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**Compliance with the Global AML/CFT Regulation:
Parameters and Paradoxes of Regulation in African
Countries and Emerging Economies**

By

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**A thesis submitted in partial fulfillment of the requirements
for the degree of
Doctor of Philosophy in Law**

Department of Law, University of Warwick.

June 2018

Table of Content

Acknowledgement	vii
Declaration.....	x
Abstract.....	xi
Abbreviations	xii
Tables and Illustrated Material	xvii
List of Figures.....	xviii
CHAPTER 1	- 1 -
COMPLIANCE WITH THE GLOBAL AML/CFT REGULATION: PARAMETERS AND PARADOXES OF REGULATION IN AFRICAN COUNTRIES AND EMERGING ECONOMIES - 1 -	
1. Introduction.....	- 1 -
1.1 Scope of Thesis	- 6 -
1.1.1 The Financial Action Task Force	- 6 -
1.1.2 The International Monetary Fund and World Bank	- 10 -
1.1.3 Why IMF/World Bank and the FATF?	- 14 -
1.1.4 Focus on African Countries and Emerging Economies	- 15 -
1.2 Hypothesis	- 16 -
1.3 The Theoretical Argument	- 17 -
1.4 Definition of Key Terms and Contribution to Knowledge	- 18 -
1.5 Structure of Thesis.....	- 22 -
1.6 Research Methods.....	- 26 -
1.7 Research Methodology	- 27 -
CHAPTER 2	- 28 -
THE INTERNATIONAL FINANCIAL SECTOR REFORM AND INTERNATIONAL LEGAL FRAMEWORK FOR AML/CFT REGULATION.....	- 28 -
2. Introduction.....	- 28 -
2.1 The Nature of International Financial Regulation	30
2.1.1 Rationale for International Financial Regulation	31
2.2 Evolution of International Financial Regulation and Institutions	35
2.3 Towards Effective Regulation of International Finance and AML/CFT	40
2.3.1 Justification for the Inclusion of AML/CFT Regulation in Financial Sector Reform	41
2.3.1.1 The Financial Stability Board (FSB)	46
2.3.1.2 The IMF and the World Bank: Financial Sector Assessment Program (FSAP)	48
2.3.1.3 The Financial Action Task Force	53
2.4 The Agency Theory: Defining International Delegation	57
2.4.1 Reverse and Continuing International Delegation in AML/CFT Regulation	65
2.4.2 The Agency Relationship between IFIs/FATF and Agent-States	66
2.4.3 Unravelling the Agency Quandary	68
2.5 Deconstructing the Concept of Legitimacy in International Law and Governance	69

2.5.1 The Importance of Legitimacy	72
2.6 Conclusion	80
CHAPTER 3	82
PRECONDITIONS FOR EFFECTIVE REGULATIONS OF AML/CFT AND COMPLIANCE DRIVERS IN AFRICAN COUNTRIES AND EMERGING ECONOMIES	82
3. Introduction.....	82
3.1 Pre-conditions for Effective Regulations of AML/CFT in African Countries and Emerging Economies	84
3.1.1 Law as a Precondition for Effective Regulation	84
3.1.2 Law as the Bedrock for Financial Regulation	89
3.1.2.1 Legislative Changes in African Countries Resulting from AML/CFT Laws	91
3.1.2.2 Legislative Changes in Emerging Economies Resulting from AML/CFT Laws	97
3.1.3 Law as the Bedrock of Financial Regulation: A Rejoinder	100
3.1.4 Design of the Law.....	106
3.2 Confidence as a Precondition for Effective Regulation.....	111
3.2.1 Defining Confidence.....	112
3.2.1.1 Confidence in Financial Stability.....	114
3.2.1.2 Confidence in the Political and Governmental System	119
3.2.1.3 Confidence in the Institutional System	121
3.2.1.4 Confidence in Regulation and Enforcement.	127
3.3 Differences in the Transplantation and Confidence Trajectory between African Countries and the BRICS	133
3.4 Perspective on Compliance with Global Standards	134
3.5 Compliance as a Function of Legal Factors	136
3.5.1 Compliance engineered by Democracy and Rule of Law	137
3.5.2 Enforcement Driven Compliance	138
3.5.3 Law: A Mirroring of Society?.....	140
3.6 Compliance as a Function of Non-Legal Factors	142
3.6.1 Political Will, Domestic Conditions and Policy Priorities	142
3.6.2 Compliance based on Reputational Concerns	144
3.6.3 Legitimacy and its effect on Compliance	145
3.6.4 Globalization and Integration	147
3.6.5 Technical Capacity and Resources	148
3.6.6 Setting out Factors that Influence Compliance	150
3.6 Benchmarking Compliance Ratings.....	151
3.7 Conclusion	156
CHAPTER 4	157
THE AGENCY RELATIONSHIP BETWEEN COLLECTIVE PRINCIPALS AND THEIR INTERACTION WITH AFRICAN COUNTRIES AND EMERGING ECONOMIES.....	157
4. Introduction.....	157
4.1 Rule Design, Implementation and Compliance	158
4.1.1 Rule Design: Relationship between the FATF and IFIs.....	159
4.1.1.1 Interaction Between Principals in Rule Making	161
4.1.2. Implementation and Compliance: Relationship between IFIs and the FATF	169
4.1.2.1 Interactions Between Principals in setting Implementation and Compliance Frameworks	171
4.2 Agency Theory: Interactions between the Collective Principals and Agent States in Rule Making, Implementation and Compliance.....	174

4.2.1 Agency Theory: Integration Between High Priority (A) and Mid Priority Countries (C) - The domination of Self Interests?	179
4.2.2 Interaction Between Principal(s) and Agents (Country Legislators)	185
4.2.3 Interaction Between Principals and Agents in implementation and compliance	197
4.3 Conclusion	207
 CHAPTER 5	 209
 DETERMINANTS OF AFRICA’S COMPLIANCE LEVELS TO THE GLOBAL ANTI-MONEY LAUNDERING REGIME	 209
5. Introduction.....	209
5.1 African States: Context	210
5.2 Africa’s Response to AML/CFT	216
5.3 Compliance by African States	221
5.3.1 Compliance as a Function of Legal Factors	223
5.3.1.1 Law: Mirroring Society to Combat ML/TF	223
5.3.1.2 Enforcement Driven Compliance	228
5.3.1.3 Compliance Engineered by Democracy and Rule of Law	230
5.3.2 Non Legal Factors that Affect Compliance	234
5.3.2.1 Compliance based on Reputational Concerns.....	235
5.3.2.2 Political Will, Domestic Conditions and Policy Priorities.....	237
5.3.2.3 Technical Capacity and Resources.....	246
5.3.2.4 Globalization and Integration	250
5.3.2.5 Legitimation	253
5.4 Cross Country Analysis of Compliance to AML/CFT Regime: FSAP and FATF.	256
5.4.1 Assessing the Financial Sector Assessment Program Reports (FSAP): The Procedure	256
5.4.2 Assessment of FSAP Country Review.....	257
5.4.3 Assessment of the Financial Action Task Force Country Reports.....	258
5.4.3.1 Empirical Assessment of FATF Country Reports	259
5.4.3.2 Analysis of AML/CFT by countries and geographical distribution	260
5.4.3.3 Analysis by FATF recommendations.....	264
5.4.3.4 Analysis by Compliance Drivers.....	266
5.4.3.5 Caveats	270
5.5 Conclusion	271
 CHAPTER 6	 273
 AML/CFT REGIME: COMPLIANCE WITHIN EMERGING ECONOMIES (EE)	 273
6. Introduction.....	273
6.1 Background to BRICS Countries.....	274
6.2 The BRICS Membership of the FATF.....	280
6.2.1 The Position of the BRICS Prior to and After their FATF Membership	283
6.3 The Determinants of Compliance to AML/CFT in Emerging Economies.....	290
6.3.1 Legal factors	291
6.3.1.1 Law Mirroring Society.....	291
6.3.1.2 Enforcement Driven Compliance	298
6.3.1.3 Compliance engineered by Democracy and Rule of Law	301
6.3.2 Non-Legal factors	305
6.3.2.1 Political Will, Domestic Conditions and Policy Priorities.....	305
6.3.2.2 Compliance based on Reputational Concerns.....	311
6.3.2.3 Legitimacy and its effect on Compliance.....	312
6.3.2.4 Globalization and Integration	313

6.3.2.5 Technical Capacity and Resources.....	316
6.4 Cross-Country Analysis of Compliance to AML/CFT Regime: FATF.....	320
6.4.1 Analysis of AML/CFT by Countries.....	320
6.4.2 Analysis by Recommendation and Topics.....	322
6.4.3 Analysis by Compliance Drivers.....	324
6.5 Conclusion.....	328
CHAPTER 7.....	330
LEGITIMACY – A MEANS OF LEVELLING THE PLAYING FIELD?.....	330
7. Introduction.....	330
7.1 The Agency Quandary: Restating the Concept and Importance of Legitimacy.....	331
7.2. Propelling Legitimacy and Ensuring Compliance: The FATF’s Strategies.....	334
7.2.1 Legitimacy in FATF Rule/Standards Design.....	334
7.2.2 Legitimacy in Rule Implementation and Compliance.....	339
7.2.3 Risk based-approach.....	343
7.2.3.1 The Ambiguity in the Definition of Risk and the Conceptualisation of the RBA ...	345
7.2.3.2 The Literal Interpretation of the FATF’s Statement on Risk and Compliance in its Methodology for Assessing Technical Compliance.....	353
7.3 Through the Lens of Legitimacy.....	355
7.4 Regulatory Paradox: A Motive for Halting Continued Implementation of the FATF Standards by ACs/EEs?.....	360
7.5. Conclusion.....	363
CHAPTER 8.....	365
EXPLANATIONS AND CONCLUSION.....	365
8. Introduction.....	365
8.1. Explanations and Conclusions by Research Questions.....	366
BIBLIOGRAPHY.....	372
Statutes.....	372
Soft Law Instruments / Treaties.....	372
Books.....	372
Contribution to Edited Books.....	378
Conference Presentations.....	382
Journals Articles.....	383
Working Papers.....	397
Online Articles.....	400
Web Resources.....	404
Staff Discussion Note.....	426

PhD / Dissertation.....	427
Reports	427
Appendix 1	429

Acknowledgement

Undertaking a PhD is like choosing to embark on a puzzling roller-coaster journey replete with a myriad of challenges. During this seemingly unending expedition, I experienced God's grace which gave me resolve beyond my capacity. This grace, sometimes expressed through the individuals mentioned in this acknowledgement, gave me the strength, knowledge and ability to see the end of this thesis.

Professor Dalvinder Singh, my supervisor, remains every doctoral student's wish. I would remain eternally grateful for his dedication, understanding and support. He challenged my thoughts in the subject area and provided consistent encouragement, allowing for a perfect combination of academic guidance and independence. It was a great privilege to work under his supervision and I hope I have done him justice with this piece of work.

My parents, Professor Epiphany Azinge, SAN and Dr Valerie Azinge, SAN, have been indispensable through this journey – without them, none of this would have been possible. I cannot deny that they have had an implicit influence on my career path. Seeing them break uncharted barriers in their academic travails engaged my curiosity in academia. Although I have yet to scratch the surface of the fountain of knowledge, I hope, that through this journey, I have made them proud.

My siblings, Asua, Nkem and Olisa, provided me with the unending support I needed to overcome difficult moments. Asua's constant prayers, Nkem's firm understanding of the focus of my thesis and barrage of questions, and Olisa's interest and assistance in my presentations goaded me on. In moments when I felt overwhelmed with doubts and deadlines, their company made me choose hope – which is the most powerful tool you can give to a person. I cannot thank them enough for encouraging me to embrace my journey. Not because it was easy, but because it was hard. I consider myself blessed to have experienced their unconditional love and support.

My wonderful cousins, Bobby and Susan Ngwu. I cannot thank you enough for your warmth, hospitality and compassion. My dearest cousin Innocent Isichei and friend Ayobami Bakare, thank you for your love and company. Nneka Osogbue, you are friendship personified. I would not be forgetting your kindness soon. Mimi Osakwe, Marilyn Okowa-Daramola and Ebi Botei, your reassurance, love and kindness kept me going. Thank you!

It is often said that ‘a PhD journey is a lonely one’. I cannot say the same. I always found myself in the company of intellectually stimulating and trustworthy colleagues who were relentless in pushing me towards my goal. Kyunguen Park and Sat Kaur, thank you for allowing me to bounce ideas and thoughts off you. Alexander Ezenagu, thank you for your constructive responses, they were instrumental in enriching my arguments. Morris Ejiro, your consistent support and attention to statistical details was empowering. For your practical insights, encouragement and honest opinions, Mavianna Mudiaga, I would always remain grateful. All of you remain an invaluable part of my life.

An interesting idiom says, ‘the rod which the elders give you can only point you in the right direction’. There is nothing like the assistance of someone who has walked the same path with a successful outcome. I found solace under the tutorship of Dr. Ife Akintunde, Dr. Folashade Adeyemo, Dr. Titilayo Adebola, Dr. Hassan Nizami and Dr. Arjumand Bano Kamzi. I cannot thank you all enough! My elders were not only persons but institutions. I am grateful to the Cambridge Economic Crime Symposium, for its quality feedback on my presentation. The International Monetary Fund, for thought-provoking interviews that enriched my work. Also, the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) for research materials and assistance. And the International Bar Association, for an internship opportunity which gave me the opportunity to improve my thesis.

I am also thankful for the many diversions I have enjoyed during my sojourn here.

Without them, crossing over to the realms of insanity would have been entirely within reach. The Sickle Cell Aid Foundation (SCAF) and the Queen's Young Leaders Program provided me with the required balance, whilst enabling me to improve the lives of others. I am especially thankful to the SCAF team for trudging on in my absence.

Egbiri Egbiri, my soulmate, friend, and mentor, who shared this journey. Egbiri personifies Mandela's words 'a good head and a good heart makes a formidable combination'. He struck a fine balance by challenging my arguments, reading all my drafts and engaging in thought-provoking conversations, whilst also providing the much-needed stability. Throughout the duration of my Ph.D. journey, his support remained steadfast and evergreen. Indeed, he is the one that puts the puzzle together. I hope I have made you proud.

Undeniably, adversity introduces a woman to herself. Over the course of my thesis, I have fine-tuned my research, analysis and time management skills. Certainly, these have been vital in bringing this thesis to an eventual end.

Declaration

This thesis is the candidate's own work. It has not been submitted for a degree at another University.

Abstract

In the light of the agency theory, this thesis examines the extent to which ACs/EEs can harness and comply with the global AML/CFT standards. Whilst appreciating the importance of cross-border AML/CFT regulation, it critiques the requirement for uniformly applicable standards, thereby exposing the parameters and paradoxes of such standards when applied to ACs/EEs. This is achieved by examining the displacement of ACs/EEs in the evolution of IFIs/FATF and resulting AML/CFT standards by IFIs/FATF, which do not consider the socio-economic and political uniqueness of ACs/EEs. It argues that ACs/EEs do not possess the pre-conditions for effective AML/CFT regulations, hence the behavioral impact of the FATF's standards on ACs/EEs do not align with the IFIs/FATF's expectations. This regulatory design flaw persists irrespective of the adopted RBA. Consequently, ACs/EEs engage strategically with IFIs/FATF to evade sanctions from non-compliance whilst facilitating their continued integration into the global economy. This is indicative of an unfavorable agency relationship between ACs/EEs and IFIs/FATF and an ingrained legitimacy crisis which are further undermined by ACs/EEs capacity challenges.

Through multidisciplinary research on law and economics, this thesis examines the impact of uniform standards on ACs/EEs. This thesis assesses the agency theory, legislations, design of law, FATF and FSAP reports, and interviews. Consequently, this thesis gives a detailed analytical account of the compliance experiences of ACs/EEs, and identifies their sources of behaviour within the context of existing pre-conditions. Findings from the analysis of secondary data revealed that although ACs/EEs had similar socio-economic and political backgrounds, EEs were better able to comply with AML/CFT standards. A crucial factor was legitimacy as EEs had slightly more leverage in the re-formulation of AML/CFT standards.

The main strength of this thesis is that it contributes to understanding the factors that influence ACs/EEs' compliance, and therefore, the conditions under which the FATF standards are likely to facilitate proactive compliance.

Abbreviations

AC/EE	African Countries and Emerging Economies.
AfDB	African Development Bank.
AGOA	Africa Growth and Opportunity Act.
AML	Anti-Money Laundering.
AML/CFT	Anti-Money Laundering and Counter Terrorist Financing.
APRM	African Peer Review Mechanism.
AU	African Union.
BCBS	Basel Committee on Banking Supervision.
BCCI	Bank of Credit and Commerce International.
BVN	Bank Verification Number.
BoE	Bank of England.
BRICS	Brazil, Russia, India, China, South Africa.
BWI	Bretton Woods Institutions.
CAS	Country Assistance Strategies.
CBA	Compliance Based Approach.
CCB	China Construction Bank Corporation
CBR	Correspondent Banking Relationship
CDD	Customer Due Diligence.
CFATF	Caribbean Financial Action Task Force.
CFLAMLR	Chinese Financial Institutions Anti Money Laundering Regulation.

CRR	Country Review Reports.
DBA	Deterrence-Based Approach.
DNFBPs	Designated Non-Financial Businesses and Professions.
EAC	East Africa Community.
EAG	Eurasia Group.
EFCC	Economic and Financial Crimes Commission.
ESAMMG	Eastern and Southern Africa Anti-Money Laundering Group.
EP	Extended Principals.
EU	European Union.
FATF	Financial Action Task Force.
FCA	Financial Conduct Authority
FIs	Financial Institutions.
FIC	Financial Intelligence Centre.
FIG	Financial Integrity Group.
FIU	Financial Intelligence Units.
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSF	Financial Stability Forum
FSSAs	Financial System Stability Assessments
FSRB	FATF-Style Regional Bodies
GAFISUD	Financial Action Task Force of South America against Money Laundering
GDP	Gross Domestic Product

GFC	Global Financial Crisis
GIABA	Inter-Governmental Group against Money Laundering in West Africa
GWP	Global World Product
G7	Group of Seven
HDI	Human Development Index
HLM	High Level Meetings
HRMJ	High Risk and Other Monitored Jurisdictions
HP	High Priority
IAIS	International Association of Insurance Supervisors
ICBC	Industrial and Commercial Bank of China
ICPC	Independent Corrupt Practices Commission
ICRC	International Co-operation Review Group
IBRD	International Bank for Reconstruction and Development
IFIs	International Financial Institutions
IFR	International Financial Regulation
IIs	International Institutions
INCSR	International Narcotics Control Strategy Report
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund.
INCB	International Narcotics Control Board
IOSCO	International Organization for Securities and Exchange Commission
KYC	Know Your Customer
LCC	Less Compliant Countries

LOLR	Lender of Last Resort
LP	Low Priority
MENAFATF	Middle East and North Africa Region FATF
MER	Mutual Evaluation Reports
ML	Money Laundering.
ML/C	Money Laundering and Corruption
MP	Mid Priority
NATO	North Atlantic Treaty Organization.
NC	Non-Compliant
NCCTs	Non-Cooperative Countries and Territories.
NDIC	Nigerian Deposit Insurance Corporation.
NDLEA	Nigerian Drug Law Enforcement Agency.
NEPAD	New Partnership for Africa's Development.
NFIU	Nigerian Financial Intelligence Unit.
NIFA	New International Financial Architecture.
OAU	Organization of African Unity
OFP	Offshore Centre Program
OECD	Organization for Economic Co-operation and Development.
PC	Partially Compliant
PCC	Pearson Correlation Coefficient
PDG	Policy Development Group
PP	Proximate Principal
PPP	Purchasing Power-Parity

RBA	Risk Based Approach
ROSCs	Reports on Observance of Standards and Codes
RMQ	Ratio of Quasi Money
SA	South Africa
SIM	Subscriber Identity Module
STR	Suspicious Transaction Reports
TA	Technical Assistance
TBML	Trade-Based Money Laundering
TF	Terrorism Financing
TGNs	Trans-governmental Networks
TIFA	Trade and Investment Framework Agency
TOCU	Bank of Sierra Leone and Transnational Organised Crime Unit
TRIEN	FATF Training and Research Institute
UBA	Uncertainty Based Approach
UN	United Nations
UNCTC	United Nations Counter-Terrorism Committee
UNDP, RBA	United Nations Development Program, The Regional Bureau Africa
UNECA	United Nations Economic Commission for Africa
UNODC	United Nations Office on Drugs and Crime
UNSC	United Nations Security Council
U.S.	United States
WW1	World War 1
WW2	Second World War

Tables and Illustrated Material

Figure 1:	Pictorial representation of ‘Reverse International Delegation.....	37
Figure 2:	Pictorial representation of the Reverse and Continuing International Delegation.....	38
Table 1:	Legal and Non-Legal Compliance Drivers.....	123
Table 2:	Factors that Influence/Trigger Information Asymmetry between Principals and Agents in AML/CFT regulation.....	149
Table 3:	Determination of Self-Interest: Interaction between HP and MP countries.....	156

List of Figures

Figure 1. Technical Compliance Levels of African Countries to the FATF Recommendations (Derived from the FATF’s countries MERs).....	234
Figure 2: Africa’s Compliance to the FATF Recommendations by Regions.....	235
Figure 3: Analysis by compliance to FATF Recommendations.....	237
Figure 4: Analysis by corruption index.....	238
Figure 5: Analysis by rule of law index.....	239
Figure 6: Analysis by Democracy Index.....	239
Figure 7: Analysis by ease of doing business.....	240
Figure 8: Analysis by human development index.....	241
Figure 9. Technical Compliance Levels of the BRICS to the FATF Recommendations (Derived from the FATF MERs of countries)	294
Figure 10: Analysis by compliance to FATF Recommendations.....	295
Figure 11: Analysis by corruption index.....	296
Figure 12: Analysis by rule of law index.....	297
Figure 13: Analysis by Democracy Index.....	298
Figure 14: Analysis by ease of doing business.....	298
Figure 15: Analysis by human development index.....	299

Chapter 1

Compliance with the Global AML/CFT Regulation: Parameters and Paradoxes of Regulation in African Countries and Emerging Economies

1. Introduction

Whilst African Countries (ACs) struggle with compliance with the anti-money laundering and counter terrorist financing (AML/CFT) regulations enunciated by the Financial Action Task Force (FATF), emerging economies (EEs) record better compliance levels. This is irrespective of the similar socio-economic and political challenges facing these countries. The difficulties faced by ACs in achieving meaningful AML/CFT compliance levels is unsettling, coming at a time when ACs are striving towards global financial integration demonstrably evidenced by their persistent economic growth.¹ Surprisingly, the drive for improved AML/CFT compliance by ACs usually fosters a regulatory paradox. For instance, the FATF's standard on customer due diligence (CDD) compels financial institutions to '*identify the customer and verify that customer's identity using reliable, independent source documents, data or information*'.² On its face value, this requirement appears logically framed, but in ACs a large percentage of the population are excluded from mainstream consumer banking due to lack of acceptable identification documentation largely driven by illiteracy, unemployment and poverty.³ Hence, the strict enforcement of CDD would only

¹ AfDB, 'Africa's Economic Performance Improves in 2017' (AfDB, 12 October 2017) < <https://www.afdb.org/en/news-and-events/africas-economic-performance-improves-in-2017-17424/> > accessed 10 January 2018.

² FATF, 'Recommendation 10' (FATF, 2012) < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 10 January 2018.

³ The regulatory circular mandates that no formal identification is necessary for accounts with amounts below 200,000 naira (in Nigeria, for instance). In practice, this is hardly the case. See Central Bank of Nigeria, 'Circular to All Banks and Other Financial Institutions: Implementation of Three-tiered Know Your Customer Requirements' (Central Bank of Nigeria, 18 January 2013) < <https://www.cbn.gov.ng/out/2013/ccd/3%20tiered%20kyc%20requirements.pdf> > accessed 30 July 2017; FATF, 'FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial

heighten financial exclusion,⁴ which is antithetical to the FATF's financial integrity objective.

More broadly, the FATF recommendations are expected to trigger regulatory law reforms even in jurisdictions where the legal structures are deemed inefficient. FATF recommendation 4 states that '*Countries should adopt measures similar to those set forth in the Vienna and Palermo Convention, and the Terrorist Financing Convention, including legislative measures....*'⁵ However, anecdotal evidence and statistical findings reveal that developing (especially African) countries struggle with harnessing these standards.⁶ This is attributable to weak legal structures underpinned by socio-economic and political limitations peculiar to these states.

The complexities involved in ACs' attainment of compliance is further heightened by the FATF's perception that the global financial system is only as strong as its weakest link and hence all countries should be equally subject to the FATF's requirement.⁷ Scholars have supported this assertion, arguing that it is paramount for all countries to inculcate the FATF's global standard for combatting illicit crimes⁸ particularly given

Inclusion – With a Supplement on Customer Due Diligence' (FATF Guidance, November 2017) < <https://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf> > accessed 10 March 2018.

⁴ FATF, 'FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence' (FATF Guidance, November 2017) < <https://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf> > accessed 10 March 2018.

⁵ FATF, 'The FATF Recommendation: Recommendation 4' (FATF, February 2012) < http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf > accessed 10 July 2015.

⁶ Concepcion Verdugo Yepes, 'Compliance with The AML/CFT International Standard: Lessons from A Cross-Country Analysis' (2011) International Monetary Fund Working Paper WP/11/177, 9 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578 > accessed 19 April 2015.

⁷ Paul Allan Schott, 'Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism: Second Edition and Supplement on Special Recommendation IX' (World Bank, 2016) < <https://openknowledge.worldbank.org/bitstream/handle/10986/6977/350520Referenc1Money01OFFICIALOUSE1.pdf?sequence=1&isAllowed=y> > accessed 10 December 2017.

⁸ Ibid.

that the borderless nature of money laundering (ML)⁹ and terrorist financing (TF)¹⁰ reinforces the need for an internationally coordinated response.¹¹ Furthermore, scholars argue that the various methods by which illicit crimes are carried out remain shrouded in secrecy, therefore un-curtailed liberalization of ACs/EEs¹² market economies can give rise to adverse socioeconomic effects,¹³ given that these crimes pose a threat to the stability of the financial system.¹⁴ However, requiring that all countries meet the same AML/CFT standard douses regulatory effectiveness and creates a paradox. Moreover, this approach is blindsided to the threat posed to the sovereignty of countries.¹⁵

A background to the coordinated response to illicit crimes provides a synopsis to the quagmire faced by ACs, and indeed EEs, in attaining desirable compliance levels. The AML/CFT regulation was inculcated in the financial sector reform which involved various global, continental and regional financial institutions.¹⁶ Most prominent of the institutions are the FATF, the International Monetary Fund (IMF) and the World Bank. These institutions recognized the dire consequences that ML/TF can have on the

⁹ FATF, 'What is money Laundering?' < <http://www.fatf-gafi.org/faq/moneylaundering/>> accessed 10 February 2015.; Nicholas Ryder, *Financial Crime In The 21st Century, Law and Policy* (Edward Publishing Limited 2011) 10.; Eleni Tsingou, 'Global Financial Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy' (2005) Centre for the Study of Globalization and Regionalization (CSGR) Working Paper No 161/05 <http://wrap.warwick.ac.uk/1959/1/WRAP_Tsingou_wp16105.pdf> accessed 11 February 2015.

¹⁰ Ilias Bantekas, 'The International Law of Terrorist Financing' [2003] 97 AJIL 315, 315.

¹¹ Barnett, Michael and Martha Finnemore, *Rules for the World: International Organizations in Global Politics* (Cornell University Press 2004) 9.

¹² Laundering poses significant threats to global financial integrity and national security. See Eleni Tsingou, 'Global Financial Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy' (2005) Centre for The Study of Globalization and Regionalization (CSGR) Working Paper No 161/05 <http://wrap.warwick.ac.uk/1959/1/WRAP_Tsingou_wp16105.pdf> accessed 11 February 2015

¹³ Paul Ashin, 'Dirty Money, Real Pain' [2012] 49 (2) Finance and Development 38, 38.; Raul Hernández-Coss, Chinyere Egwuagu, Jennifer Isern and David Porteus, 'AML/CFT Regulation: Implications for Financial Service Providers that Serve Low-income People' (2005) The International Bank for Reconstruction and Development/ The World Bank, 14 < <http://documents.worldbank.org/curated/en/497161468140979952/pdf/361690AML0CFT0regulation01PUBLIC1.pdf> > accessed June 12 2012.; See the web site of the United Nations Office on Drugs and Crime (UNODC) < www.odccp.org > accessed 10 January 2015.

¹⁴ Saby Ghoshray, 'Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law' [2014-2015] 59 N.Y.L. Sch. L. Rev. 521, 533.

¹⁵ Herbert V. Morais, 'The Quest for International Standards: Global Governance vs. Sovereignty' [2001] 50 U. Kan. L. Rev. 779, 779.

¹⁶ See Kevin Davis, 'Regulatory Reform Post the Global Financial Crisis: An Overview 2' [2011] Report for Melbourne APEC Financial Centre, Australasian APEC Study. Centre at RMIT University < http://www.apec.org.au/docs/11_CON_GFC/Regulatory%20Reform%20Post%20GFC-%20Overview%20Paper.pdf > accessed 10 July 2015.

integrity of the international financial market and its likely contribution to financial crises.¹⁷ Hence, the institutional reactions were directed at setting, disseminating and continually assessing AML/CFT standards. The FATF, strengthened by the IMF and the World Bank, was established to advance standards and ensure compliance with AML/CFT regulation. The standards set by the FATF impose restraints on the supervisory approach of regulatory bodies with the goal of determining how they regulate financial institutions (FIs).¹⁸

However, an examination of the structure and processes involved in regulating and disseminating the AML/CFT standards has exposed the institutions to criticisms of legitimacy deficiency. This is particularly due to the fact that ACs/EEs were sidelined from contributing to the standards which they are now subjected to. As can be imagined, these standards, mainly created by the G7 countries are unreflective of the ACs/EEs' peculiarities. This can further be illuminated by an inquiry into the behavioral impact of the FATF's provisions and the significant relationship between international regulatory standards and state behavior. To correct this perceived anomaly, the FATF introduced the risk-based approach (RBA) in 2012 to harness the peculiarities of individual countries and ease the assimilation of the AML/CFT standards.¹⁹ The effectiveness is however debatable.

Against this backdrop, central to this thesis is the argument that there is an unfavorable agency relationship between ACs/EEs and the international community. The international financial institutions (IFIs)/FATF, as principals, mandate compliance by ACs/EEs to the FATF's standards and sanction non-compliance. This facilitates a situation where ACs/EEs face a heightened degree of exclusion from the international financial market. The sanctions do not consider the unique challenges of these countries in meeting the demands of compliance with AML/CFT standards. This argument

¹⁷ See generally, FATF, 'Global Money Laundering & Terrorist Financing Threat Assessment' (FATF, July 2010), < https://www.imolin.org/pdf/imolin/Global_Threat_assessment.pdf > accessed 20 July 2015.

¹⁸ Ibid.

¹⁹ FATF, 'The FATF Recommendation: Recommendation 1' (FATF, February 2012) < http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf > accessed 10 July 2015.

exposes a design flaw in AML/CFT standards and processes for benchmarking compliance, irrespective of the adoption of the RBA to compliance.²⁰ Hence, the current standards and processes have to be re-evaluated to adequately take account of the peculiarities of ACs/EEs²¹ with the aim of facilitating actual and proactive compliance.

Examining the varying legal structures underpinned by dire socio-economic and political circumstances reveals that uniform standards, even where supported by the RBA, is antithetical to proactive compliance. Thus, uniform standards may be setting too high a bar for ACs/EEs, which may continually fail to meet the expected compliance standards. This underscores a regulatory paradox, where regulations achieve effects contrary to their intention, which undermines compliance prospects and hinders financial integration of ACs/EEs due to sanctions.

Consequently, this **thesis advances these questions:**

1. Has the evolution of IFIs/FATF facilitated an agency slack between these international institutions and ACs/EEs with resulting legitimacy crises?
2. Do the compliance drivers and level of compliance attained in ACs/EEs indicate a misalignment of incentives between these countries and IFIs/FATF?
3. What factors exacerbate information asymmetry between IFIs/FATF and ACs/EEs? Can the agency slack that arises from countries acting in their self-interest to hinder information sharing with other countries be resolved?
4. Does the risk-based approach sufficiently take into consideration the peculiarities of countries and facilitate increased legitimacy of the FATF?

²⁰ Abdullahi Usman Bello and Jackie Harvey, 'From a Risk-based Approach to an Uncertainty Based Approach to Anti-Money Laundering' [2017] 30 (1) Security Journal

²¹ This refers to Brazil, Russia, India, China and South Africa.

1.1 Scope of Thesis

This thesis focuses on the interrelationship between IFIs/FATF and ACs/EEs, and how this relationship affects the compliance of these countries to the FATF standards. This encompasses an examination of the evolution and legal status of the key actors in the global regulation of AML/CFT: the IMF and the World Bank, the FATF and its regional affiliates. Such examination unveils unfavorable agency and legitimacy concerns, thereby challenging the perspective that AML/CFT measures can be implemented uniformly across ACs/EEs.²² Central to this would be the recognition of socio-economic and political differences within ACs/EEs²³ coupled with the capacity deficit in these blocs of countries that hinder their ability to harness the AML/CFT regime. Consequently, it assesses the pre-conditions for effective AML/CFT regulation and the factors that engineer compliance within these bloc of countries. It concludes that the unsuitability of the current global AML/CFT regime which has not been remedied by the adoption of the RBA necessitates amendments to ensure proactive compliance.

1.1.1 The Financial Action Task Force

As one of the first collaborative international efforts towards the elimination of financial frameworks that support terrorism and money laundering, the FATF promoted 40 recommendations on money laundering and terrorist financing.²⁴ Countries are required to adopt these through national laws and effective implementation of recommendations.²⁵ Non-compliant jurisdictions are coerced into compliance by soft law mechanisms employed by the FATF. This has led scholars to argue that FATF

²² Emerging Economies include the BRICS (Brazil, Russia, India, China and South Africa); African Countries – mainly restricted to Nigeria, examples of which are applicable to other African countries.

²³ For instance – unsophisticated legal system, lack or absence of skilled financial institution staff, ineffective regulatory bodies, prevalence of corruption and financial crimes, unemployment and conflict.

²⁴ See FATF, 'FATF Steps Up the Fight Against Money Laundering and Terrorist Financing' (FATF, 16 February 2012) <<http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfstepsupthefightagainstmoneylaunderingandterroristfinancing.html>> accessed 12 March 2015.

²⁵ Nicholas Ryder, *Financial Crime in the 21st Century – Law and Policy* (Edward Elgar Publishing Limited 2011).

impacts hard law into jurisdictions.²⁶ Backed by interpretative guidance and periodic updates, the FATF recommendations form the backbone of the AML/CFT regime. Its AML regime is distinguished on two fronts: prevention and enforcement.²⁷ Prevention is focused on regulation, supervision, reporting,²⁸ consumer due diligence²⁹ and sanctions. The FATF recommendations also illustrate that prevention includes risk assessment and financial terrorism laws. Enforcement is however based on the methodology of deterrence and retribution and thus centered on investigation, confiscation, prosecution and punishment.

Adherence to the FATF requirements is assumed to be key to curbing ML/FT, though its effectiveness is however uncertain. Tsingou recognizes the role of states in harnessing the AML/CFT regime.³⁰ Yepes however expresses reservations on the possibility of uniform development.³¹ These reservations are revealed in difficulties experienced by ACs adhering to these requirements given their lack of infrastructure and skilled manpower.³² Paradoxically, these requirements have the undesirable effect of undermining attempts to curb financial exclusion, thus perpetuating illicit financial transfers via the unbanked.³³ The unbanked side of the economy is the reverse side of

²⁶ Saby Ghoshray, *Compliance Convergence in FATF Rulemaking: The Conflict between Agency Capture and Soft Law* 59 N.Y.L. Sch. L. Rev (2014–2015) 521, 521.

²⁷ Eleni Tsingou, 'Global Financial Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy' (2005) Centre for the Study of Globalization and Regionalization (CSGR) Working Paper No 161/05 <http://wrap.warwick.ac.uk/1959/1/WRAP_Tsingou_wp16105.pdf> accessed 11 February 2015

²⁸ FATF, 'The FATF Recommendation: Recommendation 20' (FATF, February 2012) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf> accessed 10 July 2015.

²⁹ FATF, 'The FATF Recommendations: Recommendation 5 - 12 and 22' (FATF, 2012) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf> accessed 10 July 2015.

³⁰ Eleni Tsingou, 'Global Financial Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy' (2005) Centre for the Study of Globalization and Regionalization (CSGR) Working Paper No 161/05 <http://wrap.warwick.ac.uk/1959/1/WRAP_Tsingou_wp16105.pdf> accessed 11 February 2015.

³¹ Concepcion Verdugo-Yepes, 'Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis' (2011) International Monetary Fund Working Paper WP/11/177, 9 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578> accessed 19 April 2015.

³² Skilled manpower in this context refers to staff of regulatory bodies, as well as those of Financial and Non-Financial Institutions required to ensure compliance; Ronald H Mynhardt and Johan Marx, 'Anti Money Laundering Recommendations for Cash Based Economies in West Africa' *Corporate Ownership and Control* 1, 2.

³³ See the European Commission, 'The EU Steps up its Response to Fight Money Laundering and Drug Trafficking in West Africa' European Commission Press Release – 18 March 2013 <http://europa.eu/rapid/press-release_IP-13-230_en.htm> accessed 10 July 2015. The implementation

the banked, the boundary between which is drawn by legislation and regulation. In contrast, EEs are assumed to be better skilled at implementing the FATF's recommendation.³⁴ The FATF requires that all member countries be 'strategically important'.³⁵ To attain this bar, FATF countries are not just mandated to be effective in combatting ML/TF, their global financial prominence is also crucial.³⁶ This rigorous two-step process has seen all EEs classified as members, a feat no AC has attained. Verdugo Yepes attributes the position of EEs to their economic growth and the quality of their domestic regulatory framework which he agrees is correlated to improved compliance to AML/CFT standards³⁷ that allows for membership.

McNeil and Ravell argue that the FATF's membership requirements and structure which evidence its politicized nature can however be counterproductive,³⁸ pushing developing countries to work sturdily towards the attainment of position of relative importance within a limited timeframe. Such pressure and time constraints motivate states to give some semblance of compliance to recommendations via changes in form - changes which are not necessarily effective.

Regardless of these criticisms, powerful institutional allies – the IMF and the World Bank have been praised for addressing some of the membership shortcomings of the FATF. The membership of the IMF/World Bank covers about 189 countries, which

of AML/CFT requirements especially through the financial institutions can lead to increased requirements in opening bank accounts, which deters unqualified persons from utilizing the banks. FATF Guidance, 'Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion' 2011 available at <http://www.fatf-gafi.org/media/fatf/content/images/AML%20CFT%20measures%20and%20financial%20inclusion.pdf> > accessed 10 May 2015

³⁴ See FATF, 'Process and Criteria for Becoming a Member' (FATF, 2012) <<http://www.fatf-gafi.org/pages/aboutus/membersandobservers/membershipprocessandcriteria.html>> accessed 4 July 2015.

³⁵FATF, 'Membership Policy' (FATF, 2012) <<http://www.fatf-gafi.org/pages/aboutus/membersandobservers/fatfmembershippolicy.html>> accessed 4 July 2015.

³⁶Ibid.

³⁷ Concepcion Verdugo-Yepes, 'Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis' (2011) International Monetary Fund Working Paper WP/11/177, 9 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578> accessed 19 April 2015.

³⁸ Chris McNeil and Stephen Ravell, 'International Anti-Money Laundering Initiatives' in Gwendoline Godfrey, *Neate and Godfrey: Bank Confidentiality* (Bloomsbury Professional 2011).

include both ACs/EEs.³⁹ However, membership does not necessarily translate to equal participatory power. Scholarly critiques accede to this, noting that the voting quota in the IMF hinders effective participation.⁴⁰ Woods argues that the current voting and board membership structure reinforces the fears of under-representation of ACs in contrast to EEs as it breeds inequality in the formulation and dissemination of policies.⁴¹ Consequently, ACs have been unable to assimilate the formulated AML/CFT recommendations due to unsophisticated legal systems and certain socio-political peculiarities⁴² inter alia, corruption and democratic deficit.

This has led to greater intrusion by international institutions and more powerful countries through the FATF's soft law enforcement mechanisms. The FATF however claims to address these issues by monitoring the progression of each country in implementing the necessary measures and carrying out periodic reviews of their techniques⁴³ and most importantly, through FATF's styled regional bodies (FSRB).⁴⁴ However, the independence of these bodies is not guaranteed due to the observatory status granted to certain 'powerful' countries.⁴⁵

³⁹ IMF, 'IMF Members' Quotas and Voting Power, and IMF Board of Governors' <<http://www.imf.org/external/np/sec/memdir/members.aspx>> accessed 14 January 2015.

⁴⁰ Leech Dennis and Leech Robert, 'A new Analysis of a priori Voting Power in the IMF: Recent Quota Reforms Give Little Cause for Celebration' (2012) Warwick Economics Research Paper Series (TWERPS) <http://www2.warwick.ac.uk/fac/soc/economics/research/workingpapers/2012/twerp_1001.pdf> accessed 10 May 2015.; Mark J Wolff, 'Failure of the International Monetary Fund and World Bank to Achieve Integral Development: a Critical Historical Assessment of Bretton Woods Institutions, Policies, Structures & Governance' [2013] 41 Syracuse j. Int'l L. & Com. 71, 73, 84, 87, 111- 114. Some emerging countries like China and Russia have seats on the board. 21 African countries are represented by 1 Executive Director and 22 by an Executive Director at the World Bank

⁴¹ Ngaire Woods, 'The Challenges of Good Governance for the IMF and the World Bank themselves' [2000] 28 (5) World Development 823.

⁴² Andrea Lenshow, Duncan Liefferink and Sietske Veenman, 'When Birds Sing: A Framework for Analyzing Domestic Factors Behind Policy Convergence' 12 (5) [2005] Journal of European Public Policy 797-816.

⁴³ IMF, 'The IMF and the Fight Against Money Laundering and the Financing of Terrorism' March 27, 2015 <<http://www.imf.org/external/np/exr/facts/aml.htm>> accessed 5 May 2015.; FATF, 'FATF Mutual Evaluations' <<http://www.fatf-gafi.org/topics/mutualevaluations/>> accessed 22 January 2015

⁴⁴ For a List of regional bodies see, APG, 'Financial Action Task Force & FATF Styled Regional Bodies' (APG) <<http://www.apgml.org/fatf-and-fsrb/page.aspx?p=94065425-e6aa-479f-8701-5ca5d07ccfe8>> accessed 14 May 2015.

⁴⁵ See Inter Governmental Action Group Against Money Laundering in West Africa (GIABA), Observer status is granted to, inter alia, the IMF, the World Bank and the United Nations on Drugs and Crime (UNODC)

1.1.2 The International Monetary Fund and World Bank

As stated, the FATF also works in collaboration with the IMF and World Bank to combat money laundering and terrorist financing. The IMF was originally designed to promote international monetary cooperation, and ensure exchange stability and economic growth.⁴⁶ Its sister organization, the World Bank, was created with the sole purpose of promoting long term economic development and poverty reduction.⁴⁷ The original mandates of these institutions have however evolved to address the growing level of ML/TF due to possible adverse macro-economic effect on the international economy⁴⁸ as well as socio-economic and political consequences on developing countries.⁴⁹ The cooperation of both institutions resulted in the launch of the Financial Sector Assessment Program (FSAP), a collaborative assessment of compliance levels, the report of which is infused into the IMF's Article IV surveillance.⁵⁰

⁴⁶ IMF, 'The International Monetary Fund and the World Bank' (IMF, March 2018) <<http://www.imf.org/external/np/exr/facts/imfwb.htm> > accessed 7 April 2018; IMF, 'Articles of Agreement' <<https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> > accessed 26 April 2017.

⁴⁷ Ibid.

⁴⁸ World Bank, 'Enhancing Contributions to Combating Money Laundering: Policy Paper' (World Bank, April 2001) <<http://www.worldbank.org/html/extdr/moneylaundering.pdf>> accessed 19 May 2015; IMF, 'Intensified Fund Involvement in Anti-Money Laundering Work and Combating the Financing of Terrorism', (IMF, November 2001) <<https://www.imf.org/External/np/mae/aml/2001/eng/110501.pdf>> accessed 19 May 2015.

⁴⁹ Paul Allan Schott, 'Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism: Second Edition and Supplement on Special Recommendation IX' (World Bank, 2016) <<https://openknowledge.worldbank.org/bitstream/handle/10986/6977/350520Referenc1Money01OFFICIALOUSE1.pdf?sequence=1&isAllowed=y> > accessed 10 December 2017.; For the IMF Action Plan, see, IMF Policy Paper, 'Review of the Fund's Strategy on Anti-Money Laundering and Combatting the Financing of Terrorism' (2014) <<http://www.imf.org/external/np/pp/eng/2014/022014a.pdf> > accessed 21 January 2015. For the World Bank Action Plan, see, 'Proposed Action Plan for Enhancing the Bank's Ability to Respond to Clients in Combating Money Laundering and the Financing of Terrorism', 22 January 2002.

⁵⁰ For the roles of the IMF, see Ngairé Woods, *The International Monetary Fund, the World Bank and their Borrowers* (Cornell University Press 2006); Andreas F. Lowenfeld, *The IMF as an Organization, International Economic Law* (OUP 2002); International Monetary Fund, 'IMF and the Fight Against Money Laundering and the Financing of Terrorism' (IMF, October 2017) <<http://www.imf.org/external/np/exr/facts/aml.htm>> accessed 1 December 2017.; R. Barry Johnston and John Abbott, 'Placing Bankers in the Front Line' [2005] 8.3 *Journal of Money Laundering Control* 215-219.

According to Jae-Myong Koh, the FSAP's findings affect three main categories of IMF/World Bank's activities:⁵¹ assessing a country's situation,⁵² lending⁵³ and technical assistance.⁵⁴ Moreover, the IMF/World Bank have incorporated operational activities aimed at curbing ML/TF which include: the promotion of sound financial systems, good governance, design and implementation of judicial reform and other related capacity building measures.⁵⁵ Serre notes that four West African countries (Burkina Faso, Mauritania, Niger and Sierra Leone) have been so assisted by the World Bank.⁵⁶ Unlike the FATF's coercive style, the IMF's technical assistance is granted on a voluntary and cooperative basis.⁵⁷ Whilst technical assistance has faced limited challenges, the role of institutional aid as a catalyst for preventing or remedying terrorist activities has generated some discussion. Serre postulates that the link between development aid and the fight against terrorism remains unproven – which has however not prevented some states from relying on aid.⁵⁸

The role of the IMF/World Bank in ML/FT has been disputed on two independent grounds, external influence and expertise. Developing countries, particularly ACs, have

⁵¹ Paul Allan Schott, 'Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism: Second Edition and Supplement on Special Recommendation IX' (World Bank, 2016) < <https://openknowledge.worldbank.org/bitstream/handle/10986/6977/350520Referenc1Money01OFFICIALOUSE1.pdf?sequence=1&isAllowed=y> > accessed 10 December 2017.

⁵² IMF's Article IV Consultation see, "IMF Articles of Agreement" < <http://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> > accessed 1 January 2014.

⁵³ The Fund has come to include the fights against money laundering, corruption, and terrorism as factors in conditional lending programs.

⁵⁴ IMF, 'IMF Policy Paper: Review of the Funds Strategy on Anti-Money Laundering and Combating the Financing of Terrorism' (IMF, 2014) < <http://www.imf.org/external/np/pp/eng/2014/022014a.pdf> > accessed 7 May 2015; Jae-Myong Koh, *Suppressing Terrorist Financing and Money Laundering* (Springer 2006).

⁵⁵ IMF, 'Articles of Agreement' (IMF, 2944) < <http://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> > accessed 2 April 2015. Paul Allan Schott, 'Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism: Second Edition and Supplement on Special Recommendation IX' (World Bank, 2016) < <https://openknowledge.worldbank.org/bitstream/handle/10986/6977/350520Referenc1Money01OFFICIALOUSE1.pdf?sequence=1&isAllowed=y> > accessed 10 December 2017.

