that individuals adapt their beliefs to avoid cognitive dissonance with their actions. See generally, FESTINGER, LEON, *A THEORY OF COGNITIVE DISSONANCE* (Stanford University Press 1957). As members of mutual evaluation teams enforce a rule, they may come to believe in the content of that rule so as to avoid such cognitive dissonance.

74. *Id.*

75. Benvenisti, *supra* note 32, at 8.

noncomplying members, and suspension from the membership of the FATF.<sup>76</sup> But even when legislators or higher-level executive officials control AML/CFT policies, they will often defer to or confer with the expertise of the FATF-participating regulators. In this way, transgovernmental networks such as the FATF function as “epistemic communities,” whose members can provide other national policymakers with highly valuable advice on issues related to their expertise.<sup>77</sup> By shaping the information that FATF participants feed to their national policymakers, the FATF exerts a form of soft power effective in shaping policy outcomes.<sup>78</sup> Peter M. Haas explains that “control over knowledge and information is an important dimension of power and . . . diffusion of new ideas and information can lead to new patterns of behavior and prove to be an important determinant of international policy coordination.”<sup>79</sup>

Overall, the FATF has developed effective means of monitoring and inducing compliance with its Recommendations among the FATF members. These practices have produced significant improvements in the AML/CFT systems of FATF member states. The critical defect in these monitoring mechanisms is that they cannot be applied to nonmember states. The FATF’s entire system of peer pressure, socialization, and expert knowledge development is based upon participation in the FATF network activities. Yet, as described above, the FATF is not able to open the network to wider participation without losing its flexible character. The practices that are so effective at monitoring and inducing compliance within the FATF provide no solution to its need to advance universal implementation of the Recommendations.

#### ***F. Coercing Compliance: The NCCT Process***

In 1998, the FATF inaugurated a process known as the Non-Cooperative Countries and Territories (“NCCT”) initiative to induce non-FATF members to comply with the Recommendations.<sup>80</sup> The NCCT process is non-voluntary and utilizes economic forces to induce changes in state behavior.<sup>81</sup> As such, the NCCT process is the FATF’s attempt to achieve external compliance with its Recommendations through coercive means.

To date, the FATF has conducted two rounds of NCCT review: in 2000 and 2001, respectively.<sup>82</sup> In total, the FATF has reviewed the AML/CFT systems of forty-seven nonmember states.<sup>83</sup> Jurisdictions are chosen for NCCT review based

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76. *Id.*

77. Haas, *supra* note 46, at 12-13 (analyzing international networks as epistemic communities and examining their role in shaping state interests).

78. See Keohane & Nye, *supra* note 48, at 91; Raustiala, *supra* note 1, at 51 (arguing that networks promote regulatory change and “regulatory diffusion” more through persuasion than command, i.e., through “soft power” or the power to attract, rather than hard power or the power to coerce).

79. Haas, *supra* note 46, at 2-3.

80. *NCCT Review 2006*, *supra* note 13, at 2.

81. *Id.*

82. *Id.*

83. *Id.*

on their reputation for AML/CFT measures among the FATF membership. The FATF notifies the selected countries that it will be reviewing the soundness of their AML/CFT policies in relation to the Recommendations.<sup>84</sup>

The FATF assesses the selected jurisdictions based on twenty-five NCCT criteria that identify “detrimental rules and practices which obstruct international cooperation against money laundering.”<sup>85</sup> These criteria are developed from the FATF Recommendations.<sup>86</sup> Based on these criteria, the NCCT evaluation process may include a fact-finding survey, analysis of any self-assessments voluntarily submitted by the state, and meetings with officials from that state.<sup>87</sup>

Once the FATF has completed its assessment, it issues a draft report outlining the state’s record on each of the twenty-five NCCT criteria. The FATF grants the states targeted by the NCCT process the opportunity to comment on the initial draft report.<sup>88</sup> The FATF plenary adopts the final report.<sup>89</sup> Any state that fails to meet the twenty-five NCCT criteria is labeled a “non-cooperative jurisdiction.”<sup>90</sup>

The FATF seeks to “encourage non-cooperative jurisdictions to adopt law in compliance with FATF Recommendations.”<sup>91</sup> In this effort, the NCCT gradually ramps up pressure against NCCT states. First, the FATF recommends that all FATF members apply Recommendation 21 procedures to noncooperative jurisdictions.<sup>92</sup> Recommendation 21 requires that financial institutions within the member state “give special attention to business relationships and transactions” with the noncooperative jurisdiction.<sup>93</sup> If Recommendation 21 fails to induce sufficient reforms within the noncooperative jurisdiction, then the FATF can recommend further countermeasures, including prohibition of financial transactions.<sup>94</sup>

The actions taken against non-cooperative jurisdictions serve two objectives. First, the measures seek to insulate FATF member states from potential money laundering or terrorism financing activities within the non-cooperative jurisdiction by requiring closer scrutiny of financial transactions. Second, and more importantly for the strengthening of the global AML/CFT system, the measures

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84. *Id.*

85. *NCCT Review 2000, supra* note 9, at 1.

86. *Id.*

87. *Id.* at 7.

88. *2003-2004 FATF Ann. Rep., supra* note 19, at 10.

89. *NCCT Review 2000, supra* note 9, at 7.

90. *Id.*

91. *Id.*

92. *NCCT Review 2006, supra* note 13, at 3.

93. FATF, *Financial Action Task Force 40 Recommendations (2003)*, available at [http://www.fatf-gafi.org/document/28/0,3343,en\\_32250379\\_32236930\\_33658140\\_1\\_1\\_1\\_1,00.html#r21](http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html#r21).

94. *NCCT Review 2000, supra* note 9, at 8. As of June 2006, the FATF has recommended additional countermeasures be taken against three countries: Nauru, Ukraine, and Myanmar. In each of these cases, the FATF later recommended that FATF member states remove the countermeasures.

inflict economic costs upon noncooperative jurisdictions for noncompliance with FATF Recommendations. As the noncooperative jurisdictions amend their AML/CFT systems to comply with the FATF Recommendations, they are removed from the NCCT list and the FATF members lift their countermeasures.<sup>95</sup>

Coercion permeates the NCCT process. First, the NCCT is not a voluntary process. The FATF selects countries for NCCT review without seeking country consent and without regard to the country's policies on banking privacy or capacity for financial regulation. Any country selected for review but refusing to cooperate with the NCCT assessment is automatically labeled as an NCCT state.<sup>96</sup> Second, the FATF uses the significant economic power of its members states to force states that have been found in noncompliance with the FATF Recommendations to implement necessary reforms. In light of the economic might of the FATF states, refusing an FATF 'Recommendation' is not a viable economic option. States must comply with the Recommendations if they wish to avoid significant economic stress.

At first glance, the NCCT process might seem like an effective solution to the FATF's suasion problem. Certain countries refuse to implement an AML/CFT system because of the direct and opportunity costs associated with strict financial oversight. Through the NCCT process, the FATF is able to raise the cost of failing to implement an AML/CFT system and thereby coerce previously unwilling countries to adopt AML/CFT measures. On this account the NCCT process has achieved a fair amount of success. Of the forty-seven states assessed through the NCCT process, the FATF identified twenty-three as NCCT jurisdictions.<sup>97</sup> The FATF has since removed each of these states from the list.<sup>98</sup> While the FATF has had to apply varying amounts of pressure to achieve these changes, the FATF resorted to recommending economic countermeasures in at least three cases.<sup>99</sup> With these results, the FATF has described the NCCT program as a "very useful and efficient tool."<sup>100</sup> In its annual reports, the FATF has noted that the NCCT process "has triggered significant improvements" in AML/CFT systems.<sup>101</sup>

The NCCT process, however, does not provide the FATF with an effective means of achieving the universal implementation of an effective AML/CFT

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95. *NCCT Review 2006*, *supra* note 13, at 3-4.

96. *2004-2005 FATF Ann. Rep.*, *supra* note 42, at 12.

97. *Id.* In June 2000, the FATF identified fifteen states as noncooperating jurisdictions: Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts and Nevis, and St. Vincent and the Grenadines. In June 2001, the FATF identified six states as noncooperating jurisdictions: Egypt, Guatemala, Hungary, Indonesia, Myanmar, and Nigeria. In September 2001, the FATF added Grenada and the Ukraine to the list of noncooperative jurisdictions. FATF, *Non-Cooperative Countries and Territories: Timeline*, [http://www.fatf-gafi.org/document/54/0,3343,en\\_32250379\\_32236992\\_33919542\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/54/0,3343,en_32250379_32236992_33919542_1_1_1_1,00.html) (last visited Mar. 3, 2008) [hereinafter *NCCT Timeline*].

98. *NCCT Timeline*, *supra* note 95.

99. The FATF recommended that states apply countermeasures against Nauru during 2001-04, Ukraine during 2002-03, and Myanmar during 2003-04. *Id.*

100. *2004-2005 FATF Ann. Rep.*, *supra* note 42, at 12.

101. *2002-2003 FATF Ann. Rep.*, *supra* note 41, at 26.

system. The reason for this is simple: lack of political will is not the only impediment to the implementation of AML/CFT measures. As described above, many states, especially developing states such as those targeted by the NCCT process, lack the regulatory capacity, the rule of law tradition, the institutions, and the experience in financial regulation to effectively implement an AML/CFT system. Coercion, of course, cannot create capacity. When capacity is lacking, the most coercion can achieve is superficial legal changes. Rather, “oversight and supervision [of implementation of financial standards] are hands-on affairs that require intimate knowledge and local institutions and management and a legal basis, which cannot be delegated to a distant and unaccountable international enforcer.”<sup>102</sup>

The FATF is keenly aware of this difficulty. Indeed, the FATF has attempted to incorporate capacity-building assistance into the NCCT program.<sup>103</sup> Throughout the NCCT process, the FATF stress that meeting the twenty-five criteria requires both legal compliance and effective implementation.<sup>104</sup> But having assumed an adversarial and coercive relationship with the NCCT states, the FATF is not well-positioned to provide collaborative assistance. Nonmember states resent the imposition of the NCCT process and protest its coercive tactics.<sup>105</sup> Developing states have called for an end to the NCCT program and have urged a more collaborative approach.<sup>106</sup> In the end, the NCCT process distances the FATF members states from the nonmembers it seeks to enlist in the AML/CFT program. The FATF has recognized the resistance to the NCCT process and its tendency towards “straining the relationship” between the FATF and nonmember states.<sup>107</sup>

The NCCT process is not without its achievements. As a result of the NCCT review, many of the countries with the weakest AML/CFT systems have begun to implement AML/CFT measures. Ultimately, however, the NCCT process can only be of limited effectiveness. By engaging FATF nonmember states in an adversarial, coercive relationship, the FATF forgoes opportunities to work with FATF nonmember states in more collaborative relationships that facilitate capacity-building necessary for regulatory implementation.<sup>108</sup>

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102. Michele Fratianni & John Pattison, *International Financial Architecture and International Financial Standards*, 579 ANNALS AM. ACAD. POL. & SOC. SCI. 183, 197 (2002).

103. *NCCT Review 2000*, *supra* note 9, at 7.

104. *2001-2002 FATF Ann. Rep.*, *supra* note 36, at 15.

105. *See infra* Part IV.

106. *See Intergovernmental Group of Twenty-Four on International Monetary Affairs Communique* (Sept. 23, 2000), available at <http://www.imf.org/external/np/cm/2000/092300.htm> [hereinafter G24 September 2000 Communique]; *Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development Communique* (April 28, 2001), available at <http://www.imf.org/external/np/cm/2001/010428.htm> [hereinafter G24 April 2001 Communique].

107. FATF, *Annual Report 2000-2001*, 11 (2001), <http://www.fatf-gafi.org/dataoed/13/2/34328033.pdf> [hereinafter *2000-2001 FATF Ann. Rep.*].

108. Raustiala notes that networks generally attain success in changing the regulatory policies of other countries using soft power rather than hard power or coercion. Raustiala, *supra* note 1, at 51.

### ***G. The FATF's dilemma***

In designing a global response to the AML/CFT problem, the FATF member states have had to choose between critical design features. On the one hand, they seek an institution that is small and flexible for the purposes of designing AML/CFT recommendations and responding to new developments in money laundering and terrorism financing techniques. On the other hand, they seek an institution able to advance implementation among FATF nonmembers. Coercive approaches to nonmember implementation come at the cost of a cooperative relationship that facilitates capacity-building. Yet the self-assessment and mutual evaluation process that has proven so effective within the FATF for advancing implementation and providing technical assistance cannot be extended to nonmember states. Ultimately, the FATF faces a tradeoff. The gains it has made with regard to its flexible rulemaking functions come at the cost of implementation and capacity-building among nonmembers.

In her analysis of international suasion problems, Lisa Martin suggests a move beyond the traditional coercive and persuasive responses to suasion problems. Martin suggests that institutional linkages may provide states facing suasion problems with a means of aligning disparate state interests.<sup>109</sup> Through such linkages, states are able to provide “side payments” to induce others to conform with their interests.<sup>110</sup> As this theory suggests, the strategy that the FATF has developed to achieve universal implementation of its Recommendations relies heavily upon partnerships that the FATF has formed with other international institutions. Through these partnerships, the FATF has accomplished two objectives. First, the FATF has built relationships with institutions that have functional advantages that the FATF itself is not able to provide. In particular, the role of the FATF partner institutions is to advance universal implementation of the FATF Recommendations by monitoring their adoption among nonmember states and by building the regulatory capacity of nonmember states for full implementation. Second, the FATF has provided a side payment, or incentive, for FATF nonmembers to participate in the AML/CFT processes of these partner institutions. The next two parts of this Article describe how the FATF has accomplished these two objectives.

## **IV. BUILDING INSTITUTIONAL PARTNERSHIPS**

In crafting an international response to money laundering and terrorism financing, the FATF has formed institutional partnerships with various international institutions.<sup>111</sup> In particular, the FATF has partnered with eight

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109. Martin, *supra* note 63, at 779-80.

110. *Id.*

111. Although this paper focuses on the FATF's partnerships with only a select group of international institutions, the FATF collaborates with a wide variety of international institutions. The FATF invites many international institutions to attend meetings on the topics of AML/CFT and regularly coordinates activities with them to avoid redundancies. See *FATF Annual Report 2000-2001*, *supra* note 107, at 4. Many of these institutions focus significant attention and resources on money laundering and the financing of terrorism, but they do not have functional partnerships with the FATF to the same depth as the institutions discussed in this article. Their

FATF-Style Regional Bodies, the IMF, the World Bank, and the U.N.<sup>112</sup> Each of these institutions has a membership that far exceeds the limited membership of the FATF. Through these institutions, the FATF is able to indirectly engage FATF nonmember states and advance the universal implementation of the Recommendations. Through a strategy of building institutional partnerships, the FATF has managed to maintain the functional advantages that derive from its limited membership while advancing universal implementation of the Recommendations.

This part describes how the FATF is an institution particularly well-suited to partnering with other institutions. I address the relationship that the FATF has developed with each of its partner institutions and how each institution contributes to the overall AML/CFT effort. First, the Regional Bodies advance universal implementation of AML/CFT measures by monitoring FATF nonmember compliance with the FATF Recommendations. By copying the FATF model, the Regional Bodies are able to utilize the same soft and persuasive means of advancing compliance with the recommendations that the FATF has found so effective internally. The IMF, the World Bank, and the U.N. also advance the implementation of FATF recommendations far beyond the FATF membership. The IMF and the World Bank do so by coordinating and overseeing the Regional Bodies' implementation assessments. The U.N. conducts its own monitoring. Equally as important, however, the IMF, the World Bank, and the U.N. provide the FATF nonmember states with technical and capacity-building assistance vital to their effective implementation of the FATF Recommendations. Finally, I argue that the division of labor among the AML/CFT institutions represents an interesting new perspective on policy disaggregation in international affairs.

#### ***A. The FATF is Well-Designed to Build Partnerships***

Before turning to the role that each of these institutions plays in the institutional AML/CFT partnership, it is important to note that the ability of the

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relationship with the FATF is analogous to the common forms of international collaboration typical among international institutions. For a list of international institutions represented at various FATF meetings in 2003 and 2004, see *2003-2004 FATF Ann. Rep.*, *supra* note 19, at 3.