⁵⁶ Julien Serre, 'Development Aid in the Fight Against Terrorism' [2012] 77 (4) *Politique étrangère*. For example, AML/CFT Technical Assistance totaling US\$2.2 million has been included in lending programs for four countries (Bangladesh, Guatemala, Honduras, and Pakistan). In addition, for Serbia/Montenegro, AML/CFT is an area to be covered in the adjustment loan; see Jae-Myong Koh, *Suppressing Terrorist Financing and Money Laundering* (Springer 2006) 176.

⁵⁷ Under the FSAP, the IMF/World Bank have set the standards and codes in 12 areas under which AML/CFT issue is subsumed. Under the FSAP, the IMF/World Bank prepare the country reports which analyze each country's status and implementation of the 12 standards and codes. It is voluntary and can only be triggered at the request of the assessed country.

⁵⁸ Julien Serre, 'Development Aid in the Fight Against Terrorism' [2012] 77 (4) *Politique étrangère*.

resisted its adoption on the ground that these international institutions have become instruments in the creation of regimes of governance coordinated by the United States and the G7 in the face of security threats.⁵⁹ The asymmetry of influence is not only evidenced by the composition of the institutions, but also by the fact that when providing technical assistance or loans to ACs, the IMF/World Bank attach conditionalities mandating that they tackle ML/TF.⁶⁰ In contrast, similar technical assistance is granted in emerging economies by way of assessment recommendations.⁶¹ Furthermore, the soft law enforcement mechanisms which function as an inducement device is meted out mainly on ACs.⁶² The paradox however is that EEs may, in certain instances, contend with more ML/FT issues due to their sophisticated financial markets.⁶³ The presence of external influence may explain the inability of the IMF/World Bank to render independent unbiased advice. There is constant underestimation of a country's economic problems, given the absence of robust information on which the conditionalities are based.⁶⁴

⁵⁹ Eleni Tsingou, 'Global Financial Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy' (2005) Centre for the Study of Globalization and Regionalization (CSGR) Working Paper No 161/05 <http://wrap.warwick.ac.uk/1959/1/WRAP_Tsingou_wp16105.pdf> accessed 11 February 2015; Ben Hayes, 'Counter Terrorism, Policy Laundering and the FATF: Legalizing Surveillance, Regulating Civil Society 14 (1) [2012] IJNL.

⁶⁰ Peter Aldridge, *Money Laundering Law: Forfeiture, Confiscation, Civil Recovery, Criminal Laundering and Taxation of the Proceeds of Crime* (Hart Publishing 2003) 194. The World Bank has provided technical assistance, assessment and policy development support to West African countries. Pertinently, the intrusion of IMF/World Bank in the assessment of a country's standard is optional, however, African countries usually submit themselves to such assessments.

⁶¹ IMF, 'Brazil: Report on the Observance of Standards and Codes – FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism' (IMF Country Report 05/207, June 2005) <<http://www.imf.org/external/pubs/ft/scr/2005/cr05207.pdf>> accessed 10 July 2015; IMF, 'People's Republic of China - Hong Kong Special Administrative Region: Report on Observance of Standards and Codes' (IMF Country Report No, 08/360, November 2008) <<https://www.imf.org/external/pubs/ft/scr/2008/cr08360.pdf>> accessed 14 July 2015.

⁶² Highlighting the asymmetry that occasions soft law, see Jon Nirger Skjaereth, Olav Schram Stokke and Jorgen Wettstad, 'Soft law, Hard Law and Effective Implementation of International Environmental Norms' [2006] 6.3 Global Environmental Politics 104, 118-119.; Eilis Ferran and Kern Alexander, 'Can Soft Law Bodies Be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board' (2011) Legal Studies Research Paper Series Paper No.36/2011 <<https://poseidon01.ssrn.com/delivery.php?ID=719105092024098122114101020086009118038069081083039091121092122090087111098064019066123029119022059121027023079089086095090068017078060077029075103079084006126071113085042032005076009081104082003024025090072098023023077127127103107006079003001087124078&EXT=pdf>> accessed 11 February 2015.

⁶³ There is an assumption that due to financial flows, emerging economies are most susceptible to illicit crimes, but may indeed be better able to curtail it as opposed to West African countries.

⁶⁴ Nicholas Ryder, *Financial Crime in the 21st Century, Law and Policy* (Edward Publishing Limited 2011).

Ngairé Woods appraises the composition of the IMF/World Bank boards, questioning their competence to effectively dispense their duties with objectivity and the requisite information.⁶⁵ Furthermore, scholars have queried the ability of the IMF's assessment to deal efficiently and legitimately with standards closely linked to criminal justice.⁶⁶ Buira and Babb re-echo this concern, stating that there is little reason to believe that the IMF's staff possess expertise in this area.⁶⁷ The choice of soft law as an enforcement mechanism is further critiqued as evidence of non-expertise.⁶⁸

In addition, mutual evaluation does not always reveal to IFIs the range of capacity related issues faced by various jurisdictions within their legal structures. Thus, IFIs' recommendations may be unsuitable to specific countries. That IFIs have been more influential in ACs as opposed to EEs⁶⁹ can be attributed to the adverse effect of porousness in countries with unsophisticated mechanisms for dealing with ML/TF on the integrity of international markets.

It is arguable that the effectiveness of AML/CFT regulation is not necessarily reliant on the legal development of jurisdictions, as exemplified by China's overt compliance with the AML/CFT regulations irrespective of its poor rule of law records.⁷⁰ This is however an exception, particularly due to the country's drive for reputational standing within the global financial space. What is however noticed with ACs is that where the

⁶⁵Ngairé Woods, *The Globalizers: the IMF, the World Bank and their Borrowers* (Cornell University Press 2006) 141.

⁶⁶ IMF, 'Public Information Notice: IMF Executive Board Reviews and Enhances Efforts for Anti-Money Laundering and Combating the Financing of Terrorism', (IMF, Public Information Notice, No.04/33, 2 April 2004) < <http://www.imf.org/external/np/sec/pn/2004/pn0433.htm> > accessed 2 May 2019.

⁶⁷ Sarah Babb and Ariel Buira, 'Mission Creep, Mission Push and Discretion: The Case of IMF Conditionality' (Presented at the XVIII G24 Technical Group Meeting, Geneva, Switzerland, March 2004).

⁶⁸ Leonard Seabrooke and Eleni Tsiongou, 'Revolving Doors and Linked Ecologies in the World Economy: Policy Locations and the Practice of International Financial Reform' [2009] 260/09 CSGR Working Paper, 14 < <https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2009/26009.pdf> > accessed 10 July 2015.

⁶⁹ Devesh Kapur, John Lewis, and Richard Webb, *The World Bank: Its First Half-Century - Volume 1 History* (Brookings Institution Press 1997) 730; Ngairé Woods, *The Globalizers: The IMF, the World Bank and their Borrowers* (Cornell University Press 2006) 141.

⁷⁰ World Justice Project, 'Rule of Law Index 2017 - 2018' (World Justice Project) < https://worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2018-June-Online-Edition_0.pdf > accessed 20 March 2018.

legal structures are ineffective, the law exists only on paper and is neither known to the public nor respected by the state.⁷¹ It is not only riddled with uncertainties but its ineffectiveness encourages corrupt practices and illicit financial crimes.⁷² Furthermore, this structure usually has an unreliable judiciary and inefficient executive.⁷³ This thesis posits that legal structures that exist mainly in ACs do not offer favorable conditions for the emergence of a suitable AML/CFT regulatory structure, thus diminishing the prospects for robust compliance. This indicates that usually the level of a jurisdiction's legal development is related to its likelihood of compliance with the AML/CFT regulations. Improving the functioning of legal structures and institutions is a prerequisite for economic development and vice versa. Yepes lends credence to this, asserting that domestic governance hinders compliance levels, which are in turn interrelated with socio-economic development.⁷⁴ To this end, this thesis asserts that legal and institutional reform is crucial not only for effective AML/CFT regulation but also for economic development.

1.1.3 Why IMF/World Bank and the FATF?

The IMF and the World Bank, which are IFIs, are considered alongside the FATF for two key reasons. Firstly, these are the paramount institutions that govern AML/CFT regulations globally. These institutions, even with diverse legal status, work in concert in re-formulating, assessing and facilitating compliance with the FATF standards. Hence, scrutinizing their evolution, legal status, legitimacy and role in AML/CFT regulation is a crucial starting point for examining how AML/CFT regulation operates

⁷¹ Cheryl Gray, 'Reforming the Legal Systems in Developing and Transition Countries' [1997] Finance and Development <<http://www.imf.org/external/pubs/ft/fandd/1997/09/pdf/gray.pdf>> accessed 15 December 2014.

⁷² Brian R. Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2000) ESRC Centre for Business Research, University of Cambridge Working Paper No.172 <http://www.researchgate.net/profile/Brian_Cheffins/publication/24101528_Does_Law_Matter_The_Separation_of_Ownership_and_Control_in_the_United_Kingdom/links/5416f0c80cf2bb7347db80d6.pdf> accessed 7 June 2015.

⁷³ Ibid.

⁷⁴ Concepcion Verdugo-Yepes, 'Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis' (2011) International Monetary Fund Working Paper WP/11/177, 9 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578> accessed 19 April 2015.

at a global level, the interrelationship between IFIs/FATF and countries, and how this relationship facilitates or hinders compliance. It is imperative to state that there is limited focus on pre-existing United Nations (UN) Conventions on ML/TF given that the FATF has inculcated the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (Vienna Convention), and the UN Convention against Transnational Organized Crime (Palermo Convention) into its recommendations.⁷⁵

Secondly, through the application of the agency theory, the degree of proximity of these institutions to countries in setting and implementing standards can be examined. Through the prism of the agency theory, the FATF is the proximate principal to countries, whilst the IFIs, as observers on the FATF, have an extended principal position. Their positions are however not static within the agency theory. Interestingly, the dynamics of their non-static position unearth legitimacy concerns which are core to this thesis.

1.1.4 Focus on African Countries and Emerging Economies

Limited literature discusses the bias that ACs/EEs encounter in complying with AML/CFT regulations due to their limited integration to the global economy. Hence, it is interesting to see how these bloc of countries that had no role in the AML/CFT policy formulation have come to align with the global standards. This thesis shows how such alignments are problematic due to the deficient legal framework of ACs, underpinned by socio-economic and political difficulties. This is enriched by quantitatively assessing the compliance drivers to AML/CFT standards within EEs who face similar issues, but are better equipped to deal with them.

⁷⁵ FATF, 'The FATF Recommendation' (FATF, February 2012) < http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf > accessed 10 March 2015.

The similarities and differences inherent in this bloc of countries allow for some generalizations in considering their likely behavioral responses to the FATF recommendations. Similarities within and across each bloc include factors such as entrenched cash-based economies, capacity deficiencies and corruption ingrained in legal, institutional and political structures. However, EEs usually have more robust capacity, stronger financial institutions and a greater degree of integration with the international financial economy. Additionally, they have greater macro-economic and political stability than ACs, which are crucial in explaining the variation in compliance behavior of countries.

1.2 Hypothesis

The agency theory, through which the creation and implementation of standards are examined at the global and national levels, has been used to develop competing hypothesis that aids in enriching the understanding of this thesis.

Hypothesis: The uniform standards and benchmarking of AML/CFT, which all countries are subjected to, create a regulatory paradox for ACs/EEs. Additionally, they hinder ACs/EEs from assimilation of standards given their capacity deficit coupled with the inability of the standards to encapsulate the peculiarities of countries. These undermine compliance prospects which is further worsened by sanctions that hinder financial integration.

Competing hypothesis: Compliance with uniform standards is crucial to mitigating illicit crimes. The inculcation of the peculiarities of ACs/EEs within the global AML/CFT framework narrowly projects the interest of these jurisdictions. Additionally, it limits the justification for combatting ML/TF globally, meaning that ML/TF will become a global issue given the weakness that accompanies taking the peculiarities of ACs/EEs into account.

1.3 The Theoretical Argument

This thesis engages the agency theory to understand the relationship between IFIs/FATF and states on one hand, and the relationship between states of varying degrees of integration to the global financial economy on the other hand.

This theory sheds light on the dynamic relationship between actors (IFIs/FATF and countries). It argues that their relationship is defined by the economic positioning of countries within the global economy which determines their membership hierarchy within IFIs/FATF.⁷⁶ It argues that the economic positioning of countries, coupled with how these countries perceive their compliance to AML/CFT standards determines the degree of information asymmetry that exist between the actors. Simply put, it determines how countries communicate their true AML/CFT compliance levels to IFIs/FATF. For instance, countries that are highly integrated with the global economy and can pre-empt high compliance to AML/CFT standards, are more inclined to curtail information asymmetry in interacting with IFIs/FATF. Additionally, these countries are more inclined to comply with the FATF standards, irrespective of their internal challenges - due to the need to avert sanctions that can affect their positioning within the global economy. Where, however, countries are not highly integrated and suffer internal compliance challenges, they are more likely to communicate strategically with IFIs/FATF. In such situations, the conflicting interest between IFIs/FATF and countries becomes more prominent. Where, for instance, IFIs/FATF strive for integrity and stability at the possible expense of financial inclusion – thereby compelling information asymmetry and compliance gaps. This indicates that the continued asymmetry of standards and benchmarking processes may hinder the ability of ACs/EEs to comply proactively with global standards. In most cases, a regulatory paradox may ensue given the dearth of legitimacy.

⁷⁶ IFIs (core member countries entitled to one vote each as against group of members), FATF (core members, belated members, associate members)

In examining the interrelationship between countries of varying degrees of integration to the global economy, this thesis argues that compliance is usually dependent on self-interest. It however finds that lesser integrated countries have less incentive to comply except when engaged in a continuing business relationship. Where however, these countries are compelled to comply, capacity deficiency hinders proactive compliance.

This theory facilitates an understanding that, as opposed to the arguments advanced by the FATF that the ‘efficiency’ of standards is crucial in addressing illicit crimes, in the absence of ‘equity’ countries may be crippled from proactive compliance. This position recognises that the legal structures of countries, coupled with the confidence level in their financial market and structures determines to a large extent, their compliance capability. Shortcomings of these indices, which is predominant in ACs/EEs has largely undermined their compliance ratings. This is further worsened by non-legal factors such as the absence of political will and resource deficiency.

1.4 Definition of Key Terms and Contribution to Knowledge

Implementation and compliance are used interchangeably, however, they are significantly different. Implementation technically refers to the transplantation of standards into domestic law, coupled with the measures geared at putting international recommendations into practice at the domestic level. Compliance however transcends implementation; it refers to an actor’s behavioral conformity to specific recommendations.⁷⁷ For example, when state introduces national laws and regulations on AML/CFT, compliance entails ensuring that the standards are obeyed and not observed in breach. This indicates that implementation is a pre-condition for compliance. Understanding the concept of compliance drivers is critical in constructing the design of recommendations to ensure proactive compliance. These concepts are

⁷⁷ Roger Fisher, *Improving Compliance with International Law* (1981); Benedict Kingsbury, *The Concept of Compliance as a Function of Competing Conceptions of International Law* [1998] 10 Mich. J. Int’l 345.

crucial themes within this thesis and are key to understanding the conflict of interest between IFIs and states.

Effectiveness cannot be divorced from these concepts. There are varying perspectives on the concept of ‘effectiveness’ within international law. It may relate to whether an international law attains its objectives⁷⁸ or the extent of behavioral improvements within targeted countries. The FATF sees effectiveness assessment as the former, given its definition of the term as ‘the extent to which the defined outcomes are achieved’.⁷⁹ This thesis however views effectiveness as the degree to which the recommendations are met through desired changes in state behavior.⁸⁰

Additionally, the terms ‘standards’, ‘recommendations’ and ‘rules’ are used interchangeably in reference to the FATF recommendations. Whilst the FATF recommendations are referred to as soft law standards, the hardening of these standards during the transplantation process acknowledges their transformation to hard law, thus the reference to rules.

Furthermore, the term ‘developing countries’ is used interchangeably with African countries. Likewise, ‘illicit crimes, activities or transactions’ refer to ML/TF and its predicate offences.

⁷⁸ Edith Brown Weiss and Harold K. Jacobson, ‘Compliance with the International Environmental Accords’ [1995] 119 *Global Governance* 119, 123.

⁷⁹ FATF, ‘Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems’ (FATF, 2012) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf> > accessed 14 July 2015.

⁸⁰ Oran R. Young & Marc A. Levy (with the assistance of Gail Osherenko), ‘The Effectiveness of International Environmental Regimes’, in Oran R. Young, *The Effectiveness of International Environmental Regimes: Casual Connections and Behavioral Mechanisms* (MIT Press, Cambridge, MA, 1999).

It is imperative to make clear that however scarce, literature exists on the global AML/CFT governance, especially as regards the transplantation of international policies.⁸¹ Eminent scholars such as Rainer Hulse, ⁸² Chris Brummer⁸³ and Jason Sharman⁸⁴ have discussed extensively on the suitability of the FATF standards to countries around the world. More particularly, Norman Mugarura has examined the adaptability of the FATF standards across various jurisdictions, especially developing countries and argued that the framework should be designed with ‘flexibility’ to ensure its adaptability.⁸⁵ Inspired by these literature, my thesis goes deeper in examining whether the evolution of the IFIs/FATF creates an agency slack and evident legitimacy crises that facilitates strategic communication between ACs/EEs and IFIs/FATF to project actual or proactive compliance. It also questions the suitability of the ‘flexibility’ introduced through the risk-based approach and whether it serves its purpose. Crucially, it examines the compliance drivers that propel or repel compliance with the FATF standards and how these are influenced by the uneven development of the ‘law and confidence’ in ACs/EEs underpinned by socio-economic and political factors. Arguments are buttressed with empirical findings from secondary data, which illustrate the compliance variances across countries, indicating that internal dynamics affect compliance.

Consequently, my critical contribution to knowledge are my findings that the level of integration of ACs/EEs to the global economy and their perceived compliance levels to the FATF standards are crucial in determining:

- a. Their delegation powers to the IFIs/FATF and
- b. Their communication strategy with these institutions.

⁸¹ See Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (First Published 2012, Routledge 2016); Jae-Myong Koh, *Suppressing Terrorist Financing and Money Laundering: The Evolution and Implementation of International Standards* (Springer, 2006)

⁸² Rainer Hulse, ‘Even Clubs Can’t Do without Legitimacy: Why the Anti-Money Laundering Blacklist was Suspended’ [2008] 2 *Regulation & Governance* 459 – 479.

⁸³ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (CUP, 2012)

⁸⁴ Jason Sharman, ‘Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developed States [2008] 52 (3) *International Studies Quarterly* 635 – 656.

⁸⁵ See Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (First Published 2012, Routledge 2016).

These in turn can propel or limit their compliance levels as well as inhibit the effectiveness of the FATF regime over these states.

This study seeks to fill the literature gap on the current global AML/CFT framework and its suitability across jurisdictions. Therefore, it explores the interplay between national and global factors and how they play out in the implementation of the global AML/CFT framework across jurisdictions. In doing so, it evaluates the role, composition, competencies and legitimacy of IFIs/FATF and the mechanisms they employ to cause behavioral changes. Conversely, the pressure on ACs/EEs to comply may occasion creative implementation and compliance. This discourse unveils the conflicting interests of the IFIs/FATF and ACs/EEs, which also results in conflicts of interests for implementing authorities. Indeed, this hinders proactive compliance with FATF standards when they do not necessarily promote national interests. The resulting divergent implementation and compliance outcomes have consequences for ACs/EEs.

Thus this study reveals that the increasing number of countries becoming associate members of the FATF is indicative of the importance attached to the institution, not of their willingness to actually implement or comply with its standards. By examining the dynamics of implementation and compliance, this study aims to contribute to understanding conditions that are likely to make the current recommendations effective. It also seeks to contribute to the wider debate about potential reform of the FATF standards and processes.

Whilst this study is focused on the compliance of countries to AML/CFT standards, it is limited in scope to the technical compliance of countries. It does not extend to the 'effectiveness compliance' levels of countries evaluated by the FATF. Furthermore, it is not a study of illicit financial crimes in ACs/EEs, rather the regulatory responses to ML/TF through the FATF strategies. Through the lens of the agency theory, the focus is on the transplantation to national legislation and implementation of the FATF regulations and recommendations and how ACs/EEs have responded to them.

1.5 Structure of Thesis

Chapter two examines the evolution of AML/CFT standards, the institutions central to AML/CFT administration and the influence of these on state compliance. It establishes a link between ML/TF regulation and the financial sector reform which was due to the challenges posed to financial integrity by financial liberalization, especially as regards cross-border financial relations. It argues that the AML/CFT standards created at different historical points only inculcated the perspectives of a select group of developed countries. Consequently, standards and processes recommended were at best suited to combatting ML/TF within these countries. Given the lack of transparency, accountability and legitimacy, the ACs/EEs have suffered a compliance deficit. This predicament is understood through the lens of the agency theory which unearths a legitimacy crisis, showing that the ACs/EEs are disproportionately involved and inexplicably affected by the regulations – an indication of hegemonic subjection.

Chapter three contends that ‘law and confidence’ are crucial pre-conditions for ensuring a conducive environment for transplantation of laws in ACs/EEs. Law matters, but most importantly, the design of the law is crucial in compelling compliance and averting the gaming of the law. Law is largely dependent on confidence – in financial stability, institutions, governmental and political systems, and enforcement structures. Confidence in these bodies would ensure that financial institutions are held accountable and regulations are effective and able to ensure financial stability. These factors are however lacking in ACs/EEs, an indication that ACs/EEs will be incapable of effectively transplanting or implementing the FATF standards as required from every country, thereby incurring unmerited sanctions. These pre-conditions feed into the compliance drivers which are categorized as legal and non-legal factors and can be internal or external to a country. An examination of the compliance drivers succinctly alludes to the agency slack that exist in delegation of standards.

Chapter four uncovers the interrelationship between the collective principals (CPs) – the IFIs/FATF. This synergy examined through the agency theory unveils the power dynamics between developed countries, the institutions they create and lead and ACs/EEs. It reveals that the AML/CFT standards reflect the priorities and interests of the global north and is sublimated with covenants of agency capture which can hinder the unique development of ACs. Analyzing the interaction between agent states and the CPs, it argues that two factors are crucial for understanding information asymmetry between these actors on ML/TF issues; the level of a country's integration with the global financial system and its perceived compliance levels. It finds that the incentive for information sharing is highest when a country is 'highly integrated' with perceived high compliance levels. In opposite situation, the countries would usually engage strategically with the principal in order to evade observatory tools or sanctions.

Furthermore, in acknowledgement of the flow of money within countries, the interaction between 'highly integrated' and 'mid-integrated' countries are examined. The chapter illustrates that these set of countries share information only when it is in their self-interest, particularly when there is a continuous financial business that is of systematic importance to both parties. It however argues that even when low-integrated countries are willing to exchange viable information, they may be limited by capacity challenges. Where however information asymmetry continually thrives, the CPs are privy to tools to rein in the agent-states. The tools utilized are dependent on the circumstances in question and the application of the inappropriate tool may indeed lead to under-regulation, as the tool would at best be inadequate.

Chapter five examines the socio-economic history of Africa, revealing the effect of premature liberalization on the African economy which placed considerable pressure on African trade and finance. This worsened Africa's position within the global economy as countries became more susceptible to external shock thereby serving as a catalyst for agency slack. Consequently, this led to inequality amongst countries in the continent, with certain banking and financial markets performing better than others. The rein of the colonial exploits which had ingrained socio-economic and political issues further restricted the growth of markets whilst facilitating illicit crimes. Yet, ACs' response to

combatting illicit crimes were tailored to meeting international standards that did not acknowledge their challenges. This necessitated a homegrown approach that would preserve the sovereignty of ACs, whilst remedying the democratic deficit at the international level. The ineffectiveness of the ‘homegrown approach’ meant that ACs remained subject to the international standards irrespective of their compliance challenges. This chapter appraises the extent to which the compliance drivers discussed in chapter 3 have an effect on the compliance levels in ACs and illustrates this empirically. It firmly argues that subjecting ACs to the same standards, methodology and sanctions would be to ignore their heritage and socio-economic challenges whilst serving as a catalyst for legitimacy crises. It would be setting these countries to fail or permitting them to engage strategically with IFIs/FATF given their low-integration with the global economy.

Chapter six focuses on the BRICS which has created newer inequalities of power and influence regionally and globally. The extension and receipt of FATF membership to the BRICS were centered on varying jurisdictional reasons. Whilst the BRICS and developing world viewed this as a means to gain increased representation within the FATF, the agenda of the West was to ensure that the financial movement to the Global South is not replete with illicit transactions. The power-play involved in negotiations between these ‘North-South strategically important countries’ was predicated on the assumption that representation would be a catalyst for improved compliance to AML/CFT recommendations. This approach however did not take into consideration pertinent issues that are peculiar to BRICS’ economies, such as their diverse legal developmental levels underpinned by chaotic political structures and creeping economic growth. Furthermore, the FATF continues to exercise some restraint in including EEs as core members and thus shapers of its standards. It had merely treated them as regulation-takers. Their coerced and belated membership has created a very unbalanced membership between EEs and developed countries – a catalyst for agency slack. It argues that the BRICS membership of the FATF does not necessarily guarantee comparable representation or legitimacy; neither does it guarantee the overtly improved compliance of BRICS countries. Rather, it taints the socio-economic complexities inherent in these countries and their ability to comply. Worse still, it conceals the asymmetry occasioned by variances in the strength of legal structures reinforced by

political and economic differences between members of the FATF. In considering the determinants of compliance empirically, it argues that for membership to equate to legitimacy, there must be extant changes along existing political and economic global structures.

Chapter seven illustrates that although ACs/EEs adopted the FATF's standards grudgingly, they have continued to implement them particularly due to the instrumentality of the IFIs. Their continued implementation has however only resulted in formal or creative compliance. The FATF's attempts to resolve this through the introduction of the RBA, which was hoped to address the legitimacy crisis and resolve agency slack has proved futile. Scholars have promoted other options to resolving this, most profoundly – the uncertainty based approach (UBA). This holds some promise in resolving issues on legitimacy, in addition to institutionally ingrained changes.

Chapter eight sets out how each chapter answers the set out research questions by pulling together insights and conclusions from all the chapters.

1.6 Research Methods

This multidisciplinary research (law of institutions and, law and economics perceptive) questions the suitability of uniform standards and benchmarking. It adopts a mixture of quantitative and qualitative analyses to draw its conclusions. Empirical data is utilized in evaluating current compliance level of countries to the FATF recommendations. This involves re-coding secondary data derived from the FATF's assigned compliance levels (from non-compliant to compliant ranked 0-4) to countries on each of the 40 recommendations. The data is gathered from an examination of 43 mutual evaluation reports and further follow-up reports. The findings from the secondary quantitative analysis of the FATF standards is then pitched against five compliance drivers' statistical variables: corruption, rule of law, democracy, ease of doing business and human development indexes. This exercise concretizes arguments for compliance drivers suitable to ACs/EEs and illustrates the impact of conformity to the FATF standards.

Furthermore, to understand the research questions posed by this thesis, a qualitative study is undertaken, which engages semi-structured interviews as the prime data collection medium. This entailed interviewing staff of, amongst others, the IMF and FATF regional bodies and Central Bank of Nigeria.

1.7 Research Methodology

This thesis which is largely library-based, is based on the agency theory. This economics theory which is sparsely used in examining the global regulation of AML/CFT provides an understanding of the dynamic relationship between IFIs/FATF and the hierarchy of countries they interact with. The applicable theory is enhanced by interview responses from IFIs/FSRB staff. These staff better understand the relationship IFIs/FATF share with countries and also can illuminate on the challenges that hinder compliance by ACs – knowledge garnered through practice. Hence, the interviews are tremendously crucial to this thesis.

Additionally, it utilizes an empirical research approach as an extension of the theoretical framework. It provides the opportunity to evaluate the interaction between institutions and countries, and how institutions rein in compliance by countries. It engages in an expository methodological approach in examining the internal and external drivers of compliance across ACs/EEs, which are categorized as legal and non-legal factors. Moreover, it provides understanding of the interaction between developed countries and developing countries, illustrating interest-driven compliance, which is sometimes circumvented by capacity deficiency.

This thesis recommends a regulatory framework that recognizes the peculiarities of ACs/EEs, whilst also advocating for regional and state involvement in a manner that does not disrupt international finance. If properly re-evaluated, this thesis would serve as a catalyst for improved compliance, whilst fortifying the integrity of the international financial architecture.

Chapter 2

The International Financial Sector Reform and International Legal Framework for AML/CFT Regulation

2. Introduction

Financial liberalization and the accompanying illicit crimes prompted international harmonization of a patchwork of domestic regulations on AML/CFT regulation. This process of global regulation, driven by IFIs and the FATF, was in response to the growing complexity of illicit crimes which increasingly occurred on a cross-border level. The relationship between the evolution of the IFIs/FATF and the suitability of the AML/CFT regulations has been questioned, particularly regarding the ability of the regulations to elicit compliance by countries. This has been examined in relation to developed countries such as the United Kingdom¹ and the United States;² and also the continental blocs, such as Europe.³ There has, however, been limited focus on ACs/EEs.⁴ Parochial emphasis on ACs/EEs has occasioned arguments that the global design of IFIs/FATF allows for suitable regulation of, and compliance with, AML/CFT standards globally. Yet, this is not the case, specifically as regards ACs/EEs given the hegemonic subjection of these countries and the resulting agency slack, an indication of regulatory paradox. To understand the mechanics of this, it is crucial to engage in an examination of the rationale for international financial regulation, the historical

¹ Nicholas Ryder, *Money Laundering – An Endless Cycle? A Comparative Analysis of Anti-Money Laundering Policies in the United States of America, the United Kingdom, Australia and Canada* (First Published 2012, Routledge 2012) 8-39, 73.

² James T Gahtii, 'The Financial Action Task Force and Global Administrative Law' [2010] 197 J. Prof. Law 1, 2-11; Saby Ghoshray Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law [2014-2015] 59 N.Y.L. Sch. L. Rev. 521, 533.

³ Ines Sofia De Oliveria, 'The Anti-Money Laundering Struggle: Actors, Interest and the EU' (4th ECPR Graduate Conference, 2012).

⁴ See Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (2nd edn, Routledge, 2016) 145.

underpinnings and legal structures of the IFIs/FATF, and how these affect the suitability of the global standards.

Section 1 of this chapter focuses on the nature and rationale for financial international regulations as instruments for curbing cross-border externalities. Sections 2 and 3 examine the evolution of international financial regulation (IFR) with an emphasis on the historical and legal status of the IFIs/FATF, coupled with justifications and reactive steps taken to tackle illicit crimes. The sections highlight that the backing of the FATF by IFIs has hardened the trajectory of the AML/CFT standards and led to a move towards mandatory compliance. Section 4 engages the agency theory to understand how the evolution of IFIs/FATF facilitates compliance with AML/CFT regulations within countries. It argues that the existing ‘reverse and continuing international delegation’ has created a global hegemony that hinders the suitability of the standards, thus limiting compliance. Section 5 deconstructs the concept of legitimacy and its compliance potential. This section also examines how agency issues flow from legitimacy crises. Section 6 draws the strands together and concludes.

2.1 The Nature of International Financial Regulation

As a sub-set of public and, arguably, private international law, IFR is focused on facilitating cross-border financial relations with the aim of bolstering trade whilst maintaining financial integrity and stability.¹ Such regulation which is designed to avoid or minimize the probabilities of a systemic risk across borders² is derived from sources such as soft law standards and treaty agreements.

One may presume that treaties, which are binding international agreements between states would serve as the primary source of international financial standards given their ability to compel enforcement. This is not the case. Rather, soft law standards which are non-binding agreements have surfaced as the primary means through which international financial standards are set. However, the role of treaty bodies, such as the IMF/World Bank in regulating international finance cannot be relegated to history. Although they are not standards-setting institutions, the treaties of the IMF/World Bank contain regulations and policies that affect FIs. For instance, the IMF's Articles of Agreement state that it shall oversee members' compliance with their general obligations.³ This underscores the monitoring and enforcement powers of the IMF to ensure member states comply with their obligations and other relevant soft-law standards. The IMF's backing hardens the trajectory of soft laws, giving them binding authority. This bolsters the argument by scholars that soft law and hard law interact on a continuum and are not necessarily opposites.⁴

¹ Shapovalov Mikhail Alexeevitch, 'History, Current State and Prospects of Development of International Financial Law' [2015] 43 *Revista de Derecho* 350.

² John William Anderson, Jr., 'Regulatory and Supervisory Independence: Is there a Case for Independent Monetary Authorities in Brazil?' [2004] 10 *L & Bus Rev. AM.* 253; Weber Rolf H., and Douglas W. Arner, 'Towards a New Design for International Financial Regulation' [2007] 29 (2) *Penn.LJ Int'l Econ. Law.* 510.

³ IMF, Articles of Agreement, 1944. Article IV Section 1 (ii) states that each member is obligated to 'seek to promote stability by fostering orderly underlying economic and financial conditions that a monetary system does not tend to produce erratic disruptions'.

⁴ Kenneth W. Abbott and Duncan Snidal, 'Why States Act through Formal International Organizations' [1998] 42 (1) *Journal of Conflict Resolution* 3; Kern Alexander, 'The Role of Soft Law in the Legalization of International Banking Supervision: A Conceptual Approach' (2000), ESRC Centre for Business Research, University of Cambridge 168 <

This thesis focuses on IFR, a crucial aspect of international law which can pre-empt and possibly forestall a financial crisis when armed with the requisite tools.

2.1.1 Rationale for International Financial Regulation

A pro-cyclical relationship exists between the internationalization of finance and regulation, one which becomes more prominent after a financial crisis.⁵ Thus, increasing integration occasions cross border capital flows which heightens the case for international regulation and national adaptation of international standards to forestall a financial crisis.⁶ This position is advanced by the proponents of financial regulatory convergence.⁷ Kern Alexander et al argue that ‘as financial markets become integrated...states must form IFIs to manage systemic risk and other types of financial risk in the global market.’⁸ Brown adds that ‘because today’s financial markets are global, we need not only proper national supervision, but also a fundamental reform – global financial regulation’.⁹ These views capture the potential damage imminent from international deregulation, whilst projecting the need for international regulation.

https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp168.pdf > accessed 10 July 2015.

⁵ Carmen Reinhart and Kenneth Rogoff, ‘Regulation Should Be International’ (Financial Times, 18 November 2008) < <https://www.ft.com/content/983724fc-b589-11dd-ab71-0000779fd18c> > accessed 28 August 2017.

⁶ Cally Jordan and Giovanni Majnoni, ‘Financial Regulatory Harmonization and the Globalization of Finance’ [2002] World Bank Policy Research Working Paper 2919 < <https://openknowledge.worldbank.org/bitstream/handle/10986/19224/multi0page.pdf?sequence=1&isAllowed=y> > accessed 11 June 2015.

⁷ Kern Alexander, Rahul Dhumale and John Eatwell, *Global Governance of Financial Systems: The International Regulation of Systemic Risk* (OUP, 2006) 35.

⁸ Ibid.

⁹ HM Treasury, ‘Speech by the Chancellor of the Exchequer, Gordon Brown MP at the Council for Foreign Relations in New York’ (HM Treasury, 16 September 1999) < http://webarchive.nationalarchives.gov.uk/20100407173039/http://www.hm-treasury.gov.uk/speech_chex_160999.htm > accessed 10 June 2015.

An unregulated integrated financial system creates various risks. For instance, it can trigger a ‘dominant neighbor’ case, where, according to Jordan et al, a country’s economy can be significantly affected by the proximity of an economically buoyant neighbor.¹⁰ Such situations prompt the affected neighbor to align its standards with international regulations in order to level the playing field and attract liquid foreign investment.¹¹ Barring such an alignment, information asymmetry and negative externalities, which are the principal drivers of market failure, are bound to arise. Information asymmetry thrives in the absence of regulation, when countries decide not to disclose damning financial information that could be dissuasive to an investor. Additionally, the interconnectedness of cross-border systemic financial institutions precipitate risk of contagion in the event of a bank failure. This can propel negative externalities resulting in systemic risk.¹² Gianni De Nicolo et al agree that high interconnectedness intensifies large shocks as they can reach more counterparts.¹³ Hence, the argument that regulation should mandate some level of transparency across countries with the sole aim of ensuring or restoring financial stability.¹⁴

The risk associated with international regulation has propelled arguments by some scholars that market forces alone should regulate the global financial market. These scholars believe that excessive regulation can damage the functioning of the financial markets and reduce their economic utility.¹⁵ Additionally, there is the perception that

¹⁰ Cally Jordan and Giovanni Majnoni, ‘Financial Regulatory Harmonization and the Globalization of Finance’ [2002] World Bank Policy Research Working Paper 2919 < <https://openknowledge.worldbank.org/bitstream/handle/10986/19224/multi0page.pdf?sequence=1&isAllowed=y> > accessed 11 June 2015.

¹¹ Ibid.; Thomas Oatley, ‘The Dilemmas of International Financial Regulation’ [2000] 23 (4) Regulation 36; Gianni De Nicolo, Giovanni Favara and Lev Ratnovski, ‘Externalities and Macro Prudential Policy’ [2012] SDN12/5 IMF Staff Discussion Note.

¹² Rick Gortett, ‘Systemic Risk as a Negative Externality’ [2009] Risk Management: Part – Two Systemic Risk, Financial Reform and Moving Forward from the Financial Crisis, Society of Actuaries (SOA) 33; Pawel Smaga, ‘The Concept of Systemic Risk’ [2014] SRC Special Paper No 5, 13.

¹³ Gianni De Nicolo, Giovanni Favara and Lev Ratnovski, ‘Externalities and Macro Prudential Policy’ [2012] SDN12/5 IMF Staff Discussion Note 1, 10.

¹⁴ Frederic Mishkin and National Bureau of Economic Research, ‘Financial Stability and Globalization: Getting it Right’ (Bank of Spain Conference - Central Banks in the 21st Century, 2006)

¹⁵ George Selgin, ‘Proposal – Let Market Forces Play a Greater Role’ (Global Economic Symposium, 2014) < <http://www.global-economic-symposium.org/knowledgebase/the-new-global-financial-architecture/proposals/let-market-forces-play-a-great-role> > accessed 10 September 2017; Masahiro Kawai and Micheal Pomerleono, ‘Who Should Regulate Systemic Stability Risk? The Relevance for Asia’ in Masahiro Kawai, Eswar Prasad (eds.), *Financial Market Regulation and Reforms in Emerging Markets* (Brookings Institution Press, 2011).

the cost of regulation may be too high for small countries, thereby leading to uneven application of regulations.¹⁶ This is no doubt a critical problem in the development of robust standards in a world with numerous jurisdictions. For this reason, Oatley believes that national regulation and international agreements can handle risk and insurance issues; and international regulations are simply a political response to avoid a race to the bottom for less regulated states caused by international competition.¹⁷ He exemplifies this with the Basel Accord I which mandated an 8% minimum capital requirement for international active banks and additional capital for loans considered more risky.¹⁸ He finds that banks in affected countries engaged in regulatory arbitrage to maintain an appearance of compliance to these standards. He states that irrespective of the advantages it brings, international regulation could cause greater harm to financial systems and less safe banking systems.¹⁹

Though strong, Oatley's argument does not consider that the failure of a financial system within an integrated global structure can create negative externalities. Furthermore, it can lead to the movement of capital towards less regulated systems, thus potentially causing financial instability. Moreover, the general welfare considerations as regards systemic risks suggest that market forces may be inadequate to ensure regulatory harmonization.

However, Oatley's argument cannot be fully discarded, particularly his recognition of the inequalities that occasion the application of international standards. Viewed from a functionalist perspective, the role of IFR is to ensure financial liberalization, stability and integrity, goals with some attendant shortcomings.²⁰ This is evidenced by the uniform regulatory standards and benchmarking mechanisms applicable to all countries, irrespective of their legal developmental stages. Such arrangements give

¹⁶ Thomas Oatley, 'The Dilemmas of International Financial Regulation' [2000] 23 (4) Regulation 36, 37.

¹⁷ Ibid.

¹⁸ Basel Accord 1988.

¹⁹ Thomas Oatley, 'The Dilemmas of International Financial Regulation' [2000] 23 (4) Regulation 36, 37.

²⁰ This perspective is focused on the operational functions of the international financial regime.

credence to the argument that international standards are prejudicial, as they establish a hierarchy of values, some of which are superfluous.²¹ Although the standards aim at efficiency, integrity and stability, the need for an equitable or legitimate regime suitable for all countries is disregarded.²² This is reflected in uniform standards, which are difficult to transplant and result in information asymmetry between countries and standard setters, particularly in ACs/EEs. Shortcomings in compliance levels, particularly in ACs, reveal this.

No doubt, the international standards are a projection of the inequalities in the distribution of power within the regulatory sphere, spearheaded by developed countries pushing their domestic policy objectives, laws and commercial preferences through as international standards.²³ Consequently, these standards have failed to take sufficient account of the interests and preferences of ACs/EEs and can potentially stifle the regulatory structures and policies of ACs, whilst producing marginal gains for ACs/EEs.²⁴ These shortcomings add to the view that international regulatory standards may be unsuitable.²⁵

²¹ Naomi Haynes and Jason Hickel, 'Hierarchy, Value and the Value of Hierarchy' [2016] 60 *Social Analysis* 1; Myres S. McDougal, 'Jurisprudence for a Free Society' [1966] 2583 *Faculty Scholarship Series* 1, 6.

²² Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (2nd edn, Routledge, 2016) 145.

²³ The FATF recommendations were derived from a combination of national strategies from Switzerland, the United Kingdom and the United States, in collaboration with the international recommendations of the Basel Committee from 1998. See Mark Pieth and Gemma Aiolfi, 'The Private Sector Becomes Active: The Wolfsberg Process' [2003] 10 (4) *Journal of Financial Crime* 359, 359-360; Braithwaite John and Peter Drahos, *Global Business Regulation* (1st edn, Cambridge University Press, 2000).; Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (CUP, 2015) 183.

²⁴ Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (2nd edn, Routledge, 2016) 145.

²⁵ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (CUP, 2015) 184; Jason C. Sharman, 'The Global Anti- Money Laundering Regime and Developing Countries: Damned if They Do, Damned if They Don't' [2006] Paper Presented at the International Studies Association Annual Conference 1, 13.

2.2 Evolution of International Financial Regulation and Institutions

Prior to the First World War (WW1), global finance was sparsely regulated, both internationally and nationally.²⁶ During the inter-war period, market activities collapsed and economies crashed. Countries raised barriers by curtailing financial freedom and risking potential currency devaluation.²⁷ Undoubtedly, this was self-defeating, leading to a decline in world trade and destruction of international monetary cooperation. Thus, after the Second World War (WW2), when trade regulation started emerging, there was still no structure for the regulation of international finance.²⁸ It was paradoxical that only trade was regulated given that finance flows more easily across borders than goods and services. Nevertheless, given the gradual breakdown of the gold standard (instituted pre-WW1 for monetary stability), finance was now based on closed domestic systems with limited capital flows and a fixed exchange rate due to the disintegration of the world economy.²⁹

IFIs, particularly the IMF, were created on the heel of the WW2 to facilitate cross-border monetary transactions and ensure currency stability. The IFIs founders generally excluded a regime for capital movements from the IFIs' structures as this was considered antithetical to trade and investment capital.³⁰ Keynes and White believed

²⁶ Gerald Epstein, 'Should Financial Flows Be Regulated? Yes' in Jomo Kwame Sundaram (eds.) *Reforming the International Financial System for Development* (CUP 2011) 194,194; Lance Taylor, 'Global Macroeconomic Management' in Peepak Nayyar (eds.) *Governing Globalization: Issues and Institutions* (OUP 2002) 51,52; Ethiopis Tafara, 'Speech by SEC Staff: How Much Regulation Is Just Enough' (US Securities and Exchange Commission, 28 February 2006) < <https://www.sec.gov/news/speech/spch022806et.htm> > accessed 27 March 2015.

²⁷ Richard Overy, *The Inter-War Crisis* (Routledge, 2016) 1, 62; Richard S. Grossman, 'Banking Crisis' (2006) Wesleyan Economic Working Papers 001 < http://repec.wesleyan.edu/pdf/rgrossman/2016001_grossman.pdf > accessed 13 July 2015; Michele Fratianni and Federico Giri, 'The Tale of Two Great Crises' [2017] 81 *Journal of Economic Dynamics and Control* 1, 25.

²⁸ Yilmaz Akyuz, 'Towards Reform of the International Financial Architecture: Which Way Forward' in Yilmaz Akyuz (eds), *Reforming the Global Financial Architecture: Issues and Proposals* (Zed Books 2002) p 1.

²⁹ Weber Rolf H and Douglas W. Arner, 'Towards a New Design for International Financial Regulation' [2007] 29.2 *University of Pennsylvania Journal of International Economic Law* 510.

³⁰ Yilmaz Akyuz, 'Towards Reform of the International Financial Architecture: Which Way Forward' in Yilmaz Akyuz (eds), *Reforming the Global Financial Architecture: Issues and Proposals* (Zed Books 2002) 4; Ross Buckley, *International Financial System: Policy and Regulation* (Kluwer Law International, 2009) 1, 105.

that, although progressive, cross border transactions could have destabilizing consequences within states.³¹ Following their concerns, the IMF's Article IV recognized the right of members to impose capital controls, as long as this did not restrict payments for transactions on the current account.³² This design, which ensured adequate national macroeconomic management, was based on a concept of embedded liberalism. It was rooted in Keynesian ideology and White's perspective that not only favored nationalistic capital controls but perceived unregulated capital mobility as an example of market failure.³³ Such failure was based on the inability of countries to pursue tailored economic policies or maintain fixed exchange rates.³⁴ Capital controls were thus perceived to be necessary for a smooth functioning of an open international economy. Indeed, this ideology resulted in a surge of economic prosperity in the 1950s and 1960s.³⁵

However, the increasing risk occasioned by the internationalization of finance in the late 1970s³⁶ and the ensuing financial and socio-economic crisis raised questions about the continued application of the embedded-liberalism ideology. The resulting neo-liberalist ideology mandated the replacement of the fixed exchange rates with a flexible exchange rate to restore stability.³⁷ This ideology also led to the creation of informal committees, including the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) to formulate unified

³¹ James M Boughton, 'The IMF and the Force of History: Ten Events and Ten Ideas that have Shaped the Institution' [2004] IMF Working Paper 04/75 < <https://goo.gl/Vhc6pr> > accessed 9 November 2015; Benjamin Cohen, 'Monetary Governance and Capital Mobility in Historical Perspective' in Rainer Grote and Thilo Maruahn (eds.) *The Regulation of International Financial Markets: Perspectives for Reform* (CUP 2006) 48-50.

³² *Ibid.*; See Article IV of IMF Articles of Agreement, 1944.

³³ Jonathan Kirsher, 'Keynes, Capital Mobility and the Crisis of Embedded Liberalism' [1999] 6 (3) *Review of International Political Economy* 313; Ikuo Gono and Hiroaki Ataka, 'Conceptual Relevance of "Embedded Liberalism" and its Critical Social Consequences' [2006] Artigo apresentado no ISA-South Annual Conference: PAIS Graduate Working Papers 3 (6) < https://warwick.ac.uk/fac/soc/pais/currentstudents/phd/resources/crips/working_papers/2006/working_paper_3_gono_and_ataka.pdf > accessed 19 November 2016

³⁴ *Ibid.*

³⁵ David Harvey, *A Brief History of Neoliberalism* (OUP, 2005) 178.

³⁶ Richard O'Brien, 'Global Financial Integration: The End of Geography' [1992] *Royal Institute of International Affairs* 531.

³⁷ Katja Freistein and Philip Liste, 'Introduction: Fragmented Territoriality' [2016] 19 (2) *Journal of International Relations and Development* 193.

approaches to curtail crises, especially as regards emerging economies.³⁸ Agreements resulting from the findings of the neo-liberalists were to be implemented via domestic and regulatory systems. Although the BCBS and IOSCO recorded successes, repeated financial crises such as the developing countries debt crisis of the 1980s, the global stock market collapse of 1987 and the periodic collapses of financial intermediaries illustrated their limitations in dealing with trends that fundamentally altered the financial landscape.³⁹

For instance, the Asian financial crisis was the sharpest to hit the developing world since the 1982 debt crisis.⁴⁰ The dynamics of this crisis prompted academic controversy as to its immediate cause.⁴¹ There was however consensus that the absence of sound regulatory oversight was significant, especially in the advent of liberalization in developing countries.⁴² Avgouleas notes that attention was focused on policies aimed at abolishing capital restrictions and opening up the market, without regard to the domestic competence or expertise of its regulatory institutions.⁴³ He also observes that international governance structures were inadequate to sustain the pressure from these policies. Combined with the financial panic that arose from weaknesses in the

³⁸ Weber Rolf H., and Douglas W. Arner, 'Towards a New Design for International Financial Regulation' [2007] 29 (2) University of Pennsylvania Journal of International Economic Law 391,403; Cally Jordan and Giovanni Majnoni, 'Financial Regulatory Harmonization and the Globalization of Finance' (2002) World Bank Policy Research Working Paper 2919 < <https://openknowledge.worldbank.org/bitstream/handle/10986/19224/multi0page.pdf?sequence=1&isAllowed=y> > accessed 11 June 2015.

³⁹ Ibid 391, 403. For the trends listed: technological innovation, liberalization of capital, disintermediation of financial markets, reduction in the role of centralized decision makers, breakdown of the Bretton Woods Institutions.

⁴⁰ Steven Radelet and Jeffrey Sachs, 'The Onset of the East Asian Financial Crisis' (1998) NBER Working Paper Series, Working Paper 6680, National Bureau of Economic Research 2 < <http://www.nber.org/chapters/c8691.pdf> > accessed 7 June 2016; Ivan Savic, 'Explaining Compliance with International Commitments to Combat Financial Crisis: The IMF and the G7' (47th Annual ISA Convention, 2006).

⁴¹ Goldstein Morris, *The Asian Financial Crisis: Causes, Cures and Systemic Implications* (Institute for International Economics, Washington DC, 1998); Biag Taimur and Ilan Glodfajn, 'Financial Market Contagion in the Asian Crisis' (1998) IMF Working Paper 26/2 < <https://link.springer.com/article/10.2307/3867666> > accessed 19 April 2016.

⁴² Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (First Published 2012, CUP 2012) p 13; Gregory W. Noble and John Ravenhill, 'Cause and Consequences of the Asian Financial Crises', in Gregory W. Noble and John Ravenhill, (eds.), *The Asian Financial Crisis and the Architecture of the Global Finance*, ed., (CUP 2000) 1.

⁴³ Emilios Avgouleas, 'Governance of Global Financial Markets': *The Law, the Economics, the Politics*' (CUP 2012) 185.

economies, these precipitated the Asian financial crisis,⁴⁴ which demonstrated that the financial sector of domestic economies is uniquely able to inflict damage on the broader economy.⁴⁵

The Asian crisis triggered financial sector reforms, aimed at promoting financial stability across borders and providing early warning signals.⁴⁶ Measures were put in place to identify potential vulnerabilities in national financial systems, with a view to forestalling any potential localized financial crisis⁴⁷ and ensuring effective resolution.⁴⁸ This myopic reform, which brought forth a New International Financial Architecture (NIFA), encompassed the enhanced involvement of transnational governance institutions wielding soft law instruments as standards setters with supervision from the IMF/World Bank.⁴⁹ Concurrently, the IMF sought to amend its Articles of Agreement, to make the promotion of capital account liberalization its specific purpose.⁵⁰ This would give it jurisdiction over capital movements and the power to mandate unrestricted capital flows as a condition for membership.⁵¹ From a Keynesian perspective, this would be unsuitable in curbing future crisis.

⁴⁴ Giancarlo Corsetti, Paolo Pesenti and Nouriel Roubini, 'What Caused the Asian Financial Crisis? Part 1: A Macroeconomic Overview' (1998) NBER Working Paper No.6833 < <http://www.nber.org/papers/w6833.pdf> > accessed 24 May 2016.

⁴⁵ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (First Published 2012, CUP 2012) 69; GAO Report, 'International Finance: Actions Taken to Reform Financial Sectors in Asian Emerging Markets' (*GAO/GGD -99 - 57*, Sept 1999) < <https://www.gao.gov/assets/230/228224.pdf> > accessed 24 May 2016.

⁴⁶ Cally Jordan, 'The Dangerous Illusion of International Financial Standards and the Legacy of the Financial Stability Forum' [2010] 12 *The San Diego Int'l LJ* 333, 336.

⁴⁷ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (First Published 2012, CUP 2012) 68.

⁴⁸ Barry J Eichengreen, *Towards a New International Financial Architecture: A Practical Post-Asia Agenda* (Peterson Institute Press: All Books, 1999); Weber Rolf H and Douglas W. Arner, 'Towards a New Design for International Financial Regulation' [2007] 29 *University of Pennsylvania Journal of International Economic Law* 391, 403.

⁴⁹ See Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (First Published 2012, CUP 2012) p 68; the IMF (transparency and liquidity) and the World Bank (technical assistance); Lawrence G Baxter, 'Understanding the Global in Global Finance and Regulation' in Ross Buckley, Doug Arner, & Emiliios Avgouleas (eds) *Reconceptualizing Global Finance and its Regulation* (CUP 2015) 1, 2.

⁵⁰ IMF Survey, 'IMF Wins Mandate to Cover Capital Accounts, Debt Initiative Put in Motion' [1997] 26.9 *International Monetary Fund* 131.

⁵¹ Pierre G. Goad, 'Acceptance of Capital Controls is Spreading' [1998] *Asian Wall Street Journal*.

Additionally, although the NIFA structure broadened representation of EEs and reinforcement of the roles of standard setting bodies, its legitimacy was however limited by two factors: the marginalization of developing countries in the standard setting process⁵² and the inability of the Financial Stability Board (FSB) to effectively exercise its mandate in generating standards, not even voluntary ones.⁵³

Although well-intentioned, the eruption of global financial crisis (GFC) on a larger scale a decade later⁵⁴ revealed the ineffectiveness of the NIFA to restore confidence in the financial system. Avgouleas attributed the GFC not to the inadequate effectiveness of regulatory initiatives, but rather to the absence of compulsory monitoring mechanisms and a binding framework for managing cross-border crisis⁵⁵ under the NIFA.⁵⁶ Disputing this, Brummer argued that the NIFA was itself riddled with ambiguities, buttressing his argument with the abstruse mandate, technique and implementation style of the Financial Stability Forum (FSF).⁵⁷ These criticisms were predicated on the soft law approach adopted by the FSF, which lacked the transparency and contestation of the legislative process.⁵⁸ These arguments reveal that though the NIFA was not fundamentally the cause of the GFC, it was inefficient in meeting the realities of global finance and its attendant risks.

⁵² See Robert Delonis, 'International Financial Standards and Codes: Mandatory Regulation without Representation' [2004] 36 NYU J. INT'L L. & POL. 563, 631- 633.

⁵³ Kern Alexander, Rahul Dhumale and John Eatwell, 'Global Governance of Financial System: The International Regulation of Systemic Risk' [2006] 55 (04) International and Comparative Law Quarterly.

⁵⁴ Emiliios Avgouleas, *Governance of Global Financial Markets: The Law, the Economics, the Politics* (First Published 2012, CUP 2012) 185.

⁵⁵ Ibid.

⁵⁶ Ibid (n 54)

⁵⁷ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (First Published 2012, CUP 2012); See also John Eatwell, 'The Challenges Facing International Financial Regulation' [2001] Western Economic Association p 14; Stavros Gadinis, 'The Financial Stability Board: The New Politics of International Financial Regulation' [2013] 48 (2) Texas International Law Journal 165.

⁵⁸ Cally Jordan, 'The Dangerous Illusion of International Financial Standards and the Legacy of the International Stability Forum' [2010] 12 San Diego Int'l LJ 1, 17.

2.3 Towards Effective Regulation of International Finance and AML/CFT

The factors considered as precipitants to previous financial crises were listed by the FSB and the Financial Sector Assessment Program (FSAP).⁵⁹ However broad, the compendium of standards compiled by the FSB enumerates twelve (12) economic and financial standards that are internationally acknowledged as crucial for a functional financial system.⁶⁰ The FSB emphasized that these key standards were considered to be deserving of priority implementation.⁶¹ Amongst the standards identified for rating a financial system were the recommendations of the FATF on AML/CFT.⁶² The IMF/World Bank endorsed these with an agreement to monitor the compliance levels of countries.⁶³

The addition of AML/CFT in the twelve (12) FSB standards generated a debate⁶⁴ that their inclusion was undemocratic, but rather based on the lobbying, networking strength and support for the governing body of the standard setting organization.⁶⁵ Furthermore, it is argued that banks are not harmed by being used as a conduit for illicit funds; rather illicit funds can be profitable to economies, banks, and depositors and thus do not warrant international regulation.⁶⁶ The international community has nevertheless

⁵⁹ Financial Stability Board, 'Table of Key Standards for Sound Financial Systems' <http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/key_standards/table-of-key-standards-for-sound-financial-systems/> accessed 13 March 2015.

⁶⁰ See OECD, *OECD Reviews of Risk Management Policies: Future Global Shocks, Improving Risk Governance* (OECD Publishing, 2011) 1, 110.

⁶¹ FSB, 'Table of Key Standards For Sound Financial Systems' <http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/key_standards/table-of-key-standards-for-sound-financial-systems/> accessed 13 March 2015.

⁶² Ibid.

⁶³ David William, 'Development and Global Governance: The World Bank, Financial Sector Reform and the Will to Govern' [2008] 45 (2) *International Politics* 1, 220- 221.

⁶⁴ Douglas Arner, 'Organizations of International Co-operation in Standard Setting and Regulation' in Garard Caprio (eds) *Handbook of Safeguarding Global Financial Stability: Political, Social, Cultural and Economic Theories and Models* (Elsevier 2013) 484-485.

⁶⁵ Ibid.

⁶⁶ Antoinette Verhage, 'Between the Hammer and the Anvil? Money Laundering-Complex and its Interactions with the Compliance Industry' [2009] 52 (1) *Crime Law Soc. Change* 1, 9-32.

continued to include the regulation of money laundering and terrorist financing (ML/TF) in its agenda.

2.3.1 Justification for the Inclusion of AML/CFT Regulation in Financial Sector Reform

To justify the inclusion of the AML/CFT regulation in the international financial sector regime, it is crucial to parallel their aims.

Financial sector reforms (FSR) were aimed at enhancing combined regulatory supervision to prevent or mitigate a financial crisis, also one of the main aims for regulating ML/TF. This is because these illicit activities can harm financial stability and integrity, hence constituting a triggering factor for a financial crisis. This argument is not far-fetched. Tsingou postulates that ML/TF is the price for financial liberalization.⁶⁷ Echoing this assertion, Schroeder argues that illegal proceeds are easily converted into seemingly legitimate funds due to increased trade liberalization and the expansion of the global financial system.⁶⁸ Increased and unanticipated cross border transfer of illicit funds can however have a destabilizing macroeconomic effect.⁶⁹ Such transfers, Schroeder argues, can lead to inexplicable changes in the demand for money, resulting in an unhealthy volatility of international capital flows and exchange rates.⁷⁰ This reveals an interesting link between market abuse and financial instability - triggering factors for a crisis.

⁶⁷ Eleni Tsingou, 'Global Finance Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy?' [2010] 47 (6) *International Politics* 617, 627.

⁶⁸ William R. Schroeder, 'A Global Threat and the International Community's Response' [2001] 70 *FBI Law Enforcement Bulletin* 1.

⁶⁹ Bartlett Brent, 'The Negative Effects of Money Laundering on Economic Development' [2002] 5967 *Asian Development Bank Regional Technical Assistance Project; The World Bank, 'Combating Money Laundering and the Financing of Terrorism – A Comprehensive Training Guide'* (2009) 1, 19.

⁷⁰ William R. Schroeder, 'A Global Threat and the International Community's Response' [2001] 70 *FBI Law Enforcement Bulletin* 1, 19; Antoinette Verhage, *The Anti Money Laundering Complex and the Compliance of Industry* (Taylor and Francis 2011) 37; Pierre –Laurent Chatain, 'The World Bank's Role in the Fight Against Money Laundering and Terrorist Financing' [2004] 6 *Int'l LFD Int'l* 1, 192.

The occasional association of financial crisis with ‘run on banks’⁷¹ can be likened to the effect of ML/TF on banks and the financial sector as a whole. Morais adds that these illicit crimes erode the integrity of FIs, weakening or destroying their positions as repositories of trust and confidence.⁷² He states that in the long run, there is the real risk that if left unchecked, criminal interests could assume greater control of FIs.⁷³ Thus, illicit activities can undermine the soundness of FIs and occasion material damage and loss of confidence or reputation as a result of fraud.⁷⁴

Additionally, illicit transfers through FIs can harm a country’s economic growth and development. This can be viewed from two perspectives. On one hand, ML/TF channel resources to less industrious activities, thus facilitating domestic corruption and crime.⁷⁵ In a bid to legalize funds, launderers may channel their monies into sterile investments such as luxury goods or front companies.⁷⁶ This diversion of funds can undermine legitimate businesses and harm a country’s economic progression. On the other hand, unconstrained illicit transfers, especially in countries with weak regulatory capacity can weaken the financial sector’s role in a country’s economic progression. The Asian and subsequent international crises illustrated that financial institutions that allow themselves to be abused by ML will bring serious detrimental effect to the economies of their countries.

⁷¹ Garton Gary, ‘Some Reflections on the Recent Financial Crisis’ (2012) National Bureau of Economic Research Working Paper Series 18397, 3 < <http://risk.econ.queensu.ca/wp-content/uploads/2013/10/Gorton-Some-reflections-on-the-recent-Crisis-2012.pdf> > accessed 10 July 2015.

⁷² Herbert V Morais, ‘The War Against Money Laundering, Terrorism and the Financing of Terrorism’ [2002] *Lawasia J* 1,6.; Antoinette Verhage, ‘Between the Hammer and the Anvil? Money Laundering-Complex and its Interactions with the Compliance Industry’ [2009] 52 (1) *Crime Law Soc Change* 9-32.

⁷³ *Ibid.*

⁷⁴ Antoinette Verhage, *The Anti Money Laundering Complex and the Compliance of Industry* (Taylor and Francis 2011) 1, 37; The World Bank, ‘Combating Money Laundering and the Financing of Terrorism – A Comprehensive Training Guide’ (2009) 1, 19.

⁷⁵ Brent L Bartlett, ‘The Negative Effects of Money Laundering on Economic Development’ in *Countering Money Laundering in the Asian and Pacific Region*, [2002] 5967 Asian Development Bank, Regional Assistance Project, 19 < <http://www.afp.gov.au/~media/afp/pdf/m/money-laundering-02.pdf> > accessed 30 April 2015; Joshua Chesoli, ‘Exploring the Concept, Significance and Adverse Impact of Money Laundering’; Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism* (World Bank Publication 2006) II-1, II-6.

⁷⁶ Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism* (World Bank Publication 2006) II-1, II-6; Loretta Napoleon, *Terrorism and the Economy: How the War on Terror is Bankrupting the Economy* (Seven Stories Press 2014) 1, 73.

Thus, it is also clear that ML/TF depress the revenue of states, particularly where tax evasion is involved.⁷⁷ Consequently, various countries, particularly developed economies have successfully argued for the inclusion of proceeds of illicit crimes in the national gross domestic profit.⁷⁸ The European statistical guideline states that illegal transactions backed by consent should be included in measurements of economic size.⁷⁹ The argument runs that the exclusion of these activities from national accounts gives rise to discrepancies as the income earned from illegal means are often invested in legal assets.⁸⁰ Critics have not only questioned the methodology utilized in generating the data, but have also argued that this inclusion is likely to provide an unrealistic representation of economic development.⁸¹ This has attendant consequences, such as investor distrust in a perceived ‘inauthentic estimate of GDP’ which can serve as a catalyst for reduced investment. Regardless, the European Union restated its position on mandatory illicit transactions accounting in the 2010 version of the European Systems of Accounts.⁸²

According to the European Union, illicit transactions have become bothersome and reporting them as part of GDP may heighten capital flight of funds to jurisdictions that abide by this requirement.⁸³ This may damage the reputation of countries, particularly

⁷⁷ Peter Alldridge, *Money Laundering Law: Forfeiture, Confiscation, Civil Recovery, Criminal Laundering and Taxation of the Proceeds of Crime* (Hart Publishing 2003) II-6; Max Everest –Phillips ‘The Political Economy of Controlling Tax Evasion and Illicit Flows’ in Peter Reuter (eds) *Draining Development? Controlling Flows of Illicit Funds from Developing Countries* (The World Bank, 2012) 1, 69; Alex Marriage, ‘Secret Structures, Hidden Crimes: Urgent Steps to Address Hidden Ownership, Money Laundering and Tax Evasion from Developing Countries’ (Eurodad Network on Debt and Development, 2015) < <http://eurodad.org/files/pdf/520a3a680437f.pdf> > accessed 14 May 2015.

⁷⁸ Richard Summerfield, ‘GDP to include illegal activity’ (Financier Worldwide, 2014) < <https://www.financierworldwide.com/gdp-to-include-illegal-activity/#.WZM5Ha2ZPUo> > accessed 10 August 2017.

⁷⁹ Sarah O’Connor, ‘Drugs and Prostitutions Add £10bn to UK Economy’ (Financial Times, May 29 2014) < <https://www.ft.com/content/65704ba0-e730-11e3-88be-00144feabdc0> > accessed 10 August 2017.

⁸⁰ OECD, ‘OECD Handbook’ (OECD) < <https://www.oecd.org/std/na/NOE-Handbook-%20Chapter9.pdf> > accessed 10 August 2015.

⁸¹ Richard Summerfield, ‘GDP to Include Illegal Activity’ (Financier Worldwide, August 2014) < <https://www.financierworldwide.com/gdp-to-include-illegal-activity/#.Wdf1yBOPLUo> > accessed 21 July 2017.

⁸² Eurostat European Commission, ‘European System of Accounts: ESA 2010’ (European Union, 2013) < http://ec.europa.eu/eurostat/cache/metadata/Annexes/nasa_10_f_esms_an1.pdf > accessed 20 August 2017.

⁸³ James K Boyce and Leonce Ndikumana, ‘Capital Flight from Sub Saharan African Countries: Updated Estimates, 1970 - 2010’ [2012] Political Economy Research Institute Research Report 1, 6; Raymond W. Baker, ‘The Scale of the Global Financial Structure Facilitating Money Laundering’ in Brigitte Unger

developing states whose funds are laundered. It may also deter foreign investments⁸⁴ and discourage foreign banks from continuing correspondent relationships with FIs in countries that report illicit transactions as part of GDP.⁸⁵

The ‘victimless’ nature of ML/TF has been contested. Adopting Mill’s argument, Groot postulates that in the presence of a valid agreement, the predicate crime of drug transactions constitutes a valid contract and therefore cannot be assumed to harm anyone.⁸⁶ He argues, in line with Posner, that on a scale of a cost benefit analysis, criminalizing money laundering would not be beneficial to society.⁸⁷ Based on this, he takes the position that, in the absence of a direct victim, ML should not be regulated. Ferwerda however takes a pragmatic stance that these illicit crimes have social, economic and political effects.⁸⁸ These serve as a catalyst for inflation, insolvency and bankruptcy, as well as increased housing and living costs, which have spillover effects. These examples defeat the ‘victimless nature’ argument, conferring undue advantage on launderers to the detriment of society.⁸⁹ Moreover, by the very act of aiding terrorism, TF causes security challenges, leading to loss of lives and livelihood, and creates an atmosphere of fear.⁹⁰

and Daan Van Der Inde (eds) *Research Handbook on Money Laundering* (Edward Elgar Publishing Limited 2013) 194, 195.

⁸⁴ Pierre –Laurent Chatain, ‘The World Bank’s Role in the Fight Against Money Laundering and Terrorist Financing’ [2004] *Int’l LFD Int’l* 6 1, 191.

⁸⁵ See Financial Action Task Force, ‘FATF Recommendation 13’ (FATF, 2013) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 20 April 2015.

⁸⁶ Groot, Loek, ‘Money Laundering, Drugs and Prostitution as Victimless Crimes’ in Brigitte Unger, Daan Van Der Inde (eds) *Research Handbook on Money Laundering* (Edward Elgar Publishing Limited 2013) 59.

⁸⁷ *Ibid.*

⁸⁸ Ferweda Joras, ‘The Multidisciplinary Economics of Money Laundering’ [2012] Tjalling C. Koopmans Institute Discussion Paper Series 1, 30-31; Pierre –Lauret Chatain, ‘The World Bank’s Role in the Fight Against Money Laundering and Terrorist Financing’ [2004] *6 Int’l LFD Int’l* 1, 191.

⁸⁹ Van de Werdt, E., and P Speenkenbrink, ‘Witwassen, een koud kunstje’ *Jaarboek Compliance* (2008) 201, 201 – 216; Pierre-Laurent Chatain, ‘The World Bank’s Role in the Fight Against Money Laundering and Terrorist Financing’ [2004] *6 Int’l LFD* 1, 191.

⁹⁰ David L. Altheide, ‘Terrorism and the Politics of Fear’ [2006] *6 (4) Cultural Studies Critical Methodologies* 415, 415- 439; Harmon Christopher, *Terrorism Today* (Routledge 2013) 66.

Increasingly disturbing was the evidence by experts that ML/TF are more detrimental to emerging and developing economies, which have less sophisticated FIs.⁹¹ Identifying that a ‘break’ in the chain of AML/CFT regime, especially in developing countries, can expose other countries to the detrimental effects of ML/TF, the international community prompted the inclusion of AML/CFT regimes in FSR. This was based on the recognition that strengthening AML/CFT regimes could significantly improve prospects for sustainable growth, development and social cohesion.

Interestingly, the regulation of ML, once predicated upon the need for the United Nations to curb drug transfer,⁹² has gone beyond considerations of financial stability.⁹³ This became evident post 9/11 attacks, spurring the innovation of FATF nine (9) additional recommendations on TF.⁹⁴ These not only mandated adherence to the International Convention for the Suppression of the Financing of Terrorism⁹⁵ but also imposed more stringent recommendations and attendant punitive measures on the regulation of TF.⁹⁶ This move prompted scholars to question why discussions on an international CFT regime occurred only in response to the attack in the United States and was not triggered by earlier terror activities in Africa, the Middle East and Europe.⁹⁷ On close scrutiny, it is clear that, unlike other terror attacks, the 9/11 attacks unearthed a pervasive network of underground banking and other financial channels that were used to finance terrorism.⁹⁸ Facing these dramatic new threats, AML/CFT was

⁹¹ Their financial sectors are lower, less diverse and more susceptible to manipulation than those of developed countries, see Pierre –Laurent Chatain, ‘The World Bank’s Role in the Fight Against Money Laundering and Terrorist Financing’ [2004] 6 Int’l LFD Int’l 1, 191.

⁹² *The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (The Vienna Convention) in 1988.*

⁹³ See Arnone Marco and Pier Carlo Pardoan, ‘Anti-Money Laundering by International Institutions: A Preliminary Assessment’ [2008] 26.3 European Journal of Law and Economics 1, 9.

⁹⁴ See FATF, ‘FATF Recommendations on Terrorist Financing’ (FATF, 2013) < http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 17 May 2015.

⁹⁵ Ibid.

⁹⁶ Ibid (n 94)

⁹⁷ Herbert V Morais, ‘The War against Money Laundering, Terrorism and the Financing of Terrorism’ [2002] 1 Lawasia J 1, 14. No international CFT regime was discussed irrespective of the fact that there had been terrorist activities in a number of African countries (Kenya and Tanzania), Middle Eastern countries (Saudi Arabia and Yemen) and Europe (Scotland in 1988).

⁹⁸ Ibid 1, 1. Is there any terror attack carried out without some measure of funding? USA might only have been discovered because of technological advances and time.

perceived as a way of ensuring global security.⁹⁹ Thus, the international community was able to mandate countries to agree on a consensus for reasons that went beyond financial stability.

These arguments reinforce the reasons why the international community has, although belatedly, recognized as crucial, the regulation of ML/TF.¹⁰⁰

IFIs and soft law bodies, including the FSB, are at the forefront of putting these agenda forward. Whilst highlighting the role of the FSB, this thesis restricts its scope to the IMF/World Bank and the FATF, given that the FSB underlines the role of these international bodies in AML/CFT regulation.

2.3.1.1 The Financial Stability Board (FSB)

The FSB, a successor of the FSF, was established by developed countries to foster international financial stability through the coordination of emerging international standards.¹⁰¹ The aim of such coordination is to ensure the effective supervision of financial markets and enhanced information exchange.¹⁰² Envisaged as a group of

⁹⁹ It is questionable whether the ‘world’ was facing dramatic changes or the United States was foisting its fears on the world.

¹⁰⁰ The World Bank only recognized the detrimental effect on AML on the formal financial sector in 1995. See David Scott, ‘Money Laundering and International Efforts to Fight it’ (Public Policy for the Private Sector, May 1995) <<http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1303327122200/048scott.pdf>> accessed 15 March 2015.; See also Michel Camdessus, ‘Money Laundering: The Importance of International Countermeasures’, address to the plenary meeting of the FATF (IMF, 10 February 1998) <<https://www.imf.org/external/np/speeches/1998/021098.htm>> accessed 10 January 2015. At the 1997 Denver Summit, the issue of anti-terrorism and corruption became the main subject for consideration, see Emilio Avgouleas, *Governance of Global Financial Markets: The Law, the Economics, the Politics* (CUP 2012) 189.

¹⁰¹ Joseph J Norton, ‘Banking Law Reform and Users-Consumers in Developing Economies: Creating an Accessible and Equitable Customer Base from the Excluded’ [2006] 42 Tex.Int’l LJ 789, 796

¹⁰² Douglas W Arner and Michael W. Taylor, ‘The Global Financial Crisis and the Financial Stability Board: Hardening the Soft law of International Financial Regulation’ [2009] 32 UNSWLJ 488, 489; Jordan Cally, ‘Dangerous Illusion of International Financial Standards and the Legacy of the Financial Stability Forum’ [2010] 12 San Diego Int’l LJ 333, 346; Eric Helleiner, ‘The Financial Stability Board and International Standards’ [2010] CiGI G20 Papers | No.1, 1, 4.

technocratic authorities with relevant expertise and experience,¹⁰³ the FSB unifies IFIs, regulators and national authorities responsible for financial stability, in order to promote convergence to minimum standards in the form of soft law, with compliance by force of law and moral suasion.¹⁰⁴ The establishment of this body underscored the importance of sound financial sectors to national macroeconomic stability and the global financial order.

As earlier mentioned, the FSB identified twelve (12) key standards as benchmarks, which are considered as quintessential minimum requirements for good practice in the various areas of their coverage. Recognized in the standard category of market integrity is the FATF's standard on AML/CFT backed by its supporting methodology for assessment and implementation. The inclusion of the FATF's standard in this category marked the recognition of the fact that ineffective application or non-compliance with the FATF's recommendations can contribute to market abuse and financial instability.

Thus whilst concentrating on dialogue amongst partners, the FSB beckoned on the IMF/ World Bank for assistance in financial stability reform. The response by these formal international organizations through FSAP¹⁰⁵ was to assert their intellectual skills on comparative policy, which provided a foundation for much of its activity, including the country-by-country assessment.¹⁰⁶ The implementation of the FSB's standards also focused on the use of FSAP, the financial sector assessment conducted by IMF in developed economies and jointly with the World Bank in developing economies.¹⁰⁷

¹⁰³ Douglas W Arner and Michael W Taylor, 'The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?' [2009] 32 UNSWLJ 488, 491; Enrique R. Carrasco, 'Crisis and Opportunity: How the Global Financial Crisis May Give Emerging Economies Greater Voice in International Finance via the Financial Stability Board [2009] 09 Univ. of Iowa Legal Studies, Research Paper 8 – 10.

¹⁰⁴ Douglas W Arner and Michael W Taylor, 'The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?' [2009] 32 UNSWLJ 488, 489.

¹⁰⁵ Jordan Cally, 'Dangerous Illusion of International Financial Standards and the Legacy of the Financial Stability Forum' [2010] 12 San Diego Int'l LJ 333, 347.

¹⁰⁶ Ibid 333, 349.

¹⁰⁷ Ibid.

2.3.1.2 The IMF and the World Bank: Financial Sector Assessment Program (FSAP)

Although 45 countries attended the Bretton Woods meeting in 1944 and agreed to establish a framework for international economic cooperation, only 29 countries signed the IMF Articles of Agreement by the following year.¹⁰⁸ These select countries formed the initial members of the IMF. The World Bank, which was formed alongside the IMF, was described as an ‘afterthought’, given initial resistance by the United Kingdom (UK) government. Support from the United States government however saw to its creation. This is not unsurprising as all accounts show that while each of the IMF and the World Bank articles were signed by several countries, their establishment was negotiated between representatives of the UK and the United States.¹⁰⁹ Whilst WW2 provided the impetus to expedite the creation of these institutions, the closed negotiation process was arguably important for expediency. However, this may have been achieved in a manner detrimental to excluded countries, particularly developing countries – a theme that will run through this thesis.

Unlike the FSB, the IMF and the World Bank are treaty bodies with detailed articles which impose legally binding obligations on their member states.¹¹⁰ Their precise rules backed by obligations and enforcement capabilities warrant their classification as ‘hard-law’ bodies.¹¹¹ Accession to their treaties deprives countries of adopting a flexible approach towards the interpretation of their articles, breach of which can result in the imposition of sanctions such as the withdrawal of membership or access to resources. Whilst this may constrain the behavior or sovereignty of states, it has the

¹⁰⁸ IMF, ‘Cooperation and Reconstruction (1944 – 71)’ (*IMF*) < <https://www.imf.org/external/about/histcoop.htm> > accessed 10 September 2017.

¹⁰⁹ See Kenneth Hoover, *Economics as Ideology* (Rowman & Littlefield Publishers, Inc., 2003) 127; Elizabeth Borgwardt, *A New Deal for the World: America’s Vision for Human Rights* (The Belknap Press of Harvard University Press, Cambridge, Massachusetts. London, 2005) 125-128.

¹¹⁰ See Articles of Agreement of the International Monetary Fund (International Monetary Fund, 2016) < <https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> > accessed 25 July 2017; Article 1 of the Articles of Agreement of the IBRD (IBRD Articles of Agreement, 1989) < <http://siteresources.worldbank.org/EXTABOUTUS/Resources/ibrd-articlesofagreement.pdf> > accessed 15 April 2015.

¹¹¹ Kenneth Abbott and Duncan Snidal, ‘Hard and Soft Law in International Governance’ [2000] 54 (3) *International Organization* 421, 426.

advantage of reducing transaction costs and strengthening the credibility of their commitments, particularly at a macro-economic level.

Whilst the IMF has responsibility for facilitating macroeconomic stability, the World Bank is responsible for reconstruction and development.¹¹² However, their mandates have evolved over time to meet global changes. The IMF has become involved in financial stability, an area that was strictly the domain of Central Banks.¹¹³ Minton – Beddoes states that this expansion reflects its yearning for a pioneering role post the deterioration of Bretton Woods Institution.¹¹⁴ Notwithstanding its underlying motivation, the IMF was key in lending to countries to assuage financial crises.¹¹⁵ For this reason, this chapter aligns with the argument by Arner and Taylor that the IMF's involvement is largely due to the fact that it has come to regard these issues as ancillary to its mandate.¹¹⁶ This is buttressed with the experience of the Asian crisis that illustrated how large contingent liabilities on government budgets results from poorly regulated banking systems; financial stability was therefore crucial for fiscal discipline and by extension, the balance of payments mandate.

The IMF seeks to ensure that countries comply with these key areas through its core functions of surveillance, financial assistance and technical assistance.¹¹⁷ These key functions allow the IMF to assess members' economic and monetary policies against its purpose to determine the probability of the risk they pose as against the stability of

¹¹² See Article 1 of the Articles of Agreement International Monetary Fund (International Monetary Fund, 2016) < <https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> > accessed 25 July 2017; Article 1 of the Articles of Agreement of the IBRD (IBRD Articles of Agreement, 1989) < <http://siteresources.worldbank.org/EXTABOUTUS/Resources/ibrd-articlesofagreement.pdf> > accessed 15 April 2015.

¹¹³ Douglas W Arner and Michael W Taylor, 'The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?' [2009] 32 UNSWLJ 32 488, 505.

¹¹⁴ Zanny Minton-Beddoes, 'Why the IMF Needs Reform' [1995] Foreign Affairs p. 123, 124; Morris Goldstein, Graciela Laura Kaminsky, Carmen M Reinhart, *Assessing Financial Vulnerability: An Early Warning System for Emerging Markets* (Peterson Institute Press 2000).

¹¹⁵ The Asian Crisis and the Global Financial Crisis.

¹¹⁶ Douglas Arner and Michael Taylor, 'The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?' [2009] 32 (2) UNSW Law Journal Volume 488, 504. Contrast with Jordan Cally, 'Dangerous Illusion of International Financial Standards and the Legacy of the Financial Stability Forum' [2010] 12 San Diego Int'l LJ 333, 347.

¹¹⁷ See Articles of Agreement of the International Monetary Fund, 'Articles IV and V' (International Monetary Fund, 2016) < <http://www.imf.org/external/pubs/ft/aa/> > accessed 19 May 2015.

the international financial systems. These tools equip the IMF with some level of intrusion, giving it power to mandate that countries make changes to monetary and economic policies to assuage existing risk.

Two agencies make up the World Bank: the International Bank For Reconstruction and Development (IBRD) and the International Development Association.¹¹⁸ The World Bank's primary aim is to act as a financial intermediary, a development institute and a development agency for countries. Interestingly, financial sector reform has been on the World Bank agenda for a considerable length of time. This is evidenced by the Bank's financial and technical support for structural reforms¹¹⁹ and improvements in country capacity building to oversee the financial systems through trainings and legislative changes. The World Bank's mandate has further evolved to cover banking supervision, creating a legal environment for the financial system, accounting and auditing practices and information provision. This was born out of the Asian financial crisis and is justified on the basis of substantial spillover threat from badly governed financial systems.

The cornerstone of the IFI's approach is the FSAP; an investigative tool launched jointly by the IMF and the World Bank post the financial crisis.¹²⁰ Described as the primary architecture for supporting the monitoring of international financial standards at global level, the FSAP was established to harness the respective strengths of IFIs in identifying financial sector vulnerabilities and developmental needs.¹²¹ Additionally, FSAPs determine countries' compliance levels with international standards of financial

¹¹⁸ See IBRD Articles of Agreement 1989 and IDA Articles of Agreement 1960.

¹¹⁹ David William, "Development and Global Governance: The World Bank, Financial Sector Reform and the 'Will to Govern' [2008] 45 *International Politics* 212, 216.

¹²⁰ Haizhou Huang and S. Kal Wajid, 'Financial Stability in the World of Global Finance' [2002] 39 (1) *Finance and Development*, a Quarterly Magazine of the IMF 1, 3.

¹²¹ Paul Kupiec, 'The IMF-World Bank Financial Sector Assessment Program: A View from the Inside' in Douglas D Evanoff and George G Kaufman (eds), *Systematic Financial Crisis, Resolving Large Bank Insolvencies* (World Scientific Publishing Co. Pte. Ltd. 2005) 69.

regulation and supervision. The overarching aim remains to ensure diminished likelihood of a crisis, thus fostering financial stability.¹²²

Seabrooke and Tsiongou strongly argue that the FSAP was introduced for two interrelated reasons; to ensure the control of policy location for financial sector reform and to rescue the IFIs from their battered reputations following their shortcomings during the 1997 financial crisis.¹²³ They stated that it was an attention gaining strategy employed by the IFIs during this period.¹²⁴ There was however evidence that the FSAP presented the fora where issues concerning international financial systems could be effectively discussed, especially the evolving issues of AML/CFT. Moreover, the IFIs possessed the technical expertise and ability to monitor compliance in these areas.¹²⁵ The advantages of these structures made a case for its establishment.

However, the IMF and the World Bank remained reluctant to intervene due to reservations held by developing countries over additional conditionalities and fears regarding the IFIs expertise in AML/CFT.¹²⁶ The IFIs were however prompted to intervene by the G7 in 2000. This intervention is the foremost cooperative approach of stakeholders to take a more significant role in countering ML/TF.¹²⁷ No doubt this was

¹²² Haizhou Huang and S. Kal Wajid, 'Financial Stability in the World of Global Finance' [2002] 39 (1) Finance and Development, a Quarterly Magazine of the IMF 1, 3; Paul Kupiec, 'The IMF-World Bank Financial Sector Assessment Program: A View from the Inside' in Douglas D Evanoff and George G Kaufman (eds), *Systematic Financial Crisis, Resolving Large Bank Insolvencies* (World Scientific Publishing Co. Pte. Ltd. 2005) 69.

¹²³ Leonard Seabrooke and Eleni Tsiongou, 'Revolving Doors and Linked Ecologies in the World Economy: Policy Locations and the Practice of International Financial Reform' (2009) 260/09 CSGR Working Paper, 14 <
<https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2009/26009.pdf>
> accessed 10 July 2015.

¹²⁴ Ibid.

¹²⁵ Marco Arnone and Pier Carlo Pardoan, 'Anti-Money Laundering by International Institutions: A Preliminary Assessment' [2008] 26 European Journal of Law and Economics 3 361, 361 – 386.

¹²⁶ Leonard Seabrooke and Eleni Tsiongou, 'Revolving Doors and Linked Ecologies in the World Economy: Policy Locations and the Practice of International Financial Reform' [2009] 260/09 CSGR Working Paper, 14 <
<https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2009/26009.pdf>
> accessed 10 July 2015.

¹²⁷ David Williams, 'Governance, Security and 'Development': The Case of Money Laundering' [2008] Working Paper on Transnational Politics 1,11.

significantly facilitated by the 9/11 terrorist attack on the United States,¹²⁸ an event which quelled the reservations of developing countries on the role of the IFIs in addressing AML/CFT issues. During this period, the AML/CFT policies served as shock therapy.¹²⁹

The IFIs have endorsed a list of twelve (12) areas of concern under which AML/CFT is incorporated¹³⁰ in the form of the 40 recommendations of the FATF.¹³¹ These indicate an accommodation of AML/CFT into the mandate of both institutions. The IFIs also commenced assessments of countries against the FATF's methodologies to ensure compliance with the FATF's standards. This marked the contracting out of assessments of compliance with the FATF recommendations to the IMF and the World Bank.¹³² Compliance and implementation records are documented in the 'Reports on Observance of Standards and Codes' (ROSCs),¹³³ which constitutes the basis for the publication of the Financial System Stability Assessments (FSSAs) in the IMF and the Financial Sector Assessment (FSA) in the World Bank. AML/CFT issues related to financial supervision and regulation by the IMF are covered under its Article IV consultation.¹³⁴ Thus broadening the scope of financial sector monitoring. Interestingly, the IFIs now integrate FSAP reports into Country Assistance Strategies (CAS) for borrower countries;¹³⁵ making it a regular part of their work. The infusion of AML/CFT regulation into the activities of these institutions illustrates the extent to which it is

¹²⁸ Marco Arnone and Pier Carlo Pardoan, 'Anti-Money Laundering by International Institutions: A Preliminary Assessment' [2008] 26.3 *European Journal of Law and Economics* pp 361, 361 – 386.

¹²⁹ Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (Macmillan, 2007).

¹³⁰ IMF, the World Bank, 'International Standards: Strengthening Surveillance, Domestic Institutions and International Markets' (IMF, World Bank, 2003) <<https://www.imf.org/external/np/pdr/sac/2003/030503.pdf>> accessed 17 July 2015.

¹³¹ FATF, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations' (FATF, 2013) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 12 May 2015.

¹³² Pierre – Laurent Chatain, 'The World Bank's Role in the Fight Against Money Laundering and Terrorist Financing' [2004] 6 *Int'l LFD* 190, 191

¹³³ See Laurence Ravillon, Helene Tourard, Eric Loquin, 'Informal Sources of International Business Law' [2011] *Int'l Bus. LJ* 1, 2.

¹³⁴ Herbert V Morais, 'The War against Money Laundering, Terrorism and the Financing of Terrorism' [2002] 1 *Lawasia J* 1, 23.

¹³⁵ David Williams, 'Governance, Security and 'Development': The Case of Money Laundering' (2008) Working Paper on Transnational Politics, 12 <http://www.city.ac.uk/data/assets/pdf_file/0003/86475/D_Williams-Governance.-Security-and-Development.pdf> accessed 12 May 2015.

considered vital in protecting the financial system and safeguarding lives.

The engagement of the IMF/the World Bank in ensuring compliance to AML/CFT regulations is further enhanced by their observer status within the FATF. However, this indicates a paradox as notwithstanding the repulsion to the centralization of standard formulation and coercive authority through governments, the FATF utilizes the IMF/World Bank framework given their membership base. Their participation however raises questions about the involvement of governments.¹³⁶ This paradox is addressed by the FATF which permits the exclusion of governments for their agents,¹³⁷ whilst seemingly maintaining the uniformity of standards with a measure of flexibility.

2.3.1.3 The Financial Action Task Force

The legal status of the FATF differs from that of treaty bodies. Established by the G7 to respond to the threat of ML/TF, the FATF is a ‘soft-law’¹³⁸ international standard-setting body for AML/CFT regulation. It is so described due to the nature of its standards and its operational base. The FATF’s standards are perceived to lack compulsion and precision.¹³⁹ They are considered as minimum standards on AML/CFT which countries are encouraged but not bound to implement. Unlike the treaty options which require a long ratification process, this model allows for flexibility of the standard making process, permitting the swift response of soft law bodies to issues such as ML/TF that pose real-time threats.¹⁴⁰

¹³⁶ Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004) 54.

¹³⁷ The FATF interacts with government representatives such as ministers who cannot bind their governments, except where the minister has express executive authority to do so.

¹³⁸ Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004) 54.

¹³⁹ Kenneth W. Abbott and Duncan Snidal, ‘Hard and Soft Law in International Governance’ [2000] 54 (3) *International Organizations*.

¹⁴⁰ Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004) 19, Kal Raustiala, ‘The Architecture of International Cooperation: Transgovernmental Networks and the Future of International law’ [2002] 43 (1) *Virginia Journal of International law* 1, 26.

Additionally, the FATF standards are not formulated or disseminated at state level, but rather, through a regulatory alliance between countries represented by Ministers of Finance and/or Central Bank Governors. This subnational participation, exercised independently of national governments, gives the FATF its trans-governmental regulatory character.¹⁴¹

Furthermore, the operational base of networks is still relatively light in comparison to the IFIs.¹⁴² For instance, the FATF is reliant on the Organization for Economic Co-operation and Development (OECD) for secretarial service. It has few employees, a limited budget, a website and operates through consultations.

The context of the legal status of the FATF gives an opportunity for in-depth understanding of the body. The FATF began operations in 1989, with the role of issuing AML/CFT recommendations addressed to countries.¹⁴³ Tsiongou recognizes that the regime, which is backed by interpretative guidance and periodic updates, is developing on two fronts: prevention and enforcement.¹⁴⁴ Prevention is focused on regulation, supervision, reporting, consumer due diligence and sanctions. The FATF recommendations preventive role also includes risk assessment and financing terrorism laws. Enforcement is however designed to be more punitive, centered on investigation, confiscation, prosecution and punishment. Tsiongou identifies the development of the regime across international and regional levels; whilst standards are formulated at international level, monitoring, enforcement and implementation are usually

¹⁴¹ Kenneth Blazejewski, 'The FATF and its Institutional Partners: Improving the Effectiveness and Accountability of Transgovernmental Networks' [2008] 22 *Temple Int'l & Comp. L.J.* 1, 8.

¹⁴² Ayelet Berman and Ramses Wessel, 'The International Legal Status of Informal International Law-Making Bodies: Consequences for Accountability' in J. Pauwelyn, R.A. Wessel and J. Wouters (Eds.), *Informal International Lawmaking: Mapping the Action and Testing Concepts of Accountability and Effectiveness*, (OUP, 2012).

¹⁴³ FATF, *History of the FATF* (FATF, 2017) < <http://www.fatf-gafi.org/pages/aboutus/historyofthefatf/> > accessed 21 May 2017.

¹⁴⁴ Eleni Tsiongou, 'Global Governance and Transnational Financial Crime: Opportunities and Tensions in the Global Anti-Money Laundering Regime' (2005) 161/05 CSGR Working Paper, 5 < <https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2005/wp16105.pdf> > accessed 19 June 2015.

undertaken by regional styled-bodies.¹⁴⁵ Actual adoption, a precondition for effective compliance is at the national level.¹⁴⁶ Continental bodies like the African Union have also been influential in necessitating the implementation and compliance of ACs to FATF recommendations.

The FATF has necessitated the development of an intrinsic commercial position towards AML/CFT from financial and non-financial institutions. As a self-protective reflex, these institutions have engaged in compliance to protect against regulatory and reputational risks. Nevertheless, in certain instances, they fall short, signaling a low level of compliance by their host country.¹⁴⁷ In the absence of legally binding authority and direct supervisory enforcement ability to bind countries to its recommendations,¹⁴⁸ the FATF employs soft law techniques to ensure compliance. It places failing countries on a High Risk and Other Monitored Jurisdictions (HRMJ) document,¹⁴⁹ which comes with attendant consequences, including financial isolation.¹⁵⁰ This sanction gains its vitality from the FATF's linkages with the IMF/World Bank, the United Nations Security Council and other related international institutions,¹⁵¹ which have given it

¹⁴⁵ Monitoring of implementation is through a self-assessment carried out by countries themselves and subsequently by mutual evaluation assessments involving onsite visits to governments and concerned institutions.

¹⁴⁶ Eleni Tsiougou, 'Global Governance and Transnational Financial Crime: Opportunities and Tensions in the Global Anti-Money Laundering Regime' (2005) 161/05 CSGR Working Paper, 5 < <https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2005/wp16105.pdf> > accessed 19 June 2015.

¹⁴⁷ FATF, High-Risk and Non-Cooperative Jurisdictions (FATF) < <http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/> > accessed 1 December 2014.

¹⁴⁸ Navin Beekarry, 'The International Anti-Money Laundering and Combating the Financing of Terrorism Regulatory Strategy: A Critical Analysis of Compliance Determinants in International Law' [2010] 31 NW.J. INT'L L & BUS, 137, 155 -66; James T. Gathii, 'The Financial Action Task Force and Global Administrative Law' [2010] J Prof. Law 197, 198.

¹⁴⁹ Previously the NCCT list, See FATF, 'Topic: High-Risk and Other Monitored Jurisdictions' (FATF, 2018) < [http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 17 January 2018. There are two list public documents: the 'countries or jurisdictions with such serious strategic deficiencies that the FATF calls on members and non-members to apply counter measures' or the 'call on members to apply enhanced due diligence measures proportionate to the risk arising from the deficiencies associated with the country.'

¹⁵⁰ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (CUP 2012) 155.

¹⁵¹ Eleni Tsiougou, 'Global Governance and Transnational Financial Crime: Opportunities and Tensions in the Global Anti-Money Laundering Regime' (2005) 161/05 CSGR Working Paper, 5 < <https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2005/wp16105.pdf> > accessed 19 June 2015.

force of compliance.¹⁵² On this basis, various scholars have argued that the FATF's relationship with established supranational bodies has 'hardened' the trajectory of its soft laws, allowing it exert sufficient authority as a legitimate supervisory body capable of setting international standards.¹⁵³

Critics have however questioned the FATF's global effectiveness in the absence of hard-law making ability.¹⁵⁴ The soft law nature has been critiqued as ineffective on the ground that various countries on the previous HRMJ document formerly known as the Non-Cooperative Countries or Territories (NCCT) list have remained unperturbed by the constant 'naming and shaming'.¹⁵⁵ However, given the scope of the FATF's regulation, hard law treaty-based solutions might be unsuitable as it would involve harmonization of the rulebooks of national regulators.¹⁵⁶ The majority of domestic financial regulation takes place not through legislation but through rules promulgated and enforced by regulatory agencies.¹⁵⁷ Arner and Taylor argue that such synchronization is highly impracticable as typified by the European Union (EU) failed experiment on regulatory harmonization. The EU eventually shifted focus to minimum standards, leaving substantial discretion to national authorities on the implementation of standards.¹⁵⁸ This indicates the impracticality of having a hard law regulatory framework. States would be unwilling to agree to a single regulatory system or structure, a process further hindered by the differences in legal systems.