One possible exception to this rule is the FATF's relationship with the Egmont Group, a transgovernmental network of financial enforcement officials. See Statement of Purpose of the Egmont Group of Financial Intelligence Units (2004), *available at* [http://www.egmontgroup.org/statement\\_of\\_purpose.pdf](http://www.egmontgroup.org/statement_of_purpose.pdf). Many features of the FATF's relationship with the Egmont Group resemble the institutional partnerships described in this article. The Egmont Group's focus on enforcement of FATF Recommendations, rather than national implementation or adoption of the Recommendations, places it beyond the scope of this paper. Future research on the contribution of the Egmont Group to the overall AML/CFT international institutional regime may provide further insight to the principles of functional disaggregation and institutional division of labor explored in this article.

112. The FATF describes this particular group of institutions, along with the Egmont Group, as those with which it has developed its primary partnerships. FATF, *Annual Report 2005-2006* 3 (2006), *available at* <http://www.fatf-gafi.org/dataoecd/38/56/37041969.pdf> [hereinafter *2005-2006 FATF Ann. Rep.*]. For a brief description of the Egmont Group, see *supra* note 111.

FATF to build institutional partnership is itself a function of the FATF's institutional design. I describe above the functional explanations for why the FATF issues nonlegal pledges or soft law norms; these international agreements provide flexibility, can be crafted by technocrats, and allow member countries to agree to deep changes in an area of uncertain compliance.<sup>113</sup> Pledges offer one additional advantage as well. The FATF must fashion an agreement that is easily applied to nonmembers of the FATF. Issuing pledges, rather than legally binding contracts, makes this possible.

Contracts, as legally binding agreements, explicitly list the parties that are bound by the terms of the agreement. Contracts draw clear lines between the “in-group” and the “out-group”. Treaty ratification is the binding act that creates these two categories. Kal Raustiala argues that legality is binary—an agreement either imposes a legal obligation or it does not.<sup>114</sup> A corollary to this argument is that any particular country is either bound by a legal obligation or it is not. For this reason, agreements that create binding legal obligations do not lend themselves to use by countries trying to influence the behavior of nonparties. If the FATF Recommendations had been written as a legal contract, then they would only bind the members of the FATF and exclude all others. Any new states that acceded to the contract would earn the right to participate in any future amendment or renegotiation of the contract. Such an inclusive process is anathema to the flexible and nimble process for updating AML/CFT Recommendations that the FATF currently employs.

Pledges, on the other hand, often do not draw such hard and fast lines between parties and nonparties.<sup>115</sup> Without a formal ratification or consent process, pledges can resist clear distinctions between the in-group and out-group. In fact, pledges, such as those of the FATF, do not claim to apply to any particular group of countries at all. Instead, many pledges, including the Recommendations, are written as best practices and global standards that all countries should strive to achieve. Proponents of such standards market them less as the product of a particular group of countries and more as the product of technical expertise.<sup>116</sup> The seemingly apolitical nature of the FATF Recommendations allows the FATF to advocate their adoption by partner institutions as global standards and technical compilations of AML/CFT best practices. The technical nature of the FATF Recommendations, however, does not alter the fact that effective AML/CFT regulation furthers the interests of some states (FATF members) more than others (nonmembers). By endorsing the Recommendations and facilitating their implementation, the partner institutions advance the interests of the FATF.

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113. *See supra* Section II.

114. Raustiala, *supra* note 28, at 581.

115. Admittedly, not all pledges bear this feature. An exchange of MOU, for example, takes place between a clear set of parties. The point is that pledges are capable of leaving the in-group and out-group distinction vague. Best practices or global standards, such as the FATF's Forty Recommendations, are particular forms of pledges that bear this feature. Raustiala, *supra* note 28, at 600.

116. *See* Zaring, *supra* note 1, at 584.

### ***B. FATF-Style Regional Bodies***

The FATF-Style Regional Bodies serve as the FATF's primary means of enlisting FATF nonmember states in AML/CFT work. Through the eight existing Regional Bodies, the FATF's reach extends to all corners of the globe.<sup>117</sup> The FATF utilizes these regional networks to influence the implementation of the Recommendations among nonmember states and to stay abreast of local developments in money laundering and the terrorism financing techniques.

The Regional Bodies are the direct product of an FATF program of regional "awareness raising" on the value of strong AML/CFT measures.<sup>118</sup> FATF countries are largely responsible for the formation of the local Regional Bodies within their respective regions and continue to play an active role in the activities of the Regional Bodies.<sup>119</sup> In each of the Regional Bodies, participating FATF members provide funding and technical training,<sup>120</sup> and are also actively involved in the full range of Regional Body activities, including mutual evaluation teams.<sup>121</sup> At times, the FATF persuades reluctant Regional Body members of the value of the full range of Regional Body activities, including the mutual evaluation

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117. The eight Regional Bodies are the Asian/Pacific Group on Money Laundering [hereinafter APG]; the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (formerly PC-R-EV) [hereinafter MONEYVAL]; the Financial Action Task Force on Money Laundering in South America [hereinafter GAFISUD]; the Middle East and North Africa Financial Action Task Force [hereinafter MENAFATF]; the Eurasian Group of combating money laundering and financing of terrorism [hereinafter EAG]; the Eastern and South African Anti-Money Laundering Group [hereinafter ESAAMLG]; Caribbean Financial Action Task Force [hereinafter CFATF]; and the Intergovernmental Action Group against Money-Laundering in Africa [hereinafter GIABA]. FATF Members and Observers, *supra* note 18.

118. Asia/Pacific Group on Money Laundering (APG), APG History and Background, <http://www.apgml.org/about/history.aspx> (last visited Mar. 4, 2008).

119. Some Regional Bodies, such as the APG, recognize local FATF members as members of the Regional Body. *See, e.g.*, Asia/Pacific Group on Money Laundering, APG Overlapping Memberships of Multilateral Institutions, <http://www.apgml.org/jurisdictions> (last visited Mar. 4, 2008). Other Regional Bodies, such as the CFATF or EAG, permit FATF members to participate as "cooperating partners." *See, e.g.*, Eastern and Southern Africa Anti-Money Laundering Group, ESAAMLG Members and Cooperating Partners, <http://www.esaamlg.org/MoU/index.php> (last visited Mar. 4, 2008). Finally, some Regional Bodies recognize the FATF members as "observers." *See, e.g.*, Eurasian Group, List of Members and Observers of Eurasian Group (EAG), <http://www.eurasiangroup.org/index-4.htm> (last visited Mar. 4, 2008).

120. *See, e.g.*, Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), Memorandum of Understanding Among Member Governments of the Eastern and Southern Africa Anti Money Laundering Group (1999), available at [http://www.esaamlg.org/documents\\_storage/ESAAMLG\\_MEMORANDUM\\_OF\\_UNDERSTANDING.pdf](http://www.esaamlg.org/documents_storage/ESAAMLG_MEMORANDUM_OF_UNDERSTANDING.pdf) [hereinafter ESAAMLG]; Memorando de Entendimiento entre los Gobiernos de los Estados del Grupo de Accion Financiera de Sudamerica contra el Lavado de Activos, available at [http://www.felaban.com/lavado/cap2/memorando\\_entendimiento\\_gafisud.pdf](http://www.felaban.com/lavado/cap2/memorando_entendimiento_gafisud.pdf) [hereinafter GAFISUD].

121. *See, e.g.*, ESAAMLG, *Programme Activities*, [http://www.esaamlg.org/work\\_programme/activities.php](http://www.esaamlg.org/work_programme/activities.php) (last visited Mar. 4, 2008).

exercise.<sup>122</sup>

The Regional Bodies are modeled on the FATF. Like the FATF, the Regional Bodies have little in the way of permanent institutional administration.<sup>123</sup> As within the FATF, decisions within the Regional Bodies are made by consensus.<sup>124</sup> Most importantly, like the FATF, the Regional Bodies feature a plenary body that serves as a forum for legal, criminal, and regulatory officials within a region to collaborate on strengthening the AML/CFT responses of their national governments. The Regional Bodies adopt the exact monitoring and implementation procedures of the FATF, requiring members to submit self-assessments and permit mutual evaluations by teams of experts drawn from other Regional Body states. The Regional Bodies also engage in regional typologies exercises that analyze regional developments in money laundering and terrorism financing activities.

Yet the Regional Bodies differ from the FATF in two significant ways. First, rather than develop their own AML/CFT Recommendations, the Regional Bodies adopt the FATF Forty Recommendations and the FATF Nine Special Recommendations wholesale.<sup>125</sup> Only one Regional Body, the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL), currently supplements the recommendations with its own AML/CFT agreement.<sup>126</sup> Each of the Regional Bodies, including MONEYVAL, conducts its mutual evaluations against the criteria and through the procedures endorsed by the FATF.<sup>127</sup>

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122. *See id.*

123. For example, GAFISUD consists of three bodies: (1) the *Consejo de Autoridades* (Council of Authorities), which is made up of high-ranking national representatives from each member state and serves as the institution's decision-making body; (2) the *Pleno de Representantes* (the Plenary), the central body of the institution, which consists of the national regulators working on AML/CFT issues and is led by a President and an Executive Secretary; and (3) the *Secretaria* (Secretariat), which carries out the technical and administrative functions of the institution. GAFISUD, *supra* note 120.

124. *See id.* CFATF seems to be a singular exception to this rule, adopting Resolutions through a two-thirds majority. *See* Caribbean Financial Action Task Force (CFATF), *Memorandum of Understanding among Member Governments of the Caribbean Financial Action Task Force* (2006), available at <http://www.cfatf.org/documentation/docadmin.asp?mcat=5>.

125. *See, e.g.*, Press Release, Middle East and North African Financial Action Task Force (MENAFATF), Inaugural Ministerial Meeting of the Middle East and North Africa Financial Action Task Force against Money Laundering and Terrorist Financing (Nov. 30, 2004), available at <http://www.mofne.gov.bh/menafatf/ArticleDetail.asp?rid=548>; ESAAMLG, *supra* note 1200.

126. Through the Council of Europe, the MONEYVAL states have adopted the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (ETS 141), updated by the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (CETS 198). The Council of Europe has also issued a Directive on the prevention of the use of the financial system for the purpose of money laundering, EEC (91/308/EEC), as amended by Directive 2001/97/EC. CFATF initially did adopt a complementary set of recommendations, but dropped them in 2003. *See infra* Section IV.

127. In conducting mutual evaluations and self-assessments, MONEYVAL complements the FATF questionnaire with questions to cover the additional Council of Europe criteria. *See* MONEYVAL Committee, Money Laundering, Proceeds of Crime, Financing of Terrorism, [www.coe.int/moneyval](http://www.coe.int/moneyval) (last visited Mar. 4, 2008).

A second key distinction between the Regional Bodies and the FATF concerns their membership. In a sense, Regional Body membership is at once both global and local. First, the Regional Bodies provide the FATF with global reach. Regional Bodies are designed to achieve broad participation within their regions. Regional Body membership is open to any state within the region interested in participating in the Regional Bodies' activities. Unlike the FATF, noncompliance with AML/CFT standards is not a bar to participating in a Regional Body.<sup>128</sup> Any state within a Regional Body region that commits to work toward implementation and participate in Regional Body activities can be admitted.<sup>129</sup> The FATF actively supports and participates in Regional Body outreach missions that seek to encourage the participation of potential new Regional Body members.<sup>130</sup> As a result, the Regional Bodies extend the FATF Recommendations to all corners of the globe. The total membership of the Regional Bodies includes 136 countries not otherwise affiliated with the FATF.<sup>131</sup>

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128. See, e.g., APG, APG EXPLANATORY NOTE ON MEMBERSHIP (2004), available at <http://www.apgml.org/documents/docs/12/Explanatory%20Note%20on%20Membership%20%20revised%202005.pdf>.

129. See, e.g., Eurasian Group, *Terms of Reference of Eurasian Group on Combating Money Laundering and Terrorist Financing* (2004), <http://www.eurasiangroup.org/index-5.htm> [hereinafter EAG]; APG, *Terms of Reference* (2006), [http://www.apgml.org/documents/docs/12/APG\\_TOR2006%20-%20FINAL.pdf](http://www.apgml.org/documents/docs/12/APG_TOR2006%20-%20FINAL.pdf) [hereinafter EAG].

130. See, e.g., APG, *Annual Report 2003-2004 15* (2004), [http://www.apgml.org/documents/docs/2/APG\\_Annual\\_Report\\_03-04.pdf](http://www.apgml.org/documents/docs/2/APG_Annual_Report_03-04.pdf) [hereinafter *2003-2004 APG Ann. Rep.*].

131. These countries are Afghanistan; Albania; Algeria; Andorra; Anguilla; Antigua & Barbuda; Armenia; Aruba; Azerbaijan; Bahamas; Bahrain; Bangladesh; Barbados; Belarus; Belize; Benin; Bermuda; Bolivia; Bosnia and Herzegovina; Botswana; British Virgin Islands; Brunei Darussalam; Bulgaria; Burkina Faso; Cambodia; Cape Verde; Cayman Islands; Chile; Chinese Taipei; Colombia; Cook Islands; Costa Rica; Côte d'Ivoire; Croatia; Cyprus; Czech Republic; Dominica; Dominican Republic; Ecuador; Egypt; El Salvador; Estonia; Fiji; Gambia; Georgia; Ghana; Grenada; Guatemala; Guinea Bissau; Guinea Conakry; Guyana; Haiti; Honduras; Hungary; India; Indonesia; Jamaica; Jordan; Kazakhstan; Kenya; Kuwait; Kyrgyzstan; Latvia; Lebanon; Lesotho; Liberia; Liechtenstein; Lithuania; Macau China; Malawi; Malaysia; Mali; Malta; Marshall Islands; Mauritius; Moldova; Monaco; Mongolia; Montserrat; Morocco; Mozambique; Myanmar; Namibia; Nepal; Netherland Antilles; Nicaragua; Niger; Nigeria; Niue; Oman; Pakistan; Palau; Panama; Paraguay; Peru; Philippines; Poland; Qatar; Republic of Korea; Romania; Samoa; San Marino; Saudi Arabia; Senegal; Serbia; Seychelles; Sierra Leone; Slovakia; Slovenia; Sri Lanka; St. Kitts & Nevis; St. Lucia; St. Vincent & the Grenadines; Suriname; Swaziland; Syria; Tajikistan; Tanzania; Thailand; The former Yugoslav Republic of Macedonia; Togo; Tonga; Trinidad & Tobago; Tunisia; Turks & Caicos Islands; Uganda; Ukraine; United Arab Emirates; Uruguay; Uzbekistan; Vanuatu; Venezuela; Yemen; Zambia; and Zimbabwe. FATF Members and Observers, *supra* note 118; APG, Members and Observers, [http://www.fatf-gafi.org/document/19/0,3343,en\\_32250379\\_32236869\\_34354899\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/19/0,3343,en_32250379_32236869_34354899_1_1_1_1,00.html) (last visited Mar. 4, 2008); MONEYVAL, Members and Observers, [http://www.fatf-gafi.org/document/46/0,3343,en\\_32250379\\_32236869\\_34355246\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/46/0,3343,en_32250379_32236869_34355246_1_1_1_1,00.html) (last visited Mar. 4, 2008); GAFISUD, Members and Observers, [http://www.fatf-gafi.org/document/35/0,3343,en\\_32250379\\_32236869\\_34355875\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/35/0,3343,en_32250379_32236869_34355875_1_1_1_1,00.html) (last visited Mar. 4, 2008); MENAFATF, Members and Observers, [http://www.fatf-gafi.org/document/11/0,3343,en\\_32250379\\_32236869\\_34864395\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/11/0,3343,en_32250379_32236869_34864395_1_1_1_1,00.html) (last visited Mar. 4, 2008); EAG, Members and Observers, <http://www.eurasiangroup.org/index-4.htm> (last visited Feb. 3, 2008); ESAAMLG, Members and Observers, <http://www.fatf->

At the same time, the Regional Bodies are decidedly local in character. Rather than create a single institution for all FATF nonmember states, the FATF pursued a deliberate policy of building smaller networks among neighboring states. This regional design of the Regional Bodies stands in stark contrast to other universal AML/CFT-related networks that the FATF member states have sponsored and designed.<sup>132</sup> The regional approach reinforces the network forces of socialization and persuasion that have proven so effective in the FATF by creating tighter communities of AML/CFT regulators and experts. Proponents of networks note that network socialization tends to work best within small, close-knit groups.<sup>133</sup> By creating “cohesiveness”<sup>134</sup> within networks for AML/CFT regulators, Regional Bodies foster all the factors that network scholars cite to explain socialization: common enterprise, regular interactions among participants, and opportunities to develop personal relationships.<sup>135</sup> The Regional Bodies deliberately reinforce the sense of community that facilitates the persuasive effect of network interactions. Within each Regional Body, AML/CFT experts participate on mutual evaluation teams with regional counterparts,<sup>136</sup> attend regional training exercises,<sup>137</sup> and work together at annual typologies meetings to analyze and build responses to common money laundering and terrorist financing challenges. All Regional Body members are invited to publicly comment on their record of cooperating with other Regional Body members through the evaluation process.<sup>138</sup> A number of Regional Bodies even publish regional AML/CFT

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[gafi.org/document/4/0,3343,en\\_32250379\\_32236869\\_34355780\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/4/0,3343,en_32250379_32236869_34355780_1_1_1_1,00.html) (last visited Mar. 4, 2008); CFATF, Members and Observers, [http://www.fatf-gafi.org/document/28/0,3343,en\\_32250379\\_32236869\\_34355164\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236869_34355164_1_1_1_1,00.html) (last visited Mar. 4, 2008); Intergovernmental Action Group against Money-Laundering in Africa, Members and Observers, [http://www.fatf-gafi.org/document/60/0,3343,en\\_32250379\\_32236869\\_34393596\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/60/0,3343,en_32250379_32236869_34393596_1_1_1_1,00.html) (last visited Mar. 4, 2008).