¹⁵² James T Gahtii, 'The Financial Action Task Force and Global Administrative Law' [2010] J. Prof. Law 197, 198.

¹⁵³ Saby Ghoshray, Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft law [2014 - 2015] 59 N.Y.L. Sch. L.Rev. 521, 530; Dieter Kerwer and Rainer Hulse, 'How International Organisations Rule the World: The Case of the Financial Action Task Force on Money Laundering' [2011] 2 J Int'l Org. Stud. 50, 53.

¹⁵⁴ Global Witness, 'How FATF Can Measure and Promote an Effective Anti-Money Laundering System' (Global Witness) <<https://www.globalwitness.org/sites/default/files/library/How%20FATF%20can%20measure%20and%20promote%20an%20effective%20anti-money%20laundering%20system.pdf> > accessed 1 June 2015.

¹⁵⁵ For Instance, Iran, North Korea, Algeria.

¹⁵⁶ Hard law is characterized by legally enforceable commitments, which take shape within international legal parlance as customary laws, self-executing treaties, and binding international agreements. It draws its force from its authoritative nature while guiding entities under its jurisdiction through prescriptive implementation guidelines.

¹⁵⁷ Douglas Arner and Michael Taylor, 'The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?' [2009] 32 (2) UNSW Law Journal Volume 488, 504.

¹⁵⁸ Ibid 488, 505.

Notwithstanding its perceived enforcement shortcomings, the FATF's sanctions are arguably effective, especially as the IMF/World Bank give it some measure of validity. Moreover, given the increasing significance of trans-governmental networks (TGNs), the soft law approach of the FATF cannot be underestimated.¹⁵⁹

For the next section, the question is whether the global design of AML/CFT regulation propagated by IFIs/the FATF is suitable by allowing for effective interactions between the FATF/the IFIs and states without a form of hegemonic subjection of a set of countries. This thesis aims to answer these questions through the lens of the agency theory in light of the concept of legitimacy.

2.4 The Agency Theory: Defining International Delegation

The powers wielded by the IFIs/the FATF is best described as 'delegated authority'. The concept of international delegation is derived from the 'agency theory' which is built on the idea of a relationship that involves the contractual engagement of, and subsequent delegation of authority from a principal to an agent.¹⁶⁰ This conditional delegation requires that the agent acts within the confines of the authority bestowed on it and always in the interest of the principal when making decisions.¹⁶¹ The agent is granted some measure of autonomy and discretion to carry out its responsibilities

¹⁵⁹ Richard O'Brien, *Global Financial Integration: The End of Geography* [1992] Royal Institute of International Affairs.

¹⁶⁰ Don Delves and Brian Patrick, 'Agency Theory Summary' [2008]; Josh Bendickson, Jeff Muldoon, Eric W. Liguori and Phillip E. Davis, 'Agency Theory: Background and Epistemology' [2016] 22 (4) *JMH* 437, 441; Darren Hawkins, David Lake, Daniel Nielson and Michael Tierney, 'Delegation Under Anarchy: States, International Organisations and Principal-Agent Theory' in Darren Hawkins, David Lake, Daniel Nielson and Michael Tierney (eds.) *Delegation and Agency in International Organisations* (CUP, 2006) 3.

¹⁶¹ Meckling H William, Jensen Michael C., 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' [1976] 3 (4) *JFE* 305, 313; Michael C Jensen, *A Theory of the Firm: Governance, Residual Claims and Organisational Forms*, (1st edn, HUP, 2003); Darren Hawkins, David Lake, Daniel Nielson and Michael Tierney, 'Delegation under Anarchy: States, International Organisations and Principal-Agent Theory' in Darren Hawkins, David Lake, Daniel Nielson and Michael Tierney (eds.) *Delegation and Agency in International Organisations* (CUP, 2006).

effectively.¹⁶² This process entails the assumption that at some point, the agent's interest and risk perspective would diverge from that of the principal. This might occasion agency slack, which comes with a cost to the principal.¹⁶³ It is the resulting dilemma that the agency theory seeks to resolve whilst avoiding a revocation of delegated authority.

Applying this theory to international delegation, the central idea is that states transfer rulemaking and adjudication authority belonging to their governments to international institutions (IIs) such as the IFIs by signing treaties concerning these institutions. This means that the ability of the FATF and the IFIs to prescribe standards is determined by delegation of authority by a state or its representative.

However straightforward the concept of international delegation seems, its true nature has been subject to scholarly debate. Guzman and Landside contend that international delegation is largely mythical in rule-making and adjudication, as states usually refrain from handing over significant authority to international institutions.¹⁶⁴ Belanger agrees that there is no true international delegation of authority in rulemaking, and any such delegation is limited to the interpretation of rules.¹⁶⁵ Their argument challenges the definition of international delegation as the assignment of responsibilities from states to international institutions.¹⁶⁶ In opposing this, Belanger argues that the state usually retains the responsibility of drafting its own rules, as such, there is no separate agent

¹⁶² Discretion is sometimes intentionally designed by the principal into its contract with the agent; autonomy is an unavoidable by-product of imperfect control over agents.

¹⁶³ Kiewiet D Roderick and Mathew D McCubbins, *The Logic of Delegation: Congressional Parties and the Appropriations Process* (UCP, 1991). Agency slack encompasses agency slippage and shrinkage. Whilst the former refers to policy shift away from the principal's outcome to the agent own preference, the latter refers to a maximization of the agent's effort to act on the principal's behalf.

¹⁶⁴ Andrew Guzman and Jennifer Landside, 'The Myth of International Delegation' [2008] 96 Cal. L. Rev. 1693, 1695.

¹⁶⁵ Belanger Louis, 'Governing the North American Free-Trade Area: International Rule-Making and Delegation in NAFTA, the SPP and Beyond' (International Political Science Association, 21st World Congress, July 2009).

¹⁶⁶ Darren Hawkins, David A. Lake, Daniel Neilson and Michael J. Tierney, 'States, International Organizations, and Principal-Agent Theory,' In Darren Hawkins, David A. Lake, Daniel Neilson and Michael J. Tierney (eds.), *Delegation and Agency in International Organizations* (CUP, 2006)

involved in international delegation.¹⁶⁷ The argument runs that states do not surrender significant degrees of autonomy or sovereignty when engaging in rule making.¹⁶⁸ Backing this assertion, Oliveria contends that although member states delegate power to IIs, these member states retain control through established mechanisms and provide guides to the IIs.¹⁶⁹ Whilst these arguments have merits, they fail to consider the true role of specialised staff of IIs in the delegation process.¹⁷⁰ Taking this into consideration, Swaine contends that international delegation simply describes the arrangements that ‘vest continuing law-making authority’ in international institutions.¹⁷¹

The concept of international delegation is distinct in its own right. For instance, the authority assigned to IIs is revocable and conditional, and can be withdrawn by a state should it choose to.¹⁷² Although bodies such as NGOs usually take actions similar to IIs, their actions do not stem from state-derived authority and hence cannot be qualified as international delegation.

There has however been a noticeable change in this arrangement. Previously, the validity of international delegation was dependent on its binding nature¹⁷³ which was

¹⁶⁷ Belanger Louis, ‘Governing the North American Free-Trade Area: International Rule-Making and Delegation in NAFTA, the SPP and Beyond’ (International Political Science Association, 21st World Congress, July 2009).

¹⁶⁸ Ibid.

¹⁶⁹ Ines Sofia De Oliveria, ‘The Anti-Money Laundering Struggle: Actors, Interest and the EU’ (4th ECPR Graduate Conference, 2012).

¹⁷⁰ Rainer Hulsse and Dieter Kerwer, ‘Global Standards in Action: Insights from AML Regulation’ [2007]14 (5) *Organisation* 629, 630.

¹⁷¹ Edward Swaine, ‘The Constitutionality of International Delegation’ [2004] 104 *Colum. L. Rev.* 1492,1494; Curtin Bradley and Judith Kelley, *The Concept of International Delegation* (2007) 81 *Duke Law School, Working Paper Series* <<https://scholarship.law.duke.edu/cgi/viewcontent.cgi?referer=https://scholar.google.com/&httpsredir=1&article=1451&context=lcp>> accessed 1 July 2016.

¹⁷² Darren Hawkins, David Lake, Daniel Nielson and Michael Tierney, ‘Delegation Under Anarchy: States, International Organisations and Principal-Agent Theory’ in Darren Hawkins, David Lake, Daniel Nielson and Michael Tierney (eds.) *Delegation and Agency in International Organisations* (Cambridge University Press, 2006).

¹⁷³ Scott Cooper, Darren Hawkins, Wade Jacoby and Daniel Nielson, ‘Yielding Sovereignty to International Institutions: Bringing Systems Structure Bank in’ [2008] 10 (3) *International Studies Review* 501, 524.

perceived to be a pre-requisite for good governance in the public interest.¹⁷⁴ However, in recognition of the emergence of ‘disaggregated states’ (a term which signifies power wielded by separate components of a state without, theoretically speaking, legal authority to bind the state),¹⁷⁵ Bradley et al contend that states also delegate to soft law institutions such as standard-setting bodies.¹⁷⁶ This position shows that binding authorities do not reflect the realities of global regulations, as international delegation is not invalidated if a state grants non-binding powers to an institution such as the FATF to issue standards or resolutions.

In international delegation, the difference between binding and non-binding arrangements can be appreciated by examining the historical underpinnings of the institutions concerned. For instance, IFIs such as the IMF/World Bank were established by a group of states at the end of WW2, a phase which ushered in a period of decolonisation¹⁷⁷ and marked the political/economic autonomy of Asian and African countries.¹⁷⁸ This transition from imperialism to a regime founded on the principle of sovereignty propelled increasing nationalism, which in turn occasioned lack of cooperation and served as a catalyst for political conflict amongst states.¹⁷⁹ Hence, IFIs were justified by the need to overcome political conflicts through cooperation and integration of technical tasks.¹⁸⁰ With 189 member states each, a measure of cooperation was achieved and collectively, these states (principals) through authority

¹⁷⁴ Zurn Michael and Christian Joerges (eds) *Law and Governance in Post-national Europe: Compliance Beyond the Nation-State* (CUP, 2005).

¹⁷⁵ Such as the ministers or regulatory bodies as opposed to the elected state officials, see Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004) 12.

¹⁷⁶ Curtis A. Bradley & Judith G Kelley, ‘The Concept of International Delegation’ [2008] 71 (1) *Law and Contemp. Probs.* 1, 36; Daniel Abebe, ‘Rethinking the Costs of International Delegations’ (2013) University of Chicago Law School Public Law and Legal Theory Working Papers, No. 391,16 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=https://www.google.co.uk/&httpsredir=1&article=1260&context=public_law_and_legal_theory> accessed 9 July 2015.

¹⁷⁷ Lawrence James, *Rise and Fall of the British Empire* (Time Warner Books, UK, 1999) 426; Gary Thorn, *End of Empires: European Decolonisation, 1919 -80* (London: Hodder & Stoughton Educational, 2000) 50.

¹⁷⁸ Ibid.

¹⁷⁹ Jon Pevehouse, Inken Von Borzyskowski, ‘International Organisations in World Politics’ in Jacob Katz Cogan, Ian Hurd and Ian Johnstone (eds) *The Oxford Handbook of International Organisations* (OUP, 2006).

¹⁸⁰ Ernst B Haas, *Beyond the Nation-State: Functionalism and International Organisation* (Stanford, CA: Stanford University Press, 1964); Robert O. Keohane, *After Hegemony: Power and Discord in International Politics* (Princeton, NJ: Princeton University Press, 1984) 6.

delegated to the IMF/World Bank's boards (agents), made binding decisions on monetary policies and development respectively.¹⁸¹

This grant of state power to IFIs is however not without its problems, primarily because it conflicts with state sovereignty.¹⁸² Daugirdas argues that international delegation is 'constitutionally suspect' as it is far removed from the people in nation states¹⁸³ and reduces democratic control.¹⁸⁴ This is particularly accurate given the chain of delegation within the states which ousts the input of certain communities/electorates in the delegation process coupled with the contested legitimacy and democratic processes in IFIs. This crisis denotes that states may have different objectives from IFIs, generating a principal-agent problem.¹⁸⁵ Moreover, IFIs may be subject to capture by interest groups such as multinational institutions or global non-governmental organisations, who can influence rule-making to serve their interests. IFIs are also critiqued on their inflexibility and lethargic response to critical issues, attributable to the difficult process of treaty amendment.

Irrespective of these problems, international delegation to IFIs remains largely beneficial creating an avenue for specialisation. It also allows for cross-country collaboration towards a unified response to these issues. Moreover, it often makes for cheaper policy making and expertise.

¹⁸¹ Daniel L. Neilson, Michael J. Tierney, 'Delegation to International Organisations: Agency Theory and World Bank Environmental Reform' [2003] 57 (02) *International Organisations* 244. These authors note that a delegation relationship can have one or more principals who come together for respect of sovereignty and distaste for domination by a supposed super ruler.

¹⁸² Oona Hathaway, 'International Delegation and State Sovereignty' [2008] 883. *Faculty Scholarship Series* 115, 120.

¹⁸³ Kristina Daugirdas, 'International Delegation and Administrative Law' [2007] 66 *Md. L. Rev.* 707, 710.

¹⁸⁴ *Ibid.*

¹⁸⁵ Syed Azhar Hussain Shah, Akher Hussain Shah, Sajawal Khan, 'Governance of Money Laundering: An Application of the Principal-Agent Model' [2006] 45 (4) *The Pakistan Development Review* 1117, 1124.

Conversely, non-binding, soft law bodies such as TGNs emerged in the early 1950s¹⁸⁶ and evolved to meet critical issues such as oil price crisis, security issues, ML/TF - crimes in which wrongdoers present a networked front.¹⁸⁷ Slaughter asserts that unlike treaty bodies, these TGNs do not operate through formalized stovepipe hierarchies.¹⁸⁸ Rather, they are usually flexible, responsive and collaborative. They engineer regulatory alliance between countries, a unique power-allocation approach that has earned them the tag of disaggregated state.¹⁸⁹

However, like IFIs, TGNs are usually created by a collection of countries or networks and so suffer from similar legitimacy concerns. For instance, the FATF was created by the G7 countries, a networked body with persuasive but decisive powers. These countries (principals) delegated authority to the FATF (agent) to create standards on AML/CFT.¹⁹⁰ Yet, due to the non-binding nature of these standards, there were concerns that it imposed no real obligations, thus occasioning a weakening of the standards adopted globally. This concern was allayed by collaborations with treaty bodies, from which TGNs gain their enforcement validity, illustrating how non-binding rules can become consequential irrespective of their voluntary nature.

International delegation to binding or non-binding institutions have also been criticized on the ground that it escalates agency costs and slippage.¹⁹¹ Such situations, where an agent (FATF/IFIs) starts to act beyond the powers granted and towards its preference is a cause for concern. Hence, countries usually engage monitoring tools such as the use of representative boards on the IFIs and membership status at the FATF. Countries have also threatened to withdraw their funding from these institutions as a means of

¹⁸⁶ Anne-Marie Slaughter, 'The Accountability of Government Networks' [2001] 8 (2) *Indiana Journal of Global Legal Studies* 347, 350.

¹⁸⁷ Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004) 54.

¹⁸⁸ *Ibid.*

¹⁸⁹ *Ibid.* 12.

¹⁹⁰ Ines Sofia De Oliveria, 'The Anti-Money Laundering Struggle: Actors, Interest and the EU' (4th ECPR Graduate Conference, 2012).

¹⁹¹ Agency slack encompasses agency slippage and shrinkage. Whilst the former refers to policy shift away from the principal's outcome to the agent's own preference, the latter refers to a maximization of the agent's effort to act on the principal's behalf.

limiting agency slippage.¹⁹² These methods have been critiqued as unsuitable given their limited capability in resolving information asymmetry and consequential escalation of agency costs that exist in international delegation. This is comparative to the minimal agency costs that accrue in domestic delegation from arms of government to regulatory institutions, attributable more to the proximity of monitoring mechanisms than to agents determined to ensure transparency.¹⁹³ Given the absence of proximity, and the fact that IIs are not representative of one country, countries are restricted from employing certain domestic oversight over IIs,¹⁹⁴ thereby according some level of respect for states sovereignty.

This bottom-up delegation from states to IFIs/TGNs focuses on one half of the delegation process which classes core members of these institution (G7 and OECD countries) as principals to the FATF. This is attributable to the role of these countries in the establishment of the FATF and the formulation of its standards. This delegation process does not however inculcate how these countries are bound by the standards and processes promulgated by IFIs/TGNs, requiring transplantation and implementation.¹⁹⁵ This reverse position which allows the IFIs/FATF to evaluate compliance levels of its core members and possibly issue sanctions is referred to in this thesis as ‘reverse international delegation’.

¹⁹² Daniel Nielson and Michael Tierney, ‘Delegation to International Organizations: Agency Theory and World Bank Environmental Reform’ [2003] 57 (2) IO 241, 246.

¹⁹³ Daniel Abebe, ‘Rethinking the Costs of International Delegations’ (2012) University of Chicago Public Law & Legal Theory Working Paper 391 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=https://www.google.co.uk/&httpsredir=1&article=1260&context=public_law_and_legal_theory> accessed 7 July 2015.

¹⁹⁴ Ibid.

¹⁹⁵ Anthea E. Roberts, ‘Traditional and Modern Approaches to Customary International Law: A Re-Conciliation’ [2001] 95 AM.J.INT’L L 757.

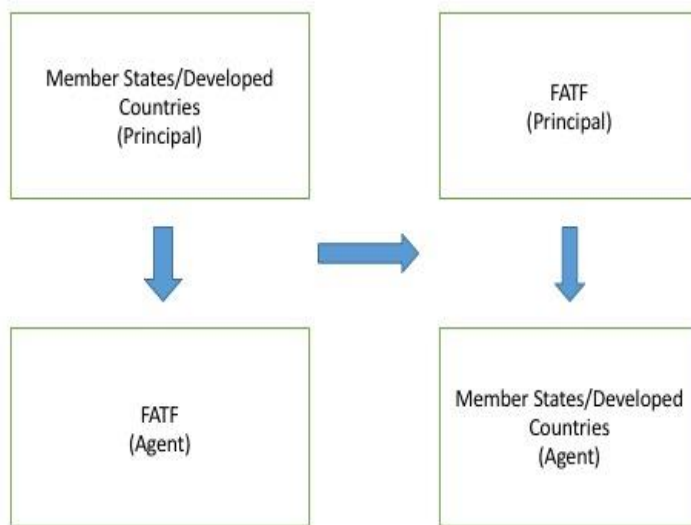


Illustration 1: Pictorial Representation of the 'Reverse International Delegation'

It is interesting to note that, for belated and associate members, there is no initial delegation, as the initial delegation only comes from core FATF member countries. EEs had no input in the FATF establishment process and have only had some measure of involvement in the FATF's standards re-formulation process, which demonstrates their role as 'rule-takers' because of their belated membership. ACs suffer a worse off fate with minimal input in standards re-formulation, which restricts them from contributing to the FATF standards and adding their peculiarities, yet ACs are still subject to the FATF rules. The position of ACs/EEs indicates a 'continuing delegation' relationship with the FATF as their 'rule-taking' position has only experienced a minimal shift, whilst the position of developed countries reversed. These models are discussed within the context of AML/CFT regulation.

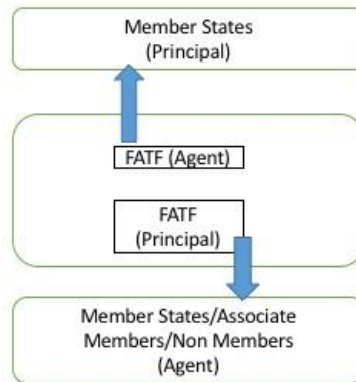


Illustration 2: Pictorial Representation of the 'Reverse and Continuing International Delegation'

2.4.1 Reverse and Continuing International Delegation in AML/CFT Regulation

That the G7 delegated authority to the FATF to procure global standards and rules for combatting ML/TF reveals a complex agency relationship. Scholarly opinions are divided on the precise nature of the relationship between the FATF and its member states. The divergence of views, as we would see, reveals that the relationship between the FATF and states is not static but dependent on the membership position of states.¹⁹⁶ This refutes the rationalist position projected by Oliveria that the FATF can always be classed as an agent of sovereign states,¹⁹⁷ a myopic perspective which advances the stance of developed member countries represented by the European Commission within the FATF.¹⁹⁸ Shah et al however project a more holistic but knotty viewpoint which emphasizes the position of developing countries as agents to developed countries through international institutions or networked bodies.¹⁹⁹ They assert that in its

¹⁹⁶ Membership can also move – so there are two angles to the non-static nature. However, since 1992, the FATF has closed its membership ranks.

¹⁹⁷ Ines Sofia De Oliveria, 'The Anti-Money Laundering Struggle: Actors, Interest and the EU' (4th ECPR Graduate Conference, 2012).

¹⁹⁸ Daniel Abebe, 'Rethinking the Costs of International Delegations' (2012) University of Chicago Public Law & Legal Theory Working Paper 391 < https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=https://www.google.co.uk/&httpsredir=1&article=1260&context=public_law_and_legal_theory > accessed 7 July 2015.

¹⁹⁹ Syed Azhar Hussain Shah, Akher Hussain Shah, Sajawal Khan, 'Governance of Money Laundering: An Application of the Principal-Agent Model' [2006] 45 (4) The Pakistan Development Review 1117, 1118.

interactions with developing countries, the FATF assumes principal responsibilities, often delegating tasks to these countries to ensure they imbibe the AML/CFT standards promulgated by developed countries in their national legislations, whilst benchmarking them to ensure implementation.²⁰⁰ Accordingly, when there is a conflict between FATF standards and national legislations, (for instance, on financial secrecy) the backing and enforcement powers of the IFIs ensure that the standard-rules will take precedence.²⁰¹ Within this context, the FATF is subservient to developed countries and acts according to their requests. This illustrates the duality of the FATF role in the delegation arrangements which are dependent on the developmental stage of countries – a criterion for FATF membership.²⁰²

This model, which takes legitimacy concerns into consideration, is not devoid of agency problems. Whilst certain agent-states, particularly ACs/EEs are driven to preserve laws for reasons of financial secrecy, exclusion or other self-serving objectives, the principal is besotted with the goal of financial integrity and stability, which are antithetical to the limited objectives of these states. To resolve this problem, the principal often relies on oversight and incentive laden mechanisms to curb the use of agent-states as instruments for facilitating ML/TF. These tools have been critiqued as unsuitable because they are incapable of resolving information asymmetry or conflict of interests. The effectivity of these mechanisms in resolving agency problems will be examined in the context of the agency relationship between principal and agents.

2.4.2 The Agency Relationship between IFIs/FATF and Agent-States

In the agency relationship between the IFIs/the FATF (collective principals) and agent states, the FATF formulates and delegates AML/CFT standards and, together with the

²⁰⁰ Syed Azhar Hussain Shah, Akher Hussain Shah, Sajawal Khan, 'Governance of Money Laundering: An Application of the Principal-Agent Model' [2006] 45 (4) *The Pakistan Development Review* 1117, 1118.

²⁰¹ This raises the question of supremacy of international law to national law. See Hans Kelsen, *General Theory of Law and State* (Harvard University Press, 1945) 121.

²⁰² FATF, 'FATF Membership Policy' < <http://www.fatf-gafi.org/about/membersandobservers/fatfmembershippolicy.html> > accessed 20 April 2017.

other principals, assesses the agent's compliance levels to resolve pending conflict of interests. The reports derived from these assessments determine whether to issue sanctions, heighten supervision or engage in capacity training. Assessments are utilized to ensure that the agent's objectives remain aligned with that of the principal. This observatory tool coupled with training and incentives, such as deeper financial integration and withholding of sanctions, are employed by the principals to reduce information asymmetry in interactions with agents. The idea is that symmetrical information exchange would indicate improved interface on confidential information between actors. This is the optimal position which would aid the collective principals in tailor-fitting country assistance programs, or in reformulating standards whilst encouraging agent-states to share private findings on their socio-economic and political information. This mutual exchange of information, derived from the observatory and incentive mechanisms, is encouraged. Principals own some private information and expertise gained from in-house research, cross-country interactions and credit agencies, which would help in analyzing information derived from countries.

Whilst seemingly ideal, the effectivity of these mechanisms in achieving symmetrical information and resultant compliance is uncertain. Allan and Fisher assert that tools employed by the principal may have limited ability to discern the actions of agents or outcomes resulting from such actions.²⁰³ This indicates that information derived from agent-governments are imperfectly observable, meaning that the agent's efforts or true actions cannot be fully ascertained,²⁰⁴ thus hindering the principal's contractual ability to rein in the agent. Furthermore, Deleanu's empirical findings signal that where there is conflict of interests and an opportunity to misinform the international community about AML combatting efforts, agents are likely to manipulate indicators during assessments.²⁰⁵ Benabou et al affirm that manipulation is possible because detection is imperfect.²⁰⁶ Rational economists reject this argument, contending that agents are

²⁰³ Drazen Allan and Stanley Fisher, 'Conditionality and Selectivity in Lending by International Financial Institutions' [1997] Washington: International Monetary Fund 002.

²⁰⁴ Loana Sorina Deleanu, 'Do Countries Consistently Engage in Misinforming the International Community about their Efforts to Combat Money Laundering? Evidence Using Benford's Law' [2017] 21(1) Plos One 2, 19.

²⁰⁵ Ibid.

²⁰⁶ Benabou Roland and Laroque Gug, 'Using Privileged Information to Manipulate Markets: Insiders, Gurus and Credibility' [1992] 107 (3) QJE 921, 941.

rational and would restrain from cheating with official statistics or information, as the market would detect such slip.²⁰⁷ Evidence has however shown that the market does not always detect this slip.²⁰⁸ Rather, there is confirmation that when governments anticipate correction strategies by the principal which threaten flows to capital and access to market, they may decide to communicate with the principals strategically²⁰⁹ by either omitting or manipulating statistics to project compliance.²¹⁰

It is however pertinent to state that not all agency slack is attributable to information asymmetry. Even when the principal monitors the agent effectively, peculiarities within a country may hinder compliance. In the absence of full knowledge of these peculiarities, incentives for compliance based on actions would at best be imperfect.

Against this backdrop, the argument runs that a reduction in information asymmetry may also occasion robust standards design and implementation. This can enhance legitimacy within the structural framework of principals. For instance, the FATF sets recommendations for recipient states, a step that does not hinder its interaction with ‘all’ states in the reformulation process of the recommendations or the evaluation and technical assistance provision.

2.4.3 Unravelling the Agency Quandary

An examination of the reverse and continuing agency model reveals complexities inherent in the formation and membership structure of the proximate principal (FATF) which has resulted in an augmented legitimacy crisis. This crisis is inherent in the

²⁰⁷ Manne Henry G, *Insider Trading and the Stock Market* (First Edition, Free Press, 1996).

²⁰⁸ Loana Sorina Deleanu, ‘Do Countries Consistently Engage in Misinforming the International Community about their Efforts to Combat Money Laundering? Evidence Using Benford’s Law’ [2017] 21 (1) Plos One 2, 19.

²⁰⁹ Crawford Vincent and Sobel Joel, ‘Strategic Informational Transmission’ [1982] *Econometrica: Journal of the Econometric Society*, 1431, 1451.

²¹⁰ Manne Henry G, *Insider Trading and the Stock Market* (First Edition, Free Press, 1996).

overlap in the FATF's position as both principal and agent to developed countries. As earlier discussed, the FATF is the agent of the developed countries given their role in the formation and continued membership of the FATF. On the other hand, the FATF's principal relationship with these countries is predicated on the fact that its rules are binding on its member states. ACs are not involved in the FATF formation process and do not hold core membership positions. They are however subject to the FATF's rules.

As we will see, the disparity in the FATF relationship within its members and between 'non-members', the resulting FATF standards derived mainly from 'original member states', coupled with the gravitation of decision making authority from the national to the international level occasions questions on accountability, transparency and legitimacy. Furthermore, questions abound on the suitability of the standards for the ACs/EEs, particularly due to the uniqueness of their terrain, such as their cash-based economy. A solution driven approach adopted with the aim of ensuring improved compliance and clarifying the nature of the legitimacy crisis is necessary.

2.5 Deconstructing the Concept of Legitimacy in International Law and Governance

The phrase 'legitimacy crisis' may presuppose the existence of a legal difficulty, given the conjecture by positivists that 'legitimacy' is the presence of valid and acceptable law, in the absence of which a legal crisis subsists.²¹¹ This perspective aligns with the origin of the word in law. The Merriam-Webster Online Dictionary defines legitimacy as 'the quality or state of being legitimate', whilst 'Legitimate' refers to 'accordant with law or with established legal forms and requirements'.²¹² It is also described as 'conforming to recognised principles or accepted rules and standards'.²¹³ Whilst the former definition constricts the usage of the word to legal matters, the latter indicates

²¹¹ C Schmitt, *Law and Legitimacy* Transl. J. Seitzer (Durham: Duke University Press, 2004).

²¹² Merriam Webster, 'Legitimate' (Merriam- Webster, 1828) < <https://www.merriam-webster.com/dictionary/legitimate> > accessed 21 May 2017.

²¹³ Ibid.

its applicability in other contexts when it is backed with ‘justification of authority’.²¹⁴ This indicates that once ‘illegal’ standards are justifiable or accepted, they are cloaked with the garment of legitimacy. For instance, slave trade was justified for economic purposes and codified constitutionally, giving it a cloak of legitimacy.²¹⁵ Those who argued that slave trade was repugnant to the British Constitution and Christian values were considered as acting ‘illegitimately’. Hence, whilst treaty organisations and nation states mirrored the law-based definition of legitimate, the justification-based definition illustrates the varied application of the word.

The foregoing gives a glimpse of the continuing debate on legitimacy which has metamorphosed into the area of international regulation and governance. Treaty bodies such as the IFIs contend with legitimacy crisis on grounds of lack of democracy and asymmetrical decision making process, which affects their perceived normative legitimacy. ‘Normative legitimacy’ in this sense means the ‘right to rule’ when attempting to secure compliance with standards.²¹⁶ This right, however contestable, is justified by the legal root of the IFIs in state accession or consent to treaty making.²¹⁷ This state-consent positivist approach which asserts that the IFIs derive legitimacy from the consent of states is focused on the source of power as a means of justifying legitimacy.²¹⁸ Conversely, decentred regulatory regimes, such as the BCBS, the IOSCO

²¹⁴ Daniel M. Bodansky, ‘The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?’ [1999] 93 (3) *American Journal of International Law* 596, 601.

²¹⁵ Clarkson Thomas, ‘An Essay on the Slavery and Commerce of the Human Species: Particularly the Africans’ [1969] honoured with First Prize in the University of Cambridge for the Year 1975 Mnemosyne Publications; Earl Leslie Griggs, *Thomas Clarkson, the Friend of Slaves* (London: G. Allen & Unwin, 1936).

²¹⁶ Allen Buchanan and Robert O. Keohane, ‘The Legitimacy of Global Governance Institutions’ in Jovan Babic, Petar Bojanic (ed) *World Governance: Do We Need It, Is It Possible, What Could It All Mean?* (Cambridge Scholars Publishing, 2010) 214.

²¹⁷ Jan Klabbers, Anne Peters and Geir Ulfstein, *The Constitutionalization of International Law* (OUP, 2009); Lukas Meyer and Pranay Sanklecha, ‘Introduction to Legitimacy, Justice and Public International Law’ (CUP, 2009); Daniel M. Bodansky, ‘The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?’ [1999] 93 (3) *American Journal of International Law* 596, 601; Rudiger Wolfrum, ‘Legitimacy of International Law from a Legal Perspective: Some Introductory Considerations’ in Rudiger Wolfrum (eds), *Legitimacy in International Law* (Springer, Berlin, Heidelberg, 2008) cf. with Nienke Grossman, ‘The Normative Legitimacy of International Courts’ [2013] 86 *Temp.L.Rev* 61, 76 argues that state consent and procedural fairness are insufficient to ground the legitimacy of institutions. Mathias Kumm, ‘The Legitimacy of International Law: A Constitutionalist Framework of Analysis’ [2004] 15 (5) *The European Journal of International Law* 907, 914.

²¹⁸ C. Schmitt, *Law and Legitimacy*, transl. J. Seitzer (Durham: Duke University Press, 2004); Jose Alvarez, ‘The Return of the State’ [2011] 20 *Minn. J. Int’l L* 1, 15.

and the FATF do not have the state as the locus of authority.²¹⁹ They have no clear legal structures such as legislative bodies, courts, national authorities or ombudsman which can ensure their accountability. Additionally, they do not have clear jurisdictional boundaries or an identifiable set of potential democratic participants in their processes,²²⁰ which raises questions about their legitimacy. Black however postulates that using law or legal validity to assess the legitimacy of these institutions would be futile.²²¹ Such transnational organisations have informed the extended definition of legitimacy in international law to encapsulate ‘*the perception of actors on the acceptability of an institution*’.²²²

Such fluid construction of ‘legitimacy’ postulates that a soft-law regulatory body perceived as holding the normative right to govern by those on whose behalf it administers is ‘legitimate’.²²³ Thomas describes this ascription to an objective perspective on legitimacy by actors as ‘legitimation’, a process by which actors come to believe in the normative legitimacy of an object.²²⁴ This extended perception grants decentralised bodies other basis for legitimacy which is rooted in the reasons for acceptance. Black categorises these reasons as ‘pragmatically-based’, ‘morally-based’ and ‘cognitively-based’.²²⁵ Pragmatically-based legitimacy suggests the belief held by

²¹⁹ Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ [2008] 2 (2) Regulation and Governance 137, 142.

²²⁰ Ibid

²²¹ Ibid 137, 145.

²²² Chris A. Thomas, ‘The Concept of Legitimacy and International Law’ (2013) LSE Law, Society and Economy Working Papers 12/2013, 14<
http://eprints.lse.ac.uk/51746/1/libfile_repository_Content_Law%2C%20society%20and%20economics%20working%20papers_2013_WPS2013-12_Thomas.pdf > accessed 10 November 2017; Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ [2008] 2.2 Regulation and Governance 137, 150.

²²³ John Jost and Brenda Major, *The Psychology of Legitimacy* (Cambridge University Press 2001); Ian Hurd, Legitimacy and the United Nations (2011) Princeton University Working Paper <
<https://poseidon01.ssrn.com/delivery.php?ID=667085003073003079126114095021119107001083027043001020067123115118106114027073093105058102060121102009115064096088103071094104060005035015015076107029100127100095034019003099119006108114117089005073006020020068084069104101125019113091069013110090088&EXT=pdf> > accessed 8 May 2015.

²²⁴ Chris A. Thomas, ‘The Concept of Legitimacy and International Law’ (2013) LSE Law, Society and Economy Working Papers 12/2013, 14<
http://eprints.lse.ac.uk/51746/1/libfile_repository_Content_Law%2C%20society%20and%20economics%20working%20papers_2013_WPS2013-12_Thomas.pdf > accessed 10 November 2017.

²²⁵ Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ [2008] 2 (2) Regulation and Governance 137, 144; cf. with Thomas who categorises these reasons as ‘legal, moral or social’ basis for legitimacy in Chris A. Thomas, ‘The Concept of Legitimacy and International Law’ (2013) LSE Law, Society and Economy Working Papers 12/2013, 14<

persons that the institution will pursue their interest directly or indirectly. Morally-based legitimacy implies the perception of the institution and its procedures as morally appropriate. Cognitively-based legitimacy refers to the perception of the institution as necessary or inevitable based on its knowledge and expertise. These different approaches to legitimacy reveal the fluidity of the concept. Whereas some actors may view legitimacy on a set of values and beliefs, others may base their reasons on different factors.²²⁶ Notwithstanding the factors that may inform legitimacy, any institution or body recognized as legitimate provides a reservoir of loyalty from which leaders or institutions can draw to govern effectively.²²⁷

2.5.1 The Importance of Legitimacy

Ensuring compliance with regulatory standards informs the need for deeming legitimacy vital. Black states that legitimacy is fundamental in motivating behavioural responses.²²⁸ Arguably, when members consider their institutions as legitimate, the members are more likely to ensure actual compliance to established standards, as opposed to formal or constructive compliance.²²⁹ What then does the term ‘compliance’ connote?

Despite various definitions ascribed to compliance, its meaning in a regulatory context is widely accepted. Hoe describes compliance with international laws in terms of compulsion, defining it as the conformation of state behavior to international law.²³⁰ Shelton sees compliance as the adherence of countries to international norms or accords

http://eprints.lse.ac.uk/51746/1/libfile_repository_Content_Law%2C%20society%20and%20economics%20working%20papers_2013_WPS2013-12_Thomas.pdf > accessed 10 November 2017.

²²⁶ Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ [2008] 2 (2) Regulation and Governance 137, 145.

²²⁷ Tom R. Tyler, *Why People Obey the Law* (Princeton University Press, 2006).

²²⁸ Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ [2008] 2 (2) Regulation and Governance 137, 148.

²²⁹ Rainer Hulse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 Regulation and Governance 459, 466.

²³⁰ Daniel E Hoe, ‘Compliance and the International Soft Law: Why Do Countries Implement the Basel Accord’ [2002] Journal of International Economic Law (OUP).

and the implementation of measures instituted.²³¹ Both Hoe and Shelton agree that implementation is a pre-condition for compliance and that effectiveness is divorced from compliance.²³² Given the above definitions, this chapter accepts the meaning of compliance as state or private institution behavior, stimulated by international norms and laws – inclusive of national motivations.

Compliance may be actual, constructive or proactive. Actual compliance in this case denotes effective adherence to the spirit of the global regulatory standards, which is usually done voluntarily.²³³ Tyler asserts that voluntary observance to the law is preferred by legal authorities given its cost effective nature.²³⁴ This varies from formal or constructive compliance which requires higher enforcement cost, is usually achieved through a coercive manner and is harder for law authorities to effectively monitor. These snags can however be avoided when compliance is voluntary and participatory, which is proactive, as opposed to coerced.²³⁵ This illustrates that the presence of coercion negates effectiveness of ‘legitimate’ standards. Irrespective of the nature of compliance, what is evident is the role of legitimacy in ensuring responses from institutions and persons.

Additionally, the concern of ‘legitimacy’ can project the need for inward re-evaluation that results in the re-engineering of an institution and its standards to become objectively legitimate. According to Shaffer, such re-engineering must be able to stand the test of input, throughput and output legitimacy.²³⁶ Input legitimacy is concerned

²³¹ Dinah Shelton, *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP, 2003)

²³² Ibid.; Jacobson H.K and Brown Weiss E, ‘Compliance with the International Environmental Accords’ 1995] 119 *Global Governance* 119, 123.

²³³ Rainer Hulse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 *Regulation and Governance* 459, 460.

²³⁴ Tom R. Tyler, *Why People Obey the Law* (Princeton University Press, 2006).

²³⁵ Cf with Rainer Hulse who argues that coercion may be a more cost effective and simpler option for institutions to disseminate an unpopular regime. See Rainer Hulse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 *Regulation and Governance* 459, 460.

²³⁶ Gregory Shaffer, *Transnational Legal Ordering and State Change* (Cambridge Studies in Law and Society, 2014) 50; cf. with Bodnasky who asserts that legitimacy can be viewed in terms of representativeness, procedures and effectiveness. Contrast to Bodansky (legitimacy in terms of sources, procedures and outcomes). See Daniel M. Bodansky, ‘The Legitimacy of International Governance: A

with the membership and participation of countries in decision making processes within institutions.²³⁷ Throughput legitimacy focuses on the quality of procedural fairness and deliberations in the absence of coercion, whilst output legitimacy deals with the effectiveness of the response of an institution to a problem.²³⁸ Any restructuring to inculcate these forms of legitimacy must ensure that all actors (states) have a voice in the process of standard formulation, its procedures are fair, devoid of coercion and its overall output is effective towards meeting set goals.²³⁹ This perspective on legitimacy was not reflected within the FATF's original processes and an overhaul is required to gain compliance and acceptability within developing countries.²⁴⁰ Emphasising the need for the club-like bodies to gain acceptability, Weber's argument that perceived institutional legitimacy translates to effectiveness aligns with Shaffer's tests for legitimacy.²⁴¹ This further buttresses the fact that a legitimate TGN would foster dialogue and reciprocal exchange of information where persuasion would be wielded as opposed to coercion.²⁴² Against this backdrop, it can be argued that the need for re-engineering foretells the presence of 'illegitimacy' in the FATF institutional processes and standards.²⁴³

As the terminology suggests, input legitimacy simply means the ability of all actors to have a voice in the FATF's processes.²⁴⁴ 'Voice' here denotes a right to uniform votes and participation by virtue of equivalent membership rights. More significantly, it symbolises involvement in the formation process of institutions and standards. Having

Coming Challenge for International Environmental Law?' [1999] 93 (3) American Journal of International Law 596.

²³⁷ Gregory Shaffer, *Transnational Legal Ordering and State Change* (Cambridge Studies in Law and Society, 2014) 50.

²³⁸ Ibid 51.

²³⁹ Ibid (n 237) 50.

²⁴⁰ At the time of original blacklisting, prior to 2006 (herein referred to as Black1) and also prior to the establishment of the FSRB and partnership with the IFIs in 2001.

²⁴¹ I Max Weber, *Economy and Society* (Guenther Roth & Clau Wittich eds., 1968).

²⁴² Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (CUP, 2011)

²⁴³ As there was an absence of 'voice-able' members in the standards formulation, lack of representativeness and procedural unfairness in its processes. These signalled accountability and transparency issues thus had the capability of hindering effectiveness.

²⁴⁴ Chris Brummer, 'How International Financial Law Works (and How It Doesn't)' [2011] 99 Georgetown Law Journal 257, 307; Marie Wilke, 'Emerging Informal Network Structures in Global Governance: Inside the Anti-Money Laundering Regime' [2008] 77 Nordic Journal of International Law 509, 520.

a voice is considered crucial in generating a sense of collective ownership in the fight against ML/TF within countries, whilst achieving geographical balance.²⁴⁵ Hulsee argues that this sense of ownership can propel pro-active compliance, which is futuristic and effective in curbing illicit crimes in dynamic environments.²⁴⁶ Differentiating actual from pro-active compliance, Hulsee argues that whilst the former is focused on implementing enshrined TGN rules into law, the latter is focused on ensuring that even when there is a lapse in the international rules or the risk envisaged by the international rules has transformed at the implementation stage, the country goes further to deal with emergent risk.²⁴⁷ In the latter example, countries comply out of self-interest and not coercion or dictation. For instance, the FATF rules last revised in 2012 did not cover emerging issues like cryptocurrencies which, as is envisaged, poses huge ML/TF challenge. However, the EEs have all reacted to this by issuing an outright ban. This may not be the most innovative approach, as signalled by the IMF's step towards understanding the risks posed by these currencies to ML/TF and how it operates.²⁴⁸ However, it signals that a sense of 'ownership' may have facilitated such futuristic move.

Given the initial presence of the G7 and certain OECD countries in the formation process, it is trite to say that any re-engineering towards input legitimacy would be 'too-late' to guarantee any involvement in the formation of institutions or standards. Consequently, this resulted in a membership asymmetry led by the global hegemon, the US (which constituted the rule makers) on one end, and the ACs/EEs who represented the rule takers on the other.²⁴⁹ To correct this emerging defect, the FATF continually reformed and expanded its membership. Subsequently, membership of the FATF grew

²⁴⁵ See the FATF-GAFI, 'Financial Action Task Force Annual Report 2005-2006' (FATF, 23 June 2006) < <http://www.fatf-gafi.org/media/fatf/documents/reports/2005%202006%20ENG.pdf> > accessed 30th May 2017.

²⁴⁶ Rainer Hulsee, 'Even Clubs Can't do Without Legitimacy: Why the Anti-Money Laundering Blacklist was Suspended' [2009] 2 Regulation and Governance 460, 467.

²⁴⁷ Ibid.; Christian Reus-Smit, International Crises of Legitimacy [2007] 44 International Politics 157, 170.

²⁴⁸ Dong He et al, 'IMF Staff Discussion Note: Virtual Currencies and Beyond: Initial Considerations' (IMF Staff Team, 2016) < <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf> > accessed 21 May 2017.

²⁴⁹ Mark C. Suchman, 'Managing Legitimacy: Strategic and Institutional Approaches' [1995] 20 (3) Academy of Management Review 571, 588; Eric Helleiner, 'State Power and the Regulation of Illicit Activity in Global Finance' in Friman RH, Andreas P (eds.) The Illicit Global Economy and State Power (Rowman & Littlefield, Lanham, 1999).

from G7 and OECD countries to the current 35 countries and 2 gulf regions; although growth was restricted to ‘strategically important countries’.²⁵⁰ Later members of the FATF appear to have been forced to incorporate the regime, whilst non-members are side-lined from the decision making processes.²⁵¹ Coerced members and non-members who are usually rendered reticent in decision making processes suffer the consequences of their non-participation during the transplantation process. One plausible outcome is the inability to foster voluntary actual or pro-active compliance with national legislations derived from global standards, due to lack of legitimacy at the international level. This is especially so when countries do not consider the standards to be in their best interest or suitable to their terrain.

Black suggests that the variance in ‘interests’ is usually prominent when there is a long chain of delegation.²⁵² For instance, the FATF usually delegates to the executive arm of government, such as ministers, which further delegates to related regulatory bodies, such as the Financial Intelligence Units (FIUs), the Central Banks, Securities and Exchange Commissions, etc. This chain of delegation habitually bypasses the elected state representatives. For this reason, delegates to the FATF are often accosted from entering compromising agreements with the institution which has an uneven effect on particular communities that bear the costs of compliance. This can be typified with the international investment arbitration process which has formed a global governance niche monopolized by an exclusive number of countries that ousts Africa and other developing countries. Furthermore, professionals from ousted countries are deprived the opportunity to contribute to the development processes governed by past judges

²⁵⁰ FATF, FATF Membership Policy (FATF, 2017) < <http://www.fatf-gafi.org/about/membersandobservers/fatfmembershippolicy.html> > accessed 21 May 2017.

²⁵¹ Zakhele Hlophe, ‘Regulating Money Laundering in Developing Countries: A Critical Analysis of South Africa’s Incorporation and Implementation of the Global FATF Standards’ [2013] Doctoral Thesis, Kings College London; Jason Campbell Sharman, ‘Power and Discourse in Policy Diffusion: Anti-Money Laundering and Developing Countries’ [2008] 52 *International Studies Quarterly* 635, 644; Rainer Hulse, ‘Creating Demand for Global Governance: The Making of a Global Money Laundering Problem’ [2007] 21 (2) *Global Society* 155, 167; Rainer Hulse, ‘Even Clubs Can’t do Without Legitimacy: Why the Anti-Money Laundering Blacklist was Suspended’ [2009] 2 *Regulation and Governance* 459, 462; Daniel Drezner, ‘Globalisation, Coercion and Competition: The Different Pathways to Policy Convergence’ [2005] 12 (5) *Journal of European Public Policy* 1, 18.

²⁵² Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ [2008] 2 (2) *Regulation and Governance* 137, 142.

from developed countries and influenced by multinationals.²⁵³ This has negative implications for socio-economic development, as countries that are far removed from the processes are forced to imbibe the rulings made.²⁵⁴ Hence, acceding to coercion by the existing hegemony can be considered illegitimate, requiring normative legitimization.²⁵⁵

Throughput legitimacy which is based on the quality of procedural fairness and deliberations devoid of coercion is important because it proves some level of normative legitimacy. To achieve this, the FATF entered into a partnership with the IFIs – through sharing of methodologies for evaluation. Cooperation between these institutions opens the FATF's standards and methodologies to increased scrutiny by the boards of the IFIs which represent about 189 countries, and are thus considered legitimate. The input of the IFIs' boards was presumed to give non-members of the FATF increased input in the FATF standards whilst enhancing the quality of the process for input. This argument is however blindsided to the asymmetries within the IFIs. Although emerging economies have high quotas, ACs have far lesser quotas, and hence a smaller voice in the decision making process. Thus, it can be argued that some level of 'double-illegitimacy' exists, particularly towards ACs. The FATF tried to cure this illegitimacy through its FATF-Style Regional Bodies (FSRBs)²⁵⁶ in the belief that an endorsement of the institution's standards would translate to an increased partnership between the FSRB and the FATF. It was hoped that elevation from observer status to membership would ensure increased sense of ownership and local acceptability amongst FSRBs countries, which would in turn secure improved compliance at the regional level.²⁵⁷ However, this continually fell short of expectations as the non-member/associate member countries were only given 'second-class membership'. This permitted only a slight increase in the input of these countries in the plenary deliberations, indicating

²⁵³ Amazu A. Asouzu, *International Commercial Arbitration and African States: Practice, Participation and Institutional Development* (CUP, 2001) 452.