132. Aside from the FATF itself, the FATF has also been very active in the creation of the Egmont Group, an enforcement network that serves to facilitate information flow between national FIUs. The Egmont Group is universal and horizontal, as the information flow function requires. *See* SLAUGHTER, *supra* note 1, at 162-65. For more discussion of the Egmont Group, *see supra* note 111.

133. SLAUGHTER, *supra* note 1, at 198-200; *see also* MANCUR OLSON JR., *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 60-65 (1965) (arguing that small-sized groups will be more effective at organizing themselves for the provision of public goods).

134. APG, *Annual Report 2004-2005* iii (2005), available at <http://www.apgml.org/documents/docs/2/APG%20Annual%20Report%2004-05%20FINAL.pdf> [hereinafter *2004-2005 APG Ann. Rep.*].

135. SLAUGHTER, *supra* note 1, at 199.

136. The FATF requires Regional Bodies to commit to not only undergoing mutual evaluations, but to contributing officials to participate in mutual evaluation teams as well. *See* ASIA/PACIFIC GROUP ON MONEY LAUNDERING, *supra* note 128.

137. *See, e.g., 2003-2004 APG, Ann. Rep., supra* note 130, at 25.

138. *See* THE COUNCIL OF EUROPE SELECT COMMITTEE OF EXPERTS ON THE EVALUATION OF ANTI-MONEY LAUNDERING MEASURES, *MONEYVAL RULES OF PROCEDURE FOR THE THIRD EVALUATION ROUND* (2004), available at [http://www.coe.int/t/e/legal\\_affairs/legal\\_cooperation/combating\\_economic\\_crime/5\\_money\\_laundering/general\\_information/MONEYVAL%20\\_2004\\_%2012%20REV%20REV%204%20RULES%20OF%20PROCEDURE%2](http://www.coe.int/t/e/legal_affairs/legal_cooperation/combating_economic_crime/5_money_laundering/general_information/MONEYVAL%20_2004_%2012%20REV%20REV%204%20RULES%20OF%20PROCEDURE%2)

newsletters updating members on recent developments and upcoming events in the particular region.<sup>139</sup>

Ultimately, the limited and regional scope of the Regional Bodies nurtures an environment where participants care to protect their professional reputations when, for example, they are reviewed by mutual evaluation teams drawn from neighboring states or publicly chastised through graduated sanctions.<sup>140</sup> Just as in the FATF, the adoption of AML/CFT norms by regulators participating in the Regional Body either influences regulations directly or affects the counsel that participants provide to national lawmakers crafting AML/CFT measures. If the FATF can be analyzed as an epistemic community that advises national regulators on the technical aspects of AML/CFT regulation, the Regional Bodies can be understood as subsidiary epistemic communities that adopt the norms of the FATF parent community and accordingly advise and influence policymakers of nonmember states as they begin to craft AML/CFT polices.<sup>141</sup>

In addition to the spread of AML/CFT norms from the FATF to the Regional Bodies, information flows in the reverse direction as well. The FATF utilizes the Regional Bodies as a source of information and analysis on regional trends in money laundering and the financing of terrorism. Through annual typologies meetings, Regional Bodies develop a collection of regional expertise on challenges to effective AML/CFT regulation.<sup>142</sup> As with the FATF typologies meetings, participants share experiences, analyze trends, and develop best practices with regional counterparts. For example, a regional body typologies meeting may study how a particular regional industry creates opportunities for money laundering or terrorist financing.<sup>143</sup> FATF members often play an active role in these regional

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030%20NOV%2006.pdf [hereinafter MONEYVAL *Rules of Procedure*].

139. See, e.g., APG, *Asia/Pacific Group on Money Laundering Information Quarterly*, available at <http://www.apgml.org/documents/default.aspx?DocumentCategoryID=3>; CFATF, *Annual Report 2004-2005* 7 (2005), available at <http://www.cfatf.org/documentation/getfile.asp?fileid=155&option=1> [hereinafter *2004-2005 CFATF Ann. Rep.*].

140. See MONEYVAL, *RULES OF PROCEDURE*, *supra* note 138, at 9. At least one Regional Body has suspended a member: the CFATF suspended Nicaragua after a period of inactivity in the activities of the Regional Bodies. See CFATF, *Annual Report 2001-2002* 10-11 (2002), available at <http://www.cfatf.org/documentation/getfile.asp?fileid=98&option=1> [hereinafter *2001-2002 CFATF Ann. Rep.*].

141. Haas argues that epistemic communities are likely to have a greater effect in states that have less experience regulating the particular area of expertise. In such inexperienced states, policymakers are likely to defer to the knowledge of the official participating in the epistemic community. Haas, *supra* note 46, at 29.

142. See, e.g., EAG, *supra* note 129 (stating as a primary objective of the EAG the analysis of money laundering and terrorist financing trends “with regard to regional peculiarities.”).

143. The CFATF has paid special attention to preventing money laundering in internet gambling, a lucrative industry in the Eastern Caribbean. CFATF, *Annual Report 1996-1997* 6-7 (1997), available at <http://www.cfatf.org/documentation/getfile.asp?fileid=93&option=1> [hereinafter *1996-1997 APG Ann. Rep.*]. Similarly, APG member states have studied how alternative remittance and underground banking systems in the region may contribute to money laundering and terrorism financing. APG, *Annual Report 2002-2003* 8-10 (2003), available at <http://www.apgml.org/documents/docs/2/APG%20Annual%20Report%2002-03%20%20final.pdf> [hereinafter *2002-2003 APG Ann. Rep.*].

body typologies exercises.<sup>144</sup> The regional information that the FATF derives from such collaboration with the regional bodies is critical to the FATF's mission.<sup>145</sup> By staying informed of local trends through the Regional Bodies, the FATF is better able to direct a global response.

### C. *The IMF and the World Bank*

The IMF and the World Bank (collectively, the “international financial institutions” or “IFIs”) play a central role in monitoring the implementation of the FATF Recommendations among their members. The IFIs are well-positioned to link the FATF with FATF nonmembers. On the one hand, the IFIs are largely funded and controlled by the same states that founded the FATF. On the other hand, the IFIs have strong working relationships and expertise in areas relevant to FATF nonmember developing nations.

The surveillance of economic conditions within IMF member states is a central component of the work of the IMF today.<sup>146</sup> In May 1999, the IMF expanded its surveillance activities by initiating the Financial Sector Assessment Program (“FSAP”) in collaboration with the World Bank.<sup>147</sup> The FSAP assesses the soundness of members’ financial systems by identifying risks and vulnerabilities, assessing assistance needs, and aiding member states in responding to these weaknesses through technical assistance and policy recommendations.<sup>148</sup> A key component of the FSAP is the creation of a Report on the Observance of Standards and Codes (“ROSC”). The ROSC reports on member state

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144. See, e.g., Eurasian Group, *Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG): An Overview* [hereinafter *EAG Overview*], <http://www.eurasiangroup.org/index-1.htm> (last visited Mar. 4, 2008).

145. 2002-2003 APG Ann. Rep., *supra* note 143, at 9.

146. The role of the IMF in maintaining international economic stability has evolved significantly since the institution's founding at Bretton Woods in 1945. Daniel D. Bradlow, *The World Bank, the IMF, and Human Rights*, 6 TRANSNAT'L L. & CONTEMP. PROBS. 47, 66-74 (1996). These changes have largely been a reaction to changing global economic conditions. Under the fixed exchange rate regime that it initially managed, the IMF was chiefly concerned with the international monetary policies of its member states. Andreas F. Lowenfeld, *The International Monetary System and the Erosion of Sovereignty: Essay in Honor of Cynthia Lichtenstein*, 25 B.C. INT'L & COMP. L. REV. 257, 260-61 (2002). Utilizing its Article IV surveillance and consultation powers, the IMF would assess member state monetary policies through an analysis of macroeconomic variables such as interest rates, money supply, public debt, inflation, and balance of payments. Bradlow, *supra* at 68-70. The abandonment of the fixed exchange rate regime for a floating exchange rate meant that the IMF concern for balance of payments would require the institution to analyze more microeconomic variables. *Id.* The willingness of the IMF to focus on internal conditions and policies of states advanced after the Southeast Asia crisis of 1997, largely understood as resulting from microeconomic deficiencies. Robert Hockett, *From Macro to Micro to “Mission-Creep”: Defending the IMF's Emerging Concern with the Infrastructural Prerequisites to Global Financial Stability*, 41 COLUM. J. TRANSNAT'L L. 153, 181 (2002). The result has been a breaching of the “jurisdictional barrier” between the IMF and its sovereign members. Lowenfeld, *supra*, at 260.

147. Int'l Monetary Fund, *Public Information Notice, IMF Executive Board Reviews Experience with the Financial Sector Assessment Program*, <http://www.imf.org/external/np/sec/pn/2005/pn0547.htm> [hereinafter *IMF FSAP Board Review*] (last visited Mar. 4, 2008).

148. *Id.*

implementation of a set of twelve standards that the IMF has recognized as “benchmarks of good practices” in areas relevant to the financial and economic soundness of a state.<sup>149</sup> The ROSC provides a description of country practice, an assessment of implementation of each of the standards, and a list of prioritized recommendations for reform.<sup>150</sup> Participation in the FSAP is voluntary for all IMF and World Bank members.<sup>151</sup>

The IMF’s Offshore Financial Centers (“OFC”) program, another component of IMF surveillance, focuses specifically on countries that provide offshore financial services. The OFC program, initiated in June 2000, emulates the design of the FSAP in conducting assessments and providing targeted technical assistance.<sup>152</sup> The OFC program reflects the IMF’s concern that lax financial supervision in offshore jurisdictions poses a threat to the stability of the

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149. Int’l Monetary Fund, *Standards and Codes: The Role of the IMF*, <http://www.imf.org/external/np/exr/facts/sc.htm> (last visited Mar. 4, 2008). The twelve standards cover accounting, auditing, banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditor rights, insurance supervision, monetary and financial policy transparency, payments systems, securities regulation, and money laundering and the financing of terrorism.

150. Int’l Monetary Fund & The World Bank, *Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)*, at 24, <http://www.imf.org/External/np/mae/aml/2002/eng/061102.pdf> [hereinafter *IMF & The World Bank Staff Progress*] (last visited Mar. 4, 2008).

151. *IMF FSAP Board Review*, *supra* note 147.

152. Int’l Monetary Fund, *Offshore Financial Centers: The Assessment Program: A Progress Report and the Future of the Program*, <http://www.imf.org/external/np/mae/osshore/2003/eng/073103.pdf> [hereinafter *IMF, Progress Report*] (last visited Mar. 4, 2008).

international financial system.<sup>153</sup> As in the FSAP, participation in the OFC is voluntary.<sup>154</sup>

The history of the partnership between the FATF and the IFIs demonstrates how the FATF has been able to construct and shape institutional relationships in ways that best suit its own needs. By 2000, only one year after the start of the FSAP program, the FATF identified the ROSC reporting process as a potentially effective means of advancing the implementation of the FATF Recommendations among FATF nonmember states. The IMF and the World Bank have 184 member countries.<sup>155</sup> Approximately two-thirds of the IMF membership, or 120 countries, participate in the FSAP.<sup>156</sup> More importantly, twelve of the offshore jurisdictions active in the IMF's OFC program have been listed as NCCT states by the FATF.<sup>157</sup> The broad reach of the IFIs' program was not their only virtue. The IMF and World Bank staff involved in FSAP assessments have developed substantial expertise relevant to AML/CFT regulation.<sup>158</sup> Perhaps most importantly, IMF surveillance is conducted with an eye towards tailoring technical assistance programs, much needed in building a global AML/CFT regime.

The IFIs' initial reception to the FATF's proposal for collaboration was lukewarm.<sup>159</sup> The IFIs recognized that money laundering likely created potential macroeconomic problems that fell within its mandate.<sup>160</sup> In fact, they had already begun to dabble in some money laundering issues through the other standards and codes in the FSAP program (e.g., such as the Basel Core Principle Assessments) and within the OFC program.<sup>161</sup> However, the IFIs expressed concern that the AML/CFT work of the FATF lay outside their mandate.<sup>162</sup>

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153. Int'l Monetary Fund, *IMF Board Reviews Issues Surrounding Work on Offshore Financial Centers*, INTERNATIONAL MONETARY FUNDS NEWS, July 26, 2000, <http://www.imf.org/external/np/sec/nb/2000/nb0062.htm> (last visited Mar. 4, 2008).

154. *IMF, Progress Report*, *supra* note 152, at 17-18.

155. Int'l Monetary Fund, *Standards and Codes*, *supra* note 149.

156. Int'l Monetary Fund & The World Bank, *Financial Sector Assessment Program – Review, Lessons, and Issues Going Forward 4*, <http://www.imf.org/External/np/fsap/2005/022205.pdf> [hereinafter IMF & THE WORLD BANK REVIEW] (last visited Mar. 4, 2008).

157. *IMF, Progress Report*, *supra* note 152, at 6.

158. *IMF & The World Bank Staff Progress*, *supra* note 150, at 18.

159. See Pete Engardio, *Commentary: Don't Use the IMF to Push U.S. Foreign Policy*, BUSINESSWEEK ONLINE, Nov. 26, 2001, [http://www.businessweek.com/magazine/content/01\\_48/b3759158.htm](http://www.businessweek.com/magazine/content/01_48/b3759158.htm).

160. See, e.g., Int'l Monetary Fund, *Financial System Abuse, Financial Crime and Money Laundering – Background Paper* (2001), available at <http://www.imf.org/external/np/ml/2001/eng/021201.pdf>. Similar work has focused on the macroeconomic effects of the financing of terrorism. See, e.g., R. Barry Johnston and Oana M. Nedelescu, *The Impact of Terrorism on Financial Markets* (2005), available at <http://www.internationalmonetaryfund.com/external/pubs/ft/wp/2005/wp0560.pdf>; *Handbook*, *supra* note 6, at 210.

161. Int'l Monetary Fund, *IMF Board Reviews Issues Surrounding Work on Offshore Financial Centers*, *supra* note 153.

162. *IMF & The World Bank Staff Progress*, *supra* note 150, at 28-29.

After September 11, 2001, the FATF stepped up its pressure on the IFIs to participate in assessing AML/CFT systems. The FATF formed a working group, chaired by the United States, to develop a framework for IFI participation.<sup>163</sup> Many of the IFIs' misgivings about collaborating with the FATF quickly took a back seat to a desire to contribute to the international response to the terrorist threat.<sup>164</sup> In November 2001 and January 2002, the IMF and the World Bank Boards respectively voted to increase IFI collaboration with the FATF.<sup>165</sup> By the summer of 2002, the IMF and the Bank had agreed to participate in a twelve-month Pilot Program to include the FATF recommendations within the FSAP and OFC assessments while the FATF and the regional bodies continued their mutual evaluations.<sup>166</sup>

Despite the decision to move forward with FATF collaboration, the IMF and World Bank still expressed misgivings about their limited mandates for addressing AML/CFT issues. As a compromise, the IMF and World Bank Boards prohibited the IFIs from undertaking assessments of law enforcement issues throughout the pilot program.<sup>167</sup> In November 2001, the IMF Board clearly resolved that "it would be inappropriate for the Fund to become involved in law enforcement issues" related to the FATF Recommendations.<sup>168</sup> IMF and World Bank participation in the FATF assessments would be limited to those FATF criteria that were "macroeconomically relevant."<sup>169</sup> To ensure comprehensive AML/CFT assessment, a complicated division of labor was worked out between the IFIs and the FATF whereby the IFIs would contract with outside independent AML/CFT experts to conduct the law enforcement aspects of the IMF and World Bank

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163. *Id.* at 12.