²⁵⁴ Ibid.

²⁵⁵ Whilst acknowledging that an equally advantageous global regulatory process is almost unachievable due to varying norms and values.

²⁵⁶ The Caribbean Financial Action Task Force (CFATF) established in 1990, the Middle East and North Africa (MENAFATF), Eurasia (EAG), South America (GAFISUD) and West Africa (GIABA).

²⁵⁷ FATF, Financial Action Task Force: Annual Report (2005 – 2006) 23 June 2006.

that the issue on non-suitability of standards persisted. Hence, it can be argued that the FSRB were nothing more than vehicles for imposing and preserving the FATF regime.

Other limits to procedural fairness can also be attributed to a resource factor. Countries with more resources focused on AML/CFT could afford to send more delegates, and thus have increased input in the FATF's deliberation processes on standards and mutual evaluation reports.

Additionally, to build procedural fairness devoid of coercion, the FATF blacklisting sanctions which was targeted at non-member countries was considered illegitimate, as it alienated certain countries from deliberation processes.²⁵⁸ This hindered actual or even proactive compliance, as alienated countries refrained from investing their resources or energy to combating ML/TF. The FATF blacklisting sanctions were expunged as a breach of the sovereignty norm due to the effect of financial isolation and the double standards that arose therefrom, which were only applicable to non-member states.²⁵⁹ Furthermore, it was argued that it contravened the AML/CFT regime of voluntary participation and non-binding rules.²⁶⁰ Sharman refutes this contention, arguing that the elimination of the blacklisting process was based on the accomplishment of the objective which it sought.²⁶¹ Contesting this, Hulse argued that the evaluation process to warrant sanctions for non-compliance by the FATF was still

²⁵⁸ Christian Reus-Smit, *International Crises of Legitimacy* [2007] 44 *International Politics* 157, 172.

²⁵⁹ Jason Sharman, 'International Organization and Implementation by Blacklisting' (Paper presented at ISA Annual Convention, Chicago, February 28-March 3 2007).; Reuter P, Truman EM *Chasing Dirty Money: Progress on Anti-Money Laundering* (Institute for International Economics, Washington, DC, 2004) 165-170; Levi M, 'Money Laundering and its Regulation' [2002] 582 *Annals of the American Academy of Political Social Science* 181, 182; Mitsilegas V, 'Countering the Chameleon Threat of Dirty Money: Hard and Soft Law in the Emergence of a Global Regime against Money Laundering and Terrorist Finance' in Edwards A, Gill P (Eds) *Transnational Organised Crime: Perspectives on Global Security* (Routledge, London, 2004); Daepf Kathrin, *Le Regulation Selective De de la Finance Internationale: L' Initiative Sur Les Pays Ou Territoires Non Cooperatifs du GAFI* Universite De Lausanne. *Travaux De Dcience Politique* (2006) *Political Science Working Paper Series* < <https://www.unil.ch/iephi/files/live/sites/iephi/files/publications/TSP/28DaepfTSP.pdf> > accessed 6 May 2015.

²⁶⁰ Doyle T, *Cleaning Up Anti-Money Laundering Strategies: Current FATF Tactics Needlessly Violate International Law* [2002] 24 (2) *Houston Journal of International Law* 279, 298.

²⁶¹ Jason Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation* (Cornell University Press, Ithaca, NY, 2006). Sharman argues that the removal of this process came head on with its rebuttal by the IFIs with whom the FATF sought partnership due to resource constraints, as it was considered to be against the nature of the fund's seemingly voluntary agenda.

ongoing when the blacklisting process was truncated.²⁶² Hulsee thus maintained that the illegitimacy of the process fostered a re-evaluation. Nevertheless, the re-engineering did not last long as it has been replaced with a two-tier list compiled by the International Co-operation Review Group (ICRG).²⁶³ As earlier discussed, a closer examination of these lists – the ‘call on members to apply counter-measures’ list and the ‘call for enhanced due diligence risk proportionate to the risk arising from defaulting countries’ reveals that similar deficiencies exist. This two-tier list can easily be categorised as a ‘black-2’ and ‘grey’ list. The effect of the earlier blacklist that was expunged in the form of financial isolation is still present in ‘black-2’ list and more subtly present in the ‘grey list’. Thus there is a need to refine this to ensure procedural fairness and deliberations devoid of any form of coercion.

Flowing from input and throughput legitimacy is output legitimacy. This is concerned with the effective response of institutions to a problem. Whilst it is arguable that the FATF would be perceived to have output legitimacy when input legitimacy is accounted for, this is not necessarily the case, particularly when output is determined by expertise. Hulsee and Kerwer argue that the FATF standards are derived on the basis of expertise and not membership politics.²⁶⁴ Acceding to this, Vibert asserts that the IFIs and the TGNs belong to the knowledge world where their decision making skills are dependent on epistemic authority.²⁶⁵ This indicates that they draw on the procedure of the natural and social sciences to identify complications and frame policy responses.²⁶⁶ Thus, Winer asserts that the product of the FATF’s plenary sessions reflected in its standards are considered ‘neutral...and fair.’²⁶⁷ This illustrates the projection of the FATF as legitimate on the basis of the expertise wielded by its secretariat and staff in its processes. This position is blindsided to the politics of the

²⁶² Hulsee argues that this illustrates the power of stronger organisations over soft law bodies.

However, he argued that the G7 and OECD could have given the FATF similar power as the IFIs and it is not for this reason that blacklisting was recoiled.

²⁶³ FATF, ‘High-Risk and Non-Cooperative Jurisdictions’ (FATF) < [http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/more/more-on-high-risk-and-non-cooperative-jurisdictions.html?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/more/more-on-high-risk-and-non-cooperative-jurisdictions.html?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 10 June 2017.

²⁶⁴ Dieter Kerwer and Rainer Hulsee, ‘How International Organizations Rule the World: The Case of the Financial Action Task Force on Money Laundering’ [2011] 2 *Journal of International Stud.* 50 – 67.

²⁶⁵ Frank Vibert, ‘Reforming International Rule-Making’ [2012] 3 (3) *Global Policy* 391, 391.

²⁶⁶ *Ibid.*

²⁶⁷ Winer Jonathan and Trifin Roule, ‘Fighting Terrorist Finance’ [2002] 44 *Survival* 84.

agenda within the institution and its effect on the FATF's design and compliance. The politics is evident in the composition of experts from the private and public sector, who are mainly representatives of developed countries. This configuration does not encompass or represent the views of developing countries. And is thus capable of stifling the compliance of these countries to the FATF standards. Thus, any restructuring should de-politicise the FATF and ensure a truly 'expertise' process that includes the views of developing countries.

2.6 Conclusion

This chapter examines the evolution of AML/CFT standards, the institutions central to AML/CFT administration and the influence of these factors on state compliance. This chapter starts by establishing a link between the regulation of ML/TF and the financial sector reform, thus reinforcing the decision to incorporate this theme into global regulation. The AML/CFT standards had a contentious beginning but emerged as a crucial theme during financial sector reforms. This is attributable to the challenges posed to financial integrity by financial liberalization, especially as regards cross-border financial relations.

Whilst the FATF was initially responsible for the setting and dissemination of standards, the IFIs evolution through various cross-border crisis occasioned their perception of illicit crimes as auxiliary to their mandate. The IFIs are now involved in ensuring compliance with AML/CFT standards through participation in assessment processes. Consequently, as observers on the FATF, the IFIs hardened the trajectory of the FATF's soft law – a means of mandating global participation and compliance. This collaborative support between the IFIs and the FATF was aimed at facilitating compliance with AML/CFT standards.

However well-intentioned, the evolution of the IFIs and the FATF, although at different historical points, only inculcated a select group of developed countries. Consequently,

standards recommended and processes were at best suited to combatting ML/TF within these countries. Given the lack of transparency, accountability and legitimacy, the AC/EE have suffered a compliance deficit. This predicament is understood through the lens of the agency theory which unearths a legitimacy crisis, showing that the AC/EE are disproportionately involved and inexplicably affected by the regulations – an indication of hegemonic subjection.

Chapter 3

Preconditions for Effective Regulations of AML/CFT and Compliance Drivers in African Countries and Emerging Economies

3. Introduction

The preconditions for effective AML/CFT regulation aimed at forestalling illicit transfers and the role of law in its development have been the subject of a long and distinguished body of research.¹ This literature, although limited, has propelled debates on whether law is crucial to the in-country development of robust AML/CFT structures; and if it is, the design it ought to take to combat illicit crimes. Whilst the development of the ‘law matters’ thesis in AML/CFT regulation is still unresolved, there is recognition that law has to be situated with ‘confidence’ for countries to effectively combat illicit crimes.

The presence of ‘law and confidence’ across ACs/EEs does not necessarily result in similar domestic circumstances to effectively combat illicit crimes. More particularly, unlike EEs, a majority of ACs have continued to deviate from the expected outcomes in terms of compliance. This can be attributed to a range of factors such as reputational concerns, capacity and resource disparities. Such challenges feed into the compliance drivers in different jurisdictions. An examination of the preconditions for effective regulation and possible compliance drivers illustrate divergent effects on ACs/EEs,

¹ Basel Committee on Banking Supervision, ‘Consultative Document: Core Principles for Effective Banking Supervision’ (Basel Committee on Banking Supervision, 20 March 2012) <<http://www.bis.org/publ/bcbs213.pdf> > accessed 1 February 2016; International Organization of Securities Commissions, ‘Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation’ (OICU-IOSCO February 2008); International Monetary Fund, ‘Canada: Financial Sector Assessment Program: IOSCO Objectives and Principles of Securities Regulation – Detailed Assessment of Implementation 2014’ (IMF Country Report No. 14/73).

further indicating the possible unsuitability of the current regime in effectively combating ML/TF in ACs.

Section 1 examines the possibility of law as a precondition for effective regulation. Whilst acknowledging counter-arguments, it posits that law does serve as a bedrock for financial regulation. Additionally, it contends that the design of law is imperative given that in the absence of proper drafting, laws can and will be gamed. More so, it argues the robustness of law is largely dependent on other factors which are internal to a country. Section 2 encapsulates these factors as ‘confidence’ and discusses this as a pre-condition for effective regulation. Confidence is examined within the framework of financial stability, governmental, political and institutional systems within a country. These factors are required for the well-functioning of law, attainable through the design of the law. Section 3 discusses the variances in confidence and the resulting effect of legal transplantation across ACs/EEs. Section 4 discusses the perspective on compliance with global standards. It builds on previous sections given that the preconditions for effective regulations feed into the compliance drivers. This leads to section 5 which advances the claim that compliance is a function of legal and non-legal factors. Section 6 focuses on how countries are benchmarked against their compliance to international standards. It argues that the process of benchmarking reveals agency problems and further raises legitimacy concerns. Section 8 concludes by drawing the strands together.

3.1 Pre-conditions for Effective Regulations of AML/CFT in African Countries and Emerging Economies

IFIs and TGNs have agreed on certain preconditions to ensure effective financial regulation.² The BCBS categorises them into six key areas which are mainly outside the scope of regulatory power. These include sound and sustainable macroeconomic policies, a well-established framework for financial stability, well developed public infrastructure, a clear framework for crisis management and an appropriate safety net.³ There are overlaps with the International Organisation of Securities Commission (IOSCO) requirements which recognise similar preconditions categorised as the presence of sound economic policies, appropriate legal, tax and accounting framework and the absence of entry barriers to the market.⁴ This chapter however takes the perspective that there are two interrelated preconditions for effective regulation of AML/CFT – law and confidence, which although debatable, are crucial in ensuring robust regulation and compliance to the AML/CFT standards.

3.1.1 Law as a Precondition for Effective Regulation

Sturdy banking sectors arguably serve as stimuli for economic growth when regulated effectively. King and Levine's cross-country empirical study finds a strong positive correlation between financial sector development indicators and economic growth.⁵

² Basel Committee on Banking Supervision, 'Sound Management of Risks Related to Money Laundering and Financing of Terrorism' (Basel Committee on Banking Supervision, June 2017) <<http://www.bis.org/bcbs/publ/d405.pdf>> accessed August 2017; International Association of Insurance Supervisors, 'Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism' (2004); The Joint Forum, 'Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism' (June 2003) <<http://www.bis.org/publ/joint05.pdf>> accessed 1 May 2016.

³ Basel Committee on Banking Supervision, 'Consultative Document: Core Principles for Effective Banking Supervision' (Basel Committee on Banking Supervision, 20 March 2012) <<http://www.bis.org/publ/bcbs213.pdf>> accessed 1 February 2016.

⁴ International Organization of Securities Commissions, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (OICU-IOSCO February 2008); International Monetary Fund, 'Canada: Financial Sector Assessment Program: IOSCO Objectives and Principles of Securities Regulation – Detailed Assessment of Implementation 2014' (IMF Country Report No. 14/73).

⁵ Robert King and Ross Levine, 'Finance and Growth: Schumpeter Might Be Right' [1993] 108 (3) The Quarterly Journal of Economics 717, 732. Indices taken into consideration are the amount of liquid

Later studies by Levine⁶ and Fink et al⁷ contend that development of the financial sector accelerates economic growth. Petkovski and Kkosevski however note that the contribution of relatively underdeveloped credit market to growth is limited, with only a minor positive effect of ratio of quasi money (RMQ) on financial development.⁸ Suggesting that although interest margin and credit to the private sector are negatively related to economic growth, RMQ has a positive correlation. This argument, which follows the global financial crisis, is aligned with Alexiou et al's empirical findings which indicate that the potential benefits of the financial sector finance has resulted in 'uncreative destruction' in recent years.⁹ This suggests a severance of link between the financial sector and real economy. Alexiou et al., therefore, advance the argument that institutional framework proxied by quality of governance have a crucial role in determining economic growth.¹⁰

However, creating a regulated framework within which banks can thrive and advance economic growth in the absence of financial crime is challenging. Indeed, it is surprising that the banking sector still exists despite the effect of numerous financial crises on the confidence of depositors and the economy as a whole. The viability of banks as the suitable savings or investment option has been threatened with 'run on the bank' in jurisdictions like the United Kingdom.¹¹ Such atmosphere indicates the need for tougher regulations. Consequently, reactive laws have resulted from the need to address the vulnerabilities in the banking system. This indicates an assumption that safe

liabilities divided by GDP, the importance of commercial banks in relation to the central bank when allocating credit, the ratio of credit allocated to private enterprises to total domestic credit, and credit to private sector divided by GDP.

⁶ Levine Ross, 'Financial Development and Economic Growth: Viwes and Agenda' [1997] *Journal of Economic Literature*, XXXV, 688, 703.

⁷ Gerhard Fink, Peter R Haiss and Sirma Hristoforova, 'Growth Triggers in the European Union' (2004) *Papers and Proceedings of the 3rd IWH Workshop in Macroeconomics, Nomos, Baden*, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1317621> accessed 4 August 2017.

⁸ Mihail Petkovski and Jordan Kjosevski, 'Does Banking Sector Development Promote Economic Growth? An Empirical Analysis for Selected Countries in Central and South Easter Europe' [2012] 27 (1) *Economic Research-Ekonomska Istrazivanja* 55, 64.

⁹ Constantinos Alexiou, Sofoklis Vogiazas, Joseph Nellis, 'Reassessing the Relationship Between the Financial Sector and Economic Growth: Dynamic Panel Evidence' [2018] 1, 17.

¹⁰ *Ibid.*

¹¹ Hyun Song Shin, 'Reflections on Northern Rock: The Bank Run that Heralded the Global Financial Crisis' [2009] 23 (1) *Journal of Economic Perspectives* 101, 101.

banking activities can only function in a tightly regulated space.¹² This is highlighted by contract law which governs the relationship between banks, their investors and depositors, and mandates adherence to conduct of business regulations. Furthermore, there is increased legislation on such issues as money laundering, cybercrime, and tax evasion¹³ in ACs/EEs. Statutory supremacy mandates that these legislations are adhered to,¹⁴ and that a breach will result in attendant consequences.

The assumption that rigid regulation serves as a catalyst for bank safety also informed the FATF's mandate on AML/CFT regulation which is designed to:

‘promote effective implementation of *legal, regulatory and operational measures* for combatting money laundering, terrorist financing and the financing of proliferation, and other related threats to the integrity of the financial system.’¹⁵

The emphasis on the implementation of legal measures is not only an indication of the assumption that in the absence of enforcement actions, ML/TF will persist. More importantly, it signifies that robust legislation is required to guide implementation of legal measures. Additionally, it indicates that in the absence of tough laws, the capacity of countries to combat illicit crimes and their predicate offences will be severely restricted.¹⁶ Reverberating this perception, the IMF states that:

¹² Gerard Caprio, Jr, ‘Financial Regulation After the Crisis: How Did We Get Here and How Do We Get Out?’ [2013] Federal Reserve of San Francisco Proceedings 1, 19; Stijin Classens, Daniela Klingebiel and Luc Laeven, ‘Resolving Systemic Financial Crisis: Policies and Institutions’ (2004) 3377 *The World Bank*, 13 <http://documents.worldbank.org/curated/en/306631468780599186/126526322_20041117165058/additional/wps3377.pdf> accessed 18 November 2015.

¹³ Indian Income Tax Act 1961 and subsequently the Finance Act 2015; Article 201 People of China Criminal Law Amendment 2015.

¹⁴ Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution* (8th Edition, Liberty Classics 1982) 3-4.

¹⁵FATF, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations’ (FATF, 2013) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 12 May 2015.

¹⁶ FATF, ‘FATF Recommendation 3 and 4’ (FATF, 2013) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 12 May 2015.

‘Money launderers and terrorist financiers exploit loopholes and differences among national AML/CFT systems and move their funds to or through jurisdictions with *weak or ineffective legal* and institutional frameworks.’¹⁷

An examination of this IMF’s statement suggests that weak or ineffective laws are unsuitable for curbing laundering because criminals are specialist in understudying the jurisdictional laws of different countries – a crucial determinant factor for where to invest in.¹⁸ Interestingly, launderers also look at other business indicators such as openness and transparency of institutions to determine the strength of laws.¹⁹ For instance, sequel to the collapse of the Central Government of Comoros, each Island started exerting fiscal sovereignty.²⁰ Of the three existing Islands, Anjouan created a business friendly and stress free regulatory environment which not only permitted the licensing of banks within forty-eight hours but acceded to the operation of shell banks with limited information on beneficial owners.²¹ This indicated its commitment to promote financial secrecy.²² Furthermore, Anjouan restrained from cooperating with foreign governments except regarding serious criminal cases which excluded tax-related matters.²³ A few months after the creation of this Island as an offshore location, launderers from Russia started opening shell banks and companies through which they transferred money.²⁴ In 2008, it was reported that 300 offshore banks operated in Anjouan, many of which were shell banks.²⁵

¹⁷ IMF, Anti- Money Laundering/Combating the Financing of Terrorism Topics – The Fund’s Involvement In AML/CFT (International Monetary Fund) <<https://www.imf.org/external/np/leg/amlcft/eng/aml1.htm>> accessed 20 June 2016.

¹⁸ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

¹⁹ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

²⁰ Tax Justice Network-Africa, *Why Africa Should Stand Up for Tax Justice* (Pambazuka Press, 2011) 36.

²¹ Hilton McCann, *Offshore Finance* (CUP, 2009) 450.

²² Tax Justice Network-Africa, *Why Africa Should Stand Up for Tax Justice* (Pambazuka Press, 2011)33

²³ Hilton McCann, *Offshore Finance* (CUP, 2009) 450.

²⁴ Scott Sencal, Murat Akuyev and Yulia Somomakhina, ‘Offshores Restricted From Participation in Privatisation and Acquisition of Russian Strategic Companies’ (Cleary Gottlieb, Alert Memorandum, 10 July 2017) <<https://www.clearygottlieb.com/~media/cgsh/files/2017/publications/alert-memos/offshores-restricted-from-participation-in-privatizations-and-acquisitions-of-russian-7-10-17.pdf>> accessed 21 August 2017.

²⁵ Tax Justice Network-Africa, *Why Africa Should Stand Up for Tax Justice* (Pambazuka Press, 2011) 37

It is crucial to note that developed countries are not exempt from this difficulty. England has particularly weak regulations on real estate investments, a shortcoming that has encouraged launderers and foreign corrupt politicians to invest in real estate.²⁶

These examples demonstrate a pattern in the operation of launderers when dealing with jurisdictions with weak domestic legislations. Premised on these assumptions, the FATF makes soft law recommendations for countries that respond by promulgating legislation on AML/CFT.²⁷

This legislative process is followed by a monitoring and evaluation exercise by the FATF and or the IFIs to determine the extent of compliance.²⁸ Where the exercise indicates that countries have failed to enact laws based on the FATF recommendations, or faulted in their implementation, such countries are characterised as ‘weak’ or ‘non-compliant’. This measurement of compliance is indicative of the failure to align legislative frameworks with the Vienna and Palermo conventions. Consequentially, pressure is mounted on countries to elicit compliance in the formulation and construction of their laws.²⁹ The primary reactionary motives of countries are usually to avoid placement on the ‘black-2’ and ‘grey list’ and the penalties associated therewith.³⁰ This is one of the reasons behind the adaptation of laws which are perceived to be a mechanism for improved compliance and financial stability.³¹ While

²⁶ Robert Booth, ‘MPs Decry ‘Failed’ Effort to Stop UK Property Money Laundering’ (The Guardian, 15 July 2016) < <https://www.theguardian.com/money/2016/jul/15/mps-decry-inadequate-efforts-stop-money-laundering-uk-property> > accessed 10 August 2017; Damien Gayle, ‘Foreign Criminals Use London Housing Market to Launder Billions of Pounds’ (The Guardian, 25 July 2015) < <https://www.theguardian.com/uk-news/2015/jul/25/london-housing-market-launder-offshore-tax-havens> > accessed 10 August 2017.

²⁷ Saby Ghoshray, ‘Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law’ [2014-2015] 59 N.Y.L. SCH.L.REV.521, 537.

²⁸ FATF, ‘Methodology: For Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT System’ (FATF, 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%202022%20Feb%202013.pdf> > accessed 10 August 2017.

²⁹ This is usually done through sanctions.

³⁰ This was previously referred to as the Non-Cooperative Countries and Territories (NCCT). Leonardo Borlini, ‘The Financial Action Task Force: An Introduction’ (U4 Brief, January 2015) < <https://assets.publishing.service.gov.uk/media/57a0898ee5274a27b2000137/U4Brief-2015-02WEB.pdf> > accessed 18 March 2016.

³¹ Hemeiri Shahar, Lee Jones, ‘Regulatory Regionalism and Anti-Money Laundering Governance in Asia’ [2015] 69 (2) Australian Journal of International Affairs 144, 145; Jackie Johnson, ‘Blacklisting:

it is plausible that a system of laws guiding businesses including corporate laws, AML/CFT laws, bankruptcy laws, contract, consumer protection and property laws may serve as a precondition for effective regulation, the extent to which they can do so has been subject to debate.

3.1.2 Law as the Bedrock for Financial Regulation

Some scholars have argued that robust laws would lead to effective supervision, efficient risk management and good corporate governance practices within banks.³² The assumption is that this would serve as a catalyst for improving confidence in the banking system, thus possibly limiting the extent of any potential financial instability.³³ Singh highlights the importance of the law in ensuring financial stability, stating that it is crucial in preserving confidence in institutions and holding government agencies accountable.³⁴

Acknowledging the diverse application of law, Medish contends that laws form the basis for microeconomic change, as such, laws of economics do not get a proper chance to work without the rule of law.³⁵ His argument underscores that accountability, transparency and legitimacy of regulatory actions are built on the premise of functional rule of law. This indicates subjection of all institutions, entities and the state itself to

Initial Reactions, Responses and Repercussion' [2001] 4 (2) *Journal of Money Laundering Control* 211, 213.

³² Klaus J Hopt, 'Corporate Governance of Banks after the Financial Crisis' in E. Wymeersch, K.J Hopt, G Ferrarini (eds), *Financial Regulation and Supervision, A Post-Crisis Analysis* (Oxford University Press 2012) 3; Klaus J Hopt, 'Better Governance of Financial Institutions' (2013) *European Corporate Governance Institute Working Paper* 207/2013, 23 < <http://personal.lse.ac.uk/schustee/hopt%20governance.pdf> > accessed 6 May 2016.

³³ Klaus J Hopt, 'Better Governance of Financial Institutions' (2013) *European Corporate Governance Institute Working Paper* 207/2013, 23 < <http://personal.lse.ac.uk/schustee/hopt%20governance.pdf> > accessed 6 May 2016.

³⁴ Dalvinder Singh and John Raymond La Brosse, 'Developing a Framework for Effective Financial Crisis Management' [2012] 2 *OECD Journal: Financial Market Trends* 1,7.

³⁵ Mark Medish, 'Lesson from Economies in Transition During Global Financial Crisis', in Joseph R Sisignano, William C Hunter, George Kaufman, *Global Financial Crises: Lessons from Recent Events* (Bank for International Settlement Federal Reserve Bank of Chicago, 2000) 61.

legislation,³⁶ which provides for judicial independence and consistent enforcement. These assertions feed into the five criteria for effective regulation enumerated by Baldwin et al, the top criterion listed as a robust legislative mandate.³⁷ They argue that regulatory action deserves support when authorised by parliament, the recognised bedrock of democratic authority.³⁸ As a supervisory law, banking law is a specialised area of administrative law. It elucidates how agencies operate and circumstances where the right of citizens can be contained by the state.³⁹

However, there is the recognition that the strength of laws are predicated on the system in which they operate.⁴⁰ Chinn and Ito argue that financial openness can only be beneficial when appropriate legal systems and institutions are in place.⁴¹ This study reveals that equity market development can be spurred by financial openness if a threshold of legal development has been attained.⁴² Cooter, Schafer and Ulen argue that the differences in legal institutions are reflective of the level of development in countries.⁴³ An application of these studies to global regulation of AML/CFT provides some explanation for the disparities in the assimilation of the FATF recommendations by ACs/EEs. Through a historical perspective, the following sub-sections will illustrate that, in comparison with ACs, EEs have more robust legislative responses due to stronger legislative capacity, however, they do not necessarily have stronger rule of law. Nevertheless, legislative capacity amplifies their ability to adopt tougher laws to

³⁶ Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution* (1960) 191.

³⁷ Robert Baldwin, Martin Cave, Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (First published 2012, 2nd Edn., OUP 2014) 27.

³⁸ Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution* (1960) 9.

³⁹ Wouter Bossu and Dawn Chew, "But We Are Different!" 12 Common Weaknesses in Banking Laws, and What to Do About Them (2015) IMF Working Paper WP/15/2000 < <https://poseidon01.ssrn.com/delivery.php?ID=576121020003020082097102019092078064000043077033024024075002002042074000025083108029104081102046010030004002117098116116088024092072071025071093071007095108077089010030086006021071&EXT=pdf> > accessed 19 May 2016

⁴⁰ Rahmat Mohamad, 'Access to International Justice: The Role of the International Criminal Court in Aiding National Prosecutions of International Crimes' [2012] 1 (2) AALCO Journal of International Law 1.8.

⁴¹ Chinn Menzie and Ito Hiro, 'What Matters for Financial Development? Capital Controls, Institutions and Interactions' [2006] 81 (1) Journal of Development Economics 163, 165.

⁴² Ibid 163, 187.

⁴³ Cooter, R. and Schafer, H.B, *Solomon's Knot: How Law Can End the Poverty of Nations* (First published 2012 Princeton University Press 2012) 173; Ulen T, The Uneasy Case for Competition Law and Regulation as Decisive Factors in Development: Some Lessons for China in M, Faure and Z., Xang (eds), *Competition Policy and Regulation. Recent Developments in China, the US and Europe* (Edward Elgar 2011) 13 – 44.

combat illicit crimes. Additionally, the economic position of EEs makes it imperative to address reputational concerns before they manifest, an issue which is easier to address in countries with sturdier legal structures.

3.1.2.1 Legislative Changes in African Countries Resulting from AML/CFT Laws

The importance of law as a bedrock of financial regulation can be exemplified with the significant changes recorded within countries resulting from AML/CFT legislations; particularly in ACs, as can be seen through the continent's legislative and technical evolution post the colonial era.⁴⁴

It is imperative to state that during the colonial period, the crime of 'money laundering' was nonexistent. Although certain predicate offences like bribery, corruption, extortion and other offences had been acknowledged to exist. Attesting to this, Rodney stated that 'colonialism was not merely a system of exploitation, but one whose essential purpose was to repatriate the profits to the so-called motherland'.⁴⁵ Rodney speaks of an era dominated by slave trade and a gradual move to a period characterized by the exploitation of labor and forced labor where 'Africans in their country were forced to grow cash crops by gun and whip'.⁴⁶ The gradual change evidences the tactical means employed by colonial masters to circumvent the 1833 Abolition of Slave Trade Act, which was not only illegal but a process through which ill-gotten wealth in Africa was made clean through transfers to capitalist economies. Interestingly, during this dictatorial period, such 'illicit' transfers, exorbitant taxation and exclusive rights of

⁴⁴ Focus here will be on Nigeria in particular, as a prism through which other African countries can be viewed.

⁴⁵ Walter Rodney, *How Europe Underdeveloped Africa* (Bogle L'Ouverture Publications Ltd, London 1988).

⁴⁶ *Ibid.*

exploitation granted to British and European firms over mineral and natural resources were legalized.⁴⁷

The prevalent exploitation that riddled the colonial era set the tone for the decolonization struggle, given that the structures instituted by the colonial masters hindered the fight for independence in ACs. Colonial masters struggled to give up power, arguing instead that their colonies were politically corrupt and unable to handle independence. For instance, colonial masters contended that Nigeria was ridden with ‘corruption and bribery’⁴⁸ and hence required ‘ceaseless vigilance of the British Staff to maintain a high standard of integrity and...prevent the oppression of peasantry’.⁴⁹ Tignor, however, argued that the colonial masters had expected their collaborators to behave this way.⁵⁰ Hence, as the struggle for independence grew, colonial masters continually produced reports which indicted leaders of the movement as corrupt and unjustly enriched to the detriment of their people.⁵¹ Nevertheless, ACs began to gain their independence in the 1950s.

During the decolonization period, the ruling class had opportunities to amass wealth. They were made ministers or chairmen of parastatals, with power to issue licenses, award contracts or scholarships, subject only to veto powers of colonial authority.⁵² They exploited these positions to gain ‘kickbacks’ which are illegal pre-payment of a percentage of the contract awarded to the official in power.⁵³ This was particularly predominant in Nigeria after she gained independence in 1960, a period marred by widespread corruption. To combat these illicit crimes, coupled with the disregard for

⁴⁷ Austine Ejovi, Mgbonyebi Charles and Akpokighe Okiemute Raymond, ‘Corruption in Nigeria: A Historical Perspective’ [2013] 3 (16) *Research Humanities and Social Sciences Journal* 1, 19.

⁴⁸ Robert Tignor, ‘Political Corruption in Nigeria before Independence’ [1993] 31 (2) *Journal of Modern African Studies* 175, 178.

⁴⁹ Lord Lugard, *The Dual Mandate in Tropical Africa* (6th edn, Routledge 1922) 198; Colonial Office, Report of the Commission of Enquiry into the Disorders of the Eastern Province of Nigeria, November, 1949 (London, 1950) 12 and 30.

⁵⁰ Robert Tignor, ‘Political Corruption in Nigeria before Independence’ [1993] 31 (2) *Journal of Modern African Studies* 175, 178.

⁵¹ *Ibid* 175, 201.

⁵² Dudley B.J, *Instability and Political Order: Politics and Crisis in Nigeria* (Ibadan, Ibadan University Press, 1973).

⁵³ Ajayi Adegboyega Isaac, ‘Military Regimes and Nation Building in Nigeria, 1966-1999’ [2013] 5 (7) *African Journal of History and Culture* 138, 141.

rule of law and lack of accountability, the military took over control in 1966 and dominated for about 32 years.⁵⁴ Over six successful military coups occurred aimed at curbing corruption.⁵⁵ The regimes of Murtala Mohammed in 1975 and Muhammadu Buhari in 1983 made considerable progress.⁵⁶ Murtala Mohammed was killed 6 months into his regime, whilst Muhammadu Buhari was deposed by another military coup in 1985.⁵⁷ Sadly, disregard for rule of law, corruption, lack of accountability and transparency remained mainstream; most prominently showcased during the Sani Abacha regime, which looted about £5 billion from Nigeria's coffers and stashed in jurisdictions including the United Kingdom and Switzerland.⁵⁸

Whilst there were steps to curb corruption by each successive military government, there was limited focus on money laundering until Nigerian's accession to the 1988 Vienna Convention. This culminated in Nigeria's first significant piece of legislation (by decree) – the Drug Law Enforcement Agency (NDLEA) Act, imbuing the NDLEA with enforcement powers against drug crime. Mirroring the Vienna Convention, the NDLEA decree focused on tackling money laundering through a fight on drugs alone. At that time, Nigeria had developed large-scale drug trafficking and was classed as second only to China in the trafficking of drugs to the United States.⁵⁹ The environment was facilitated by drug lords who operated from a relatively safe home-base given the absence of laws. The NDLEA cracked down on drug lords at the point of cultivation, processing, sale and trafficking.⁶⁰ However, the NDLEA decree could not take

⁵⁴ Ibid 138, 140. It should be noted that a period of civilian rule existed between 1979 and December 1983 under President Shehu Shagari.

⁵⁵ Ibid.

⁵⁶ Ogbewere Bankole Ijewereme, 'Anatomy of Corruption in the Nigeria Public Sector: Theoretical Perspectives and some Empirical Explanations' [2015] Sage Open 1, 7.

⁵⁷ Ibid 1, 4.

⁵⁸ The Associated Press, Late Nigerian Dictator Looted Nearly \$500 Million, Swiss Say (New York Times, 19 August 2004) < <http://www.nytimes.com/2004/08/19/world/late-nigerian-dictator-looted-nearly-500-million-swiss-say.html> > accessed 29 September 2017; Michael Ogedi, 'Political Leadership and Corruption in Nigeria Since 1960: A Socio-Economic Analysis' [2012] 1 (2) Journal of Nigeria Studies 1, 9.

⁵⁹ Chibuike Ugochukwu Uche, 'The Adoption of a Money Laundering Regime in Nigeria' [1988] 1 (3) JMLC 220, 220.

⁶⁰ National Drug Law Enforcement Agency Act 1989.

cognizance of other crimes in Nigeria, such as corruption, bribery, etc. This shortcoming led to the enactment of the Money Laundering Decree (MLD) 1995.⁶¹

A perusal of the MLD reveals the recognition that the use of financial institutions as a conduit to launder funds could potentially trigger financial instability.⁶² Hence, this decree was focused on ensuring financial stability and integrity. As a result, for the first time, financial institutions and individuals were mandated to commence consumer due diligence in cash payment above a certain threshold, a process which kickstarts once a customer seeks to open an account.⁶³ The decree mandated banks to comply with these requirements given the force of law and the regimented structure put in place to combat money laundering. Financial institutions were also mandated to disclose overseas transfers and ensure that all details are precise.⁶⁴ It also covered the activities of casinos and gambling houses, mandating that due diligence be carried out on all customers and appropriate recordings made.⁶⁵ More importantly, this decree required a continued relationship between financial institutions and the NDLEA, to ensure that drug traffickers do not get under the radar of the laws.⁶⁶

These decrees which changed the landscape of money laundering regulation in Nigeria, had their limitations. For instance, the MLD which was the first legislation to require customer due diligence by financial institutions saw individuals and institutions gradually align their practices to conform with its provisions. It however failed to the extent that it provided discretionary powers to financial institutions on whether or not to report suspicious transactions. Additionally, penalties were only targeted at staff of the financial institution and not the institutions themselves, a shortcoming which may have warranted limited compliance. More so, the decree was unclear regarding its definition of money laundering. Additionally, Nigeria was still largely a cash-based

⁶¹ Adegboyega Ige, 'A Review of the Legislative and Institutional Frameworks for Combating Money Laundering in Nigeria' [2011] 1 NIALS; Nlerum Okogbule, 'Combating Money Laundering in Nigeria: An Appraisal of the Money Laundering Act 2004' [2007] 28 (2) Statute Law Review 156, 157.

⁶² Money Laundering Decree 1995.

⁶³ Money Laundering Decree 1995, S 1 (a) (b), S 10 (2).

⁶⁴ Money Laundering Decree 1995.

⁶⁵ Ibid.

⁶⁶ Ibid S 4 (1) (a); S 4(1) (b).

economy where less than 37% of adults had access to financial services.⁶⁷ Hence, like drugs, money was usually laundered physically – mainly through airports or seaports, an area unaddressed by the MLD. These deficiencies proved the limitations of legislative capacity in terms of comprehension of the scale of the problems and how best to tackle it. It showed that Nigeria was not ready to effectively tackle money laundering or its predicate offences. The focus of the decree was mainly on criminalization and enforcement (breeding a ‘don’t-be-caught’ mentality), not necessarily on prevention. These shortcomings led to the FATF blacklisting of Nigeria in 2001.

Nigeria enacted the Money Laundering (Amendment) Act 2002 in order to cure existing deficiencies and avoid the possible effects of the FATF’s sanction. This Act expanded the scope of predicate offences to other illegal acts. It also extended AML obligations to other non-financial institutions and required enhanced due diligence. The FATF however still faulted the Act, leading to the enactment of the Money Laundering (Prohibition) Act 2004 which repealed the 2002 Act. The 2004 Act was modelled to ensure the delisting of Nigeria from the FATF’s blacklist. Hence, it limited the amount of cash that private individuals and corporate entities could hold for the purpose of making any payments to five hundred thousand naira (N500,000) and one million naira (N1,000,000) respectively.⁶⁸ It also provided that transfers above the stipulated amount be done through a financial institution. Additionally, it limited international transfers to ten thousand dollars (\$10,000), mandating a report to the Central Bank of Nigeria or the Securities and Exchange Commission when the mandated limit was exceeded.⁶⁹ The aim of these requirements were to ensure a move away from a cash-based to a cashless economy, whilst ensuring that regulatory agencies can formulate and implement practical futuristic policies. The Act achieved the aim of delisting Nigeria from the FATF’s blacklist.

⁶⁷Financial Inclusion Insights, ‘Nigeria: Wave 3 Report, FII Tracker Survey Conducted August – September 2015’ (FinInclusion.org, 2015) <<http://finclusion.org/uploads/file/reports/InterMedia%20FII%20Nigeria%20W3%20%2030%20April%202016.pdf>> accessed July 2016.

⁶⁸ Money Laundering Act 2004, S1(1).

⁶⁹ Ibid S 2(1); S2 (2).

Importantly, two other notable laws, the Corrupt Practices and Other Offences Act 2000 which sets up the Independent Corrupt Practices and Other Related Offences Commission (ICPC) and the Economic and Financial Crimes Commission (EFCC) Act 2002, also facilitated the delisting of Nigeria.⁷⁰ The ICPC focuses squarely on fighting corruption through investigations, arrests, prosecutions, corrective, preventative and educational responsibilities. The EFCC has a broader agenda, focused on the investigation and prosecution of all financial crimes.⁷¹ The EFCC is also authorized to freeze bank accounts, seize assets or arrest suspects.⁷² The Nigerian Financial Intelligence Unit (NFIU) is domiciled within the EFCC and serves as the national center for the collation and analysis of suspicious transaction reports and other relevant information to money laundering. The NFIU mainly derives its power from the Money Laundering Prohibition Act 2011, as amended in 2012 and the EFCC Act. It is also responsible for establishing and maintaining relationships with other Financial Intelligence Units (FIUs) within the Egmont Group.

Following these legislations, there has been appreciable progress in the way money laundering and terrorist financing is combatted in Nigeria, particularly through financial institutions. For instance, banks now implement the CDD requirements as mandated by law with the aim of creating and maintaining a paper trail. Reporting requirements entrenched by law mandate that suspicious transactions be brought to the attention of regulators. Management can now be held responsible for their acts and omissions in facilitating money laundering.

Consequently, it is arguable that Nigerian and, indeed, Africa laws may be capable of curbing illicit crimes. EENA2 states that ‘it is not as dire as one might think in ...African countries – in fact, the letter of the law is pretty good’.⁷³ However, recently, the Egmont Group suspended Nigeria for failing to enact legislations to autotomize the

⁷⁰ The Corrupt Practices and other Related Offences Act 2000 No.5 Laws of the Federation of Nigeria; the Economic and Financial Crimes Commission (Establishment) Act 2002.

⁷¹ Nuhu Ribadu, *Show Me the Money – Leveraging Anti-Money Laundering Tools to Fight Corruption in Nigeria: An Insider Story* (Centre for Global Development 2010) 16.

⁷² Economic and Financial Crimes Commission (Establishment) Act 2004, Section 7(1) (a).

⁷³ EENA2, Senior Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA2, ‘Telephone Call’ (2017).

country's NFIU from the EFCC.⁷⁴ Nigeria is yet to take positive steps to avert an impending expulsion. Chukwuma Utazi, the Chairman, Nigerian Senate Committee on Anti-Corruption has stated that 'they (Egmont) already said that if we did not comply, they would expel us, so there is no fresh news there...we are working towards it, nothing has been done.'⁷⁵ This sort of response illustrates a nonchalant approach to addressing an issue pending for over five years. Furthermore, it shows a lack of legislative capacity and concern for reputational damage. It also demonstrates legislators' reactive approach in ACs to addressing pressing issues.

3.1.2.2 Legislative Changes in Emerging Economies Resulting from AML/CFT Laws

Legislation-inspired changes are more profound in EEs, taking China as an example. China's history indicates the effects of ML/TF during the ancient period (BC 2000), when all properties were vested in the ruler.⁷⁶ Merchants had engaged in extortion, bribery and subsequent investment of these properties in other jurisdictions, circumventing restrictions imposed by the government.⁷⁷ Measures devised to curb the appropriation of properties proved insufficient in the face of varied ways of laundering.

⁷⁴ Damilola Oyedele, 'Egmont: Senate, House Disagree on NFIA as Threat of Nigeria's Expulsion Looms' (Thisday, 6 February 2018) < <https://www.thisdaylive.com/index.php/2018/02/06/egmont-senate-house-disagree-on-nfia-as-threat-of-nigerias-expulsion-looms/> > accessed 11 February 2018.

⁷⁵ Ibid.

⁷⁶ Sterling Seagrave, *Lord of the Rim* (Bantam Press, London 1997).

⁷⁷ Nigel Morris –Cotterill, 'Money Laundering' [2001] 124 Foreign Policy 16 – 20.

Like ACs, the first legislation came as a result of China's accession to the 1988 Vienna Convention.⁷⁸ These laws could only combat drug crime.⁷⁹ Subsequent legislation included other predicate offences – in line with evolving international standards.⁸⁰

China's evolving laws were inspired by responses to external pressures, for instance, from the FATF. Two thematic areas stand out – customer due diligence and reporting.

There is evidence that legislation on customer due diligence (CDD) impacted the active fight against illicit crimes.⁸¹ Prior to these legal requirements, there was no evidence that Chinese banks, especially smaller banks, implemented CDD requirements.⁸² Thus, it is unsurprising that the first regulation requiring customers to use genuine names to open bank accounts was in 2000.⁸³ Lack of CDD requirements cloaked launderers in anonymity, enabling them to operate for so long without detection. China has now implemented CDD requirements to combat AML/CFT following FATF's stipulations,⁸⁴ thus potentially reducing the extent to which financial institutions can be used to transfer illicit funds.

⁷⁸ The Chinese Government signed the convention on December 20, 1998, handed over the instrument of accession on December 25, 1989. The convention came into effect in China on November 11, 1990, NB: In 1979, prior to the criminalization of money laundering internationally, Art. 312 Chinese Criminal Law criminalized activities receiving and handling proceeds of crime.

⁷⁹ The Chinese Government signed the convention on December 20, 1998, handed over the instrument of accession on December 25, 1989. The convention went into effect in China on November 11, 1990, NB: In 1979, prior to the criminalization of money laundering internationally, Art. 312 Chinese Criminal Law criminalized activities receiving and handling proceeds of crime.

⁸⁰ This was in 2001 to include 'terrorist financing' and in 2006 to include other financial crimes/predicate offences, it was previously expanded to cover only drug and organised crime, terrorism and smuggling in 1997.

⁸¹ "Rules for Anti-Money Laundering by Financial Institutions" and the "Administrative Rules for the Reporting of Large-Value and Suspicious Transaction by Financial Institutions"; Asian Banker Research, Identifying Anti-Money Laundering Issues in Chinese Banks <[https://www.theasianbanker.com/assets/media/dl/whitepaper/Asian%20Banker%20White%20Paper%20-%20China%20Anti-Money%20Laundry%20\(English\).pdf](https://www.theasianbanker.com/assets/media/dl/whitepaper/Asian%20Banker%20White%20Paper%20-%20China%20Anti-Money%20Laundry%20(English).pdf) > accessed 13 February 2016.

⁸² Prior to 2003.

⁸³ Xue Bin Li, 'Money Laundering and its Regulation in China' (UMI Dissertation Publishing 2009) 256.

⁸⁴ Rules for Anti-Money Laundering by Financial Institutions, Administrative Rules for the Reporting of Large-Value and Suspicious RMB Payment Transactions and the Administrative Rules for the Reporting by Financial institutions of Large-Value and suspicious foreign exchange transactions – has been extended to cover all financial institutions, See recent Article 6 and 9 of the Chinese Financial Institutions Anti-Money Laundering Regulation (CFLAMLR).

Law has also changed the culture regarding ‘reporting’ of suspicious transactions by financial institutions. China’s 2003 AML/CFT legislation introduced for the first time - the requirement to report suspicious transactions. However, due to legislative capacity challenges, it failed to capture FATF current recommendations 9 – 12 and 20 – 23 on reporting.⁸⁵ In the absence of appropriate prescriptive guidelines on detection and reporting of suspicious transactions, compliance officers honoured the laws in breach. The shortcomings of the Chinese Financial Institutions Anti Money Laundering Regulation (CFLAMLR) do not overshadow its advantages. It set out the thresholds for identifying suspicious transactions.⁸⁶ Furthermore, China imposed penalties for non-compliance with reporting requirements, which emphasized its drive to foster a robust corporate governance culture. Persons found liable of non-compliance face disciplinary sanctions, usually in form of fines.⁸⁷ Serious cases could lead to the revocation of business licences.⁸⁸

Considering that transplantation of global standards was key to advancing its economic vision, China enacted stricter AML/CFT laws, sometimes graver than international standards. For instance, whilst international standards impose financial penalties or imprisonment for tax evasion as a predicate offense,⁸⁹ the Chinese Government made it a capital offence.⁹⁰ This approach has gained scholarly support. Lacking empirical

⁸⁵ FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations’ (FATF, 2013) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 12 May 2015.

⁸⁶ For instance, it required financial institutions to identify suspicious transactions on the basis of set thresholds for daily transfers from companies and/or individuals for which customer due diligence (CDD) is required. There are also minimum transaction thresholds under which CDD is not required; The PwC financial services KYC AML guide list further areas where a CDD would not be considered expedient in China, for instance, where the property insurance contracts paid in cash is a single amount insurance premium less than RMB 10,000 or foreign currency of value US\$1,000 or equivalent. - This indicates that not all cases fall under this bracket, it is wide but not too wide.

⁸⁷ Penalties include disciplinary sanction or revolving qualification to hold a post, a fine of RMB 500,000 to the individual or/and RMB 20,000 up to RMB5 million to the organization.

⁸⁸ PricewaterhouseCoopers, Know Your Customer: Quick Reference Guide (PwC, January 2016) <<https://www.pwc.com/gx/en/financial-services/publications/assets/pwc-anti-money-laundering-2016.pdf>> accessed 17 May 2017.

⁸⁹ FATF, ‘Methodology: For Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT System’ (FATF, 2013) <<http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf>> accessed 10 August 2017.; The Effectiveness of AML/CFT Systems Recommendation 3.3.