164. The IMF acknowledges that its increased role in AML/CFT activities was a direct response to "calls from the international community" after the events of September 11, 2001. IMF Factsheet, *supra* note 15.

165. Int'l Monetary Fund & The World Bank, *Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) ASSESSMENTS 7* (2004), available at <http://www.imf.org/external/np/aml/eng/2004/031004.pdf> [hereinafter *IMF & The World Bank Pilot Program Assessment*].

166. *Id.* at 4. Each of these assessments, including those conducted by the FATF and the Regional Bodies, would produce an ROSC. See, e.g., Press Release, Financial Action Task Force on Money Laundering in South America (July 4, 2003), available at <http://www.gafisud.org/pdf/ComPrensaVIIIPleno.pdf>; *2004-2005 CFATF Ann. Rep.*, *supra* note 140, at 9.

167. Int'l Monetary Fund & The World Bank, *Anti-Money Laundering and Combating the Financing of Terrorism: Review of the Quality and Consistency of Assessment Reports and the Effectiveness of Coordination* 23 (2006), available at <http://www.imf.org/external/np/pp/eng/2006/041806r.pdf> [hereinafter *IMF & The World Bank, Review of Assessment Reports*].

168. *IMF & The World Bank Staff Progress*, *supra* note 150, at 28. In April 2001, the Bank made a similar determination. See *Id.* at 31.

169. Int'l Monetary Fund & The World Bank, *Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), Proposals To Assess A Global Standard and to Prepare ROSCs 2* (2002), available at <http://www.imf.org/external/np/mae/aml/2002/eng/071702.pdf> [hereinafter *IMF & The World Bank, Proposals To Assess A Global Standard*].

assessments.<sup>170</sup>

The IFIs reported positively about their increased AML/CFT work through the pilot program.<sup>171</sup> At year's end, the IMF had assessed twenty jurisdictions, the World Bank had assessed six, and the two institutions had collaborated on an additional seven assessments.<sup>172</sup> Nearly all of these assessments focused on FATF nonmember developing countries and offshore jurisdictions.<sup>173</sup> For the most part, the FATF was also pleased with the program.<sup>174</sup> The FATF, however, criticized the IFI reluctance to assess the law enforcement aspects of the FATF Recommendations, arguing that it hampered the production of fully integrated assessments. In separate letters to the IMF and the World Bank, the FATF urged the IFIs to reassess the limitations of their respective mandates.<sup>175</sup>

In March 2004, the IMF Executive Board adopted the FATF Recommendations as a regular component of its FSAP and OFC programs.<sup>176</sup> The Board determined that future IMF assessments would extend to the full scope of the FATF Recommendations, including those related to criminal law.<sup>177</sup> The World Bank soon took similar action.<sup>178</sup> In doing so, the IFIs noted that their extension into law enforcement matters related to AML/CFT were *sui generis* and should not be taken as precedent for activities in other areas.<sup>179</sup>

Today, the IMF and the World Bank play a central role in the FATF's mission to advance the implementation of the Recommendations.<sup>180</sup> The FATF's partnership with the IFIs contributes to AML/CFT implementation in five ways.

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170. *Id.* at 6-7; 2002-2003 FATF Ann. Rep., *supra* note 41, at 22.

171. The IMF stated, “[k]ey elements of the program have worked well.” *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, at 4.

172. *Id.*

173. *Id.* at 13.

174. *Id.* at 4.

175. See Letter from Claes Norgren, President of the FATF, to Horst Köhler, Managing Director of the IMF, February 11, 2004, reproduced in *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, Annex III; Letter from Claes Norgren, President of the FATF, to James D. Wolfensohn, President of the World Bank, February 11, 2004, reproduced in *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, Annex IV.

176. Int'l Monetary Fund, *IMF Executive Board Reviews and Enhances Efforts for Anti-Money Laundering and Combating the Financing of Terrorism*, <http://www.imf.org/external/np/sec/pn/2004/pn0433.htm> (last visited Nov. 12, 2008) [hereinafter *IMF Board AML/CFT Review*].

177. *Id.*

178. Press Release, World Bank, IMF Enhance Efforts at Combating Money Laundering, Terrorist Financing, (April 2, 2004), available at <http://go.worldbank.org/OBQX2U4ND0> (last visited Nov. 11, 2008).

179. *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, at 28 (noting that “[t]aking on these new areas would constitute a significant expansion in the involvement of the Fund and the Bank in the AML/CFT area, and it would be advisable to acknowledge the exceptional character of this extension . . . and seek ways to demarcate it from other Fund and Bank's [sic] activities.”).

180. 2003-2004 FATF Ann. Rep., *supra* note 19, at 4 (stating that a “key priority” of the FATF was to develop the relationship with the IMF and the World Bank as part of its effort to “ensure global action in combating money laundering and terrorist financing”).

First, the IFIs conduct a significant number of AML/CFT assessments.<sup>181</sup> Every evaluation conducted through the FSAP or the OFC Program includes a thorough assessment of AML/CFT measures.<sup>182</sup> As of June 2006, the IMF and the Bank had assessed over sixty jurisdictions on their compliance with the FATF Recommendations.<sup>183</sup> Second, the IFIs accept ROSC reports based on assessments carried out by the FATF and the Regional Bodies.<sup>184</sup> In order to assure conformity with ROSC format, these assessments are conducted according to a common methodology<sup>185</sup> developed jointly by the FATF, the Regional Bodies, and the IFIs.<sup>186</sup> The common methodology details the precise assessment criteria for each of the Recommendations and the procedures for completing an ROSC.<sup>187</sup> Interestingly, the AML/CFT standards are the only ROSC standards for which the IFIs accept assessments conducted by external partners.<sup>188</sup>

Third, the IFIs maintain quality control, standardization, and coordination of AML/CFT assessments.<sup>189</sup> IFI quality control begins with the *pro forma* review of each ROSC report produced by the FATF or the Regional Bodies to ensure consistency between the detailed assessment and the more concise ROSC.<sup>190</sup> In

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181. IMF, *Factsheet*, *supra* note 15.

182. *Id.*

183. U.S. Dep't of Treasury, *Implementation of Legislative Provisions Relating to the International Monetary Fund: A Report to Congress* 11 (2006).

184. FATF, *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations* (2007), available at <http://www.fatf-gafi.org/dataoecd/14/53/38336949.pdf> [hereinafter *FATF Methodology*].

185. *Id.*

186. *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, at 24. The initial version of the common methodology issued in 2002 provided a basis for evaluating states' implementation of the 1996 version of the FATF Recommendations and the 2001 FATF Eight Special Recommendations on Terrorist Financing. In February 2004, the FATF issued a revised version of the common methodology based on the FATF Forty Recommendations 2003 and the FATF Eight Special Recommendations on Terrorist Financing. This 2004 Methodology provides the framework for the third round of mutual evaluations by the FATF, IFIs, and the Regional Bodies. *2003-2004 FATF Ann. Rep.*, *supra* note 19, at 8-9. The common methodology was updated in 2007 again.

187. *Handbook*, *supra* note 6, at 214.

188. Public Information Notice (PIN), IMF Executive Board Reviews the Quality and Consistency of Assessment Reports for Anti-Money Laundering and Combating the Financing of Terrorism and the Effectiveness of Coordination (June 30, 2006), available at <http://www.imf.org/external/np/sec/pn/2006/pn0672.htm> [hereinafter IMF, PIN on Exec. Bd. Review].

189. U.S. Treasury Secretary Paul O'Neill stated that the IMF's involvement serves to advance a "unified, comprehensive, and integrated approach to assessing the FATF Recommendations." Statement of Paul O'Neill, U.S. Treasury Secretary, at the International Monetary and Financial Committee Meeting (Apr 20, 2002), available at <http://www.ustreas.gov/press/releases/po3018.htm>. The IMF and the World Bank cite the ability to provide "consistency" and "quality control" as chief among their institutional comparative advantages within the FATF partner institutions. *IMF & The World Bank Staff Progress*, *supra* note 150, at 23.

190. The *pro forma* review does not cover the substance of the assessments. *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, at 9.

April 2006, the IFIs issued a thorough report on the comparative quality and coordination of the ROSC reports compiled by the IMF, the World Bank, the FATF, and each of the Regional Bodies. The 2006 report described “a high degree of variability in the quality of the reports”<sup>191</sup> and between the ongoing efforts to increase assessment quality.<sup>192</sup> One key element of quality control is the IFIs’ ability to assure consistency and harmonization across the ROSCs produced by the various assessing bodies.<sup>193</sup> As a coordinating body, the IFIs ensure that the FATF and the Regional Bodies produce ROSCs that are expeditiously integrated into the FSAP and OFC assessment programs and that duplication of efforts is avoided.<sup>194</sup> By managing the schedule of AML/CFT assessments, the IFIs seek to ensure that each country undergoes a full AML/CFT assessment once every five years.<sup>195</sup>

Fourth, the IFIs’ top-down perspective on AML/CFT monitoring efforts permits their staff to analyze global trends and common weaknesses in the implementation of AML/CFT measures.<sup>196</sup> The IFIs release this analysis in well-marketed publications. In July 2003, the IMF published a progress report on the OFC program that provided an exhaustive profile of the overall compliance with FATF Recommendations within the offshore countries that participate in the OFC program.<sup>197</sup> The September 2005 Financial Sector Assessment Handbook highlighted some key weaknesses common among national AML/CFT regulatory systems.<sup>198</sup> In February 2005, the IMF conducted a review of the FSAP program and reported that one-third of all countries assessed were in need of an AML/CFT overhaul.<sup>199</sup>

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191. *IMF & The World Bank, Review of Assessment Reports*, *supra* at note 167, at 6.

192. *Id.* at 8-10.

193. Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting*, in *INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM* 45, 45 (Mario Giovanoli ed., 2000) (noting that the IMF is able to harmonize the implementation of financial standards across states to avoid weakness that could result from disparate regulatory regimes). For instance, under the common methodology, all countries are graded on each of the FATF Recommendations according to a four-level compliance rating: compliant, largely compliant, partially compliant, or noncompliant. *Handbook*, *supra* note 6. The IFIs oversee the reports to ensure that these ratings are applied consistently.

194. *IMF & The World Bank, Review of Assessment Reports*, *supra* note 167, at 12.

195. *Id.* at 3 and 11.

196. The IMF considers “multilateral surveillance,” the analysis of “global and regional economic trends,” as central to the surveillance mandate founded in Article IV of the IMF’s Articles of Agreement. <http://www.imf.org/external/np/exr/facts/surv.htm>. The World Bank’s vast experience with finance sector projects in developing states has equipped the World Bank to assist the IMF in financial sector surveillance. The value of collaboration between the IMF and the World Bank in analyzing financial regulations of developing economies has been noted at least since the 1997 Asian financial crisis. See Christopher Gilbert, Andrew Powell, & David Vines, *Positioning the World Bank*, 109 *ECON. J.* 598, 623 (1999).

197. *IMF, Progress Report*, *supra* note 152; *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, at Annex II.

198. The two weaknesses identified as most pressing by the report were in customer due diligence arrangements and the development of financial intelligence units. *Handbook*, *supra* note 6, at 216-17.

199. IMF, *Financial Sector Assessment Program – Background Paper*, at 4 (Feb. 22, 2005),

Last, the robust technical assistance programs of the IMF and the World Bank increase the capacity of FATF nonmembers to comply with the FATF Recommendations. Based on analyses of the AML/CFT assessments, the IMF and the World Bank have noted that many weaknesses in the global AML/CFT regime result from insufficient resources and training in developing nations.<sup>200</sup> The Fund and the World Bank respond to this need by providing member states with the resources and guidance necessary to improve the weaknesses identified in their AML/CFT systems.<sup>201</sup> Past technical assistance programs have focused on matters ranging from instructing AML/CFT evaluators how to conduct mutual evaluations in compliance with the common methodology<sup>202</sup> to guiding legislators on drafting effective AML/CFT laws.<sup>203</sup> Both the IMF and the Bank AML/CFT assistance programs pay particular attention to the needs of small jurisdictions.<sup>204</sup> The IFIs' AML/CFT capacity development programs have expanded steadily since they began in 2003.<sup>205</sup>

The IFIs serve as the linchpin of the FATF's efforts to advance the implementation of the Recommendations among nonmember states. The FATF's successful campaign for the IMF to adopt the Recommendations as the international standard on money laundering and the financing of terrorism has provided it with a much broader reach than the FATF could have achieved alone. Yet the IMF does not seek to displace the Regional Bodies. On the contrary, the IMF has sought to ensure that the FATF and Regional Bodies "take on an equitable sharing of the burden" in assessing AML/CFT compliance.<sup>206</sup> The IMF

incorporates Regional Body representatives in its own FSAP evaluations<sup>207</sup> and regularly conducts training exercises for Regional Body evaluators.<sup>208</sup>

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available at <http://www.imf.org/external/np/fsap/2005/022205a.pdf>.

200. *IMF & The World Bank Review*, *supra* note 156, at 23.

201. *2001-2002 CFATF Ann. Rep.*, *supra* note 140, at 33, 35.

202. *IMF & The World Bank Pilot Program Assessment*, *supra* note 165, at 15.

203. Int'l Monetary Fund Legal Dep't, *Suppressing the Financing of Terrorism: A Handbook for Legislative Drafting* (2003).

204. IMF, *Offshore Financial Centers: The Assessment Program – A Progress Report*, at 6 (February 8, 2006), available at <http://www.imf.org/external/np/pp/eng/2006/020806.pdf>.

205. During the twelve-month pilot program in 2003, the IMF and the Bank delivered 117 AML/CFT technical assistance projects. U.S. Dep't of Treasury, *Implementation of Legislative Provisions Relating to the International Monetary Fund: A Report to Congress* 11 (2005) (noting that the World Bank and the IMF delivered 210 technical assistance projects between January 1, 2004 and June 30, 2005). *See also*: *IMF & World Bank, Pilot Program Assessment*, *supra* note 165, at 15 (noting that the IMF and the Bank delivered 117 AML/CFT technical assistance projects in 2003).

206. *IMF Board AML/CFT Review*, *supra* note 176; *see also* IMF, PIN on Exec. Bd. Review, *supra* note 188 (reaffirming the "current policy of burden sharing of assessment work" between the IFIs and the FATF and the Regional Bodies).

207. *CFATF Annual Report 2002-2003* 16 (2003), available at <http://www.cfatf.org/documentation/getfile.asp?fileid=99&option=1> [hereinafter *2002-2003 CFATF Ann. Rep.*].

208. *2004-2005 APG ANN. REP.*, *supra* note 134, at 28.

The FATF partnership with the IFIs is unprecedented in several ways, including its questionable inclusion in the mandate of the IFIs and the reliance on outside experts to generate ROSC reports. The political capital the FATF expended in building this relationship speaks to the significant functional gains the IFI partnership provides for AML/CFT implementation.

#### *D. The United Nations*

Although the U.N.'s AML/CFT work predates September 11, 2001,<sup>209</sup> its attention to the issue reached new heights after that tragic day. This redirection was led by the U.N. Security Council. In the immediate wake of September 11th, the Security Council adopted Resolution 1373 under its Article VII authority, imposing broad requirements on member states in the campaign against terrorism.<sup>210</sup> Chief among the requirements imposed by Resolution 1373 is the obligation to “[p]revent and suppress the financing of terrorism.”<sup>211</sup> In addition, Resolution 1373 created the Security Council Counter-Terrorism Committee (“CTC”), a fifteen-member Committee including representatives from each member of the Security Council, to monitor the implementation of Resolution 1373.<sup>212</sup> Through this and Security Council Resolution 1535,<sup>213</sup> the CTC has become the backbone of the U.N.'s effort to enlist all member states in a global campaign against terrorism.<sup>214</sup> In this work, the CTC is aided by the Counter-

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209. The U.N. hosts several terrorism-focused programs and committees that extend beyond AML/CTF regulation. For instance, the U.N. is home to thirteen conventions or protocols that create state obligations related to terrorism. One, the International Convention for the Suppression of the Financing of Terrorism, directly addresses the financing of terrorism. This Convention was initially adopted by the U.N. General Assembly on December 9, 1999. By September 11, 2001, only four states had ratified the Convention. Press Release, United Nations Association of the United States of America (Mar. 2004), *available at* <http://www.unausa.org/site/pp.asp?c=fvKRI8MPJpF&b=337343>. The FATF, however, made ratification of the Convention the first of its Special Recommendations. By April 2002, the Convention received the requisite twenty-two ratifications to take effect. As of June 2007, 158 countries had ratified the Convention. The other twelve U.N. Conventions address other terrorism-related issues only of tangential significance to the FATF: the Convention on Offenses and Certain Other Acts Committed on Board Aircraft; the Convention for the Suppression of Unlawful Seizure of Aircraft; the Convention for the Suppression of Unlawful Act Against Safety of Civilian Aviation; the Convention on the Prevention and Punishment of Crimes Against Internationally Protected Persons, including Diplomatic Agents; the International Convention Against the Taking of Hostages; the Convention on the Physical Protection of Nuclear Material; the Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation; the Protocol for the Suppression of Unlawful Acts Against the Safety of Fixed Platforms Located on Continental Shelf; the Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation; the Convention on the Making of Plastic Explosives for the Purpose of Detection; the International Convention for the Suppression of Terrorist Bombings; and the International Convention for the Suppression of Acts of Nuclear Terrorism.

210. S.C. Res. 1373, U.N. Doc. S/Res/1373 (Sep. 28, 2001).

211. *Id.*

212. *Id.* ¶ 7.

213. S.C. Res. 1535, U.N. Doc. S/Res/1535 (Mar. 26, 2004) (adopted as part of the CTC “revitalization,” created the CT Executive Directorate).

214. Aside from the CTC, the Security Council has created two other entities to deal with

Terrorism Committee Executive Directorate (“CTED”), a committee that reports to the CTC and employs twenty technical experts in all areas covered by Resolution 1373,<sup>215</sup> including the financing of terrorism.<sup>216</sup>

In monitoring the implementation of Resolution 1373, the CTC and CTED serve three primary functions. First, the CTC receives periodic reports from member states on the implementation of Resolution 1373.<sup>217</sup> By 2006, the CTC had received more than 600 reports from member states.<sup>218</sup> These reports, much like the FATF self-assessments, require member countries to evaluate their own progress in complying with the terms of the Resolution. The CTED’s experts analyze the technical aspects of incoming reports and open dialogue with the reporting states on areas relevant to full implementation. The exchange is an opportunity for the CTED to form a preliminary picture of areas of weakness that may require technical or regulatory assistance.<sup>219</sup>

In the second, more “proactive”<sup>220</sup> approach to assessing compliance with Resolution 1373, members of the CTED travel to U.N. Member States to conduct their own exhaustive assessments of compliance with Resolution 1373.<sup>221</sup> Countries participate in this program voluntarily. The CTED regularly invites

terrorism issues. First, Resolution 1267 (1999), as subsequently amended by Resolutions 1333 (2000), 1390 (2002), 1455 (2003), 1526 (2004), and 1617 (2005), established the Al-Qaeda and Taliban Sanctions Committee to oversee sanctions imposed on individuals and entities associated with Al-Qaeda, Osama bin Laden, or the Taliban. Second, Resolution 1540 established the 1540 Committee to oversee the implementation of a series of obligations imposed on states to prevent terrorist organizations from acquiring nuclear, chemical, or biological weapons. Both the 1267 Committee and the 1540 Committee occasionally cooperate with the CTC through information exchange and other forms of collaboration. U.N. Counter-Terrorism Committee, *Communicating the Work of the Counter-Terrorism Committee and its Executive Directorate: A Public Information Work Plan*, 7, ¶ 1, available at [http://www.un.org/sc/ctc/documents/communications\\_strategy%20plan.pdf](http://www.un.org/sc/ctc/documents/communications_strategy%20plan.pdf). Neither, however, plays a significant role in the country reports or capacity building exercises of the CTC.

215. Letter from the Chairman of the Security Council Committee established pursuant to Resolution 1373 (2001) concerning counter-terrorism, Ellen Margrethe Loj, to the President of the Security Council (Dec. 16, 2005) [hereinafter CTC Letter December 2005].

216. For a description of the structure and responsibilities of the CTED, see Letter from the Chairman of the Security Council Committee established pursuant to Resolution 1373 (2001) concerning counterterrorism, Inocencio F. Arias, to the President of the Security Council (Feb. 19, 2005) (for a description of the structure and responsibilities of the CTED) [hereinafter CTC Letter February 2004].

217. S.C. Res. 1373, *supra* note 2100, ¶ 6. According to Resolution 1373, the Security Council “calls upon all States to report to the Committee, no later than 90 days from the date of adoption of [Resolution 1373] and thereafter according to a timetable to be proposed by the Committee, on the steps they have taken to implement this resolution.” *Id.*

218. CTC Letter December 2005, *supra* note 215.

219. *See id.* ¶ 25 (noting that the CTED’s visits to Member States help it to understand their progress in implementing Resolution 1373).

220. CTC Letter February 2004, *supra* note 216, ¶ 4.

221. The Security Council authorized the CTED to travel to Member States in Resolution 1535 (2004). S.C. Res. 1535, pmb., S/RES/1535 (Mar. 26, 2004). The initial proposal for granting the CTED such authority is found in the CTC’s proposal for revitalization. CTC Letter February 2004, *supra* note 216, ¶ 7(f).

technical experts from other international organizations, such as the FATF, to participate in evaluation visits.<sup>222</sup> Similar to the FSAPs and OFC assessments conducted by the IMF and the World Bank, these exercises provide outside technical experts with an opportunity to “identif[y] areas where a State would benefit from receiving technical assistance in order to fully implement resolution 1373.”<sup>223</sup>

The third and most vital function of the CTC is to provide U.N. Member States with capacity building and technical training assistance to fill the gaps in their counter-terrorism efforts.<sup>224</sup> The CTC does not provide technical assistance itself. Instead, it functions as a “switchboard”<sup>225</sup> connecting Member States’ needs with international organizations, such as the FATF, other U.N. bodies or states capable of providing capacity-building support. The CTC also coordinates its capacity building activities with the AML/CFT technical assistance programs of the IFIs.<sup>226</sup> In this effort, the CTC works closely with a committee of G8 donors<sup>227</sup> called the Counter Terrorism Action Group (“CTAG”).<sup>228</sup> Through CTAG, the G8 countries, all of which are members of the FATF, work to ensure that the CTC is sufficiently staffed and work with the CTC to identify relevant international best practices, codes, and standards, and coordinate capacity building among donor states, the FATF, and the IFIs.<sup>229</sup>

While Resolution 1373 establishes the substantive obligations of member

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222. CTC Letter December 2005, *supra* note 215, ¶ 19. For specific mention of the FATF participation, see U.N. Security Council Counter-Terrorism Committee, About Us/Committee Working Methods, <http://www.un.org/sc/ctc/page1.html> (last visited Dec. 1, 2008) [hereinafter U.N. Security Council, About/Working Methods].

223. U.N. Sec. Council, Counter-Terrorism Comm. [CTC], *Framework Document for the CTC visits to States in Order to Enhance the Monitoring of the Implementation of Resolution 1373 (2001)*, <http://www.un.org/sc/ctc/documents/frameworkdocument.htm>.

224. In 2005, the CTED visited Morocco, Kenya, Albania, Thailand, and Algeria. As of early 2006, it was scheduled to travel to Tanzania, the former Yugoslav Republic of Macedonia, and the Philippines. U.N. Sec. Council, About/Working Methods, *supra* note 222.

225. U.N. Sec. Council, Counter-Terrorism Comm. [CTC], *Note Transmitting Report of the Chair of the Counter-Terrorism Committee*, Annex at 8, U.N. Doc. S/2004/70 (Jan. 26, 2004); United Nations, Counter-Terrorism Exec. Dir., *Technical Assistance Implementation Plan, January to December 2006* (Feb. 27, 2006), available at [http://www.un.org/sc/ctc/documents/implementation\\_plan.pdf](http://www.un.org/sc/ctc/documents/implementation_plan.pdf).

226. See *IMF & The World Bank Pilot Program Assessment*, *supra* note 1655, at 18-19 (noting cooperation on identifying CFT weaknesses and technical assistance needs).

227. United Nations, U.N. Counter-Terrorism Comm., *Operational Conclusions for Policy Guidance Regarding Technical Assistance*, U.N. Doc. S/AC.40/2005/PG.1 (Dec. 6, 2005). With the exception of Russia, the members of the G8 made up the initial group of countries to conceive of the FATF. 1989-1990 FATF ANN. REP., *supra* note 14, at 3. The members of the G8 are the United States, Japan, Germany, France, United Kingdom, Italy, Canada, Russia, and the European Community (the Commission of the European Communities participated in the initial FATF meeting). *Id.*

228. See CTC Letter December 2005, *supra* note 215, ¶ 24 (encouraging the CTED to “strengthen the fruitful cooperation” with the CTAG in providing technical assistance).

229. G8 Evian Summit 2003, *Building International Political Will and Capacity to Combat Terrorism – A G8 Action Plan* (2003), available at [www.g8.fr/evian/extras/499.html](http://www.g8.fr/evian/extras/499.html); see also *2003-2004 FATF Ann. Rep.*, *supra* note 19, at 7.

states to suppress terrorism financing, it does not delineate the measures states must take in order to comply with that obligation. In 2004, in an attempt to provide some regulatory guidance, the Security Council instructed the CTC “to develop a set of best practices to assist States in implementing the provisions of resolution 1373 (2001) related to the financing of terrorism.”<sup>230</sup> In response, the CTC developed the Directory of International Best Practices, Codes and Standards (“Directive”).<sup>231</sup> The Directive lists several sources of international standards on terrorism financing, especially the FATF Recommendations but also including standards developed by the U.N., the Basel Committee, the International Association of Insurance Supervisors, the International Organization of Security Commissions, and the World Customs Organization. In 2005, the primacy of the FATF Recommendations was underscored when, less than one year after instructing the CTC to develop a set of best practices, the Security Council adopted Resolution 1617, explicitly endorsing the FATF Recommendations. The Security Council stated in Resolution 1617 that it “strongly urges all Member States to implement the comprehensive, international standards embodied in the Financial Action Task Force’s (FATF) Forty Recommendations on Money Laundering and the FATF Nine Special Recommendations on Terrorist Financing.”<sup>232</sup>

The United Nations provides the FATF with a mechanism for advancing the regulatory implementation of the Forty Recommendations to all corners of the globe. In assessing compliance with FATF Recommendations, identifying areas for technical assistance, and providing capacity building assistance, the CTC consults and coordinates with the FATF.<sup>233</sup> As an institution with true global participation, the U.N. is able to form collaborative and productive working relationships with regulatory authorities in virtually every FATF nonmember state. Such a cooperative relationship facilitates the provision of capacity-building assistance.

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230. S.C. Res. 1566, ¶ 7, U.N. Doc. S/RES/1566 (Oct. 8, 2004).

231. See U.N. Sec. Council, Counter-Terrorism Comm. [CTC], *Directory of International Best Practices, Codes and Standards*, <http://www.un.org/sc/ctc/page4.html> (last visited Dec. 1, 2008).

232. S.C. Res. 1617, ¶ 7, U.N. Doc. S/RES/1617 (July 29, 2005).

233. See, e.g., *2002-2003 FATF Ann. Rep. supra* note 41, at 9; *2001-2002 FATF Ann. Rep.*, *supra* note 36, at 7.

The self-assessment exercises mandated by Resolution 1373 and the external evaluations conducted by the CTED are effective monitoring activities. The Security Council's endorsement of the FATF Recommendations and the participation of FATF officials in CTED missions advance the implementation of effective AML/CFT measures well beyond the membership of the FATF.

### ***E. Analysis of the FATF's Institutional Partnerships***

The FATF's strategy of partnering with other international institutions has served it well. The partner institutions of the FATF assist with functions that the FATF cannot itself provide. The FATF has achieved a level of organizational complexity that allows it to preserve its own organizational structure and functional advantages while advancing the other functions that lie beyond its organizational reach.<sup>234</sup> Specifically, through its institutional partners, the FATF is able to advance the universal implementation of the FATF Recommendations and assure that nonmember states receive the capacity building and technical assistance they need to effectively enforce AML/CFT regulations.

The rise of transgovernmental networks has been described as accompanying a disaggregation of the state.<sup>235</sup> The focus of governmental networks is determined by the specific expertise of the national officials that compose the network. Securities regulators network with other securities regulators and environmental regulators network with environmental regulators. The result is that securities regulation and environmental regulation become separated out from one another in international cooperation. In the case of AML/CFT, there is a second level of disaggregation that occurs at the international level. The governance functions

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234. Scholars have noted the increasing complexity of international institutions. Richard B. Stewart states that some international regimes "have such a high degree of institutional differentiation and legalization that they can accordingly be characterized as complex regimes . . ." Richard B. Stewart, *U.S. Administrative Law: A Model for Global Administrative Law?*, 68 LAW & CONTEMP. PROBS. 63, 98 (2005). Kal Raustiala and David Victor define a "regime complex" as "an array of partially overlapping and nonhierarchical institutions governing a particular issue area . . . [with] no agreed upon hierarchy for resolving conflicts between rules." Kal Raustiala & David G. Victor, *The Regime Complex for Plant Genetic Resources*, 58 INT'L ORG. 277, 279 (2004). This concept is distinct from the institutional partnerships of the AML/CFT institutions that I have described here. The institutional partnerships surrounding the FATF are neatly organized in a clear division of labor. Their high level of cross-institutional organization serves to avoid the potential conflicts and redundancies that mark "regime complexes" as defined by Victor and Raustiala. Finally, José Alvarez argues that transgovernmental networks embed themselves in other more traditional public international institutions, such as the IMF, the World Bank, and the WTO, and lend to the effectiveness of public international law. See José Alvarez, *Do Liberal States Behave Better? A Critique of Slaughter's Liberal Theory*, 12 EUR. J. INT'L L. 183, 227-28 (2001). Despite their differences, each of these concepts focuses on the link between the rising proliferation or complexity of international institutions and the ways in which they interact.

235. See SLAUGHTER, *supra* note 1, at 19 (arguing, "[t]he structural core of a disaggregated world order is a set of horizontal networks . . . operat[ing] both between high-level officials directly responsive to the national political process . . . as well as between lower level national regulators"); Anne-Marie Slaughter, *Global Government Networks, Global Information Agencies, and Disaggregated Democracy*, 24 MICH. J. INT'L L. 1041, 1066 (2003) (noting concerns that transgovernmental networks contribute to a democracy deficit above the nation-state level).

necessary to an effective AML/CFT regime—rulemaking, monitoring, capacity building, and information sharing—are themselves disaggregated and assigned to different international institutions. This disaggregation is driven by the difficulty that any one institution would meet in attempting to address all the features of money laundering and terrorism financing. At least in the case of the FATF, the institution cannot at the same time be flexible in terms of rulemaking, universal in participation, and collaborative in addressing capacity shortfalls.

By disaggregating the governance functions, the FATF is able to divide the AML/CFT labor so as to match a particular governance function of the overall AML/CFT regime with the institution best-suited to execute that function. The Regional Bodies are assigned the task of monitoring and advancing the implementation of the AML/CFT measures because their regional and close-knit nature facilitates the social dynamics essential to the FATF implementation model. The IFIs oversee the monitoring and implementation missions of the Regional Bodies because they have the expertise and strong working relationships with developing country financial regulatory officials. The IFIs and the U.N. are charged with capacity-building and technical assistance because they have broad memberships with FATF nonmember states, cooperative relationships with the relevant officials, and extensive experience and expertise in capacity-building in the developing world. Finally, the rulemaking function is reserved for a small, exclusive group of states with a deep interest in resolving money laundering and terrorism financing issues. Taken as a whole, the FATF and its partner institutions exercise a broad range of administrative functions. Individually, however, each institution focuses on its relative strengths. As a result, the FATF and its partner institutions are able to advance AML/CFT regulation more effectively than if acting as a single, unified body.