⁹⁰ Death Penalty was eventually ended in 2011, see Ian Jeffries, *Political Developments in Contemporary China: A Guide* (First published 2011, Routledge 2011) 128; see also Chris Higg, China Ends Death Penalty for 13 Economic Crimes (*BBC News Shanghai*, February 2011) <

evidence, Shuceng suggests that modifications of the punishment regimes have contributed to reduced criminal offences in China.⁹¹ Subsequent cross-country empirical studies support Shuceng's suggestion, showing how tougher money laundering regulations, particularly those that criminalise feeding activities or improved disclosure are linked to lower levels of money laundering.⁹²

Given the foregoing legislative alignment with global standards, it is fair to postulate that China's legislators have stronger capacity. This explains why, despite the omissions in the legislation regarding reporting suspicious transactions, the law gave room for effective implementation. This warranted the 2016 International Narcotics Control Strategy Report (INCSR) which recorded China's milestones in addressing the early challenges posed by lack of relevant laws.⁹³ This milestone demonstrates an awareness by the legislators of China's economic and international relations agenda, including the need to maintain its global reputation.

3.1.3 Law as the Bedrock of Financial Regulation: A Rejoinder

The weakness or absence of AML/CFT laws in certain countries has revealed that tough laws may not necessarily be a precondition for effective regulation.⁹⁴ Davis and Trebilcock reinforce this with empirical reports, which indicate that there is limited correlation between enhanced legal systems and development.⁹⁵ Additionally, law and

<http://www.bbc.co.uk/news/world-asia-pacific-12580504> > accessed 11 February 2016; NB The effectiveness is however questionable as only a few people were actually executed.

⁹¹ Wang Shucheng, Predictions on the Development and Direction of Legislation, in Yuwen W. Li (edn) *The China Legal Development Yearbook*, (Volume 2, 2009).

⁹² Alberto Chong and Florencio Lopez-de Silanes, 'Money Laundering and Its Regulation' [2015] 27 *Journal of Economics and Politics* 1, 25.

⁹³ U.S. Department of State, '2016 International Narcotics Control Strategy Report: Countries/Jurisdictions of Primary Concern - China' (U.S. Department of State, 2016) < <https://www.state.gov/j/inl/rls/nrcrpt/2016/vol2/253391.htm> > accessed 11 February 2017; Tax Justice Network, 'Financial Secrecy Index' (Tax Justice Network, 30 January 2018) < <http://www.financialsecrecyindex.com/database/China.xml#t129> > accessed 11 February 2018

⁹⁴ Alberto Chong, Florencio Lopez-De-Silanes, 'Money Laundering and its Regulations' [2015] 27 *Economics and Politics* 1, 5.

⁹⁵ Kevin Davis and Michael Trebilock, 'What Role Do Legal Institutions Play in Development' (Draft for the IMF Conference of 2nd Generation Reform, October 1989).

economics scholars have argued that statutory laws are either immaterial or ineffective.⁹⁶ Moreover, it can be argued, further to the principal-agent theory, that laws can be gamed as countries have the power to manipulate and direct behaviour given their interpretation of the law. Consequently, it is imperative to question the need for statutory law in AML/CFT regulation. Scholars have postulated five situations where laws may not be ideal for robust regulation.

First, it is argued that laws are misdirected and the unintended consequences thereof are increased predicate offences. Chong and Lopez De Silanes argue that from legal and economic perspectives, the ineffectiveness of money laundering legislation is responsible for the misdirection of regulatory policies which focus mainly on laundering acts, as opposed to predicate offences.⁹⁷ They argue that regulatory focus on predicate offences will eventually lead to a reduction in ML/TF crimes, given that ML/TF is an outcome of predicate offences.⁹⁸ They also posit that AML/CFT statutes have not only been inactive in combatting initial predicate offences of drug crimes, but have further perpetuated other crimes such as kidnapping and smuggling.⁹⁹ Resultantly, it is argued that AML/CFT regulation is immaterial and disadvantageous, as it increases demand for services by inventing new crimes, fostering the creation of a new criminal industry to evade new laws.¹⁰⁰ Though compelling, this argument does not present the true nature of AML/CFT laws which no doubt includes predicate offences. Additionally, certain predicate offences such as tax evasion or kidnapping have separate laws which can be read alongside AML/CFT laws.

The second perspective posits that the reputation of financial institutions alongside enforcement actions by courts are sufficient preconditions for effective regulation of

⁹⁶ R.H Coase, 'The Nature of the Firm' *Economica* [2007] 4 (16) ; Alberto Chong, Florencio Lopez-De-Silanes, 'Money Laundering and Its Regulation' [2015] 27 *Economics and Politics* 1,5.

⁹⁷ Alberto Chong, Florencio Lopez-De-Silanes, 'Money Laundering and its Regulations' [2015] 27 *Economics and Politics* 1, 5.

⁹⁸ *Ibid.*

⁹⁹ *Ibid.*

¹⁰⁰ Richard W. Rhan , 'The Case Against Federalising Airport Security,' (CATO Institute, 2001) <<http://www.cato.org/publications/commentary/case-against-federalizing-airport-security> > accessed 16 August 2016.

ML/TF. This argument recognises that potentially damaging penalties on financial institutions can propel robust regulation. For instance, blacklisting of tax havens by OECD potentially restricts the activities of institutions within the sanctioned countries, causing reputational damage and consequently leading to improved regulation and compliance.¹⁰¹ Furthermore, it also acknowledges the role of courts in ‘law-making.’¹⁰² Lending credence to this position, La Porta et al and North argue that irrespective of the content of the law, better enforcement could be associated with lower levels of criminal activity – including money laundering.¹⁰³ However, this perspective that court-driven enforcement is sufficient to tackle ML/TF and render AML/CFT regulation needless is limited given that in the absence of legislative structures, regulation may not have the force of law. It fails to recognise the difference between legislation (laws enacted by the legislature or the governing body of a country)¹⁰⁴ and regulation (the process of monitoring and enforcing legislation or a written instrument containing rules built on laws).¹⁰⁵ Thus, for instance, where the legislature enacts a law requiring telecommunication companies to register all Subscriber Identity Module (SIM) card users, the relevant regulatory body is duty-bound to guide implementation of the law. This underscores that law informs regulation and enforcement.

Thirdly, scholars have postulated that legislation that is not backed by tough regulatory measures would not serve as a precondition for effective regulation.¹⁰⁶ This can be illustrated by the weak regulation of beneficial ownership in Nigeria, Togo and China,

¹⁰¹ Robert Thomas Kudrie, ‘Did Blacklisting Hurt the Tax Havens?’ [2009] 12 (1) *Journal of Money Laundering Control* 1,3; OECD, ‘List of Uncooperative Tax Havens’ <<http://www.oecd.org/countries/monaco/listofunco-operativetaxhavens.htm>> accessed 17 January 2017.

¹⁰² William B Hornblower, ‘A Century of “Judge-Made” Law’ [1907] 7 (7) *CLR*.

¹⁰³ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny ‘The Quality of Government’ [1999] 15 (1) *The Journal of Law, Economics and Organisation* 222, 235; North Douglass, *Growth and Structural Change* (W.W. Norton, New York, 1981).

¹⁰⁴ Some authors have however defined both to mean the same thing, for instance, Christine Parker defines regulation to include ‘laws, formal and informal orders, subordinate rules issued by all levels of government...’ See OECD, ‘Reducing the Risk of Policy Failure: Challenges for Regulatory Compliance’ (OECD, 2000) <<https://www.oecd.org/gov/regulatory-policy/1910833.pdf>> accessed 20 July 2016.

¹⁰⁵ Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1, 11.

¹⁰⁶ Mark J. Roe, ‘Corporate Law’s Limits’ [2002] 31 (2) *Journal of Legal Studies* 233-271, Columbia Law and Economics Working Paper No.186.

notwithstanding their tough legislation which signals a gaming of the law.¹⁰⁷ Beneficial ownership which refers to the ‘real ownership’ of funds or stocks held in trust or corporate vehicles is an identified avenue for ML/TF.¹⁰⁸ ‘Nominees’ who hold assets on trust have no executive authority over the business affairs of their clients, but merely charge for use of their details on official documents. In certain instances, the nominee is usually unaware of the owner’s true identity. Weak regulatory measures on beneficial ownership means that funds may be laundered through this structure by industries that have evolved to meet the demands of individuals and organisations seeking privacy for legitimate and illegitimate reasons.¹⁰⁹ These weak regulatory measures can however be supplanted by parliamentary committees, the ombudsman, competition commissions or judicial review.¹¹⁰ The parliamentary committee’s role was decisive in ensuring financial due process in the Nigerian Securities and Exchange Commission.¹¹¹

Fourthly, there is a global challenge to evaluate the effectiveness of AML/CFT legislations and resulting regulations. Academics have noted the difficulties in estimating the annual cost of laundering due to varying and evolving money laundering

¹⁰⁷ Transparency International, ‘Were G20 Corruption Promises Nothing More than a Photo –Op?’ (12 November 2015) (Transparency International, 2015) <http://www.transparency.org/news/feature/were_g20_corruption_promises_nothing_more_than_a_photo_op> accessed 1 January 2016; Mimi Lau, ‘Loophole for the Corrupt: China and US worst in G20 for Transparency over ‘Real Ownership’ of Shares and Companies’ (South China Morning Post: Policies and Politics 12 November 2015) < http://www.scmp.com/news/china/policies-politics/article/1878350/loophole-corrupt-china-and-us-worst-g20-transparency?_hstc=52789303.810863f5634170c81c80dbc356af6baa.1450137600060.145013760006.1.1450137600062.1&_hssc=52789303.1.1450137600063&_hsfp=1119992871 > accessed 21 May 2016.

¹⁰⁸ FATF, ‘FATF Guidance on Transparency and Beneficial Ownership’ (FATF, 2014) < <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf> > accessed 1 April 2016 ; Temenos, ‘Identifying Anti Money Laundering Issues in Chinese Banks’ (Asian Banker Researcher) < [https://www.theasianbanker.com/assets/media/dl/whitepaper/Asian%20Banker%20White%20Paper%20-%20China%20Anti-Money%20Laundry%20\(English\).pdf](https://www.theasianbanker.com/assets/media/dl/whitepaper/Asian%20Banker%20White%20Paper%20-%20China%20Anti-Money%20Laundry%20(English).pdf) > accessed 4 June 2016.

¹⁰⁹ FATF GAFI, Financial Action Task Force, ‘Summary of the First Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism – Peoples Republic of China’ (FATF, 29 June 2007) <<http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20China%20full.pdf> > accessed 10 June 2016.

¹¹⁰ Georgina Lawrence, ‘Who Regulates the Regulators’ (Centre for Study of Regulated Industries, Occasional Paper 16, 2012) 27 < [http://www.bath.ac.uk/management/crri/pubpdf/Occasional Papers/16 Lawrence.pdf](http://www.bath.ac.uk/management/crri/pubpdf/Occasional%20Papers/16%20Lawrence.pdf)> accessed 11 February 2017.

¹¹¹ Idris Kasumu’s Blog, ‘Arunma Oteh Faces Query Over Hostilities in SEC’ (Idris Kamusu’s Blog, 10 May 2012) < <http://idriskasumu.blogspot.co.uk/2012/05/> > accessed 11 February 2017.

techniques, especially in underground banking methods.¹¹² There remains a concern that actions based on AML/CFT laws would be inaccurate and ineffective. Levi and Gilmore contend that it was never clear that measures such as confiscation and monitoring constituted a significant condition for success.¹¹³ This indictment can be backed by the 2015 International Narcotics Control Strategy Report (INCSR) which revealed that China's involvement in money laundering is still growing, as it currently leads the world in illicit capital flow.¹¹⁴ Additionally, in 2016, the International Narcotics Control Board (INCB) raised concerns over increased drug trafficking and laundering in West African States.¹¹⁵ This reveals the challenges in gathering empirical data for measuring the effectiveness of AML/CFT laws.¹¹⁶ This scenario indicates that although contextually different, these jurisdictions suffer similar issues relating to mining data and combatting illicit crimes.

Lastly, there is the argument on the cost involved in legislation and regulations. Studies have shown that, in certain jurisdictions, money laundering has a negative effect on bank efficiency,¹¹⁷ particularly given the cost-implication of compliance. However, compliance-related cost is not comparable to the risk money laundering could pose to the financial system, if it contributes to a financial crisis. Recent studies have however illustrated that tougher AML/CFT regulations are associated with reduced levels of

¹¹² Michele Fletcher, 'China's Underground Bank' (Global Financial Integrity, 16 July, 2014) <<http://www.gfintegrity.org/chinas-underground-bank/>> accessed 21 January 2016.

¹¹³ Levi M and Gilmore William, 'Terrorist Finance: Money Laundering and the Rise of Mutual Evaluation: A New Paradigm for Crime Control' [2002] 4 (2) European Journal of Law Reform 87.

¹¹⁴ According to the 2015 International Narcotics Control Strategy Report (INCSR) of the Bureau of International Narcotics and Law Enforcement Affairs of the U.S. State Department, which monitors international money laundering. The report not only states that China is a leading source of illegal money transfers, but that it consistently fails to cooperate with other countries in resolving cross-border money laundering. See US Department of State, Diplomacy in Action, '2015 International Narcotics Control Strategy Report' (US Department of State, 2015) <<http://www.state.gov/j/inl/rls/nrcrpt/2015/>> accessed 30 April 2016.

¹¹⁵ Africanews, 'UN: Drug Trafficking on the rise in West Africa' (Africanews, 2 March 2016) <<http://www.africanews.com/2016/03/02/un-drug-trafficking-on-the-rise-in-west-africa/>> accessed 20 July 2017.

¹¹⁶ To appreciate this argument, it is imperative to decipher if the AML/CFT structure evolved stronger in countries that have more developed laws and legal structures.

¹¹⁷ Donato Masciandaro and Alessandro Portolano, 'It Takes Two to Tango: International Financial Regulation and Off-shore Centers' (2003) Università di Lecce Department of Economics Working Paper No.11/4 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=289541> accessed 1 May 2016.

ML/TF, particularly those that criminalise predicate offences and improve disclosure.¹¹⁸

Other arguments that critique the position of law as the bedrock of financial regulation include the role of market forces and customary norms. Posner¹¹⁹ and Lessig¹²⁰ postulate that the assumption that legislation is the bedrock of regulatory effectiveness and compliance is erroneous and empirically unsubstantiated, as compliance is not a sequence of regulatory efforts. Posner attributes effective regulation to community customary norms rather than legislation,¹²¹ whilst Lessig attributes it to market forces.¹²² Taking such factors as primary influencers to compliance as opposed to law comes with consequences. Market forces can be manipulated and customary norms do not necessarily take into consideration the interests of all parties – women for instance are usually prejudiced by customary norms in developing countries.¹²³

The above responses to the rejoinder illustrates that the role of law in financial regulation cannot be displaced. For this reason, the vagueness of the FATF soft laws have facilitated increased public-private partnerships in combating ML/TF.¹²⁴ Wlike argues that this explains the shift from rule-based to risk-based regulation, where banks engage in self-regulation unless indicators of risk are detected. The FATF has acknowledged these principles on the basis of pragmatism.¹²⁵ This pragmatism

¹¹⁸ Alberto Chong, Florencio López-de-Silanes. 'Money Laundering and its Regulations' [2015] 27 (1) *Economics & Politics* 78, 109.

¹¹⁹ Richard A. Posner, 'Social Norms and the Law: An Economic Approach' [1997] 87 (2) *The American Economic Review* 365, 368.

¹²⁰ Lawrence Lessig, 'The Zones of Cyberspace' [1996] 48 (5) *Stanford Law Review* 1403, 1406.

¹²¹ Richard A. Posner, 'Social Norms and the Law: An Economic Approach' [1997] 87 (2) *The American Economic Review* 365, 368.

¹²² Lawrence Lessig, 'The Zones of Cyberspace' [1996] 48 (5) *Stanford Law Review* 1403, 1406.

¹²³ Richard A. Posner, 'Social Norms and the Law: An Economic Approach' [1997] 87 (2) *The American Economic Review* 365, 368.

¹²⁴ Marie Wilke 'Emerging Informal Network Structures in Global Governance: Inside the Anti-Money Laundering Regime' [2008] 77 (4) *Nordic Journal of International Law* 509, 511; See Wolfsberg Anti-Money Laundering Principles for Private (The Wolfsberg Group, 2012) < <http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Private-Banking-Principles-May-2012.pdf> > accessed 10 June 2016.

¹²⁵ Jared Wessel, 'The Financial Action Task Force: A Study in Balancing Sovereignty with Equality in Global Administrative Law' [2007] 13 *Widener Law Review* 169, 193; Wilke Marie, 'Emerging Informal Network Structures in Global Governance: Inside the Anti-Money Laundering Regime' [2008] 77 (4) *Nordic Journal of International Law* 509, 518.

contributes to the argument that the development of law does not necessarily translate to robust AML/CFT regulations. Nevertheless, as shown above, in the absence of robust laws, proactive steps are usually not taken by ACs/EEs to combat illicit crimes. The effectiveness of legislations is however not solely dependent on transplantation, but on the design of the law.

3.1.4 Design of the Law

Where laws would serve as a precondition for effective regulation, the content and drafting technique employed is vital. This is because the robustness of laws and their ability to supervise market operations are largely dependent on their design. Poorly drafted laws give room for subjective interpretation by regulators and financial institutions, which facilitates gaming of the law, thus resulting in breach. Bossu and Chew assert that the problems with banking laws are not inherent in local circumstances but attributable to challenges in drafting and designing laws globally.¹²⁶ However, given the positioning of developed countries in training ACs/EEs in legislative drafting through their agencies, it can be assumed that the robustness of laws are subject to jurisdictional circumstances.¹²⁷

The question then is, to what extent have international network bodies like the FATF and BCBS provided sufficient legislative or regulatory guidance to ACs/EEs? This question is posed against the background of the FATF recommendations and exemplified with Recommendation 3 on criminalisation.

¹²⁶ Wouter Bossu and Dawn Chew, “But We Are Different!” 12 Common Weaknesses in Banking Laws, and What to Do about Them’ (2015) IMF Working Paper WP/15/2000 < <https://poseidon01.ssrn.com/delivery.php?ID=576121020003020082097102019092078064000043077033024024075002002042074000025083108029104081102046010030004002117098116116088024092072071025071093071007095108077089010030086006021071&EXT=pdf> > accessed 19 May 2016.

¹²⁷ Victor Thuronyi, ‘Drafting Tax Legislation’ (Tax Law Design and Drafting: IMF, 1996) 2 < <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch3.pdf> > accessed 11 February 2017.

Recommendation 3 (Money Laundering Offence) states that:

‘Countries should criminalise money laundering on the basis of the Vienna Convention and the Palermo Convention. Countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences.’¹²⁸

‘Should’, the operational word in Recommendation 3, which also resonates in other recommendations, reflects the persuasive nature of the framework document. The soft law documents express more of a moral obligation than a mandatory requirement. The non-mandatory signpost to the Vienna and Palermo Conventions leave room for over-inclusion or under-inclusion in legislative drafting. For this reason, legislative documents in various countries do not meet up with the expectations of the recommendations. Hinterseer argues that the leverage given to legislators place them in a quandary between controlling the abuse of financial services and penalising those who utilise these services legitimately.¹²⁹ The soft law adaptation system has however created a situation where financial institutions may be unduly penalised despite compliance with obligations mandated by criminal law.¹³⁰ This illustrates the limitation of the FATF as an intergovernmental body blindsided to law making but focused on standard setting.

This shortcoming is further highlighted by the recommendations review (or selection process). Potential recommendations are proposed to the FATF plenary by the FATF’s Policy Development Group.¹³¹ The plenary then presents the proposal before its

¹²⁸ FATF, ‘FATF Recommendation 3’ (FATF, 2012) < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 10 February 2017.

¹²⁹ Kris Hinterseer, *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* (Kluwer Law International 2002) 290.

¹³⁰ Despite the dearth of detailed analyses, governments have not hesitated to implement extensive legislation to control ML/TF, focused on criminalizing ML/TF and implementing supporting initiatives to facilitate its prosecution. Inevitably, criminalizing ML/TF raises both juridical and practical challenges on interpretation and enforcement, but also on its interface with legal areas such as civil law.

¹³¹ Nicholas Ryder, Magaret Griffiths, Lachmi Singh, *Commercial Law: Principles and Policy* (CUP, 2012).

members and associate members to deliberate on its adoption. Noting the power asymmetry in the deliberation process, EENA5, a GIABA staff member stated that ‘there are powers that their opinions supersede the others’¹³² Acknowledging this, Rose contended that recommendations are produced by consensus reached by largely developed like-minded states.¹³³ However developed, precision is sometimes forfeited for compromise during the negotiation process. Thus, without conceding transparency and flexibility, the FATF should ensure that there is an element of certainty afforded to legislative drafters to carry out their duties effectively or risk the gaming of the law.¹³⁴

Primary and secondary legislation should have well defined rules governing supervision of financial institutions. For instance, they should encompass independence, accountability, resourcing and legal protection for supervisors.¹³⁵ The inclusion of these would indicate the required absence of government or industry interference with the role of the supervisor to avoid regulatory capture.¹³⁶ The mandate of the supervisor and the ambits of his powers should be properly set out. It should be clearly stated whether the supervisors will be granted executive powers over banking laws, or limited powers which would be determined on the basis of the implementation of regulations.¹³⁷ Both options have implications; whilst the former grants the supervisor broad regulatory powers in unforeseen instances and grants the opportunity to catch up with advances not captured by legislation, it however makes regulation susceptible to arguments that it was not established on sufficient legal grounds. Contrariwise, where subject to regulations, it restricts the ability of supervisors to react to issues not expressly stated by the legislation. Limiting the discretionary powers of

¹³²EENA5, Researcher, GIABA Interview with EENA5, ‘Telephone Call’ (2017).

¹³³ Cecily Rose, *International Anti-Corruption Norms: Their Creation and Influence on Domestic Legal Systems* (OUP 2015) 55.

¹³⁴ This can be done thoroughly through its explanatory notes / plenary meetings.

¹³⁵ Basel Committee on Banking Supervision, ‘Consultative Document: Core Principles for Effective Banking Supervision’ (Basel Committee on Banking Supervision, 20 March 2012) <<http://www.bis.org/publ/bcbs213.pdf>> accessed 1 February 2016.

¹³⁶ Pierre C Boyer, Jorge Ponce, ‘Regulatory Capture and Banking Supervision Reform’ [2012] 8 (3) *Journal of Financial Stability* 1, 10.

¹³⁷ Basel Committee on Banking Supervision, ‘Consultative Document: Core Principles for Effective Banking Supervision’ (Basel Committee on Banking Supervision, 20 March 2012) <<http://www.bis.org/publ/bcbs213.pdf>> accessed 1 February 2016; Marc Quintyn and Michael W Taylor, ‘Regulatory and Supervisory Independence and Financial Stability’ (2002) IMF Working Paper WP/02/46 <<https://www.imf.org/external/pubs/ft/wp/2002/wp0246.pdf>> accessed 19 November 2016.

the supervisor has an adverse effect on the market, as it may lead to frequent update of the law, which regulatory bodies and institutions may struggle to adjust to.

For the above reason, the IMF/World Bank provide technical assistance to enable legislative draftsmen to construct robust laws. However, does this legal guidance take into consideration the level of development of countries or their local circumstances? In collaboration with the United Nations Office on Drugs and Crime (UNODC), the IMF crafted model legislation on money laundering for countries to adopt.¹³⁸ Such model laws come across as a prototype that does not address the particular local circumstances of countries. EENA3 argues that the legal development of countries is not factored into discussions on law formulation, rather, the process of law making smacks of quasi-imperialism.¹³⁹ He exemplifies this with the case of Sri Lanka which was pushed to adopt AML/CFT laws by the IMF, without factoring its weak legal system or its attempt to settle a war with the Tamel Tigers, an insurgent group that would have viewed the adoption of the AML/CFT standards as bad faith.

EENA1 however argues that the IMF does not necessarily engage in a ‘one-size-fits-all’ approach, but spends time discussing with countries and customizing standards.¹⁴⁰ He posits that such modifications take into consideration the legal development, framework and culture of countries. EENA1 exemplifies his stance by alluding to recommendation 4 on *Confiscation and Provisional Measures* which clearly states that ‘Countries should consider adopting measures that allow... proceeds or instrumentalities to be confiscated without requiring a criminal conviction (non-conviction based confiscation) ... to the extent that such a requirement is consistent with the principles of their domestic law.’ Although precise, this standard allows for some manoeuvre to give precedence to domestic law when drafting legislation or regulations, a feature that model laws may be blindsided to. Conceding, EENA1 asserts

¹³⁸UNODC, ‘Model Legislation’ (UNODC) < <https://www.unodc.org/unodc/en/money-laundering/Model-Legislation.html> > accessed 10 August 2017.

¹³⁹ EENA3, Anti-Money Laundering Specialist (CAMS), Expert Witness and Former Banking Regulator (FDIC), Interview with EENA3, ‘Telephone Call’ (2017).

¹⁴⁰ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

that prior to the institutionalisation of discussions that served as a prelude to technical assistance, ACs were involved in ‘copying, pasting and publishing laws’ such as the penalty of 15 years for ML/TF, which were not often implemented.¹⁴¹ EENA1 acknowledges that the involvement of ACs, coupled with the deference to their domestic legislation has led to the inclusion of pieces of legislation in the right place in the legal framework. Examples include the addition of standards relating to criminalisation in the country’s criminal code and the reduction of sanctions to 5 to 10 years imprisonment.¹⁴² These were achievable mainly through partnership with Inter-Governmental Group Against Money Laundering in West Africa (GIABA). Although better design of the law has led to remarkable improvement in technical compliance, this does not translate to effective compliance.

EENA1’s arguments, though practical, does not acknowledge that the transplantation of AML/CFT laws in ACs were simply to evade sanctions of the FATF. Hence whilst 15 years’ penalty might have been unsuitable, ACs adopted it to avoid sanctions and repercussions that flow thereof. Additionally, whilst recommendation 4 may have provided room for ‘domestic requirements’, alongside recommendations 37 and 39, other recommendations impose a blanket requirement. This would severely limit the IMF’s ability to tailor-fit legislations to a country’s domestic challenges or its ability to take into consideration the level of legal development, without breaching its collective principal arrangement with the FATF.

The literature on the design of the law is however incomplete without an appraisal of the current and potential lawmakers. EENA1 argues that prosecutors and legislators alike, inclusive of law schools and students are wary of new topics on how to fight financial crime and hence kick against them. An example of such area is civil confiscation, an FATF recommendation that permits the confiscation of proceeds of crime without a criminal conviction.¹⁴³ This is largely rejected in countries where laws

¹⁴¹ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

¹⁴² Ibid; Money Laundering (Prohibition) Act 2011 Explanatory Memorandum.

¹⁴³ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

require that a civil confiscation can only commence after a criminal conviction, because it is regarded as an affront on traditional legal structures. Such countries usually refuse to amend their laws to reflect the evolving requirement of standards. This is also the case with the FATF requirement on criminal liability of legal persons, that is, the conviction of a legal entity misused by criminals. Countries have however failed to amend their laws for non-conformity with national laws and norms. This indicates that although the design of laws is seemingly good, there is still room for improvement to eliminate existing bottlenecks.

The design of law reiterates the argument that law is insufficient as a sole precondition for robust regulation of AML/CFT for two reasons. Firstly, law can be gamed by countries even when drafted perfectly on paper. Secondly, the strength of well-designed laws cannot be divorced from broader political and economic settings in which they function.¹⁴⁴ For this reason, law must be discussed in concert with confidence as preconditions for effective regulation.

3.2 Confidence as a Precondition for Effective Regulation

Absence of confidence in financial institutions not only destabilises an orderly market, it also increases market volatility. This warrants action from financial regulators to make and enforce regulations aimed at resolving a destabilised market. Governments in various jurisdictions devote resources and manpower to guarantee against systemic and non-systemic risk to the market. Otherwise, the market may remain volatile, resulting in an unexpected crash, which would trigger loss of confidence.

¹⁴⁴ Cheryl Gray, 'Reforming Legal Systems in Developing and Transitional Countries' [1997] *Finance and Development* 14, 14.

Ruziev and Dow assert that confidence is the backbone of financial institutions and systems and is thus necessary in a free enterprise system.¹⁴⁵ Presenting a graphical representation of this assertion, they liken the financial system to an inverted pyramid built on confidence in outside money held as reserves in the central bank by commercial banks.¹⁴⁶ If confidence in outside money falls, there is a danger that the entire inverted pyramid of the private financial sector may collapse.¹⁴⁷ This indicates that internal and external factors contribute significantly to the build-up of confidence.

To this end, this section argues that effective regulation requires confidence. Confidence in this context is further subdivided into four thematic areas; confidence in financial stability, political and governmental systems, institutional systems and regulation and enforcement. To explain these, it is imperative to understand the concept of confidence.

3.2.1 Defining Confidence

Black's Law Dictionary defines 'confidence' as 'trust, reliance (or) grounds of trust'.¹⁴⁸ The interchangeable nature of the words indicate that 'trust' and 'confidence' are not mutually exclusive.

Confidence is derived from the legitimate expectations of specific actions from people or institutions due to the rules, conventions and morals which dictate their activities.¹⁴⁹ Kaufman and Ciesolka postulate that this expectation is built on trust in robust

¹⁴⁵ Kobil Ruziev, Sheila Dow, 'A Re-Evaluation of Banking Sector Reforms in Transition Economies: Intentions and Unintended Consequences' in Kobil Ruziev and Nicholas Perdakis (eds.) *Development and Reforms in Financial Economies* (Taylor & Francis 2016) 88.

¹⁴⁶ Ibid.

¹⁴⁷ Ibid.

¹⁴⁸ The Black's Law Dictionary (The Law Dictionary) <<http://thelawdictionary.org/confidence/>> accessed 1 January 2016.

¹⁴⁹ Bernhard Schlink, *Wirtschaft und Vertrauen* in Bernhard Schlink *Vergewisserungen u ber politik, schreiben und Glauben* (Zurich: Diogenes Verlag, 2005).

regulatory frameworks and actors loyalty to the framework and each other.¹⁵⁰ Where such trust is established, investors can entrust a financial institution with the management of their assets. A depositor can also be restrained from withdrawing funds from an institution at the slightest sign of market turbulence. Legitimate expectations can however be violated, resulting in financial crises and devastating effect on financial stability and integrity. Thus, the importance of confidence cannot be overstated.

Murphy argues that financial regulations should be constructively designed to not only mitigate risks in stressed conditions but to be seen as mitigating such risk to stimulate confidence.¹⁵¹ The appearance of a crack in the system occasioned by information asymmetry can cause a mini crisis of confidence leading to investor withdrawal.¹⁵² This denotes a twofold problem. Firstly, withdrawal – a catalyst for increased cash transaction¹⁵³ which facilitates ease of laundering across weak borders. Secondly, information asymmetry between financial institutions, regulators and stakeholders. In such instances, stakeholders' confidence and their rational expectations will not be dependent on the actual health of individual banks, but moulded on the chance of future bailouts, hence relying on information on government's financial constraints and bailout policy.¹⁵⁴

Scholars have argued that drastic alterations in stakeholders' confidence are only affected by massive scandals¹⁵⁵ such as the Asian crisis.¹⁵⁶ While this is usually the

¹⁵⁰ Christine Kaufmann and Mirja Ciesolka, 'Wann Baute Noah die Arche – Vermögensverwaltung als Akteurin einer nachhaltigen Marktentwicklung in Peter R Isler and Romeo Cerutti (eds.), Vermögensverwaltung III (Zurich: Schriftenreihe Nr. 105 des Europäischen Instituts an der Universität Zürich 2010) 3.

¹⁵¹ David Murphy, *Maintaining Confidence* (LSE Financial Markets Group Research Centre, 2012)

¹⁵² Sophia Grene, 'European Banks Suffer a Mini Crisis of Confidence' (Financial Times March 6, 2016) <<https://next.ft.com/content/daf9f04a-e07d-11e5-8d9b-e88a2a889797>> accessed 2 January 2016.

¹⁵³ Kobil Ruziev, Sheila Dow, 'A Re-Evaluation of Banking Sector Reforms in Transition Economies: Intentions and Unintended Consequences in Kobil Ruziev and Nicolas Perdakis (eds) *Development and Reforms in Financial Economies* (Taylor & Francis 2016) 88.

¹⁵⁴ Se Jik Kim and Ashoka Mody, 'Managing Confidence in Emerging Market Bank Runs' (2004) IMF Working Paper WP/04/235, 26 <<https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Managing-Confidence-in-Emerging-Market-Bank-Runs-17847>> accessed 18 June 2016.

¹⁵⁵ Lindsay A Owens, 'The Polls – Trends, Confidence in Banks, Financial Institutions and Wall Street, 1971 – 2011 [2012] 76 (1) Public Opinion Quarterly 142, 147.

¹⁵⁶ Augustine Pang and Yeo Su Lin, 'Crisis Aftermath: Image Reinvention in Restoring Corporate Reputation and Regaining Stakeholder Confidence' (Nanyang Technological University, 2014)

case, pockets of mini crises of confidence indicate that business cycles have an effect on public opinion in this domain. Murphy stressed how important it is for investors to believe that banks can absorb losses in stressed conditions, observing that well capitalised banks do fail, but confidence in them gives these banks the opportunity to survive long enough to correct problems that may arise.¹⁵⁷

These arguments illustrate that ‘confidence’ vested in the ability of financial regulatory bodies to deliver cannot be underestimated. Confidence serves as a guide to financial regulators, keeping them abreast of public opinion in financial regulation and is a check against illicit activities in financial institutions.

3.2.1.1 Confidence in Financial Stability

ML/TF weaken financial institutions and pose harm to the stability of the financial market as a whole. When stakeholders evaluate accessible information on financial markets, findings of illicit crimes can destroy their confidence. To retain their confidence in the system, there must be a clear framework for crisis management, resolution, discipline and prevention.

A crisis management structure sends a message to stakeholders that potential disruptions to financial stability would be properly managed.¹⁵⁸ A lender of last resort, which is usually a central bank and robust deposit insurance system fall within the

<<http://www.wkwsci.ntu.edu.sg/Research/Pages/Crisis-Aftermath-Image-Reinvention-in-Restoring-Corporate-Reputation-and-Regaining-Stakeholder-Confidence.aspx> > accessed 13 May 2016; Patthanij Gonjanar and Supawadee Suttirak, ‘The Effects from Asia’s Financial Crisis: Factors Affecting on the Value Creation of Organisation’ [2012] 3 (16) *International Journal of Business and Social Science* 78, 81.

¹⁵⁷ Ibid.; David Murphy, *Maintaining Confidence* (LSE Financial Markets Group Research Centre, 2012).

¹⁵⁸ Dalvinder Singh, John Raymond LaBrosse, ‘Developing a Financial Crisis Management’ [2012] 2 *OCED Financial Market Trends* 1, 8.

framework of crisis management.¹⁵⁹ Their roles are critical for systemic protection against financial instability. Central to their financial stability mandate is minimising the likelihood of a bank-run whilst also protecting depositors and retaining their confidence in the financial system.¹⁶⁰ The presence and effectiveness of these institutions enhance stakeholder confidence in financial stability.

The crisis management institutions have their distinct functions, inclusive of the mandate to curtail illicit crimes. Central banks offer loans to financial institutions with liquidity problems,¹⁶¹ particularly those that pose systemic risk.¹⁶² This mandate is however discretionary. Goodhart contends that central banks would usually not support the most egregiously badly-behaved banks,¹⁶³ indicating that where banks are heavily dependent on laundered funds for liquidity and suffer a solvency crisis, such banks are unlikely to receive support from the central banks. This was the case with Bank of Credit and Commerce International (BCCI), which although had become ‘too big to fail’ could not be restructured with liquidity provision by the Bank of England (BoE) due to largescale evidence of fraud, money laundering and terrorist financing.¹⁶⁴ Hence, the BoE let the bank fail. Whilst this may lead to short term crisis of confidence, in the long-term, stakeholders would support the government’s decision. This is particularly so because central banks allow financial institutions to fail in an orderly manner.

¹⁵⁹ Arnoud W.A Boot and Matej Marinc, ‘Crisis Management and Lender of Last Resort in the European Banking Market’ in Pietro Alessandrini, Michele Fratianno and Alberto Zazzaro (eds) *The Changing Geography of Banking and Finance* (Springer, 2009) 234.

¹⁶⁰ Ketcha Nicholas J, ‘Deposit Insurance System Design and Considerations’ [1999] 7 *Strengthening the Banking System in China: Issues and Experience*, Policy Paper 221, 223; James Barth, Cindy Lee and Triphon Phumiwasana, ‘Deposit Insurance Schemes’ [2013] *Encyclopedia of Finance* 207, 208; Dalvinder Singh, John Raymond LaBrosse, ‘Developing a Financial Crisis Management’ [2012] 2 *OCED Financial Market Trends* 1, 3.

¹⁶¹ Charles Goodhart, ‘Balancing Lender of Last Resort Assistance with Avoidance of Moral Hazard’ in Frank Heinemann, Ulrich Klüh, Sebastian Watzk (eds) *Monetary Policy, Financial Crises and the Macroeconomy: Festschrift for Gerhard Illing* (Springer, 2017) 20.

¹⁶² *Ibid.*

¹⁶³ *Ibid.*

¹⁶⁴ Senator John Kerry and Senator Hank Brown, *The BCCI Affair: A Report to the Committee on Foreign Relations* (102d Congress 2d Session Senate Print 1-2-140) 358.

The deposit insurance system protects depositors from losses caused by a bank's inability to pay its debts when due as a result of bank failure.¹⁶⁵ This is usually done by insuring customers' deposits up to a certain limit.¹⁶⁶ However, the deposit insurers are only required to pay out to eligible depositors and not launderers, demonstrating that endemic cases of financial crime can undermine the deposit insurers pay-out mandate. This indicates that some due diligence is mandatory to delineate clean money from illicit funds in the process of transfer of funds from a collapsed bank. The presence of a deposit insurer can lead to a moral hazard; a situation whereby financial institutions take on more risk than necessary given the desensitised approach of insured customers to the bank's risk appetite.¹⁶⁷ However, profit maximising launderers would be deterred from depending on such bailouts and may seek alternative, non-regulated institutions to deposit their funds. This may no doubt protect the desensitised customers and elevate their confidence in financial stability.

In addition to crisis management structures, market discipline also provides confidence in financial stability and serves as a precondition for effective regulation. This form of discipline, which complements official supervision, is utilised where there is unavoidable information asymmetry between financial institutions and their supervisors or forbearance associated with political considerations.¹⁶⁸ These circumstances place an onus on market participants to monitor financial institutions and discipline excessive risk-taking behaviours.¹⁶⁹ Market discipline is however largely dependent on the dissemination of information within the market, appropriate incentives to reward well-managed institutions and arrangements that ensure that investors are not insulated from the consequences of their decisions.¹⁷⁰ Where market

¹⁶⁵ Patricia A. McCoy, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence' (Seminar on Current Developments in Monetary and Financial Law, October 2006) 8.

¹⁶⁶ Ibid.

¹⁶⁷ Ibid 1; Gillian Garcia, 'Deposit Insurance and Crisis Management' (2000) IMF Working Paper WP/00/57/2000, 19 <<https://www.imf.org/external/pubs/ft/wp/2000/wp0057.pdf>> accessed 10 January 2017.

¹⁶⁸ Constantinos Stephanou, 'Rethinking Market Discipline in Banking: Lessons from the Financial Crisis' in Panagiotis Delimatsis and Nils Herger, *Financial Regulation at the Crossroads: Implications for Supervision* (Wolters Kluwer, 2011) 212.

¹⁶⁹ Ibid.

¹⁷⁰ Basel Committee on Banking Supervision, 'Sound Management of Risks Related to Money Laundering and Financing of Terrorism' (Basel Committee on Banking Supervision, June 2017) <<http://www.bis.org/bcbs/publ/d405.pdf>> accessed August 2017.

discipline is robust, information such as governments' lending or guarantee of lending is disclosed. Furthermore, governments are not permitted to influence or override commercial decisions to achieve public policy objectives.¹⁷¹ Given the complementary nature of this disciplinary approach to official supervision, it engineers improved compliance in financial stability.¹⁷² For this reason, there is improved emphasis on market discipline as illustrated by Pillar 3 in the Basel II framework which is focused on obtaining empirical data on banks' capital, risk profile and risk assessment.¹⁷³

Financial institutions saddled with ML/TF problems are prone to concentration, operational, legal and reputational risks.¹⁷⁴ The reflection of these risks to the market however undermine the confidence of stakeholders, especially depositors and investors, prompting withdrawal of funds from the affected bank or country.

Concentration risk is the potential for loss resulting from the exposure of financial institutions to particular individuals or sectors as a result of their lending patterns.¹⁷⁵ Restrictions put in place by regulations are usually honoured in breach, thus creating a scenario where a group of persons or sham companies can subsequently withdraw laundered funds from the bank within a period of time – thus posing a risk to the associated institutions. Losses from bad loans also result from unenforceable contracts and contracts entered with fictitious persons.¹⁷⁶ FIs are not adequately protected in the absence of a robust CDD regime which mandates that beneficial owners of an account are identifiable to forestall chances of laundering. Defrauded stakeholders question

¹⁷¹ Bank for International Settlement, 'Working Paper on Pillar 3 – Market Discipline' (2001) Basel Committee on Banking Supervision < https://www.bis.org/publ/bcbs_wp7.pdf > accessed 10 November 2016.

¹⁷² Constantinos Stephanou, 'Rethinking Market Discipline in Banking: Lessons from the Financial Crisis' in Panagiotis Delimatsis and Nils Herger, *Financial Regulation at the Crossroads: Implications for Supervision* (Wolters Kluwer, 2011) 212.

¹⁷³ Bank for International Settlement, 'Working Paper on Pillar 3 – Market Discipline' (2001) Basel Committee on Banking Supervision < https://www.bis.org/publ/bcbs_wp7.pdf > accessed 10 November 2016.

¹⁷⁴ Kern Alexander, Rahul Dumale, John Eatwell, *Global Governance of Financial Systems: The International Regulation of Systemic Risk* (OUP, 2006); Basel Committee on Banking Supervision, 'Sound Management of Risks Related to Money Laundering and Financing of Terrorism' (Basel Committee on Banking Supervision, June 2017) < <http://www.bis.org/bcbs/publ/d405.pdf> > accessed August 2017.

¹⁷⁵ Ibid.

¹⁷⁶ Ibid.

their trust in FIs and consequently financial stability. Their search for remedies result in numerous lawsuits and unenforceable contracts. McCormick argues that loss of significant funds attracts frivolous litigations¹⁷⁷ with stakeholders contesting light touch regulations. These result in penalties which generate losses for the associated institutions.¹⁷⁸

Conversely, operational risk, which is the breakdown of internal procedures, people and systems, thrives in the absence of sturdy corporate governance structures.¹⁷⁹ Barakat and Hussainey argue that enhanced risk reporting, a component of operational risk disclosure quality in European banks, is best achieved when there is board independence, enhanced audit committee activity, and greater proactive roles for bank supervisors.¹⁸⁰ Buttressing this, Wang and Hsu argue that the board is to set the proper governance structure and culture for effective operational risk.¹⁸¹ Losses that occasion operational risk also occur when institutions incur reduced, terminated, or increased cost for inter-bank or correspondent banking services.¹⁸² In the absence of sturdy operational risk structures, confidence in financial stability may dwindle.

Lastly, reputational risk is associated with confidence, as it has the ability to affect multiple institutions, given the contagious effect of information asymmetry. Information in the market, coupled with a lax regulatory system or repeated sanctions can lead to loss of confidence. Likewise, the blacklisting of countries effectively restricts foreign investment.

¹⁷⁷ Roger McCormick, 'Legal Risk in the Financial Market Following the Global Financial Crisis: A UK Perspective' (LSE, 2009) <<https://www.lse.ac.uk/collections/law/projects/lfm/Legal%20risk%20in%20the%20financial%20markets.pdf>> accessed 10 May 2016.

¹⁷⁸ The investigation carried out to establish certain cases also involved cost.

¹⁷⁹ Ahmed karakat and Khaled Hussainey, 'Bank Governance, Supervision and Risk Reporting: Evidence from Operational Risk Disclosures in European Banks' [2013] 30 *International Review of Financial Analysis* 254, 255.

¹⁸⁰ Ibid.

¹⁸¹ Tawei Wang and Carol Hsu, 'Board Composition and Operational Risk Events of Financial Institutions' [2013] 37 (6) *Journal of Banking and Finance* 2042, 2043; Chernobai, A., Jorion, P., Yu, F., 'The Determinants of Operational Risk in US Financial Institutions' [2011] 46 (6) *Journal of Financial and Quantitative Analysis* 1683, 1698.

¹⁸² Money Laundering Impacts Development.

In handling risks which undermine effective regulation, supervisors and relevant authorities are to identify high risk sectors and ensure proper direction of resources. These risks differ in presentation and in manifestation and thus would require a tailored approach towards their resolution. This would improve internal and external confidence within the system.

3.2.1.2 Confidence in the Political and Governmental System

Confidence in the political system is vital for financial stability, serving as a precondition for effective regulation. Political systems that create an atmosphere where rule of law prevails and crime is punished deter ML/TF activities and, more importantly, create confidence in FIs. This can be attributed to the fact that FI's become increasingly adherent to prescribed regulations, knowing that breach would result in severe penalties and reputational damage. This indicates a top-down approach where the scene is set by the executives elected or appointed into power.

This top-down approach requires that governments do not compromise on sound macroeconomic policies for effective regulation. In the absence of sound policies, discrepancies such as astronomical spending by government, excessive shortage or supply of liquidity may affect the stability of the financial system.¹⁸³ Furthermore, certain government policies may specifically use banks and other financial intermediaries as instruments and this may inhibit effective supervision.¹⁸⁴ Where this is allowed to flourish, the state in question would not experience effective regulation.

¹⁸³ Anand Sinha, 'Financial Sector Regulation and Implications for Growth' (CAFRAL-BIS International Conference on Financial Sector Regulation for Growth, Equity and Financial Stability in the Post-Crisis World, Mumbai, November, 2011).

¹⁸⁴ Examples of such policies include accumulation of large quantities of government securities, reduced access to capital markets due to government controls or growing imbalances; degradation of asset quality after loose monetary policies; and government-directed lending or forbearance requirements as an economic policy response to deteriorating economic conditions.

Sequential patterns in ACs have indicated that government representatives may be actively involved in ML/TF,¹⁸⁵ exemplified in Sub-Saharan ACs where corruption is an integral part of the political fabric. In Sierra Leone, for instance, government officials were recently embroiled in the laundering of UKAid in excess of £1million which was granted to support ‘peacekeeping’.¹⁸⁶ In Uganda, £800,000 intended for schools was embezzled by education ministers.¹⁸⁷ There is also evidence that corrupt officials in Senegal, Equatorial Guinea and Nigeria have used their children to embezzle funds overseas.¹⁸⁸ These actions are antithetical to financial stability and the dictates of good governance, thereby undermining confidence in the governments. Former South Africa’s president, Jacob Zuma faced a no-confidence vote partly due to corruption allegations, which resulted in his removal from office.¹⁸⁹ Similarly, there was an unsuccessful coup attempt on the current president of Equatorial Guinea due to prevalent corruption and inequality.¹⁹⁰ Where the government is successful in curtailing the leakage of this intelligence, the resulting asymmetry of information may create a false sense of confidence in the political and financial system.

Confidence in the political and governmental system also encompasses political will. This requires that governments must fight corruption and be publicly perceived to be doing so. Resultantly, there would be effective regulation of regulators, publication of enforcement actions, timely judicial decisions and effective partnership for repatriation

¹⁸⁵ David Thompson, ‘Panama Papers: Putin Associates Linked to “Money Laundering”’ (*BBC News*, 2 April 2016) < <http://www.bbc.co.uk/news/world-europe-35918845> > accessed 2 May 2016.

¹⁸⁶ Robert Rayner and Steven Swinford, ‘Wikileaks Cables: Millions in Overseas Aid to Africa was Embezzled’ (*The Telegraph*, 5 February, 2011) < <http://www.telegraph.co.uk/news/worldnews/wikileaks/8304640/WikiLeaks-cables-millions-in-overseas-aid-to-Africa-was-embezzled.html> > accessed 10 July 2017; Aljazeera News, ‘UK Suspends Uganda Aid Over Corruption’ (*Aljazeera News*, 12 November 2012) < <http://www.aljazeera.com/news/africa/2012/11/20121117155051480786.html> > accessed 15 June 2017.

¹⁸⁷ Robert Rayner and Steven Swinford, ‘Wikileaks Cables: Millions in Overseas Aid to Africa was Embezzled’ (*The Telegraph*, 5 February, 2011) < <http://www.telegraph.co.uk/news/worldnews/wikileaks/8304640/WikiLeaks-cables-millions-in-overseas-aid-to-Africa-was-embezzled.html> > accessed 10 July 2017.

¹⁸⁸ Anne Look, ‘Investigations Underway into Corruption and Embezzlement in West Africa’ (*Voice of Africa*, 5 December 2012) < <https://www.voanews.com/a/west-Africa-corruption-investigation/1558980.html> > accessed 19 August 2016.

¹⁸⁹ Alexander Winning, ‘South Africa’s Zuma Faces new No-confidence Vote this Month’ (*Reuters*, 2 February 2018) < <https://uk.reuters.com/article/uk-safrica-politics/south-africas-zuma-faces-new-no-confidence-vote-this-month-idUKKBN1FM1B9> > accessed 10 February 2018.

¹⁹⁰ Business Day, ‘Clashes in Equatorial Guinea after Thwarted Coup’ (*Business Day*, 4 January 2018) < <https://www.businesslive.co.za/bd/world/africa/2018-01-04-clashes-in-equatorial-guinea-after-thwarted-coup/> > accessed 10 February 2018.

of laundered assets. Furthermore, independence of the legislature and law enforcement agencies would be guaranteed to ensure that they are not prey to corruption, under-resourced or demoralized. Without such circumstances backed by political will, the presence of sturdy legislation as a pre-condition for effective regulation would be invalidated. Political will and the resultant AML/CFT regime will encourage domestic coordination and exchange of information among the various domestic parties at policy and operational levels.¹⁹¹

3.2.1.3 Confidence in the Institutional System

Confidence in the institutional system is largely dependent on agencies external to FIs. Government regulations, budgetary allocations and factors such as the global financial crisis play a vital role in ensuring trust in FI in any economy.

Positive governmental regulations are crucial in building and sustaining confidence as a precondition for effective regulation. These regulations ensure a suitable political and economic climate for investment and business. Where, however, government policies create a hostile environment that facilitates corruption, high inflation and unemployment rates coupled with low social wellbeing, FIs would be unable to carry out their day-to-day businesses satisfactorily.¹⁹² This indicates that the public's confidence in institutions may be pro-cyclical.¹⁹³ So when countries experience a sharp rise in unemployment, there is a dramatic decline in public confidence in national

¹⁹¹The World Bank, 'Combating Money Laundering and the Financing of Terrorism: A Comprehensive Training Guide' (The World Bank, 2016) <<http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/CombattingMLandTF.pdf>> accessed 12 April 2016 > accessed 10 July 2017.

¹⁹²Montfort Mlachila, Dennis Dykes, Sabrina Zajc, Paul-Harry Aithnard, Thorsten Beck, Mthuli Ncube, Oskar Nelvin, 'Banking in Sub-Saharan Africa: Challenges and Opportunities' (European Investment Bank, January 2013) < http://www.eib.org/attachments/efs/economic_report_banking_africa_en.pdf > accessed 10 July 2017.

¹⁹³Betsey Stevenson and Justin Wolfers, 'Trust in Public Institutions over Business Cycle' (2011) Federal Reserve Bank of San Francisco Working Paper Series 11/2011, 4 < <https://www.frbsf.org/economic-research/files/wp11-11bk.pdf> > accessed 5 March 2016 .

governments and financial sectors.¹⁹⁴ This suggests that decline in confidence may sometimes be a standard response to a cyclical downturn.¹⁹⁵ Thus, there is a challenge for governments to ensure long term domestic growth as opposed to short term investment, in order to engineer confidence within FIs.

Additionally, there are concerns that budget constraints contribute to the loss of confidence in FIs. Budget constraints can indirectly promote ML/TF given that insufficient funding provision to equip regulatory bodies with the technical skills to combat illicit crimes promotes an environment where criminals are permitted to thrive. Additionally, on a tight budget, regulators usually work with fewer staff or unmotivated staff in comparison with staff of FIs, otherwise known as under-regulation which may result in regulatory arbitrage. Recognising the occurrence of this situation in ACs, Interviewee - EENA4 stated that, ‘from all African countries, Nigeria has the most resources directed to curb ML/TF, but it is usually diverted.’¹⁹⁶ Such diversion leads to under-provision of necessary resources which has socio-economic consequences.

The effect of budget constraints is also noted in the limited regulation on internet and mobile use, which is the direction of crime in ACs/EEs.¹⁹⁷ Within the African continent, Nigeria records the highest overall value of fraud.¹⁹⁸ The 2015 Nigeria Deposit Insurance Corporation (NDIC) report disclosed a 15.71% increase in fraud cases.¹⁹⁹ It revealed that most fraudulent activities were particularly relating to internet banking and bank card fraud.²⁰⁰ Undoubtedly, these activities pose significant cost to the Nigerian economy and hinders financial inclusion. It illustrates the limited regulatory

¹⁹⁴ Ibid.

¹⁹⁵ Ibid.

¹⁹⁶ EENA4, Interview with Anonymous, ‘Telephone Call’ (2017).

¹⁹⁷ Jayshree Chavan, ‘Internet Banking-Benefits and Challenges in an Emerging Economy’ [2013]1 (1) International Journal of Research in Business 19, 23.

¹⁹⁸ Sahara Reporters, ‘Nigeria is the Most Fraudulent Country in Africa, KPMG Report Says’ (Sahara Reporters, 23 November 2012) < <http://saharareporters.com/2012/11/23/nigeria-most-fraudulent-country-africa-kpmg-report-says> > accessed 10 July 2016.

¹⁹⁹ Nigeria Deposit Insurance Corporation, ‘NDIC Releases 2015 Annual Report’ (NDIC, 2015) < <http://ndic.gov.ng/ndic-releases-2015-annual-report/> > accessed 10 May 2017.

²⁰⁰ Ibid.

powers, capacity and resources in addressing these issues.²⁰¹ Globally, Brazil and India are ranked 2nd and 3rd respectively in the list of countries with the highest fraud levels.²⁰² These include credit card fraud and internet fraud which create room for increased opportunities for ML/TF. The false sense of security projected by banks in Brazil has done little to salvage the situation.²⁰³ For instance, a 2014 financial cyber threat report ranked Brazil second in online banking fraud and financial malware.²⁰⁴ The situation seems to be worsening with research showing that cyber-attacks grew by 197% and online fraud by 20% in 2014.²⁰⁵ The effect is reduced stakeholder confidence as customers who have once experienced fraud are less likely to continue using the mode of banking that exposed them to that risk.²⁰⁶ It also indicates the need for customers to be properly informed of fraud levels and their responsibility to safeguard their bank details.²⁰⁷

Also, external forces that affect confidence is further highlighted by the global financial crisis. This accentuated a shift in investment from developed to ACs/EEs who were not so severely hit by the financial crisis.²⁰⁸ This indicated the impact of loss of confidence on FIs and the security offered to stakeholders needing to diversify their risk beyond

²⁰¹ Abel Ezeoha, 'Internet Banking Strategy in a Highly Volatile Business Environment: The Nigerian Case' in *E-Banking and Emerging Multidisciplinary Processes: Social, Economical and Organizational Models* (Business Science Reference) 76.

²⁰² Shirley W Inscoc, 'Global Consumers: Losing Confidence in the Battle against Fraud' (*Aite*, June 2014) < <http://www.aciworldwide.com/-/media/files/collateral/global-consumers-losing-confidence-in-the-battle-against-fraud-report> > accessed 21 March 2016. The United Arab Emirates (UAE) has the highest rate of fraud overall at 44%, followed by China at 42%, and India and the United States at 41% each (Figure 1)

²⁰³ Fernando Guerreiro De Lemos, President of Banrisul boasted, 'Our bank is a leader in banking technology' See, Forbes Custom 'Brazil: Confidence is the Keyword' (*Forbes Custom*), <<http://www.forbescustom.com/EconomicDevelopmentPgs/BrazilP1.html> > accessed 1 May 2016.

²⁰⁴ Kaspersky Lab Report, Financial Cyber Threats in 2014 (Kaspersky Lab Report, February 2015) <[https://securelist.com/files/2015/02/KSN Financial Threats Report 2014_eng.pdf](https://securelist.com/files/2015/02/KSN_Financial_Threats_Report_2014_eng.pdf) > accessed 2 May 2016.

²⁰⁵ Centre of Studies, Response and Treatment of Security Incidents in Brazil (Centre of Studies, 28 July 2015) <http://diariodocomercio.com.br/noticia.php?tit=numero_de_ataques_ciberneticos_cresceu_197_&id=157314 > accessed 2 May 2016.

²⁰⁶ Shirley W Inscoc, 'Global Consumers: Losing Confidence in the Battle against Fraud' (*Aite*, June 2014) < <http://www.aciworldwide.com/-/media/files/collateral/global-consumers-losing-confidence-in-the-battle-against-fraud-report> > accessed 21 March 2016.

²⁰⁷ Ibid.

²⁰⁸ International Trade Forum Magazine, 'New World Order: Shifting Markets in Trade, Investment and Opportunity' [2010] 2 International Trade Forum; Organization for Economic Cooperation and Development, *Society at a Glance 2014: OECD Social Indicators* (OECD Publishing, 2014); Lindsay Owens, 'Confidence in Banks, Financial Institutions and Wall Street, 1971 – 2011' [2011] 76 (1) Public Opinion Quarterly 142, 147.

developed countries. The 2014 OECD report stated that whilst confidence in FIs in general declined in OECD countries, it increased in other countries, including Russia²⁰⁹ and Brazil.²¹⁰ These reports indicate the necessity for FIs in emerging economies to continually ensure compliance with regulatory authorities in order to retain confidence in their financial systems. It also requires that FIs accept their pivotal role in the fight against ML/TF.²¹¹

Scholars however believe that although highly resisted by practitioners, the obligations of banks and other FIs to curtail ML/TF is unlikely to diminish in the near future²¹² because they are able to monitor movement of funds. Professor Rider states:

‘it is not surprising that increasingly those who handle other people’s money have been placed in the forefront of attacks on money laundering... of course, it is a very unpleasant place to be, particularly if you are ill prepared, ill advised, unsupported and probably entirely sacrificial.’²¹³

From Rider’s statement, two factors which are required for improved functionality and confidence in the institutional system can be deduced. Firstly, efficiency of FIs in curtailing ML/TF backed by supervision and secondly, an institution supported by insurance in the event of a mishap. These two factors are not mutually exclusive, but are contradictory. The paradox is that the presence of an insurance system would give

²⁰⁹ Organization for Economic Cooperation and Development, *Society at a Glance 2014: OECD Social Indicators* (OECD Publishing, 2014).

²¹⁰ Forbes Custom ‘Brazil: Confidence is the Keyword’ (Forbes Custom), <<http://www.forbescustom.com/EconomicDevelopmentPgs/BrazilP1.html>> accessed 1 May 2016 - Brazil, land of the samba, Sugar Loaf Mountain and Copacabana beach, is also distinguishing itself in the midst of the worldwide financial crisis by the resilience of its economic performance.

²¹¹ Vern McKinley, ‘After the Crisis: Revisiting the “Banks Are Special” and “Safety Net” Doctrines’ (Mercatus Research – George Mason University 2015) <<https://www.mercatus.org/system/files/McKinley-Are-Banks-Special.pdf>> accessed July 2017.

²¹² Steven Beattie, Donald Lamson, Marc Oliver Schmidt, ‘Anti-Money Laundering Issues for Financial Institutions’ (*Financier Worldwide*, December 2013) <<http://www.financierworldwide.com/anti-money-laundering-issues-for-financial-institutions/#.Vw6nV7TFvKI>> accessed 10 January 2016.

²¹³ Professor Barry Rider, ‘The Limits of the Law: An Analysis of the Interrelationship of the Criminal and Civil Control in the Control of Money Laundering’ [1999] 2 (3) *Journal of Money Laundering Control* page 209, 210.

room for banks to engage in excessive risk-taking, with the knowledge that they would be bailed out.²¹⁴ The resolution of these goals requires effective and continuous supervision to set risk parameters whilst ensuring that regulatory capture is avoided.

In light of the above, regulatory agencies are to ensure that FIs have a framework to facilitate strict adherence to AML/CFT regulations as a precondition for entry and continued operation in the market. This would foster a culture of accountability where efficiency is also measured by the competence and reputation of board members in adhering to the AML/CFT regulatory requirements. Such atmosphere would protect the reputation of FIs and the public interest in their integrity. Operationalizing this framework comes with challenges. For instance, regarding financial secrecy laws, certain jurisdictions mandate FIs' staff like lawyers and other bank professionals to honour the confidentiality of their contract with their client(s).²¹⁵ However, their position as gatekeepers in curtailing illicit crimes places them in a legal quandary whereby the contract on confidentiality may be honoured in breach to uncover illegality. Scholars and practitioners have argued that bank secrecy may sometimes be for legitimate purposes²¹⁶ like tax avoidance. Whilst acknowledging that illegal use can occasion untold hardships, there are significant cost implications associated with appropriately distinguishing legitimate from illegitimate use.²¹⁷ Moreover, any-less-than universally applied bank secrecy policy can have stringent adverse consequences for institutions, triggering a race to the bottom. Conversely, strict adherence to FATF recommendations by institutions can unveil the rot in non-compliant institutions. In these instances, there are increased possibilities of customers wishing to safeguard their savings or interests by moving their business to more adherent institutions. Additionally, dissolving bank secrecy laws for AML/CFT risks is not only a trigger for

²¹⁴ Adhering to the laws may cause even the best regulatory system to err in their supervision.

²¹⁵ For instance, in Brazil bank secrecy cannot take place without the approval of the judiciary. See Jorge Nemr, 'Brazil' in Gwendoline Godfrey, Nate and Godfrey: *Bank Confidentiality* (5th Edition, IBA, 2011).

²¹⁶ Kris Hinterseer argues that financial secrecy laws are said to protect private assets from wrongful expropriation by public authorities. See Kris Hinterseer, *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* (Kluwer Law International, 2002) 286.

²¹⁷ This should be done in a manner that does not impose significant compliance costs and comparative disadvantage on those who provide such services in a legal and legitimate manner.

competition within FIs, it also risks driving customers to underground banking, especially in ACs which are still largely unbanked and unregulated.

Thus, it is evident that resolving this dilemma requires the building, acceptance and integration of the culture of integrity within FIs in such a way that is not antithetical to the business of banking. Although countries vary in their adoption of laws, policies and standards aimed at combatting AML/CFT as well as in the quality of their institutional framework and general level of development, an optimal institutional framework should encompass certain key traits. Examples of these traits include an operative corporate governance where the tone is set at the top, as well as continuous staff training.²¹⁸ The challenge is however not usually one of intention but complexity and execution.²¹⁹ To this end, Wheatley argues that ‘it is not straightforward to govern the behaviour of individuals in large, heavily stratified banking institutions. Invariably, it takes time.’²²⁰

This illustrates the difficulty for FIs to control the risk posed by their staff based on individual behavioural values and choices. In seeking measurable conclusions, value judgements are to be made and competitive peer evaluations may replace standard appraisals.²²¹

The effect of curtailing these factors is financial stability and improved confidence of stakeholders in FIs.

²¹⁸ On customer relationship, forgery detection etc. to build confidence from within whilst managing existing relationships.

²¹⁹ Martin Wheatley, ‘Debating Trust and Confidence in Banking’ (*Financial Conduct Authority*, 28 May 2015) <[https://www.fca.org.uk/news/debating-trust-and-confidence-in-banking->](https://www.fca.org.uk/news/debating-trust-and-confidence-in-banking-) accessed 3 December 2015> accessed 10 May 2016

²²⁰ Ibid.

²²¹ *ibid.*

3.2.1.4 Confidence in Regulation and Enforcement.

The robustness of regulation is dependent on the strength of the law and legal structures in place. Law is crucial in determining the framework of regulations and providing a safe and sound banking system. For this reason, Cheffins argues that in the absence of laws, and the legal protections that flow thereof, investors will be deterred from investing in an affected country, but would consider it risky and fear possible exploitation.²²² This is recognized by the BCBS which highlights the role of the law as a pre-condition for effective regulation.²²³ Hinterseer contends that legal measures such as regulations will remain subject to market discipline because information blind spots will permit money laundering to fester.²²⁴ This view however ignores the study by Masciandaro which highlights the inverse relationship between the degree of diffusion of ML activities and AML regulation in a given economy.²²⁵ This indicates that tougher regulation can reduce ML and its feeder activities, controlling for other country characteristics, legal enforcement and potential endogeneity.²²⁶ This is reiterated by Chong et al who argue that AML/CFT laws and regulations can deter launderers focused on maximizing profit.²²⁷ This is particularly so because, in reaction to regulations, financial intermediaries mandatorily engage in CDD, ensure transparency in financial dealings and construct a culture that facilitates accountability.

The adoption of a suitable enforcement mechanism is crucial in curtailing ML/TF, allowing for the collection of information and the setting of rules that sanction misconduct. It also fosters a safe and sound banking system, expanding public

²²² Brian R. Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2000) ESRC Centre for Business Research, University of Cambridge Working Paper No 172, 463 < https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp172.pdf > accessed 8 May 2016.

²²³ Basel Committee on Banking Supervision, 'Consultative Document: Core Principles for Effective Banking Supervision' (Basel Committee on Banking Supervision, 20 March 2012) <<http://www.bis.org/publ/bcbs213.pdf>> accessed 1 February 2016.

²²⁴ Kris Hinterseer, *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* (Kluwer Law International 2002) 414.

²²⁵ Donato Masciandaro, 'Money Laundering: The Economics of Regulation' [1999] 7 *European Journal of Law and Economics* 225, 239.

²²⁶ Alberto Chong, Florencio López-de-Silanes. 'Money Laundering and its Regulations' [2015] 27 (1) *Economics & Politics* 78, 121.

²²⁷ *Ibid* 78, 81; Gary Becker, 'Crime and Punishment: An Economic Approach' in Nigel Fielding, Alan Clarke and Robert Witt (eds), *The Economic Dimensions of Crime* (Macmillan Press Ltd) 33.

disclosure, transparency, enhanced financial reporting and audit.²²⁸ Two enforcement mechanisms can be adopted; the compliance based approach (CBA) and/or the deterrence-based approach (DBA).²²⁹ Adopting a mechanism is dependent on various factors, such as, the gravity of the approved person's offence, the perception of the regulatory agencies and the characteristics of the offender or institution.²³⁰ During examination of FIs, regulatory bodies consider the identity, personal history and responsiveness of the regulated to sanctions or assistance.²³¹ They also consider whether the regulated is engaged in a business, the fall of which poses systemic risk. If the regulated's activities would not have disastrous consequences on the economy, the regulator can use the CBA. Where however, the activity of the regulated carries grave consequences, e.g. when it relates to the liquidity of a bank, the regulator may use the DBA. These approaches are not mutually exclusive. The CBA focuses on creating an avenue for interaction between the regulator and the regulated,²³² to ensure that it complies with regulatory rules. The DBA is focused on imposing sanctions and retributions²³³ to serve as deterrence. This exposes FIs to a variety of sanctions which may be punitive or non-punitive.²³⁴ FIs may also be subjected to legal claims, with possible civil, administrative or criminal sanctions.²³⁵

Confidence in institutions is based on the potency and immediacy of prescribed actions, the ability of regulatory institutions to follow through, the frequency of interactions with regulatory institutions and possible publication of enforcement actions. The enforcement activities and design of adopted regulations are vital in determining and

²²⁸Gary Becker, 'Crime and Punishment: An Economic Approach' in Nigel Fielding, Alan Clarke and Robert Witt (eds), *The Economic Dimensions of Crime* (Macmillan Press Ltd) 15.

²²⁹ Dalvinder Singh, *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing 2007) 113 -115.

²³⁰ Ibid.

²³¹ i.e. whether he is a political citizen, an amoral calculator or organizationally incompetent. See Dalvinder Singh, *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing 2007) 113 -115.

²³² Dalvinder Singh, *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing 2007) 113 -115.

²³³ Ibid.

²³⁴ Ibid (n 232).

²³⁵ Ibid (n 232).

influencing compliance. Becker and Stigler argue that institutions comply with regulations when they believe that non-compliance will be harshly dealt with.²³⁶

The deterrent effect of criminal punishment, the harshest form of DBA is highly contested. Reviews on the impact of varying levels of punishment do not suggest that harsher sanctions deter illicit activities.²³⁷ Moreover, Coglianesse et al emphasize that the organizationally incompetent may not be amenable to criminal sanctions.²³⁸ Black further expressed fears that criminal sanctions would not have an impact on behavior over a long term period.²³⁹ The practicalities of holding bank officials responsible for fiduciary duties or to a criminal prosecution is also problematic.²⁴⁰ The practical and conceptual difficulties that occasion this method of enforcement has led to the advancement by Brummer of the compliance based approach.²⁴¹ He asserts that effective monitoring systems can have important deterrent effects, having been designed to deter and prevent launderers from using FIs as conduits for illicit transfers.²⁴² It must be noted that however persuasive the compliance approach seems,

²³⁶ Gary Becker, 'Crime and Punishment: An Economic Approach' in Nigel Fielding, Alan Clarke and Robert Witt (eds), *The Economic Dimensions of Crime* (Macmillan Press Ltd) 15; George Sigler, 'The Optimum Enforcement of Laws' in Gary Becker and William Landes (eds.) *Essays in the Economics of Crime and Punishment* (NBER 1974).

²³⁷ Anthony Doon and Cheryl Webster, 'Sentence Severity and Crime: Accepting the Null Hypothesis' [2003] 30 *Crime and Justice* 143, 146.

²³⁸ Cary Coglianesse, Elizabeth K., Michael Micheal L., Healey Thomas J., 'The Role of Government in Corporate Governance' [2004] 1243 *Faculty Scholarship* 219, 234 cf with Lois M. Musikali, 'Why Criminal Sanctions Still Matter in Corporate Governance' [2009] *International Company and Commercial Law Review* 1.1.

²³⁹ Julia Black and David Kershaw, 'Sanctions for Bank Directors: Response from Professor Julia Black and Professor Kershaw, London School of Economics and Political Science' (LSE Collections 11 January 2013) <<http://www.lse.ac.uk/collections/law/news/Sanctions%20-%20submission%20from%20Black%20and%20Kershaw%2011%20Jan%202013.pdf>> accessed 16 July 2013.

²⁴⁰ William Cohan, 'How Wall Street's Bankers Stayed Out of Jail' (*The Atlantic*, September 2015) <<http://www.theatlantic.com/magazine/archive/2015/09/how-wall-streets-bankers-stayed-out-of-jail/399368/>> accessed 1 January 2016; Jed Rakoff, 'The Financial Crisis: Why Have No High-Level Executives Been Prosecuted' (*The New York Review of Books*, 2014) <<http://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/>> accessed 13 January 2016.

²⁴¹ Chris Brummer, 'How International Financial Law Works and How It Doesn't' [2011] 99 *Georgetown Law Journal* 257, 290; John Braithwaite and Philip Petit, *Not Just Deserts. A Republican Theory of Criminal Justice* (Oxford: Clarendon Press 1990) 3.

²⁴² Chris Brummer, 'How International Financial Law Works and How It Doesn't' [2011] 99 *Georgetown Law Journal* 257, 290; Levi Michael and Peter Reuter, 'Money Laundering' [2006] *Crime and Justice* 289, 296.

it does not exist in a vacuum, as it occurs within the context of an application of legal rules.²⁴³

Enforcement mandates that in the absence of regulatory capture,²⁴⁴ regulatory agencies must be willing to authorize FIs to comply with AML/CFT regulations in the form of negotiated non-compliance. Publicity of enforcement actions has also been undertaken in various jurisdictions, to punish erring financial institutions and deter others from engaging in sharp practices or economic crimes. By so doing, governments define what is considered acceptable, in the hope that policy makers ensure that unacceptable activities are less economically attractive. This is no doubt a way to eliminate the benefits of crime through a deterrent approach, including sanctions. It is however recognized that deterrence is not necessarily the best option for certain institutions, as already discussed.

In light of this, the ability of regulatory bodies to ensure robust enforcement systems aimed at improving confidence in the financial system is largely dependent on the quality of their workforce and the levels of interaction between regulatory bodies. Their effectiveness in achieving these is dependent on their understanding of the nature of criminal expertise and the cultural aspect of criminal organizations. However, in the absence of sturdy capacity and collaboration, expertise would be stretched and unable to deliver. This is typified with Nigeria, alongside other developing countries where ill-equipped regulatory bodies are limited in capacity to combat regulatory deficiencies, inclusive of illicit crimes.²⁴⁵ In Brazil, although regulators are equipped with trained

²⁴³ Compliance entails applying those measures designed to attain the legal mandate, with the regulator being primarily more concerned with improved outcomes than prosecution results see Keith Hawkins, *Law as Last Resort: Prosecution Decision-Making in a Regulatory Agent* (OUP 2002) 253.

²⁴⁴ There is increased compliance in emerging economies, however compliance levels are still substandard; Negotiated non-compliance between the inspector and the enforcement officer, see Peter Grabosky and John Braithwaite, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* (First published 1986, OUP in association with Australian Institute of Criminology) 230.

²⁴⁵ Peter Reuter, 'Illicit Financial Flows and Governance: The Importance of Disaggregation' (World Development Report, 2017) <<http://pubdocs.worldbank.org/en/677011485539750208/WDR17-BP-Illicit-Financial-Flows.pdf>> accessed 2 February 2018; OECD, 'Illicit Financial Flows from Developing Countries: Measuring OECD Responses' (OECD, 2014) <<https://www.oecd.org/corruption/Illicit-Financial-Flows-from-Developing-Countries.pdf>> accessed 12 February 2018.

quality supervisors, this is challenged by the limited numerical capacity of its workforce.²⁴⁶ Consequently, their ability to effectively combat ML/TF is restricted.

This argument is also applicable to the judicial system. The strength of the judiciary serves as a vital pre-condition for effective regulation. It plays a pivotal role in building stakeholder confidence in a financial system that offers significant protection. Cheffins asserts that a reliable and corrupt-free court system is crucial for speedy dispensation of justice, serving as a catalyst for confidence building in investors.²⁴⁷ This argument emphasizes that a corrupt system delays and possibly denies justice. It also creates an atmosphere where illicit activities become acceptable. This results in increased utilization of a country's 'weak points' by criminal syndicates, confident in their profit maximization in the face of the inability of judicial structures to issue sound judgments. This was the situation in Brazil, as recorded in its 2010 FATF Mutual Evaluation report. It noted that although sentences and convictions were recorded for ML/TF, these were insignificant compared to the size of the country and the sophistication of its financial system.²⁴⁸ In response, Brazil introduced specialized trial courts in financial crimes and money laundering to ensure improvements in the quality of decisions and information exchange.²⁴⁹ This novel approach however ensures that quality judgments are not sacrificed on the altar of expediency, especially given the complexities of cases involving ML/TF. Consequently, Brazil has been making strides towards combating corruption in the judiciary, particularly by improving the interface between the regulators, police, judiciary and public prosecution.²⁵⁰

²⁴⁶ Alba Kiihl, 'U.S. and Brazil AML Audit Comparative Analysis How a Review of AML Legislation and Practices Can give a Board of Directors the Confidence to Invest – or Not' (ACAMS, 2011) < <http://www.acams.org/wp-content/uploads/2015/08/US-and-Brazil-AML-Audit-Comparative-Analysis-Alba-Kiihl.pdf> > accessed 14 June 2017.

²⁴⁷ Brian R. Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2000) ESRC Centre for Business Research, University of Cambridge Working Paper No 172, 468 < https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp172.pdf > accessed 8 May 2016.

²⁴⁸ FATF, 'Brazil Mutual Evaluation Report 2010' (FATF) < <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20Brazil%20full.pdf> > accessed 10 May 2016

²⁴⁹ 2003 by Resolution No 314/2003 of the Federal Justice Council.

²⁵⁰ See the Judgement of Criminal Case no 470 (The Mansalao Case) by the Brazilian Supreme Federal Court.

Improving the capacity of judges can contribute positively to the financial market. La Porta et al support this assertion with empirical research which indicates that there is a strong correlation between the strength of a country's law and order and the size of its equity market.²⁵¹ This suggests that an independent and efficient judiciary may guide and determine investment from other countries²⁵² whilst ensuring that erring FIs are punished effectively. The expertise and ability of judges can however be hindered by existing laws which may cause lawyers to exploit procedural irregularities to favor their claim, or to simply stall the case. Courts may not have the necessary legal tools to ensure that the goals of criminal law are achieved.²⁵³ In instances that concern substantive law, judges are sometimes forced to engage in judicial activism to bring the purpose of legislations to life. This would be necessary where the tools provided by the legislature are insufficient to ensure conviction. This is imperative as statistics have illustrated that lower levels of enforcement are invariably related with higher levels of ML activities.²⁵⁴ This indicates that well-crafted laws in corporate bankruptcy, contract, private property, tax, consumer protection and financial regulation are consistently enforced through a well-structured public infrastructure. In the absence of these, there can be a weakening of financial systems, markets and confidence. Thus countries are charged with improving their legal systems.²⁵⁵

In the presence of structured and robust laws, regulatory institutions and enforcement agencies have to work closely to ensure accessibility to information and swift action in curbing illicit crimes. The conflict of interest that hinders this cooperation becomes clearer when the issue of trust between enforcement agencies and FIs is broached. Whilst FIs presume that clients are innocent until guilty, the law enforcement agencies think otherwise because they realize that swift action is needed to freeze or confiscate the assets of a suspect.²⁵⁶ Notwithstanding their differences, the strategies of

²⁵¹ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, 'Legal Determinants of External Finance' [1997] 11 (3) *The Journal of Finance* 1131, 1132.

²⁵² *Ibid.*

²⁵³ Alberto Chong, Florencio López-de-Silanes. 'Money Laundering and its Regulations' [2015] 27 (1) *Economics & Politics* 78, 80.

²⁵⁴ *Ibid* 78, 106.

²⁵⁵ See Demirguc-Kunt and Detragiache, 'The Determinants of Banking Crises in Developing and Developed Countries' [1998] 45 (1) *IMF Staff Papers* 82 – 109.

²⁵⁶ Kris Hinterseer, *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* (Kluwer Law International 2002).

enforcement bodies in supplementing regulatory approaches in combatting illicit crimes cannot however be undermined.

3.3 Differences in the Transplantation and Confidence Trajectory between African Countries and the BRICS

From the foregoing discourse, it is evident that transplantation and confidence patterns differ in ACs/EEs. For instance, Nigeria's AML/CFT standards suffered from legislative and enforcement lapses that hindered implementation. Conversely, China opted for stricter legislative and enforcement standards to ensure implementation of standards. EENA1 asserts that these differences are attributable to variances in compliance levels and strength of institutions.²⁵⁷ EENA1 acknowledges that all ACs are unique, however, corruption is a rife issue and stifles the growth of sturdy institutions.²⁵⁸ He adds that whilst corruption is rife within the BRICS, these countries have been more proactive in combatting these illicit crimes.²⁵⁹ More so, the BRICS have an agenda to build reputable institutions to facilitate cross-border information exchanges, an agenda that is not firmly on the table of ACs.

Concurring with EENA1, EENA2 states that 'by virtue of having more at stake, having an AML/CFT framework that is consistent with the international standards is a bigger priority for EEs than for African states.'²⁶⁰ This is attributable to EEs financial sector size and interlinkage of these financial sectors with other financial sectors within and outside the region. For this reason, EEs are subject to scrutiny by other jurisdictions and groupings like the OECD and G7. Consequently, it becomes a political matter to adopt the AML/CFT laws and ensure a conducive environment for this to thrive. In contrast, ACs have a more contained and smaller financial sector. Thus, ACs have other

²⁵⁷ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, 'Telephone Call' (2017).

²⁵⁸ Ibid.

²⁵⁹ Ibid (n 257).

²⁶⁰ EENA2, Senior Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA2, 'Telephone Call' (2017).

pressing issues to focus on and an established AML/CFT framework is not considered pressing.

Another explanation for the disparity in legal transplantation and confidence in ACs/EEs is their timeline of ascension to the FATF membership. EENA1 stated that ‘BRICS became members of the FATF in the late 90s – now they are going through their third or fourth mutual evaluations...whereas African countries only became members of the FSRBs post 2001’.²⁶¹ Whilst membership is not necessarily a catalyst for improved transplantation and confidence, it can be deduced that early ascension gave the BRICS the opportunity to understand the FATF standards better, and faster. The lapse of time before the ascension of ACs to the position of associate membership no doubt hindered their ability to adapt to the standards, transplant them and improve their confidence levels.

3.4 Perspective on Compliance with Global Standards

Academics have increasingly scrutinized factors that precipitate government compliance with international instruments.²⁶² The economics perspective takes the stand that compliance is determined by a comparative analysis between the supposed benefits of non-compliance with the probability of detection and punishment.²⁶³ Therefore an effective enforcement system with severe punishment will ensure that

²⁶¹ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

²⁶² Beth Simmons, ‘International Law and State Behavior: Commitment and Compliance in International Monetary Affairs’ [2000] 94 (4) *American Political Science Review* 819 – 835; Harold Hongju Koh, ‘Review: Why Do Nations Obey International Law?’ [1997] 106 (8) *The Yale Law Journal* 2599 - 2642; Andrew T Guzman, ‘A Compliance Based Theory of International Law’ [2002] 90 (6) *California Law Review*, pp. 1823 – 1887; Benedict Kingsbury, ‘The Concept of Compliance as a Function of Competing Conceptions of International law’ [1998] 19 *Mich. J. International Law* 345 – 368; Oran R Young, *Compliance With Public Authority* (Baltimore: John Hopkins University Press, 1979); Ronald B Mitchell, ‘Regime Design Matters: International Oil Pollution and Treaty Compliance,’ [1994] 48 (3) *International Organizations* 425, 439.

²⁶³ Gary Becker, ‘Crime and Punishment: An Economic Approach’ in Nigel Fielding, Alan Clarke and Robert Witt (eds), *The Economic Dimensions of Crime* (Macmillan Press Ltd) 46.

compliance is attractive to amoral calculators.²⁶⁴ Political determinants of compliance are largely dependent on the direction of political will of country leaders and the reaction of pressure groups to non-compliance.²⁶⁵ Bounded rationality and behavioral theory postulates that there are operational risks which undermine compliance – these risks are triggered by the limits of organizations in processing and acting on information.²⁶⁶ Alternative explanations include social norms,²⁶⁷ negative effect of formal sanctions, deterrent impact, legitimacy and trust.²⁶⁸ In certain instances, compliance is determined by moral obligations and social influence.²⁶⁹

An appraisal of the varying compliance perspectives provides an understanding of the interplay between international agreements, domestic politics and financial institutions on ML and counterterrorism.²⁷⁰ Examining the perspectives reveal that the motivations for compliance are either calculated, normative or social²⁷¹ and operate as a legal or non-legal factor. As a result, policy responses for enhanced compliance have moved from pure-command and control approach to one favoring a mix of enforcement strategies as listed in the regulatory pyramid.²⁷² These changes are predicated on the general agreement that the borderless nature of illicit crimes warrants an internationally coordinated response²⁷³ managed by IFIs, tackled through cooperation among states

²⁶⁴ Robert A. Kagan and John T. Scholz, 'The "Criminology of the Corporation" and Regulatory Enforcement Strategies' in K Hawkins and J.M Thomas (eds) *Enforcing Regulation* (Boston, Mass: Kluwer-Nijhoff 1084) 323.

²⁶⁵ Emmanuel C. Areno, 'Beyond Lip Service: Using Social Contracts to Achieve Participatory and Accountable Governance in the Philippines' in Carmen Malena (eds.) *From Political Won't to Political Will: Building Support for Participatory Governance* (Kumarian Press, 2009) 246.

²⁶⁶ James March and Herbert Alexander Simon, *Organizations* (First edn 1958, 3rd edn, Blackwell Business 1993).

²⁶⁷ John Coffee, 'Do Norms Matter? A Cross-Country Evaluation' [2001] 149 (6) *University of Pennsylvania Law Review* 2151, 2175.

²⁶⁸ Scholz John T and Mark Lubell, 'Trust and Taxpaying: Testing the Heuristic Approach to Collective Action' [1988] 42 (2) *American Journal of Political Science* 398-417.

²⁶⁹ Jon G Sutinen and Keith Kuperan, 'A Socio-Economic Theory of Regulatory Compliance' [1999] 26 (1) *International Journal of Social Economics* 174, 178; Ian Ayres & John Braithwaite, *Responsive Regulation* (OUP 1992) 124.

²⁷⁰ Beth Elise Whitaker, 'Compliance Among Weak States: Africa and the Counter Terrorism Regime' [2010] 36 *Review of International Studies* 640, 644.

²⁷¹ Winter Soren C and Peter J May, 'Motivation for Compliance with Environmental Regulations' [2001] 20 (4) *Journal of Policy Analysis and Management* 678, 680.

²⁷² Ian Ayres & John Braithwaite, *Responsive Regulation* (OUP 1992).

²⁷³ Jason C Sharman, 'Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developing States' [2008] 52 (3) *International Studies Quarterly* 635, 640.

and implemented by states.²⁷⁴ This logic is premised on the fact that the AML/CFT regime is only as strong as the weakest link in the chain, because astute criminals would reroute their finances to countries with weaker regimes.²⁷⁵

Regarding AML/CFT regulation, the crucial question is whether the commitment of ACs/EEs to the FATF standards and compliance interests are aligned? What factors influence their regulatory and compliance responses? The next section will address this succinctly, given that the following chapters discuss this in more detail.

3.5 Compliance as a Function of Legal Factors

Scholars have argued that various legal factors affect the compliance of countries to domesticated international standards. Whilst Yepes refers to cultural, institutional, socioeconomic and financial factors,²⁷⁶ Simmons refers to reputational concerns as one of the most crucial factors that propel compliance.²⁷⁷ Kal Raustiala and Anne-Marie Slaughter²⁷⁸ refer to enforcement and legalization as some factors that influence compliance. This thesis however restricts these legal factors to democracy and rule of law, enforcement and the mirroring of law.

²⁷⁴ Peter Romaniuk, 'Institutions as Swords and Shields: Multilateral Counter-terrorism Since 9/11' [2010] 36 *Review of International Studies* 591, 594.

²⁷⁵ I beg to argue that this is not always the case as criminals know that even if they move their finances to such states, the odds might not favor them. It is not a veritable land for investment as opposed to countries like England where their investment returns would be higher.

²⁷⁶ Concepcion Verdugo Yepes, 'Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis' (2006) IMF Working Paper 11/177, 17 < <https://www.imf.org/external/pubs/ft/wp/2011/wp11177.pdf> > accessed 10 July 2015.

²⁷⁷ Beth Simmons, 'International Law and State Behavior: Commitment and Compliance in International Monetary Affairs' [2000] 94 (4) *American Political Science Review* 819, 819.

²⁷⁸ Kal Raustiala and Anne-Marie Slaughter, 'International Law, International Relations and Compliance.' in Walter Carlsnaes, Thomas Risse and Beth Simmons (eds.) *The Handbook of International Relations* (Sage Publications, Ltd., 2002) 538, 539 – 542.

3.5.1 Compliance engineered by Democracy and Rule of Law

Key amongst factors that influence government's compliance to international instruments is the presence of domestic political institutions driven by democracy.²⁷⁹ Studies suggest that non-democratic governments are less likely to comply as opposed to liberal democratic governments.²⁸⁰ The reasons for this include the democratic government's respect for legal processes through the judiciary or the presence of domestic interest groups.²⁸¹ Civil societies, court processes and democratic political constituencies may act as enforcement mechanisms pressuring governments to comply. Against this backdrop, Simons argues that governments with respect for rule of law and stable democracy are unlikely to harm their reputation by breaching commitments to standards.²⁸² Conversely, the restriction on human rights in dictatorial regimes will prevent activists pushing the government for results.²⁸³ These arguments suggest that democracies are reliable partners in ensuring compliance with AML/CFT regulations.²⁸⁴

However, it may be too simplistic to assume that non-democratic countries are not compliant with international standards, or that countries with entrenched rule of law would comply. Other factors may come into play that propel countries to comply notwithstanding the rule of law status, such as the culture or imperative need of a country.

²⁷⁹ Helen Milner, *Interests, Institutions and Information: Domestic Politics and International Relations* (Princeton University Press, 1997) 110.

²⁸⁰ Beth Simmons, 'Compliance with International Agreements' [1998] *Annual Rev. Polit. Sci.* 75, 83; Anne-Marie Slaughter, 'International law in a World of Liberal States,' [1995] *EJIL* 503, 534.

²⁸¹ Andrew Guzman, 'International Law: A Compliance Based Theory of International Law' [2002] *California Law Review* 1823 – 1887. This however is not always the case, with the recent rise in social networking usage, sometimes the loudest voice is what counts and not necessarily the perception of pressure groups.

²⁸² Beth Simmons, 'Compliance with International Agreements' [1998] *Annual Rev. Polit. Sci.* 75, 84; Anne-Marie Slaughter, 'International Law in a World of Liberal States,' [1995] *EJIL* 503 – 538.

²⁸³ For Instance, Cameroon and Chad have been ineffective in ensuring compliance due to the dictatorial nature of their governments.

²⁸⁴ They may be advocates against compliance also. On the contrary, an authoritarian government may be best suited to comply with international agreements on ML/TF.

3.5.2 Enforcement Driven Compliance

According to the enforcement model, compliance occurs ‘in the shadow of the law’, given that state behavior can be shaped by concerns about the possibility of adjudication, rule enforcement and legal sanctions.²⁸⁵ Within the context of AML/CFT regulation, the FATF does not have an adjudicatory framework or process to resolve conflicts and mandate compliance, thus foreclosing the possibility of international adjudication.²⁸⁶ This shortcoming has however not limited its ability to drive compliance through sanctioning. This idea is central to the economics perspective which is focused on a comparative analysis between the cost and benefit of compliance.²⁸⁷ The assumption is that the motivation of states to comply with standards are influenced by their interests and only in manipulation of benefits and costs defined in terms of those interests can compliance be achieved.²⁸⁸ Therefore, where enforcement powers are used, severe punishment will ensure that compliance is attractive even to amoral calculators.²⁸⁹

Enforcement in this context refers to mechanisms such as sanctions. Within the framework of international law, it is assumed that the aim of enforcement is to put ‘measures (in place) to ensure the observance of rules’.²⁹⁰ As already noted, the FATF carries out enforcement actions through reputational damage to countries which has the

²⁸⁵ Olu Fasan, ‘Compliance with WTO Law in Developing Countries: A Study of South Africa and Nigeria’ (PhD Thesis, London School of Economics 2006)

²⁸⁶ Norman Magurura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (Routledge, Taylor & Francis Group, London and New York, 2012) suggestion for the FATF to legitimise itself.

²⁸⁷ Alan O Skyes and Eric Posner, ‘An Economic Analysis of State and Individual Responsibility under International Law’ (2006) Coase-Sandor Working Paper Series in Law and Economics 279/2006 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1042&context=law_and_economic_s> accessed 6 March 2016.

²⁸⁸ Alan O Skyes and Eric Posner, ‘An Economic Analysis of State and Individual Responsibility under International Law’ (2006) Coase-Sandor Working Paper Series in Law and Economics 279/2006 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1042&context=law_and_economic_s> accessed 6 March 2016.

²⁸⁹ Robert A. Kagan and John T. Scholz, ‘The “Criminology of the Corporation” and Regulatory Enforcement Strategies’ in K. Hawkins and J.M. Thomas (eds) *Enforcing Regulation* (Boston, Mass: Kluwer-Nijhoff 1084).

²⁹⁰ Tam Christian, ‘Enforcement’ in Ulfstein G, Marauhn T and Zimmermann (eds). *Making Treaties Work* (Cambridge University Press, 2007) 319-407.

effect of further isolating countries from the global financial market. This creates a strong enforcement regime, particularly for countries that want to remain strong players in the market.

Counter arguments however hold that compliance is better induced through instruments of active management, such as verification, review and monitoring.²⁹¹ The FATF provides such enforcement tools through the Mutual Evaluation Reports (MER).²⁹² Mutual evaluations entails gathering information on countries to decipher their compliance levels. Information derived from this ‘review and verification process’ forms the basis for further interactions with countries and decisions on sanctions.

Active management and enforcement cannot however be totally divorced. Koh observes that the success of the management model is sometimes dependent on the ‘shadow of sanctions, however rare or remote that possibility might be’.²⁹³ This indicates that whilst dialogue established through monitoring and review may be ineffective on their own, when backed with sanctions – countries may be willing to comply. So also, countries may be unresponsive to sanctions or threat of same in the absence of persuasiveness.

Additionally, the enforcement and management models derive their validity from laws and regulations. Laws and regulations are not constricted to serving as preconditions for effective regulation, but work to ensure compliance within states. For laws and regulations to ensure compliance within states, national legislation and implementation is necessary.²⁹⁴ Laws are not only symbolic but serve as a catalyst for practical changes

²⁹¹ Abram Chayes and Antonio Handler Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Harvard University Press, 1995) 197.

²⁹² FATF, ‘Mutual Evaluations’ (FATF) < [http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 5 January 2017.

²⁹³ Koh Harold, ‘Why do Nations Obey International Law’ [1997] 106 Yale Law Journal 2599, 2639.

²⁹⁴ Daniel E. Ho, ‘Compliance and International Soft law: Why Do Countries Implement the Basel Accord’ [2002] Journal of International Economic Law.

because laws usually serve as the primary basis upon which courts can enforce judgment, or regulators issue penalties in cases of AML/CFT.

However, as earlier discussed, enshrined laws may not always be a determinant factor for compliance, even when non-compliance would result in reputational damages. Black argues that it is overly simplistic to assume that putting laws in play would result in predictions on improved compliance solely on the basis of reputational concerns.²⁹⁵ This indicates the likely repulsion towards laws and the need for laws and regulations to be translated to regulatory practice. This requires that regulatory bodies make clear their mandate. A clear mandate may however not result in formal adherence to regulations, especially when such a mandate is prescriptive or technologically outdated.

3.5.3 Law: A Mirroring of Society?

An age old argument is that laws reflect how a society views itself. Friedman states that ‘legal systems do not float in some cultural void, free of space and time and social context: necessarily, they reflect what is happening in their own societies.’²⁹⁶ Vago also argues that law reflects the intellectual, social, economic and political climate of its time.²⁹⁷ Wendel Holmes’s statement that ‘the law, wherein, as a magic mirror, we see reflected, not only our lives, but the lives of all men that have been’, encapsulates the mirroring thesis of law.²⁹⁸ This view is reflected by Teubner’s autopoiesis which views law as a deeply integrated aspect of society, and that the external environment influences law only as it is filtered through legal discourse.²⁹⁹ According to this author, autopoietic systems, such as laws construct their images of other systems only through

²⁹⁵ Julia Black, Martyn Hopper and Christa Band, ‘Making a Success of Principles-Based Regulation’ [2007] 1 (3) *Law and Financial Markets Review* 191, 194.

²⁹⁶ Lawrence Friedman, ‘Borders: On the Emerging Sociology of Transnational Law’ [1996] 32 *Stan.J.Int’l L* 65, 72.

²⁹⁷ Steven Vago, *Law and Society* (Englewood Cliffs, N.J: Prentice-Hall, 1981).

²⁹⁸ Oliver Wendell Holmes, Jr., *The Speeches of Oliver Wendell Holmes* (Cambridge, MA, 1981).

²⁹⁹ Teubner Gunther, *Law as an Autopoietic System* (Oxford/Cambridge, Blackwell Publishers, 1993); Niklas Luhmann, ‘The Autopoiesis of Social Systems’ in Felix Geyer, Johannes Van Der Zouwen, *Sociocybernetic Paradoxes: Observation, Control and Evaluation of Self Steering Systems* (SAGE Publications, India, 1986).

the distorting lens of their perceptual view.³⁰⁰ When domestic laws which are considered legitimate are in conflict with international laws, the latter may be internalized gradually or not at all.³⁰¹ These arguments illustrate that law provides a representation of a society's value and norms.