Critics of the network approach may be correct that networks *qua* networks are not well-equipped to address suasion problems.<sup>236</sup> This is not to say, however, that networks will not form an integral part of an effective international response to such problems. By partnering with other international institutions, the FATF has managed to accomplish vital functions in addressing AML/CFT that would have not otherwise been possible. This observation highlights both a weakness and a strength of transgovernmental networks. On the one hand, at least in areas of diffuse regulatory authority, networks are more likely to rely upon relationships with other institutions for their success.<sup>237</sup> On the other hand, networks are well positioned to build such relationships. Through the formation of institutional

partnerships, transgovernmental networks are able to play a critical role in

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236. Alvarez, *supra* note 234, at 228; Raustiala, *supra* note 1, at 607-08 (describing the FATF's use of pledges in an area that requires strong review of implementation as aberrational). Beth Simmons suggests that the FATF may require a means of imposing hard legal obligations in order to be effective. Simmons, *supra* note 15, at 260-263.

237. Alvarez, *supra* note 234, at 228 (arguing that the success of networks is often dependent on their ability to embed themselves in more traditional international institutions).

addressing a wide range of international problems.

### V. ACCOUNTABILITY PROBLEMS IN THE FATF INSTITUTIONAL RESPONSE

Through its institutional partnerships, the FATF ensures that the FATF Recommendations are enacted into the national legal and regulatory systems of members and nonmembers alike. In effect, the FATF issues the international rules of AML/CFT governance by which all states must abide. By now, the functional advantages of this system are clear. Yet, the glaring problem with this system is not functional—it is democratic. As initially designed, the FATF nonmember states had no influence over the formation of the FATF Recommendations and no mechanism for holding the designers of the Recommendations accountable<sup>238</sup> for their decisions.<sup>239</sup> An offshore jurisdiction, for example, that preferred a different balance between financial disclosure and client confidentiality than that reflected in the FATF Recommendations lacked the ability to ensure that the FATF “rulemakers” considered this preference in designing the rule. The initial FATF Forty Recommendations were drafted in a closed session of the FATF that included only the initial fifteen members. Likewise, the Special Recommendations on the Financing of terrorism were drafted and adopted in the immediate wake of September 11th by the FATF plenary. Nonmembers were voiceless in the process of crafting the FATF Recommendations.

Accountability concerns are not new to transgovernmental networks such as the FATF. Many analysts, including some of the strongest proponents of transgovernmental networks, have noted the accountability concerns that networks create.<sup>240</sup> Chief among these concerns is the tendency of networks to exclude the participation of developing countries in critical decision-making processes. Slaughter recognizes the tendency of networks to reflect existing power distributions to the exclusion of developing nations as one of the central accountability problems confronting transgovernmental networks.<sup>241</sup> Philip Alston, generally less sympathetic to the network approach, argues that the rise of international decision-making by transgovernmental networks reflects “a definitive move away from arenas of relative transparency into the back rooms” where

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238. I follow the definition of accountability articulated by Ruth W. Grant and Robert O. Keohane as “the right to hold other actors to a set of standards, to judge whether they have fulfilled their responsibilities in light of these standards, and to impose sanctions if they determine that these responsibilities have not been met.” Ruth W. Grant & Robert O. Keohane, *Accountability and Abuses of Power in World Politics*, 99 AM. POL. SCI. REV. 29, 29 (2005).

239. *But see* Jared Wessel, *The Financial Action Task Force: A Study in Balancing Sovereignty with Equality in Global Administrative Law*, 13 WIDENER L. REV. 169, 187 (2006) (describing procedural controls within the FATF that serve as accountability constraints).

240. Among the proponents of networks is Anne-Marie Slaughter. *See* Slaughter, *supra* note 1. Other critics are less enthusiastic about networks and see the accountability problem as a critical flaw. *See, e.g.*, Philip Alston, *The Myopia of the Handmaidens: International Lawyers and Globalization*, 8 EUR. J. INT'L L. 435 (1997); Alvarez, *supra* note 234.

241. SLAUGHTER, *supra* note 1, at 227.

“those with power consolidate it and make the decisions which will continue to determine the fate of the excluded.”<sup>242</sup>

FATF nonmember states have raised two primary criticisms of the FATF related to accountability and participation. First, nonmember states seek greater opportunities to participate in the work of the FATF, particularly in designing the Recommendations. Often, this complaint has been lodged by nonmember states collectively through the Regional Bodies.<sup>243</sup> In one annual report the Caribbean Financial Action Task Force (“CFATF”) stated that “[i]t should not fall to FATF alone to devise and impose Recommendations. These matters are for us all.”<sup>244</sup>

Second, nonmember states protest the nonvoluntary and coercive procedures of the NCCT.<sup>245</sup> With no choice over participating, limited opportunity to respond to NCCT assessments, and no role in designing the criteria for assessment, many nonmember states view the NCCT as blatantly “unfair.”<sup>246</sup>

These two criticisms are not easily separated. The CFATF protested both when it stated:

[w]e need a genuinely consultative and participatory mechanism for all FATF and all the FATF style regional bodies to meet as equal partners in the fight against money laundering and terrorism financing. All parties should have an equal voice. None should be subject to coercion by another. Blacklists should be a thing of the past.<sup>247</sup>

The FATF itself, however, does not produce the accountability problem. As an exclusive group of states implementing self-designed rules among its membership, the FATF does not raise North-South accountability concerns. Within the FATF, each member state has the right to participate in the formation of the Recommendations and decisions are made by consensus. The accountability

242. ALSTON, *supra* note 240, at 441.

243. GAFISUD, Comunicado de Prensa, Montevideo, Uruguay, (Dec. 12, 2002), available at <http://www.gafisud.org/pdf/ComunicoprensaUruguayViPleno.pdf>. APG stated that one objective of the APG 2003-2006 strategic plan was “[t]o contribute to the development of global standards against money laundering and the financing of terrorism, which take due account of differences between legal, financial and law enforcement systems of APG members jurisdictions.” *2003-2004 APG Ann. Rep.*, *supra* note 130, at 7. CFATF reports successfully advocating for a “greater role of the FATF Style Regional Bodies [Regional Bodies] network in resolving issues relating to international co-operation between members of the [Regional Bodies] and the FATF.” *2004-2005 CFATF Ann. Rep.*, *supra* note 139, at 2.

244. CFATF, *Annual Report, 2003-2004* 8 (2004), available at <http://www.cfatf.org/documentation/getfile.asp?fileid=100&option=1> [hereinafter *2003-2004 CFATF Ann. Rep.*].

245. Statement of Pedro Malan, Minister of Finance of Brazil to the Third Meeting of the International Monetary and Finance Committee (Apr. 29, 2001), available at [www.imf.org/external/spring/2001/imfc/bra.htm](http://www.imf.org/external/spring/2001/imfc/bra.htm) (representing Brazil, Colombia, Dominican Republic, Ecuador, Guyana, Haiti, Panama, Suriname, and Trinidad and Tobago and arguing that any process for assessing implementation of the AML/CFT measures must be voluntary).

246. G24 April 2001 Communiqué, *supra* note 106, ¶ 10; *Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development Communiqué*, ¶ 20, Sept. 27, 2002, available at <http://www.imf.org/external/np/cm/2002/092702.htm> [hereinafter G24 September 2002 Communiqué].

247. *2003-2004 CFATF Ann. Rep.*, *supra* note 244, at 8-9.

problem arises only when the FATF enforces the Recommendations beyond its membership, whether through the NCCT process or through its institutional partnerships. Analyzing why this is so will help explain that nature of the FATF's accountability problems and possible means of resolving them.

Exercising accountability requires the ability to impose sanctions on those exerting power. "To be accountable means to have to answer for one's action or inaction, and depending on the answer, to be exposed to potential sanction, both positive and negative."<sup>248</sup> Understood in this way, accountability presupposes a relationship between the power-wielder and the accountability holder.<sup>249</sup> From these basic premises, it is evident that accountability holders engaged in deep and broad relationships with power-wielders are likely to have more opportunities and greater ability to hold the latter accountable. Accountability holders with little or no relationship to those that wield power will struggle to find a means of imposing sanctions. Within this framework, the FATF can be understood as facing a menu of relationships with nonmember states.

At one extreme, the deepest and broadest relationship that the FATF could form with nonmember states would be to invite them to participate equally in the rulemaking process. If nonmember states were invited to participate in the FATF on equal terms with FATF members, they would have access to all of the "peer pressure" sanctions that FATF members use to shape each other's behavior. More importantly, the nonmember states would participate in designing the Recommendations on equal footing with the FATF members. However, the functional demands for flexibility make this an unattractive option for the FATF. Traditionally, the FATF resisted any calls to expand its membership.

On the other extreme of the relationship scale lies the NCCT process, though which the FATF imposes the Recommendations on the nonmember states without forming any larger relationship with them. The economic sanctions imposed through the NCCT process are unidirectional: the powerful countries of the FATF can inflict economic distress on the weaker economies of FATF nonmember states, but nonmembers have no means of exerting similar influence on the FATF members. As a result, the states selected for NCCT review lack any ability to hold the FATF accountable for its actions. Again, however, the NCCT process is not the most attractive option for the FATF, either. The adversarial relationship that the NCCT process creates does not facilitate the sort of regulatory capacity-building that AML/CFT implementation requires.

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248. Ronald J. Oakerson, *Governance Structures for Enhancing Accountability and Responsiveness*, in HANDBOOK OF PUBLIC ADMINISTRATION 114, 114 (James L. Perry ed., 1989).

249. Grant & Keohane, *supra* note 238, at 29. According to Grant and Keohane, "Accountability presupposes a relationship between power-wielders and those holding them accountable where there is a general recognition of the legitimacy of (1) the operative standards for accountability and (2) the authority of the parties to the relationship (one to exercise particular powers and the other to hold them to account)."

Compared to these two extremes, the FATF's decision to interact with nonmembers through its institutional partnerships can be viewed as a compromise position. The FATF is able to maintain its small and exclusive membership while indirectly forming collaborative relationships to advance AML/CFT implementation. Through the institutional partnerships, the FATF forms some relationship, albeit an indirect and limited one, with the nonmember states. This relationship should provide the FATF nonmember states with a small window of opportunity to threaten to sanction the FATF and thereby impose some accountability constraints.

Initially, the claim that the nonmember states, many of which are developing nations, are able to effectively sanction the powerful FATF member states may seem unlikely. But the sorts of sanctions that facilitate relationships of effective accountability need not resemble traditional interstate sanctions in the sense of embargos or countermeasures. In their study *Accountability and Abuses in World Politics*, Ruth Grant and Robert Keohane demonstrate the wide variety of mechanisms that states can use to effectively sanction power-wielders.<sup>250</sup> The essential requirement of an effective accountability sanction is that it impose a cost on the power-wielder.<sup>251</sup>

FATF nonmembers are fully capable of imposing such a cost on the FATF by threatening to pull out of the cooperative and voluntary relationships that have been formed through the partner institutions. The potential refusal of FATF nonmembers to participate in the AML/CFT programs of the partner institutions threatens the global AML/CFT regime that the FATF requires. If the nonmember states decide to terminate their participation in the AML/CFT operations of these institutions, then the FATF would be left to pursue universal implementation through the NCCT process, an inadequate mechanism for reform. By using their voluntary participation in the FATF partner institutions as a potential sanction against the FATF, nonmember states should be able, to some extent, to hold the FATF to account. In other words, the FATF and the nonmember state should strike a bargain through the institutional partnerships where nonmember states agree to participate in collaborative AML/CFT programs and the FATF agrees to enact the accountability reforms sought by the nonmembers, abandoning coercive tactics and opening opportunities for participation.

One potential objection to this argument is that nonmember participation in the AML/CFT programs of the FATF partner institutions not as voluntary as they claim. If nonmembers are not free to refuse participation in the AML/CFT activities of the partner institutions, then they have no real leverage or ability to threaten the FATF with sanctions. Indeed, this argument has been made with some strength with regard to the ROSC reporting process at the IMF and the World

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250. *Id.* at 36 tbl.2 (describing a wide variety of institutional mechanisms as tools of accountability, including "loss of career opportunities," "budget restrictions," and "diffuse effects on reputation, prestige, [and] self-esteem").

251. *Id.*

Bank.<sup>252</sup> At its core, this argument claims that developing countries must participate in the ROSC process in order to prove their economic health to international investors. Investors, the argument suggests, interpret a refusal to participate in ROSC as an indication of economic instability. As a result, any country that seeks foreign investment has no real alternative other than participating in the ROSC process.

There is good reason to question the strength of this argument as applied to the FATF partner institutions. While some investors might seek the IFI stamp of approval before entering a particular market, other elements of the private sector are equally interested in doing business in countries precisely because they have not implemented rigorous AML/CFT systems. Offshore clients are attracted by minimal regulations and lack of disclosure requirements. In this environment, countries that refuse to participate in FATF-sponsored AML/CFT programs are also signaling their attractiveness to the private sector, albeit a different segment of the private sector than that which traditionally relies on IMF and World Bank assessments.

Obviously, the claim that nonmember states should be able to use their own cooperation as a potential sanction in bargaining for increased accountability at the FATF is not the same as demonstrating that these nonmember states actually succeed in imposing such accountability. I argue that there are two reasons for believing that the nonmember states have in fact managed to hold the FATF to account.

First, the mere fact that FATF nonmember states participate voluntarily in the AML/CFT partner institutions suggests that the FATF is providing them with some benefit for participation. Once again, we return to the basic principles of a suasion game. As described above, the FATF must provide nonmembers with an incentive, or side payment, in order to secure their participation in the AML/CFT activities of the FATF's institutional partners. The incentive that the FATF offers is the opportunity for nonmembers to influence the decision-making processes and policies of the FATF. The institutional bargain between the FATF and the nonmembers provides something to both sides: the FATF gains the participation of nonmember states in the AML/CFT global regime and nonmembers gain accountability reforms within the FATF. The resolution of the suasion problem and the improvement in accountability are two sides of the same coin, made possible only through the formation of an indirect relationship between the FATF and nonmember states through the FATF's institutional partners.

The second and more compelling reason for believing that the FATF nonmember states are able to use their voluntary cooperation to exact accountability gains from the FATF is found in the evolution of the FATF itself. As the FATF has extended its reach through its partner institutions, it has been forced to reform its structure and practices in ways that reflect the interests of

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252. See Robert P. Delonis, Note, *International Financial Standards and Codes: Mandatory Regulation Without Representation*, 36 N.Y.U. J. INT'L. L. & POL. 563, 595-615 (2004). But see Hockett, *supra* note 146, at 182. ("Members do not in general object to Fund surveillance, and were they to do so there would be little of punitive nature the Fund could do . . . There is therefore nothing resembling coercion; voluntariness inheres in Fund membership.")

nonmember states. Many of these reforms have been explicitly enacted in exchange for the voluntary cooperation of nonmember states or the partner institutions themselves. Other reforms simply addressed the criticisms raised by developing nations traditionally excluded from the FATF. I examine how this process of reform developed through the FATF's relationship with the Regional Bodies and the IFIs.

#### ***A. Accountability Reforms Sought by the Regional Bodies***

As the FATF has deepened its relationship with the nonmember states through the formation of Regional Bodies, it has been forced to open itself up to far more participation and inclusion than it originally preferred. The most obvious example of this development has been the expansion of the FATF's membership. In its early years, the FATF was determined to maintain its small size, fearing that even a modest expansion would cost the network its flexibility.<sup>253</sup> In 1998, however, the FATF changed course and issued a policy for future membership expansion.<sup>254</sup> This policy specifically sought to expand the FATF membership in areas of the world previously unrepresented in the FATF.<sup>255</sup> In addition, the FATF declared that it would make membership decisions without prejudice to the level of an applicant's economic development.<sup>256</sup> In June 2000, the FATF welcomed Argentina, Brazil, and Mexico as new members to "reinforce" the representation of Central and South America in the FATF.<sup>257</sup> In 2007, China became a member of the FATF after several years of observer status.<sup>258</sup> Currently the FATF is working with India and the Republic of Korea to secure their membership.<sup>259</sup>

More recently, the FATF created a new role for select Regional Bodies as "associate members" of the FATF. The creation of this new position seeks to "afford members of [Regional Bodies] much greater participation in the processes within the FATF"<sup>260</sup> and "provide [the Regional Bodies] enhanced access to and influence on FATF policies and decisions."<sup>261</sup> Specifically, Regional Bodies that are named as associate members will be permitted to send a limited number of

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253. FATF, *Annual Report 1991-1992* 18-19 (June 25, 1992), available at <http://www.fatf-gafi.org/dataoecd/31/19/34041197.pdf> [hereinafter 1991-1992 FATF ANN. REP.] (stating that the "FATF now has twenty eight members. For an organization that prides itself on its informality of procedure and ready ability to achieve consensus, this is clearly approaching the maximum membership possible. The FATF has, therefore, decided not to accept any new members for the time being.").

254. In 1998, the FATF identified seven target countries for membership: Argentina, Brazil, China, India, Mexico, South Africa and the Russian Federation. *2003-2004 FATF Ann. Rep.*, *supra* note 19, Annex 4 at 2.

255. *Id.*

256. *2001-2002 FATF Ann. Rep.*, *supra* note 36, at 4.

257. *Id.* at 8.

258. FATF, *Annual Report 2006-2007* 8 (June 29, 2007), available at <http://www.fatf-gafi.org/dataoecd/46/1/39162982.pdf> [hereinafter 2006-2007 FATF Ann. Rep.]

259. *Id.*

260. Kader Asmal, *Foreword to 2005-2006 FATF Ann. Rep.*, *supra* note 112.

261. Alain Damais, *Introduction to 2005-2006 FATF Ann. Rep.*, *supra* note 112.

delegates to FATF plenary meetings.<sup>262</sup> Regional Bodies do not automatically qualify for associate membership. Rather, each Regional Body must demonstrate that it is able to ensure effective implementation of the FATF Recommendations among its membership and that it engages in analyses of money laundering and terrorism financing typologies exercises.<sup>263</sup> By October 2008, the FATF had granted associate member status to five of the eight Regional Bodies.<sup>264</sup>

Beyond the formal categories of membership and associate membership, the FATF has opened its internal functions to greater external participation. It is important, however, to recognize that mere representation at FATF meetings does not mean that nonmembers will necessarily have influence over the outcome of FATF deliberations.<sup>265</sup> In order to judge whether nonmember states are effectively participating in FATF decisions, it is necessary to look at the product of those decisions.

In 2005, the FATF explicitly stated its interest in focusing more on “discussions, perspectives, and issues that are important to developing nations in all regions of the world.”<sup>266</sup> For instance, the FATF conducted its plenary meeting as a joint meeting with the APG Regional Body in June 2005.<sup>267</sup> Unlike past FATF plenary meetings, the 2005 meeting focused directly on the concerns and challenges of developing states. At the suggestion of the APG, the joint plenary paid special attention to the relationship between corruption and money laundering.<sup>268</sup> The two institutions created a joint FATF/APG Project Group to explore “the symbiotic relationship among corruption, money laundering and terrorist financing and how the FATF’s AML/CFT experience could best be used to combat these combined threats.”<sup>269</sup> One year later, the FATF plenary adopted

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262. *Id.* at 5.

263. Kader Asmal, Chairman of the Financial Action Task Force, *Chairman’s Summary, Paris Plenary*, (June 23, 2006), available at <http://www.fatf-gafi.org/dataoecd/14/38/36994880.pdf>; Frank Swedlove, Financial Action Task Force, *Current Initiatives of the FATF: Briefing to the United Nations Security Council Committee Established Pursuant to Resolution 1373 (2001)*, 14 (Dec. 14, 2006), available at <http://www.fatf-gafi.org/dataoecd/34/43/37865126.pdf>.

264. The FATF associate members are the Asia/Pacific Group on Money Laundering (APG), Caribbean Financial Action Task Force (CFATF), the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), the Financial Action Task Force on Money Laundering in South America (GAFISUD), and the Middle East and North Africa Financial Action Task Force (MENAFATF). See FATF, *Members & Observers*, [http://www.fatf-gafi.org/pages/0,3417,en\\_3225037\\_9\\_32236869\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/pages/0,3417,en_3225037_9_32236869_1_1_1_1,00.html) (last visited Mar. 26, 2008) (listing the members and associate members of FATF).

265. SLAUGHTER, *supra* note 1, at 229 (“Having a voice in collective discussions is better than being silenced by exclusion but it does not guarantee that you will be heard.”).

266. Asmal, *supra* note 260, at 1; Asmal, *Foreword to 2005-2006 FATF Ann. Rep.*, *supra* note 112.

267. See APG, *Yearly Typologies Report 2005-2006*, 27-28, (July 2006), available at [http://www.apgml.org/documents/docs/6/APG%20Yearly%20Typologies%20Report%2005-06\\_PUBLIC.pdf](http://www.apgml.org/documents/docs/6/APG%20Yearly%20Typologies%20Report%2005-06_PUBLIC.pdf).

268. *Id.*

269. *2005-2006 FATF Ann. Rep.*, *supra* note 112, at 7.

the report of the Project Group and committed to incorporating corruption-related concerns more closely into its assessments, supporting further study of the link between corruption and money laundering and encouraging greater focus on issues of corruption among its partner institutions.<sup>270</sup> Building on the success of this meeting, the FATF held a similar joint plenary meeting with the Eastern and South African Anti-Money Laundering Group [ESAAMLG] Regional Body in February 2006. The discussions at this meeting also focused on issues of concern to developing countries, including efforts to increase access to banking services, connections between corruption and money laundering, and the AML/CFT experiences of member countries of the ESAAMLG.<sup>271</sup>

The FATF has also invited Regional Bodies to join them in their annual typologies exercises. In November 2005, the FATF and GAFISUD held a joint typologies meeting in Rio de Janeiro. Among the various items on the agenda for the meeting was a discussion of complex money laundering schemes from a South American perspective, led by GAFISUD.<sup>272</sup> The FATF held a similar joint typologies meeting with MONEYVAL, hosted by the Federal Financial Monitoring Service of the Russian Federation, in December 2004.<sup>273</sup>

Undoubtedly, the most significant increase in the participation of nonmembers, however, has come in the area of the FATF Recommendations themselves. As described above, the initial articulation of the FATF Forty Recommendations and the Special Recommendations took place entirely within the FATF membership. Subsequent rounds of revisions of the Recommendations, however, have included far wider participation. The most recent round of revisions was the most inclusive to date. In May 2002, the FATF published a “public consultation document,” drafted with collaboration from the Regional Bodies,<sup>274</sup> which addressed the upcoming revision of the Recommendations, proposed potential solutions to the issues, and invited comments from all countries, international organizations, private sector players, and other interested parties. The FATF sought to achieve the “widest possible participation”<sup>275</sup> in this revision of the Recommendations. In response to the public consultation document, the FATF received more than 150 written comments.<sup>276</sup> It established a working group to develop the initial FATF proposals and the comments into a new set of Recommendations. This working group was open to FATF members, observers, and members of the Regional Bodies.<sup>277</sup> Once the working group produced the draft list of recommendations, it forwarded it to the FATF for final approval. The

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270. *Id.* at 3.

271. *Id.* at 7.

272. *Id.* at 8.

273. Damais, *supra* note 261.

274. The Regional Bodies were active in drafting this public consultation document. *See, e.g., CFATF, Annual Report 2001-2002, supra* note 140, at 32.

275. *FATF Ann. Rep. 2001-2002, supra* note 36, at 18.

276. *FATF Ann. Rep. 2002-2003, supra* note 41, at 4.

277. *Id.*

FATF adopted the new recommendations at its plenary meeting in June 2003.<sup>278</sup>

Once again, the increased participation of FATF nonmembers effectively influenced the substance of the FATF decisions. The Regional Bodies recognized the new FATF Recommendations as more fully incorporating their interests and concerns. The change in attitude of one particular Regional Body, the CFAAT, best demonstrates this new perspective toward the new FATF Recommendations. Founded in 1990, the CFATF is the oldest of the Regional Bodies. The FATF made an early push to establish a mechanism for implementing its Recommendations among the well-known offshore jurisdictions within the Caribbean region. From the beginning, however, the CFATF resented and resisted the FATF's attempt to dictate the rules of an effective AML/CFT system to them. At its formation, the CFATF adopted its own nineteen recommendations—the Nineteen CFATF Aruba Recommendations—along with the FATF's Forty Recommendations.<sup>279</sup> The CFATF describes the Nineteen CFATF Aruba Recommendations as having “specific relevance to the region” and as “complementary” to the FATF Recommendations.<sup>280</sup>

As CFATF committed to a process of self-assessments and mutual evaluations, it insisted upon reviewing member jurisdictions on the basis of both the FATF Recommendations and its own.<sup>281</sup> When the FATF revised its Recommendations in 1996, the CFATF once again protested the exclusive process of FATF decisionmaking and reasserted its decision to complement the FATF recommendations with its own revised recommendations.<sup>282</sup>

The drafting of the 2003 FATF recommendations, however, followed the far more participatory process described above. For the first time, the CFATF countries were invited to participate in crafting the FATF Recommendations. At the invitation of the FATF, the CFATF created a working group to collaborate with the FATF Working Group on the Review of the Forty Recommendations.<sup>283</sup> The CFATF Working Group submitted comments, which the Working Group members and the FATF Secretariat considered.<sup>284</sup>

The collaborative approach produced a set of recommendations that the CFATF was willing to accept unconditionally. The CFATF stated that “FATF's revised 40 Recommendations . . . essentially raised the global anti-money laundering standards to incorporate most of CFATF's Recommendations, thereby facilitating the creation of a level playing field between the CFATF Members and their international counterparts.”<sup>285</sup> The CFATF commended the FATF for its newfound willingness to “work closely with and to ensure the fullest participation of FATF style regional bodies like the CFATF in the development of the

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278. *Id.*

279. CFATF, CFATF 19 Recommendations, [www.cfatf.org/eng/recommendations/cfatf/index.txt](http://www.cfatf.org/eng/recommendations/cfatf/index.txt) (last visited Nov. 19, 2008).

280. CFATF, CFATF: An Overview, [www.cfatf.org/](http://www.cfatf.org/) (last visited Nov. 19, 2008).

281. 2003-2004 CFATF Ann. Rep., *supra* note 244, at 19.

282. *Id.*

283. 2002-2003 CFATF Ann. Rep., *supra* note 207, at 21.

284. *Id.*

285. 2003-2004 CFATF Ann. Rep., *supra* note 244, at 20.

AML/CFT standards.”<sup>286</sup> Consequently, the CFATF finally rescinded the Nineteen CFATA Aruba Recommendations and committed to conducting the next round of mutual evaluations solely on the basis of the FATF Recommendations.<sup>287</sup>

The story of the CFATF Recommendations follows the same pattern as the rest of the FATF’s relationships with nonmember states and Regional Bodies. As the FATF has sought to develop closer relations with nonmembers through the regional bodies, it has had to offer greater opportunities for participation and accountability. Because nonmember states were able to hold out their voluntary participation in the work of the FATF, the FATF has had to make compromises to its exclusive and insular decision-making processes in order to court their collaboration. In the end, the FATF is only able to achieve the functional advantages associated with universal implementation of the AML/CFT measures by making critical reforms that improve accountability and participation.

### ***B. Accountability Reforms Sought by IFIs***

The FATF’s ability to form relationships with the nonmember states through the Regional Bodies has greatly extended its reach. The IMF and the World Bank, however, have played a crucial role in assisting the Regional Bodies to carry out effective mutual evaluations and oversee the decentralization of the recommendation monitoring. If the FATF has had to make accountability concessions in order to extend its reach to nonmember states, then the formation of the partnership with the IMF and the World Bank would be a critical moment where concessions would be expected

The IFIs are obviously very different institutions than the Regional Bodies. The IMF and World Bank are formal international institutions with centralized decisionmaking procedures. Rather than urging individual nonmember states to participate in regional AML/CFT activities, the FATF has negotiated with the IFIs at the institutional level to incorporate AML/CFT programs into their ongoing activities. The policy decisions of the IFIs, however, are made by their governing body—the Board of Governors—itself comprised of representatives of IFI member states. Ultimately, it was the national representatives in their capacities as members of the Board of Governors who endorsed the IFIs’ adoption of the FATF Recommendations. Any concomitant demand for increased accountability or participation would have to originate with that group.

Judging from the political make-up of the Board of Governors, it would seem unlikely that the IFIs would effectively represent the interests of FATF nonmember states in dealings with the FATF. The original fifteen members of FATF make up roughly 54% of the voting power of the World Bank<sup>288</sup> and 55% of

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286. *Id.* at 21.

287. *Id.* at 20.

288. The World Bank, *International Bank for Reconstruction and Development Subscription and Voting Power of Member Countries*, available at <http://go.worldbank.org/L6GICALX00> (last visited Mar. 4, 2008).

the voting power of the IMF.<sup>289</sup> The representatives of these states are likely more concerned with utilizing the IFIs as an additional tool in international AML/CFT efforts, rather than exacting accountability improvements from the FATF. Indeed, several aspects of the IFIs' involvement in the AML/CFT issue suggests that they seek to advance the interests of the FATF countries.

First, the timing of the IFIs' entrance into AML/CFT issues suggests that they were responding to political pressure from FATF countries and not concerns about the effects of lax financial regulation on macroeconomic stability. While there had been some discussion within the IFIs addressing money laundering issues before September 11th, the governing body of the IFIs did not take clear action on the AML/CFT issues until immediately after those attacks.

Second, the willingness of the IFIs to extend their AML/CFT work into criminal enforcement matters was a clear concession to the preferences of the FATF.<sup>290</sup> This move was opposed by developing states<sup>291</sup> and was agreed to over the objection of a vocal minority of Fund Executive Board Directors.<sup>292</sup> Indeed, the United States Department of Treasury claims much of the credit for IMF and World Bank involvement in AML/CFT issues.<sup>293</sup>

Finally, even within the FSAP and OFC programs, the IFIs have placed the highest priority on AML/CFT assessments, placing it above other traditional areas of IFI monitoring.<sup>294</sup> Some members of the governing body of the IFIs have even expressed concern that the high priority placed on AML/CFT activities would impede the effective assessment of the other standards in the FSAP and OFC activities.<sup>295</sup>

Despite the disproportionate influence of FATF countries in the decisionmaking of the IFIs, FATF nonmember states, including developing nations, do have some influence over IMF and World Bank decisions. In further examining the partnership between the IMF and the FATF, it is clear that developing states have used their collective power to effectively influence the IFIs' decision-making in this area. In agreeing to partner with the FATF, the IFIs, much like the Regional Bodies, demanded significant changes to the FATF's operations that marked an improvement in participation and FATF accountability. Specifically, the IFIs conditioned their partnership with the FATF on the termination of the NCCT program and the standardization of a symmetrical and

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289. IMF, IMF Members' Quotas and Voting Power, and IMF Board of Governors, available at <http://www.imf.org/external/np/sec/memdir/members.htm> (last visited Mar. 4, 2008).

290. Critics note that this decision is part of a larger change within the IMF towards a willingness to pursue U.S. foreign policy interests. See Engardio, *supra* note 159.

291. See G24 September 2000 Communiqué, *supra* note 106.

292. IMF Board AML/CFT Review, *supra* note 176.

293. U.S. Dep't of Treasury, *Implementation of Legislative Provisions Relating to the International Monetary Fund: A Report to Congress* (2005) (describing IMF and World Bank participation in the global war on terrorism as a "consistent policy priority" that was achieved "[a]s a result of U.S. leadership").

294. In early 2005, the IMF and the World Bank reported that FSAPs only assessed states on four of the twelve standards. AML/CFT standards were the only standards included in every FSAP. IMF & The World Bank Review, *supra* note 156, at 13.

295. IMF FSAP Board Review, *supra* note 147.

fair assessment process.

From the beginning of their dialogue with the FATF, the IFIs recognized that some FATF activities did not reflect the “principles” embodied in the ROSC reporting program.<sup>296</sup> At their core, these principles required that assessments be conducted on a uniform, voluntary, and cooperative basis.<sup>297</sup> Certain subsidiary requirements flowed from these principles. First, the assessments could not produce a black-and-white list of “cooperative” and “non-cooperative” states, as the NCCT process established.<sup>298</sup> Second, jurisdictions must have a right of reply alongside the assessment report or the ROSC, a feature not found in the NCCT process.<sup>299</sup> Third, the assessment should take account of different stages of economic development, administrative capacity, and cultural and legal conditions.<sup>300</sup> Finally, assessments should consider the progress made in implementation of the standards and plans for future implementation.<sup>301</sup>

The IFIs were clear from the outset that any incorporation of the FATF Recommendations into the FSAP program would be conditioned on the FATF’s reform of its assessment procedures to meet the ROSC principles.<sup>302</sup> Most immediately, this would require that the FATF agree to terminate the nonvoluntary and coercive NCCT program.<sup>303</sup>

Although the NCCT program was not the ideal means of implementing AML/CFT measures in nonmember states, proponents of the FATF felt that its termination would significantly weaken the institution’s AML/CFT efforts.<sup>304</sup> The FATF determined, however, that the advantages gained through a partnership with the IFIs outweighed this loss. The FATF decided once again to make a concession that strengthened its accountability in order to build a partnership that would improve its functional reach. The FATF agreed not to engage in any additional rounds of NCCT review while it maintained its partnership with the IMF and the World Bank. Since agreeing with the IFIs to forgo additional rounds of NCCT review, the FATF has utilized the NCCT program strictly to monitor the AML/CFT progress in those states identified as non-cooperative jurisdictions in the 2000 and 2001 NCCT reviews. Since October 2006, no states remain on the NCCT list of non-cooperative jurisdictions. The FATF also agreed to conduct future assessments according to the common methodology through a voluntary, co-

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296. *IMF & The World Bank Staff Progress*, *supra* note 150, at 24-25.

297. *Id.* at 10. *See also IMF & The World Bank, Proposals To Assess A Global Standard*, *supra* note 169, at 4.

298. *IMF & The World Bank Staff Progress*, *supra* note 150, at 10, 25.

299. *Id.*

300. *Id.* at 24.

301. *Id.*

302. *Id.*

303. *IMF & The World Bank Staff Progress*, *supra* note 150, at 24-25 (explaining that the NCCT process violated the “principle of uniformity,” “the voluntary nature of the ROSCs,” the requirement not to “provide a pass-fail judgment,” and failed to “give economies an opportunity to publish a right of reply”).

304. Jeremy Scott-Joynt, *IMF Blocks Terror Fund Blacklist*, BBC NEWS, Sept. 2, 2002, available at <http://news.bbc.co.uk/1/hi/business/2223601.stm>.

operative, and uniform process.<sup>305</sup> Moreover, assessments are now conducted in light of “each jurisdiction’s stage of economic development, its range of administrative capacities, and different cultural and legal conditions . . . [taking] note of any progress that has been or is being made in implementing” the FATF Recommendations.<sup>306</sup>

In addition to ending the nonvoluntary NCCT assessments, the IFIs also responded to long-standing criticism espoused by developing states that the FATF held nonmember states to a higher standard (the Twenty-Five NCCT criteria) than it applied to its own members (the Forty Recommendations). Developing states had called for an end to this unfair practice and had identified the IFIs as a potential means of attaining it.<sup>307</sup> The IFIs responded to this appeal from FATF nonmember states and argued that these distinct criteria created a double standard whereby only the FATF nonmember states were judged for the actual effectiveness of their AML/CFT measures. The IFIs determined that they could not support this double standard.<sup>308</sup> As a condition of their collaboration with the FATF, the IFIs required that the FATF conduct its mutual assessments in strict compliance with the common methodology developed in collaboration with the IFIs and the Regional Bodies.<sup>309</sup> This common methodology has served as the basis for all mutual evaluations and FSAP and OFC assessments since first adopted by the IFIs in 2002.<sup>310</sup> The primary objective of this common methodology has been to ensure

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305. Letter from Jochen Sanio, President, FATF, to Horst Köhler, Managing Director, IMF (Oct. 24, 2002) in Int'l Monetary Fund, *Report on Outcome of the FATF Plenary Meeting and Proposal for the Endorsement of the Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) STANDARDS ANNEX I* (2002), available at <http://www.imf.org/external/np/mae/aml/2002/eng/110802.pdf>; see also IMF & The World Bank, *Proposals To Assess A Global Standard*, *supra* note 169, at 7 (quoting FATF President-elect Jochen Sanio's statement that “[t]he FATF, on the understanding that the IFIs adopt the comprehensive methodology and embark on a program of comprehensive assessments in accordance with that methodology, is prepared to indicate that it has no plans, at present, to undertake a further round of the NCCT exercise”). The FATF does not state that the NCCT process has been permanently terminated. Instead, it says that it “has not decided to launch a new NCCT round since 2001.” NCCT REVIEW 2006, *supra* note 13, at 12. It reserves the right to engage in a future NCCT review. The IFIs, however, are clear that this would mean an end to their institutional partnership and the inclusion of the FATF Recommendations in the FSAP and OFC programs.

306. *Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards*, at 6, in Int'l Monetary Fund, *Report on Outcome of the FATF Plenary Meeting and Proposal for the Endorsement of the Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) STANDARDS ANNEX I* (Nov. 8, 2002), available at <http://www.imf.org/external/np/mae/aml/2002/eng/110802.pdf>.

307. See G24 September 2000 Communiqué, *supra* note 291; G24 April 2001 Communiqué, *supra* note 246.

308. Int'l Monetary Fund & The World Bank, *Enhancing Contributions to Combating Money Laundering: Policy Paper* 16-17, 23 (2001), available at <http://www.imf.org/external/np/ml/2001/eng/042601.pdf>.

309. *2003-2004 CFTAF Ann. Rep.*, *supra* note 244, at 15-18 (stating that the Regional Bodies participated in the process of forming the methodology and reported good experiences).

310. The 2002 Methodology was replaced by the 2004 Methodology after the 2003 revision of the 40 Recommendations. Although the 2004 Methodology differs from the previous version

that the FATF and Regional Bodies conduct the mutual evaluations consistently across countries. Consistency serves two purposes. First, consistency in the mutual evaluation and ROSC reports permit the IMF to compare the AML/CFT measures implemented by different countries, drawing global trends and identifying areas of particular difficulty. More importantly for accountability purposes, consistency assures that FATF mutual evaluations assess FATF nonmember states on the same basis that it assesses its own members. The FATF's adoption of the common methodology was therefore a key accountability reform that resulted directly from the formation of the FATF's institutional partnership with the IFIs.

The concessions that the FATF has made in order to build its institutional partnership with the IFIs have produced significant improvements in the FATF's overall inclusion and collaboration of FATF nonmembers. Like the Regional Bodies, the IFIs have used their own voluntary participation in FATF AML/CFT activities as a sanction for inducing changes in the way that the FATF operates. In other words, the IMF has held the FATF accountable for its activities at the same time that it has extended the functional reach of the FATF's monitoring and capacity-building efforts. The standards that IMF has used in holding the FATF to account reflect the interests of the FATF nonmembers. Specifically, the IMF has demanded that the FATF conduct its assessments through voluntary relationships and symmetrically among FATF members and nonmembers.

The developing states supported the IMF in this move. They viewed the IMF as a relatively neutral middleman preferable to the NCCT process.<sup>311</sup> In 2001, the Minister of Finance of Brazil, serving as the IMFC member representing several Latin American countries, stated:

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in some significant respects, the basic purpose of structuring the FATF assessments to conform to the ROSC principles remains the same. IMF & THE WORLD BANK PILOT PROGRAM ASSESSMENT, *supra* note 165, at 2.

311. See News Brief, Int'l Monetary Fund, IMF Board Reviews Issues Surrounding Work on Offshore Financial Centers, News Brief No. 00/62 (July 26, 2000), available at <http://www.imf.org/external/np/sec/nb/2000/nb0062.htm> (stating that IMF Directors representing NCCT states viewed the IMF OFC Program assessment as a more fair process than the NCCT).

[a]n approach [to the implementation of AML/CFT standards] based on international cooperation is preferable to one based on confrontation and would yield better [sic] in the long run. The Fund has a broad membership and a tradition of due process and uniformity of treatment of all members that make it well placed to contribute to the issue.<sup>312</sup>

### ***C. Process and Substance Legitimacy and the United Nations Resolution 1617***

The FATF has long justified its actions, including the NCCT process, by arguing that the Forty Recommendations and the FATF's monitoring processes reflect the values expressed by the international community on the issues of money laundering and terrorism financing. The FATF stated that its actions are "fully in line with measures elaborated by the international community to protect the global and financial system from money laundering and render it more transparent."<sup>313</sup> Among the sources cited by the FATF as calling for an AML/CFT regime are three U.N. conventions and numerous Security Council resolutions.<sup>314</sup> Indeed, the Recommendations and their interpretive notes often directly incorporate legal obligations contained in these treaties. Through such statements, the FATF establishes the legitimacy of its actions by appealing to the substantive legitimacy of its objectives rather than the fairness or inclusiveness of its processes.<sup>315</sup>

The wide international acceptance of its Recommendations bolsters the FATF's claim to substantive legitimacy. The IFIs, for example, commonly state that the FATF Recommendations are a "basic, universally applicable framework"<sup>316</sup> that is "recognized widely as an international standard" in the area of AML/CFT.<sup>317</sup>

Interestingly, however, the FATF has only managed to achieve partnerships by reforming the process of decision making, not by refocusing the substance of its work. Offering greater participation to nonmember states, conducting wide consultations before setting recommendations, terminating monitoring programs such as the NCCT that do not seek voluntary participation, and agreeing to strictly

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312. Statement of Pedro Malan, *supra* note 245.

313. 1989-1990 FATF ANN. REP., *supra* note 14, at 15.

314. The three conventions are the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1998), the International Convention against Transnational Organized Crime (2000), and the International Convention for the Suppression of the Financing of Terrorism. The two primary Security Council resolutions are Resolution 1373 and Resolution 1267. *See generally*, FATF METHODOLOGY, *supra* note 184.

315. Benvenisti notes that networks such as the FATF tend to legitimize their actions based on the substance of their objectives. She states,

"Perhaps the most striking feature of the law made by coalitions of the willing [such as the FATF] is that its claim for legitimacy is not based on the idea of a coherent legal system in which states are equally sovereign and like cases are treated alike. . . . Instead, this type of law's claim for legitimacy is based on the perceived justness of the cause pursued by the coalition, whether it is enhanced security (i.e. fighting global terrorism) or promoting human rights (i.e. setting core labor rights)."

Benvenisti, *supra* note 32, at 26.

316. IMF Factsheet, *supra* note 15.

317. HANDBOOK, *supra* note 6, at 210-11.

abide by a common methodology in conducting all evaluations are reforms to the FATF processes, not to the substance of its work. Nonetheless, these process reforms are directly responsible for achieving the wider partnerships that the FATF relies upon as evidence of its substantive legitimacy.

Perhaps no other institutional partnership reinforced the FATF's claim to substantive legitimacy as much as the U.N. Security Council through Resolution 1617. By formally endorsing the FATF Recommendations, Resolution 1617 arguably raises these rules as close to international law as possible without imposing direct legal obligations. International law is commonly viewed as one of or perhaps the primary source of legitimacy in international relations.<sup>318</sup> Resolution 1617 can effectively be read as an ex post delegation to the FATF of the task of developing international standards on AML/CFT, much as the U.S. Congress delegates regulation to administrative agencies.<sup>319</sup> The FATF was very pleased with the U.N. Security Council endorsement, calling it a "major step forward toward effective global implementation of the Recommendations."<sup>320</sup>

There are two possible interpretations to the United Nations' decision to elevate the Recommendations to this level of international legitimacy. First, Resolution 1617 might be considered nothing more than a reflection of the interests of the members of the Security Council. Not surprisingly, the core FATF member states hold substantial voting power on the Security Council.<sup>321</sup> Under this interpretation, the Security Council vote says nothing about the legitimacy of the processes within the FATF.

In light of the recent improvements in participation and accountability within the FATF, however, a second interpretation of Resolution 1617 can be considered. The Security Council members may have determined that the FATF has managed to reach an optimal balance between functional reach and accountability to nonmember states. If this interpretation is correct, the substantive legitimacy granted by the Security Council is once again a reflection of the improved legitimacy of the processes behind the FATF's decisionmaking. In the end, by making critical procedural reforms, the FATF has managed to greatly improve both the efficacy and the legitimacy of its operations.

## VI. CONCLUSION

The FATF's formation of institutional partnerships with the Regional Bodies,

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318. See THOMAS M. FRANCK, *THE POWER OF LEGITIMACY AMONG NATIONS* (1990).

319. For an insightful analysis of how U.S. administrative law can guide the development of global administrative law, see Stewart, *supra* note 234, at 98 (exploring how U.S. administrative law could guide the development of global administrative law).

320. In the FATF 2005-2006 Annual Report, Kader Asmal, then-President of the FATF, reported that the FATF was "especially pleased with the United Nations Security Council Resolution 1617 (2005). . . . The formal endorsement of the FATF standards by the Security Council is a major step forward toward effective global implementation of the Recommendations." Kader Asmal, *Foreword to FATF, Annual Report 2005-2006*, *supra* note 112.

321. Alston, *supra* note 240, at 439.

the IFIs, and the United Nations has provided the FATF with significant functional advantages in advancing the implementation of a global AML/CFT system. The FATF has been able to maintain its flexible decisionmaking structure while advancing universal implementation of AML/CFT measures and facilitating the regulatory capacity to effectively enforce these measures. In effect, the FATF sets the AML/CFT rules that the countries of the world adopt. This authority to set AML/CFT rules raises serious concerns about democratic participation and accountability within the FATF for the rules it imposes on nonmember states. These accountability concerns are at least partly assuaged by the significant concessions that the FATF has been forced to make in order to win the support of its partner institutions. In effect, the FATF partner institutions have used their own voluntary cooperation with the FATF as a carrot for holding the FATF accountable. The final product of this process has been the creation of a global AML/CFT regime that is more effective in advancing AML/CFT measures and more accountable to FATF nonmembers than any program the FATF could have pursued alone.

Many analysts have hailed the functional advantages that transgovernmental networks provide in addressing international problems. At the same time, many have criticized networks for their tendency to exclude developing nations from important decisions that affect the interests or policies of those same excluded states. In my examination of the FATF I have tried to demonstrate that, at least when addressing certain types of international problems, transgovernmental networks will not be able to achieve their functional objectives without addressing their accountability flaws.

Two caveats should be noted. First, in the case of the FATF, nonmember states are able to exact accountability concessions because the FATF requires their voluntary participation in the AML/CFT system in order to achieve its objective of universal implementation of AML/CFT measures. Other international problems, however, may not provide nonmember states with such leverage. For instance, transgovernmental networks that seek to harmonize accounting standards or set minimum bank deposits do not require universal participation in order to fully achieve their objectives. In other words, these networks do not face suasion problems. While networks addressing these issues have in fact sought to implement their recommendations through institutional partnerships similar to the FATF, they likely do not place the same value on nonmember cooperation. In such instances, it is less likely that the transgovernmental networks would be willing to cede to the accountability demands of nonmember states. Such networks will likely not need to improve their accountability mechanisms in order to maximize their functional advantages.

Second, even among the transgovernmental networks confronting suasion problems, the accountability improvements will only be as deep as the partner institutions require. If international institutions are willing to partner with networks without demanding meaningful reforms, then the networks can achieve functional advantages without the concomitant accountability improvements. For instance, had the IMF been willing or able to sideline the interests of the FATF nonmembers, then the FATF could have partnered with the FSAP and OFC programs without forfeiting the advantages of the NCCT process. Interestingly,

the IMF's determination to exact meaningful reforms from the FATF in exchange for its partnership is a function in itself of the IMF's accountability to its own member states. In this way, the accountability of a partner institution affects the depth of accountability reforms that it is likely to demand of a partner transgovernmental network.

Despite these caveats, developing nations may be encouraged to learn that at least in some instances states that are excluded from transgovernmental networks possess the capacity to demand greater participation and accountability for network decisions. In fact, the concern of nonmembers might be less that they are excluded from decisions that will be imposed upon them and more that they do not get a say in what issues these highly effective international bodies decide to address. The powerful states that most often utilize the network approach may have little incentive to form networks dedicated to the particular problems of developing states. In this way, the real challenge confronting transgovernmental networks may be closer to Philip Alston's critique that governance by transgovernmental networks only pursues a "minimalist international agenda" that limits international cooperation to solving the problems that industrial states cannot address on their own. Alston argues that under this "narrow . . . vision of the role of the international community . . . the plight of a billion or so people living in poverty seems to become a domestic problem, or at least to have disappeared from the international agenda."<sup>322</sup>

The suggestion that states traditionally excluded from transgovernmental networks should be able to exact accountability from those networks soliciting the cooperation of nonmember states is not to say that such networks will be free of accountability flaws. Rather, the process described in this paper suggests that in some instances networks will have to balance functional and accountability improvements. Accountability problems will likely remain a key shortcoming of governance by transgovernmental networks, but networks themselves will likely remain a key component of international responses to pressing international problems. In this environment, scholars of international relations and international law should seek to maximize the functional contributions of transgovernmental networks while minimizing their accountability flaws. This Article describes the way in which the FATF has managed to accomplish both.

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322. *Id.*