This argument has faced a myriad of contestation, particularly from the notion of transplantation of international law.³⁰² Transplantation holds that the transfer of rules, principles and legal concepts from one legal system to another usually occasions some measure of legal transformation, either voluntarily or otherwise.³⁰³ Roos et al argue that laws are crossing geographical and cultural boundaries³⁰⁴ and this has an impact on the social ordering of law.

Nevertheless, it is recognized that the surrounding social circumstances determine how rules are interpreted or function.³⁰⁵ To that effect, the design or construction of globally applicable standards for governance should entail some flexibility for universal adaptability. Consequently, IFIs and the FATF should take into consideration the peculiarities of countries in crafting standards. It must not only interact with a set of countries, but all countries involved should have a say in the adaptability and applicability of standards for suitability.

Legal factors cannot by themselves drive compliance, but they work in tandem with non-legal factors. Non-legal factors are variable and not developed on the basis of legal considerations. They are nevertheless instrumental in shaping compliance responses of states.

³⁰⁰ Ibid.

³⁰¹ Ibid (n 299).

³⁰² Alan Watson, *The Evolution of Law* (Baltimore: John Hopkins University Press, 1985).

³⁰³ Ibid.; Brian Z Tamanaha, *A General Jurisprudence of Law and Society* (OUP, 2001).

³⁰⁴ Jagtenberg R, Orucu E, and de Roos A, 'Introduction', in Jagtenberget al (eds.), *Transfrontier Mobility of Law* (Boston: Kluwer Law International, 1995).

³⁰⁵ Alan Watson, *The Evolution of Law* (Baltimore: John Hopkins University Press, 1985).

3.6 Compliance as a Function of Non-Legal Factors

An examination of the pre-conditions that allow for effective regulation has given pointers to certain factors that can influence compliance outside the law. Five main factors are discussed. These include: (1) political will, domestic conditions and policy priorities; (2) compliance based reputational concerns; (3) legitimacy; (4) globalisation and integration; and (6) technical capacity and resources.

3.6.1 Political Will, Domestic Conditions and Policy Priorities

The concept of political will is illusive and ambiguous with various scholars defining it contextually.³⁰⁶ This thesis however adopts the definition by Post et al, that political will is the ‘extent of committed support amongst key decision makers for a particular policy solution to a particular problem’.³⁰⁷ This encompassing definition reveals that political will is usually the collective aspiration of a majority of citizens within a country represented by decision makers. These aspirations are reflected in budget allocation,³⁰⁸ drive of civil societies, pro regulation interest groups, voice of the people and determination of the different arms of government. This reveals that domestic conditions and policy priorities are crucial in generating political will.

Domestic conditions are also indicated in the system of government operational within a state. Scholars have argued that the level of democracy of states determine their compliance records.³⁰⁹ They argue that internal structures, including budgetary

³⁰⁶ See Lori Ann Post, Amber N.W. Raile, Eric D Raile, ‘Defining Political Will’ [2010] 38 (4) *Politics & Policy* 653, 653.

³⁰⁷ *Ibid* 653, 659.

³⁰⁸ *Ibid* (n 306) 653, 668.

³⁰⁹ Anne- Marie Slaughter, ‘International Law in a World of Liberal States’ [1995] *EUR. J. Int’l L* 503, 538; Helen V Milner and Andrew Moravcsik (eds.), *Power, Interdependence and Non-State Actors in World Politics* (Princeton University Press, 2009).

allocations, reflect the policy priorities and the domestic conditions of a state.³¹⁰ Also, domestic politics has long been understood to determine the decision of the state to accept international obligations.³¹¹

Yet, in certain instances, political will is foisted on a country through its external agreements. The extent to which this can produce compliance is however debatable. For instance, there are expectations that involvement of ACs/EEs with the FATF would propel political will within these states and translate to improved compliance. In such instances, compliance is largely dependent on the perception by states that FATF's recommendations reflect their national interests and priorities.³¹² For instance, countries faced with high level predicate offences, including high crime rates, terror attacks, capital flight, tax evasion and diminishing financial stability are more inclined to comply with these recommendations as a means of combatting these difficulties. States that are predominately financial inclusive also tend to be more compliant with AML/CFT regimes.³¹³

However ideal this may seem, the degree of political will and institutional commitment in responding to AML/CFT regulations may produce varying demands of accountability.

³¹⁰ Lori Ann Post, Amber N.W. Raile, Eric D Raile, 'Defining Political Will' [2010] 38 (4) *Politics & Policy*.

³¹¹ See also Beth Simmons, *Mobilizing for Human Rights: International Law in Domestic Politics* 23-56 (CUP 2009) 130.

³¹² Tatiana Tropina, 'Do Digital Technologies Facilitate Illicit Financial Flows? (World Development Report: Digital Dividends, 2016) < <http://pubdocs.worldbank.org/en/396751453906608518/WDR16-BP-Do-Digital-Technologies-Facilitate-Illicit-Financial-Flows-Tropina.pdf> > accessed 10 February 2017.

³¹³ Hennie Ester et al, 'Implementing FATF Standards in Developing Countries and Financial Inclusion – Findings and Guidelines' (First Initiative, 2008) < http://cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf > accessed 4 June 2016.

3.6.2 Compliance based on Reputational Concerns

Scholars have argued that reputation affects state behavior.³¹⁴ Goldsmith and Posner believe that states refrain from violating treaties or non-legal agreements simply because they are motivated by the need to avoid reputational loss.³¹⁵ Guzman also agrees that reputation encourages states to comply with international law.³¹⁶ This reputational perspective can be applied to the AML/CFT regime which is derived from the desire for financial stability and integrity – factors which can have an effect on the reputation or credibility of countries. It also forms the basis for understanding the FATF’s sanction through listing of countries.

Reputational concerns are not necessarily always external to a country, sometimes it is internal. For instance, the pressure for compliance with AML/CFT standards can come from large localized institutions which are more predisposed to comply for reputational reasons.³¹⁷ Such banks recognize that a ‘good reputation’ would enable them to compete effectively in the market. These efforts sometimes serve as a catalyst for increased national regulatory supervision on banks and other FIs.

Concerns are however expressed about the role of reputation in ensuring compliance. Downs and Jones argue that states have multiple reputations, not a single reputation.³¹⁸ So whilst for instance a state has a good reputation for complying with environmental standards, it may have a negative record for complying with ML standards. This suggests that reputations vary according to commitments. Consequently, Downs and Jones argue that with increasing global integration, reputational concerns alone is

³¹⁴ Jack Goldsmith & Eric Posner, *The Limits of International Law* (2005) 159.

³¹⁵ *Ibid* (n 314) 98.

³¹⁶ Andrew T Guzman, ‘Reputation and International Law’ [2005] 34 *Ga J. Int’l n & Comp. L* 379, 381.

³¹⁷ Ashby, S.G. and Daikon, S.R, ‘The Value of Corporate Risk Management: Empirical Evidence from Large UK Companies’. [1996] 1 (2) *Risk Decision and Policy*, 203- 215; Beth Simmons, ‘International Law and State Behavior: Commitment and Compliance in International Monetary Affairs’ [2000] 94 (4) *American Political Science Review* 819 – 835.

³¹⁸ George W Downs & Michael Jones, ‘Reputation, Compliance and International Law’ [2002] 31 *JLS* 95, 97.

insufficient to ensure improved compliance.³¹⁹ They assert that states would comply with standards that are more likely to be beneficial, or agreements with high sanctions that have a detrimental effect on their economy.

3.6.3 Legitimacy and its effect on Compliance

Legitimacy is considered crucial in encouraging compliance with regulatory standards and in motivating behavioural responses.³²⁰ Proactive compliance with international law would be improved when institutions are considered legitimate, where they permit ownership, inclusiveness and procedural fairness in their processes.³²¹ This is ingrained in Shaffer's perspective that legitimacy must be able to stand the test of input, throughput and output.³²² According to Tyler, such compliance is a catalyst for voluntary observance of the law and is preferred due to its cost-effective nature.³²³ This varies from formal or constructive compliance by countries which not only necessitates higher enforcement cost, but is usually achieved through coercion.³²⁴

Given that the G7 and certain OECD countries formulated FATF's standards, the extent to which 'associate members' can perceive the FATF or its standards as legitimate is questionable. The membership asymmetry within the FATF has occasioned arguments that a global hegemony exists³²⁵ which facilitates an agency slack. This explains why

³¹⁹ Ibid.

³²⁰ Julia Black, 'Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes' [2008] 2 Regulation & Governance 138, 148.

³²¹ Gregory Shaffer, *Transnational Legal Ordering and State Change* (Cambridge Studies in Law and Society, 2014).

³²² Ibid 50; cf with Bodnasky who asserts that legitimacy can be viewed in terms of representativeness, procedures and effectiveness. See Daniel M. Bodnasky, 'The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?' [1999] 93 (3) American Journal of International Law 596.

³²³ Tom R. Tyler, *Why People Obey the Law* (Princeton University Press, 2006).

³²⁴ Cf with Rainer Hulsee who argues that coercion may be more cost effective and simpler for institutions to disseminate an unpopular regime. Rainer Hulsee, 'Even Clubs Can't Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended' [2008] 2 Regulation and Governance 459, 460.

³²⁵ Mark C Suchman, 'Managing Legitimacy: Strategic and Institutional Approaches' [1995] 20 (3) Academy of Management Review 571, 588; Eric Helleiner, 'State Power and the Regulation of Illicit

the FATF has yet to gain acceptability and its ability to engineer compliance by ACs/EEs has been stalled. For this reason, it is argued that the FATF's standards and processes be re-engineered, particularly its sanction scheme.³²⁶

Scholars have however argued that any re-engineering in favour of legitimacy ignores that fundamentally, soft law bodies such as the FATF are epistemic authorities. Hulse and Kerwer argue that the FATF standards are derived on the basis of expertise and not membership politics.³²⁷ Acceding to this, Vibert asserts that the IFIs/TGNs belong to the knowledge world where their decision making skills are dependent on their epistemic authority.³²⁸ They draw on the procedure of the natural and social sciences to identify complications and frame policy responses.³²⁹ This illustrates the projection of the FATF as legitimate on the basis of the expertise wielded by its secretariat and staff in its processes. A position blindsided to the politics of the agenda within the institution and its effect on the FATF's rule design and compliance. The politics is evident in the composition of the experts from the private and public sector who are mainly representatives of developed countries, a configuration that does not encompass or represent the views of developing countries. It is thus capable of stifling the effectiveness of developing countries to the FATF standards. This suggests that any restructuring should de-politicise the FATF and ensure a truly 'expertise' process that includes the views of developing countries.

Activity in Global Finance. In FrimanRH, AndreasP (eds) *The Illicit Global Economy and State Power* (Rowman & Littlefield, Lanham, 1999) 76.

³²⁶ As there was an absence of 'voice-able' members in standards formulation, lack of representativeness and procedural unfairness in its processes, thus hindering effectiveness.

³²⁷ Dieter Kerwer and Rainer Hulse, 'How International Organisations Rule the World: The Case of the Financial Action Task Force on Money Laundering' [2011] 2 *Journal of Int'l Stud.* 50, 55.

³²⁸ Frank Vibert, 'Reforming International Rule-Making' [2012] 3 (3) *Global Policy* 391, 392.

³²⁹ *Ibid.*

3.6.4 Globalization and Integration

Several macroeconomic variables determine a country's level of integration to the global financial market. These include a country's level of financial exposure, openness, relevance, transparency or the interconnectedness of its banking and financial markets.³³⁰ These indices are utilized by the IMF in determining the systematic importance of a country.³³¹ Such categories separate countries whose financial sectors potentially have the most impact on systemic stability from those that do not and subjects the former to a heightened surveillance process.³³² These variables arguably have an effect on the level of compliance to international standards.

Countries that are plugged into the international economy arguably have more incentives to comply for two reasons. The level of supervision by multilateral institutions and the potential effect of sanctions. Supervision, which usually entails monitoring can reveal the shortcoming of countries, a catalyst for reputational damages that such countries would rather avoid. Furthermore, sanctions meted out by the FATF and backed by the IFIs have the effect of limiting the involvement of these countries in global economic activities – a position countries are uncomfortable about. Conversely, it can be argued that countries not connected to the international global economy may defer compliance knowing that sanctions would have a limited effect on them.

Nevertheless, the ability of countries not classed as 'systemically important countries' to renege on AML/CFT compliance is largely limited by the involvement of IFIs. As a pre-condition for financial assistance, IFIs have incorporated law reforms and

³³⁰ IMF, 'Mandatory Financial Stability Assessment under the FSAP' (IMF, 24 September 2014) < <https://www.imf.org/external/np/fsap/mandatoryfsap.htm> > accessed 4 May 2016 - Warranting South Africa's compliance levels.

³³¹ Ibid.

³³² IMF, 'Mandatory Financial Stability Assessments Under the Financial Sector Assessment Program: Update' (International Monetary Fund, 15 September 2013) < <https://www.imf.org/external/np/pp/eng/2013/111513.pdf> > accessed 7 October 2017.

compliance requirements.³³³ Additionally, multilateral institutions and FIs within highly-integrated countries use compliance with accredited standards to determine potential finance opportunities or threats within developing countries.³³⁴

Consequently, although the impact of globalization and integration in propelling compliance cannot be overlooked, it needs not be overelaborated. This is because, countries have internal reasons that can propel compliance irrespective of external pressure.³³⁵ More difficult is the position whereby internal factors within the country prevent compliance.

3.6.5 Technical Capacity and Resources

Technical capacity of countries is crucial in ensuring compliance to international standards. Within the private and regulatory sector, a new market has emerged for lawyers, accountants, auditors, economists, front desk officers and other professionals. These officers are bestowed with a gate-keeper responsibility of ensuring that FATF recommendations are adhered to, particularly in carrying out strict CDD. It requires that financial transactions are monitored and prompt reports made to the FIU where suspicion arises. These responsibilities mean that staff should be trained in the requisite skills required to drive the new market.³³⁶ Hence, countries are to intensify training for these set of professionals to ensure compliance, or risk falling short of required standards.

³³³ Fletcher I, Mistelis L, and Cremona, M (eds.) *Foundations and Perspectives of International Trade Law* (London: Sweet & Maxwell, 2001)

³³⁴ *ibid.*

³³⁵ Garrett G, 'Global Markets and National Politics: Collusion Course or Virtuous Circle?' [1998] 52 (4) *International Organization*.

³³⁶ Gregory Shaffer, *Transnational Legal Ordering and State Change* (Cambridge Studies in Law and Society, 2014) 76.

Training is also required due to the increased use of technology in facilitating illicit transfers. Internet penetration and evolving payment methods have increased the vulnerability of financial systems to a new form of risk. Regulators and operators are to get acquainted with the new processes of transfers, such as cryptocurrencies, so as to ensure that their countries are not adversely affected by illicit autonomous transfers.

In recognition of the need for capacity building, IFIs provide technical assistance to countries. The aim is to ensure that countries can address the vulnerabilities within their system locally. This is however largely dependent on the political will of the country which is reflected through its interactions with IFIs and the resources it approves for this purpose. In the absence of resources, the ability of countries to combat illicit crimes would be greatly limited, illustrating the interaction between varying non-legal factors.

An important point is that the source of funding may determine its influence on compliance. For instance, international funding may come with pre-conditions and specificity which is likely to ensure improved compliance resulting from the buildup of pre-conditions for effective regulation. However, when funding is from a government's budget, it usually comes without conditions and lacks the transparency associated with foreign funding.

It is imperative to state however that adequate training and funding may not always translate to improved compliance. This is because the 'human factor' element cannot be overlooked. Training and resources are no guarantee that staff cannot be manipulated or funds diverted.

3.6.6 Setting out Factors that Influence Compliance

The literature on compliance has been examined with the aim of explaining internal and external compliance drivers in ACs/EEs. In line with the core argument of this thesis, these factors are set out as legal and non-legal factors, both of which are not mutually exclusive.

<u>Legal Factors</u>	Description
<i>Compliance engineered by Democracy and Rule of Law</i>	This refers to factors such as ‘democratic’ or ‘non-democratic’ governments, judicial independence and respect for the rule of law.
<i>Enforcement driven Compliance</i>	This refers to factors such as legal sanctions, ‘instruments of active monitoring’ such as monitoring or surveillance, effective contract law and sturdy judicial systems.
<i>Law Mirroring Society</i>	Culture (e.g. remittances/financial inclusions).
<u>Non-Legal Factors</u>	Description
<i>Political Will, Domestic Conditions and Policy Priorities</i>	Government stance, pressure groups/civil societies.
<i>Compliance based on Reputational Concerns</i>	Reputation, Sanctions.
<i>Legitimacy and its effect on Compliance</i>	Perception of legality of institution.
<i>Globalization and Integration</i>	Position of countries within the global financial market.
<i>Technical Capacity and Resources</i>	Human and financial resources, training, technological advancements.

Table 1: *Legal and Non-Legal Compliance Drivers.*

3.6 Benchmarking Compliance Ratings

Notwithstanding the above drivers of compliance that have an impact on a country's compliance levels, the IFIs/FATF benchmark all countries to the same standards using the same methodology. To appreciate the impact of this, it is crucial to understand the concept of benchmarking.

Benchmarks, which are usually indicators that measure the achievements of set goals, are widely used to track market developments. They serve as a guide to investors, and thus determine the direction of investments.³³⁷ This instrument is however not novel and has been used in diverse areas, including health industry³³⁸ and service productivity industry³³⁹ to achieve improved compliance. Although originally recognized as an instrument for improving compliance with policy goals, it has recently been usurped by international organizations to circumvent their enforcement problems.³⁴⁰ This usually requires reliance on states for sanctions,³⁴¹ indicating the renewed ability to employ coercive tools to effect policy change.

Although the determinant factors considered in building a global AML/CFT benchmark are usually unspecified, the effectiveness of macro and micro prudential supervision is largely determined by benchmarking scores attributed to each FATF recommendation. Countries are adjudged to be compliant to AML/CFT regulations by the extent to which

³³⁷ European Parliament News, 'Benchmarks: Restoring Confidence in the Financial Market' (European Parliament News, 6 April 2016) < <http://www.europarl.europa.eu/news/en/news-room/20160404STO21313/benchmarks-restoring-confidence-in-the-financial-markets> > accessed 23 July 2016.

³³⁸ Susanne Wait, Ellen Noite, 'Benchmarking Health Systems: Trends, Conceptual Issues and Perspectives' [2005] 12 (5) *Benchmarking: An International Journal* 436, 437.

³³⁹ Stephan Klingner, Stephanie Pravemann, Michael Becker, 'Service Productivity in Different Industries' [2015] 22 (2) *Benchmarking: An International Journal* 238 – 253.

³⁴⁰ Andre Broome and Joel Quirk, 'The Politics of Numbers: The Normative Agendas of Global Benchmarking' [2015] 41 *Review of International Studies* 813, 817.

³⁴¹ James Caporaso and Joerg Wittenbrinck, 'The New Modes of Governance and Political Authority in Europe' [2006] 13 (4) *Journal of European Public Policy* 471-480; Anna Van Der Vleuten and Mieke Verloo, 'Ranking and Benchmarking: The Political Logic of New Regulatory Instruments in the Field of Gender Equality and Anti-Corruption' [2012] 40 (1) *Policy and Politics*. 71, 85.

they conform to FATF indicators or other regulatory benchmarks.³⁴² The extent of compliance is however determined by a combination of technical compliance, and effectiveness in meeting defined outcomes.³⁴³ In both estimates of compliance, there is a measure of benchmarking; however, whilst the technical compliance approach adopts a more rigid methodology, the effectiveness measure adopts an open but exploratory language.³⁴⁴

Technical compliance with FATF recommendations is categorized into four different levels against which countries are measured: Compliant, Largely Compliant, Partially compliant and Non-Compliant.³⁴⁵ It measures the implementation of specific requirements of the FATF recommendations, including framework of laws and enforceable means.³⁴⁶ Effectiveness on the other hand aims to provide an appreciation of a country's AML/CFT, how well it works and how defined outcomes are achieved.³⁴⁷

The FATF methodology presents the illusion that its benchmarks are supposed to highlight the best practice attainable by countries. Indicating a purpose focused on fostering creativity and encouraging improvements whilst giving countries the opportunity to learn from each other.³⁴⁸ The implication, however, is that states are urged to emulate these standards, failing which they would face enforcement sanctions. The benchmarking process which is a ground for sanctioning countries is however not infallible.

³⁴² FATF, 'Methodology: For Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT System' (FATF, 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf>> accessed 10 August 2017.

³⁴³ Ibid.

³⁴⁴ Ibid (n 342).

³⁴⁵ Ibid.

³⁴⁶ Ibid.

³⁴⁷ Ibid.

³⁴⁸ John Williams, Cheryl Brown, Anita Springer, 'Overcoming Benchmarking Reluctance: A Literature Review' [2012] 19 (2) *Benchmarking: An International Journal* pp 255 -276.

Firstly, the FATF reports may be unreliable. For instance, monitoring and measurement of compliance is done through mutual evaluations, self-assessment surveys and progress reports³⁴⁹ carried out by FATF staff in agreement with related FIs and criminal justice agencies. The ratings produced from this technical exercise are however generalized, whilst giving the impression of democratic standard setting. For instance, in India (as with other EEs), only about three FIs are assessed along with several regulatory bodies. In a country with over 93 commercial banks, an assessment of only three FIs cannot be reflective of actual compliance levels. It is immaterial that an examination of regulatory bodies, criminal justice agencies and relevant ministries are also carried out, as a 'clear picture' can only be obtained directly from FIs, which serve as first point of call, providing information to other bodies. Blacklisting a country based on an unrepresentative assessment of the true position of compliance levels is unsatisfactory. Lombardo asserts that the judgment of performance is strictly formal, assessing the legal implementation of the standard does not adequately reflect the de facto attainment of the policy goals contained in the standard.³⁵⁰

Secondly, the subjective nature of data collection is also problematic. However, the problems associated with subjective measurements vary. For instance, the FATF methodology has an open and closed perception-based index which asks specific questions linked to industry experience, as opposed to simply measuring the perception of money laundering in a particular country. However, the variance in such reports as the Basel AML Index 2015 and the FATF NCCT 2015 list demonstrate the difficulty of subjective criteria.³⁵¹ For instance, whilst the FATF list Algeria, Ecuador and Myanmar as countries with strategic AML/CFT deficiencies and high risk, Basel AML Index only list Myanmar as one of the top 10 highest risk countries.³⁵² Additionally,

³⁴⁹ Kern Alexander, Rahul Dhumale, John Eatwell, *Global Governance and International Standard Setting* (OUP 2006) 71.

³⁵⁰ Dean Lombardo, *Benchmarking: An Adviser's Guide to Client Engagement Model* (2013).

³⁵¹ International Centre for Asset Recovery, *Basel AML Index 2015 Report*, <https://index.baselgovernance.org/sites/index/documents/Basel_AML_Index_Report_2015.pdf> accessed 20 June 2016; Thomson Reuters, 'Country Risk Ranking' (Thomas Reuters) <<https://risk.thomsonreuters.com/products/thomson-reuters-country-risk-ranking>> accessed 20 July 2016.

³⁵² International Centre for Asset Recovery, 'Basel AML Index 2015 Report', (*International Centre for Asset Recovery*, 2015) <https://index.baselgovernance.org/sites/index/documents/Basel_AML_Index_Report_2015.pdf> accessed 20 June 2016; Thomson Reuters, 'Country Risk Ranking' (Thomas Reuters)

whilst the FATF MER-derived statistics of China list it as one of the most compliant countries, the Basel AML Index classifies China as a country with high risk.³⁵³ The result is that key institutions in certain jurisdictions may stretch data to meet the policy objectives of the most renowned standard setter.³⁵⁴ Countries that are in the lower regions of the ranking would be the most likely to engage in these sharp practices in a bid to avoid associated financial stigma and reputational damage, indicating existent information asymmetry.

Flowing from this is the argument that countries may become immune to the ranking process. For instance, it may be easier to report notorious countries like Afghanistan, overlooking its growing ability to combat AML/CFT. In comparison, reporting countries such as China which is assumed to be clean would demand a higher threshold requiring substantial proof. Oliver suggests that this could demotivate those that come out at the top of the ranking.³⁵⁵

The backlash that has trailed the culture of benchmarking has classed this concept as a power-based instrument for two reasons. Firstly, it is negotiated by groups with conflicting interests. This is evident in the composition of FATF members with China, an EE, which has diverse socio-political interests from countries like the UK and the US. Although the interest of the latter set of countries trumps that of the EEs. Secondly, its resulting policies and sanctions are imposed on groups that are not privy to the negotiation process, particularly developing countries.³⁵⁶ Expounding on this, EENA4

<<https://risk.thomsonreuters.com/products/thomson-reuters-country-risk-ranking> > accessed 20 July 2016. See also FATF, FATF Public Statement – 27 February 2015' (*FATF*, 27 February 2015)<<http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-february-2015.html> > accessed 15 January 2017.

³⁵³ Ibid.

³⁵⁴ Wendy Nelson Espeland and Michael Sauder, 'Rankings and Reactivity: How Public Measures Recreate Social Worlds' [2007] 113 (1) *American Journal of Sociology* 1. 28.

³⁵⁵ Adam Oliver, 'The Folly of Cross-Country Ranking Exercise' [2012] 7 *Health, Policy and Law* 15, 15.

³⁵⁶ James Caporaso and Joerg Wittenbrinck, 'The New Modes of Governance and Political Authority in Europe' [2006] 13 (4) *Journal of European Public Policy*; Anna Van Der Vleuten and Mieke Verloo, 'Ranking and Benchmarking: The Political Logic of New Regulatory Instruments in the Field of Gender Equality and Anti-Corruption' [2012] 40 (1) *Policy and Politics*. 71, 85; The G7 countries who spearheaded the initiation of the FATF have a greater say in the negotiation of recommendations; Kern Alexander, Rahul Dhumale and John Eatwell, *Global Governance of Financial Systems* (OUP, 2006) 72.

stated that ‘the ICRG usually list developing countries. Whereas, the money flows from these countries are much less than that from developed countries...it [the ICRG list] does not represent a totality of the countries not complying’.³⁵⁷ EENA4’s statement illuminates on the subjectivity of the benchmarking process which usually seeks to sanction non-member countries. This is reflected in the two-tier list compiled by the ICRG – the black-2 and grey list.³⁵⁸ It is indeed deplorable that whilst these listings can have grievous consequences, such as the financial isolation of countries – the criteria for listing is unclear and shrouded in secrecy.

Thus, compliance with the FATF standards is mandatory irrespective of this absence of democracy in the negotiation or ‘listing’ process. Additionally, the lack of preconditions for robust AML/CFT regulations coupled with the variances in internal country circumstances are not considered in subjecting ACs to the same standards, yet these countries are benchmarked similarly.

This can result in information asymmetry, with countries producing false compliance standards, but more deeply, it unearths a pervasive legitimacy crisis. This is not peculiar to the FATF. More damning financial scandals which have involved benchmarks such as *libor* and *eurolibor* have shown the susceptibility of the benchmarking system to manipulations. These benchmarks were used to price EU citizen’s mortgages, loans and other forms of lending. However, the daily values of these were usually determined and manipulated by a few big players in the market. What becomes obvious is the need for benchmarking administrators to be independent, registered and carefully selected to ensure a transparent process.

The importance of an independent set of benchmarking administrators is imperative to address concerns related to how benchmark indicators are formulated and classified

³⁵⁷ EENA4, Interview with Anonymous, ‘Telephone Call’ (2017).

³⁵⁸ FATF, ‘High-Risk and Non-Cooperative Jurisdictions’ (FATF) < [http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/more/more-on-high-risk-and-non-cooperative-jurisdictions.html?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/more/more-on-high-risk-and-non-cooperative-jurisdictions.html?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 10 June 2017.

according to importance. The conceptual framework of benchmarking is particularly important given the effect of the benchmarking process which is noted by the exercise of the determinants of compliance backed by statistical evidence. Furthermore, it is against this benchmark that determinants for compliance are deduced.

3.7 Conclusion

‘Law and confidence’, factors which are crucial to ensuring a conducive environment for transplantation of laws in ACs/EEs are weak. Law matters, but most importantly, the design of law is crucial in propelling compliance and averting gaming of the law. Law however does not work in a vacuum but is largely dependent on confidence. Confidence in financial stability, institutions, governmental and political systems, and enforcement structures. Confidence would ensure that FIs are held accountable and regulations are effective and able to ensure financial stability. These factors are however lacking in ACs/EEs, an indication that ACs/EEs will be incapable of effectively transplanting or implementing FATF’s standards. This is particularly so for ACs due to the enhanced effect of corruption, belated understanding of the FATF standards, coupled with their absence of integration within the global economy. Yet, due to the subjection of states to AML/CFT regulation, they are mandated to comply or face sanctions.

The preconditions for effective regulation and variances in the internal country structures feed into the compliance drivers that are determinants of compliance levels. Compliance drivers, categorized into legal and non-legal factors are not always internal to a country and may in certain instances, be external – not within the control of the country’s authorities. The legal factors considered include democracy and rule of law, enforcement and mirror of the law. Political will, domestic conditions and policy priorities, reputational concerns, legitimacy, globalization and capacity are non-legal factors found to have an impact on the compliance level of countries with AML/CFT standards. It is however noteworthy that none of these factors can influence compliance solely, rather, they work in tandem and are interlinked.

Chapter 4

The Agency Relationship between Collective Principals and their Interaction with African Countries and Emerging Economies

4. Introduction

Information sharing is crucial in combating financial crimes. Hence, the collaboration between IFIs and the FATF is aimed at presenting a synchronized global approach to counter illicit crimes which would facilitate information sharing with agents. The collective principals (IFIs/FATF) interact with agents (countries) to advance transparency of information and cure any underlining asymmetries. Findings however reveal that countries with the highest degree of integration and potential compliance levels have the strongest incentive to interact with IFIs/FATF. ACs do not fall within this category and to evade sanctions, these countries interact strategically with the collective principals. Yet, financial crime remains a borderless crime and can flow from ACs to highly integrated countries. Acknowledging this, the interaction between these set of countries are examined to determine how compliance is generated in these instances.

Section 1 examines the relationship between the collective principals. The evolution of their relationship is examined in light of AML/CFT rulemaking, implementation and compliance measures aimed at fostering standardization for ease of application. Section 2 focuses on the relationship between the collective principals and agent states. It analyses how the level of integration with the global financial system and perceived compliance levels play a role in resolving or escalating information asymmetry. It further considers how information asymmetry can hinder cross-border transactions between countries at various ends of the spectrum of global financial integration and compliance. Regarding cross-border banking, it contends that countries converge better when it serves their self-interest and they have capacity. The monitoring and

sanctioning tools employed by the collective principals in evading the shortcomings associated with information asymmetry are considered. Section 3 concludes the analysis.

4.1 Rule Design, Implementation and Compliance

The reverse and continuing agency relationship postulates that all developed and developing countries are agents to the collective principals (IFIs/FATF). This means that ACs/EEs fall within the purview of agents to the collective principals. The FATF, as the proximate principal (PP) within this context, has the authority, as delegated from the agents, to issue rules which incorporate compliance measures. IFIs, as extended principals (EP) only have the authority to assess compliance levels, provide technical assistance, organize high-level meetings and back up sanctions by the PP. However, in discharge of their assessment responsibilities, IFIs usually acquire practical knowledge of the workability or suitability of rules. This grants them the expertise to advise the PP on the amendment of or addition to certain existing rules/standards.

It is against this background that this chapter discusses the evolution of the relationship between the collective principals in rulemaking, implementation and compliance aimed at ensuring a unified approach to combatting ML/TF. Whilst recognizing that ‘ideally’ all countries delegate authority to collective principals for this purpose, there is a recognition that certain countries, particularly ACs, are not involved in the delegation process. The implication is that their interests are not reflected at any stage, or are discounted as unparalleled to the direction of the global financial economy. This has occasioned agency slack aimed at ensuring continued compliance in a bid to retain their corner within the global economy.

4.1.1 Rule Design: Relationship between the FATF and IFIs

The construction of global recommendations for transplantation to nation-states (agents) is the task of the international standard-setter principal (FATF), with the assistance of other assessment and implementation principals (IFIs). Agents, i.e. national legislators, ensure that transplanted recommendations transcribed to legislations reflect the objectives of the principals. A deviation, which may be in favour of local factors, may necessitate sanctions in the form of financial isolation from the international financial market.

Recommendations/Standards for transplantation created by principal(s) are referred to as ‘soft law’, a nomenclature attributed to the creation of a global order through the stipulation of best practices applicable to autonomous countries and organisations.¹ These recommendations which set benchmarks that ‘gives advice to many’² gain their peculiarity from capturing rule-making through the use of voluntary standards injected with a measure of flexibility.³ Put simply, standards form a category of rules that address public policy issues.⁴ Vibert contends that this form of recommendation design is employed to solve cross-border issues affecting various countries, with the advantage of adding to the predictability of the world.⁵ This is arguably a major stabilising factor in a world where relative power is rapidly shifting.

Arguably, there are profound differences between hard law and soft law instruments, and the spaces they regulate. For instance, though borne out of negotiations with actors that are seemingly bound by a unified objective, unlike hard law, ‘soft laws’ lack binding enactment power.⁶ This can be typified with organisations such as the BCBS

¹ Rainer Hulsse and Dieter Kerwer, ‘Global Standards in Action: Insights from Anti-Money Laundering Regulations’ [2007] 14 (5) *Organization* 625, 627.

² Brunsson Nils, ‘Standardization as Organization’ in M. Egeberg and P Laegried (eds.) *Organizing Political Institutions: Essays for Johan P. Olsen* (Oslo: Scandinavian University Press, 1999) 109 -28.

³ Rainer Hulsse and Dieter Kerwer, ‘Global Standards in Action: Insights from Anti-Money Laundering Regulations’ [2007] 14 (5) *Organization* 625, 627.

⁴ *Ibid.*

⁵ Frank Vibert, ‘Reforming International Rule Making’ [2012] 2 (3) *Global Policy* 391, 391.

⁶ Dinah Shelton, *Normative Hierarchy in International Law* [2006] 100 *AM. J. Int’l* 291, 319.

that is involved in setting best-practices on banking capital requirements.⁷ The role of the BCBS requires it to undertake a large amount of rulemaking due to the uncertainty in its regulatory niche.⁸ Consequently, these rules are sometimes classified as ‘hard-law’ due to their precision coupled with requirements on countries to legislate on the guidelines. This extends the concept beyond treaties⁹ which are employed to deal with areas of law that have some measure of certainty such as trade or monetary policy. Additionally, with hard law, there is reliance on military intervention, coercive diplomacy and economic means for binding powers.¹⁰ Such enforcement approaches are unavailable with soft law. However, unlike soft law rules which can be easily reassessed,¹¹ hard law is rigid, with changes to treaty agreements possible only through costly and burdensome renegotiation.¹²

There is a dichotomy between hard and soft law rules in the context of international law. However, the hardening of the boundaries of soft law through separate legal instruments internationally or domestically denotes a continuum within which several instruments of coercion or persuasion exists.¹³ Nevertheless, its source is usually not authoritative or binding. It is within this setting that the FATF, the foremost standard-setting body for AML/CFT sits.¹⁴

⁷ Kerwer Dieter, ‘Rules that Many Use: Standards and Global Regulation’ [2005] 12 (4) *Governance* 611, 619; Timothy Meyer, ‘Soft Law as Delegation’ [2008] 32 (3) *Fordham International Law Journal* 888, 892.

⁸ *Ibid.*

⁹ Raustiala Kal and Anne-Marie Slaughter, ‘International Law, International Relations and Compliance’ [2002] 02 (2) *Princeton Law & Public Affairs Paper* 538, 539.

¹⁰ Gallarotti Giulio, ‘Soft Soft Power: What it Is, Why it’s Important, and the Conditions for its Effective Use’ [2011] 4 (1) *Journal of Political Power* 25, 29.

¹¹ For instance, the FATF recommendations were reassessed in 2001, 2012.

¹² Wilson, Ernest. J, ‘Hard Power, Soft Power, Smart Power’ [2008] 616 (1) *The Annals of the American Academy of Political and Social Science*.

¹³ Brooke A. Smith-Windsor, ‘Hard Power, Soft Power Reconsidered’ [2000] 1 (3) *Canadian Military Journal* 51, 52. Soft law is hardened in application but its source is usually not authoritative or binding, see Timothy Meyer, ‘Soft Law as Delegation’ [2008] 32 (3) *Fordham International Law Journal* 888, 892.

¹⁴ Saby Ghoshray, ‘Combating Threats to the International Financial System: The Financial Action Task Force: Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law’ [2014/2015] 59. *N.Y.L School Review* 521, 528.

Ideally, international rules should permit for regulatory space to ensure its adaptability. Vibert contends that in engineering compliance, international rule making does not in fact overregulate an area.¹⁵ This can be attributable to the ‘mirroring’ of law which postulates that the design or construction of globally applicable rules for governance should reflect socio-economic and political peculiarities of countries. Hence, flexibility of international rules is required for universal adaptability. Put simply, laws reflect how societies see themselves.¹⁶ Therefore, the creation of these rules/standards through networks requires that actors construct and convey them in a way that appreciates the uniqueness of countries.¹⁷ The actors in this case are staff of international institutions, such as the FATF, the IMF and the World Bank. As principals, these actors must interact with representatives of member states’ legislature to ensure that rules adopted are suitable to those states. This will ensure that rules adopted result in the best outcomes for global regulation of ML/TF in the form of financial integrity and stability. More importantly, these actors must also interact with themselves to ensure a synchronisation of rules which makes for easy adaptability.

4.1.1.1 Interaction Between Principals in Rule Making

The FATF manages global regulation in AML/CFT through a comprehensive array of recommendations related to prescribed conduct.¹⁸ However, as earlier stated, its lack of an internal constitution or constituent charter¹⁹ coupled with a non-direct supervisory enforcement ability renders its laws soft. This seeming deficiency is resolved by two

¹⁵ Frank Vibert, ‘Reforming International Rule Making’ [2012] 2 (3) *Global Policy* 391, 391.

¹⁶ Gregory Shaffer, ‘Transnational Legal Process and State Change’ [2012] 37 (2) *Law & Social Inquiry* 229, 238.

¹⁷ *Ibid* 229, 259. They are constructed or conveyed by actors, including government officials, members of international secretariats, professionals’/ business representatives and civil society representatives.

¹⁸ FATF, ‘International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations’ (FATF, 2012) < http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf > accessed 13 April 2017.

¹⁹ James T Gathii, ‘The Financial Action Task Force and Global Administrative Law’ (2010) *J Prof. Law* 197, 198; Beth Simmons, ‘International Efforts Against Money Laundering’ in Dinah Shelton (eds.), *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP, 2000, First Published 2000) 255.

means. Firstly, its issue of specific guidelines for prudent behaviour and publication of compliance levels of countries. These ensure that the FATF recommendations become a comprehensive governance framework for member and non-member jurisdictions.

The second means is through collaboration with established supranational bodies such as the IMF, the United Nations Security Council (UNSC) and the World Bank who have observatory membership on the FATF.²⁰ Such engagements reveal that the FATF does not act in isolation when prescribing recommendations, since assessment reports from IFIs are fed back into the remodelling of the FATF standards.²¹ Recommendation 1 of the FATF which adopts a risk-based approach to technical compliance illustrates this. It is argued to have been included to douse the FATF's legitimacy crisis as requested by the IFIs.²²

Additionally, these relationships have compelled the FATF to exert authority as a legitimate supervisory body capable of setting international standards.²³ The FATF also gains its normative authority through its working relationship with the United Nations Counter-Terrorism Committee (UNCTC) and endorsement of its recommendations by the Sanctions Committee of the UNSC.²⁴ Ghoshray asserts that the global endorsement of various recommendations through specific UNSC resolutions have significantly contributed to the enhancement of the FATF status as a supervisory body, transforming its recommendations from mere prescriptions to legitimate legal norms.²⁵

²⁰FATF, 'FATF Members and Observers' (FATF) < <http://www.fatf-gafi.org/about/membersandobservers/> > accessed 13 April 2017.

²¹ FATF, 'Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations' (FATF, 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf> > accessed 10 April 2017.

²² Sean Hagan, 'Revision to the Financial Action Task Force (FATF) Standard – Information Note to the Executive Board' (IMF, July 2012) <<https://www.imf.org/external/np/pp/eng/2012/071712a.pdf> > accessed 11 May 2017.

²³ Saby Ghoshray, 'Combating Threats to the International Financial System: The Financial Action Task Force: Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law' [2014/2015] 59. N.Y.L School Review 521, 529.

²⁴ FATF, 'Briefing Briefing to the United Nations Security Council Committee, New York' (26, October 2009) < http://www.un.org/en/sc/ctc/docs/statements/2009_10_26_fatf_brief.pdf > accessed 19 April 2017.

²⁵ Kenneth S Blazejewski, 'The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Trans-Governmental Networks' [2008] 22 Temp. Int'l & Comp LJ 1, 14; Saby

An examination of the relationship between the FATF and the IFIs reveals a collective principal framework, with the FATF as the PP and the IFIs as EPs to the agents in the context of rulemaking. This position is attributable to the individual and collaborative roles of the actors in the realisation that so long as they are bound by principal responsibilities, no principal of nation-states is an island.²⁶ Rather, efficiency is derived when expertise and specialisations are harnessed. Cooperation in this circumstance can be defined to include exchange of information, analysis, views and deliberations on best practices between IFIs and FATF officials.²⁷

A sequential scrutiny of the partnership between the FATF and IFIs illustrates how the FATF has cultivated these institutional relationships to advance its objectives. IFIs have now assumed the role of providing technical assistance and carrying out assessments on the soundness or vulnerabilities of economies to ML/TF. Prior to that, the IMF was solely responsible for providing short-term loans to stabilise members' balance of payments concerns,²⁸ whilst the Bank was responsible for providing long term loans for development projects.²⁹ Such disparity in their specialisations required no collaboration or consultation. However, these institutions began to overlap their mandates over time, requiring partnership and continuous discussions for effective division of labour.³⁰ In 1997, the Bank-Fund Financial Sector Liaison Committee was established to oversee collaboration between the two institutions, a process which culminated in the creation of the FSAP in 1999.

Ghoshray, 'Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law' [2014/15] 59 NYL. Sch.L. Rev. 521, 542.

²⁶ James M Boughton, 'Tearing Down Wall' (International Monetary Fund 1990-1999) 82.

²⁷ *ibid*; FATF, 'Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations' (FATF, 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf> > accessed 10 April 2017.

²⁸ IMF 'Articles of Agreement' < <https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> > accessed 26 April 2017.

²⁹ IMF and IBRD, 'Articles of Agreement: International Bank for Reconstruction and Development' [1944] <http://siteresources.worldbank.org/EXTARCHIVES/Resources/IBRD_Articles_of_Agreement.pdf > accessed 10 April 2017.

³⁰ James M Boughton, 'Tearing Down Wall' (International Monetary Fund 1990-1999) 82.

The integration of these institutions was not without hitch. The IMF's mission chiefs consistently complained of the World Bank's bureaucracy or indifferent response. Conversely, World Bank staff complained that the IMF staff were inflexible and too quick to draw conclusions.³¹ This revealed that irrespective of similar structures and culture of cross-fertilization of staff, the ethos within these organisations were varied, hindering their abilities to collaborate effectively. Through this period of IFIs collaboration, the FATF's relationship with these institutions was strained. Although the FATF considered a relationship expedient, the IFIs did not. Engardio contends that the IFIs' initial reception of the FATF's proposal for collaboration was lukewarm,³² expressing concern that AML/CFT lay outside their mandate.³³

However, some elements of coordination between these institutions existed for two reasons. Firstly, IFIs and the FATF are created and largely funded by the same set of countries – a commonality that led to frequent networked meetings. Secondly, the role of the IFIs in assessing compliance level of countries in specific areas and providing technical expertise based on its FSAP reports – a niche which was observably crucial in expanding the FATF's reach. This meant that coordinated meetings were vital.³⁴ The latter reason propelled the FATF to seek partnership with the IFIs post the commencement of the FSAP, of which the Report of the Observance of Standards and Codes (ROSC) is a key component.³⁵ The ROSC is particularly relevant as it reports on the implementation of 12 benchmarks of good practice earmarked by the IMF as areas relevant to the financial and economic soundness of the state.³⁶ One of the

³¹ Ibid.

³² Pete Engardio, 'Commentary: Don't Use the IMF to Push U.S. Foreign Policy' (Bloomberg, 26 November 2001) <<https://www.bloomberg.com/news/articles/2001-11-25/commentary-dont-use-the-imf-to-push-u-dot-s-dot-foreign-policy> > accessed 10 April 2017.

³³ IMF and the World Bank, 'Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT): Materials Concerning Staff Progress Towards the Development of a Comprehensive AML/CFT Methodology and Assessment Process' (IMF and World Bank, 2002) <<http://www.imf.org/External/np/mae/aml/2002/eng/061102.pdf> > accessed 10 April 2017.

³⁴ Given the role of the IFIs in monitoring and implementing the FATF's recommendations, an area that overlaps the FATF provision of technical assistance, meetings are required to ensure coordinated efforts that save resources without unnecessary overlaps. This is also important in engineering changes to set recommendations.

³⁵ Kenneth S Blazejewski, 'The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Trans-Governmental Networks' [2008] 22 Temp. Int'l & Comp LJ 1, 30.

³⁶ International Monetary Fund Factsheet, Standards and Codes: The Role of the IMF (IMF Factsheet, 2017) <<http://www.imf.org/About/Factsheets/Sheets/2016/08/01/16/25/Standards-and-Codes?pdf=1> > accessed 10 April 2017.

benchmarks is the FATF AML/CFT recommendations. Its inclusion signalled a recognition of the macroeconomic problems posed by ML/TF.³⁷ Hence, the ROSC has been identified as a means of assessment of its recommendations amongst non-member states of the FATF. This move was also partly based on the FATF's membership shortage which necessitated partnership to penetrate hard-to-reach states through the voluntary FSAP instruments.³⁸ More importantly, the 9/11 attack propelled the IFIs to engage collaboratively with the FATF and align with its participation schedule³⁹ as endorsed by their boards.⁴⁰

Consequently, the IFIs engaged in a 12 month pilot programme to include FATF recommendations within the FSAP and Offshore Centre Program (OFC) assessment, whilst the FATF and its regional bodies continued their mutual evaluations.⁴¹ This scheme, which facilitated an effective working relationship between the necessary actors,⁴² was, however, not without its difficulties. For instance, IFIs continually critiqued the FATF recommendations on the ground that it did not take the peculiarities of countries into consideration. The subsequent adoption of a risk-based AML/CFT approach by the FATF propelled the IFIs to re-endorse the recommendations and work hand-in-hand to ensure reflective standards.⁴³ This working relationship has been further cemented by cross-fertilisation of information, as IFIs usually employ previous

³⁷ IMF, 'Financial System Abuse, Financial Crime and Money Laundering – Background Paper' (IMF, 2001) < <http://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Financial-System-Abuse-Financial-Crime-and-Money-Laundering-Background-Paper-PP128> > accessed 10 February 2017.

³⁸ IMF Press Release No.14/447, 'Press Release: IMF Executive Board Concludes Review of the Financial Sector Assessment Program' (2014) < <http://www.imf.org/external/np/sec/pr/2014/pr14447.htm> > accessed 12 April 2017. Both IFIs had 184 member countries and over 120 participated voluntarily in the FSAP. See International Monetary Fund and the World Bank, 'Financial Sector Assessment Program – Review, Lessons and Issues Going Forward' (2005) < <https://www.imf.org/External/np/fsap/2005/022205.htm> > accessed 11 April 2017.

³⁹ Ibid.; Both IFIs had 184 member countries and over 120 participated voluntarily in the FSAP. See IMF and the World Bank, 'Financial Sector Assessment Program – Review, Lessons and Issues Going Forward' (2005) < <https://www.imf.org/External/np/fsap/2005/022205.htm> > accessed 11 April 2017.

⁴⁰ IMF and the World Bank, Twelve Month Pilot Program of Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT) Assessments 7 (2004) < <https://www.imf.org/external/np/aml/eng/2004/031004.pdf> > accessed 10 April 2017.

⁴¹ Ibid.

⁴² IMF, 'The IMF and the World Bank' (2016) < <http://www.imf.org/en/About/Factsheets/Sheets/2016/07/27/15/31/IMF-World-Bank> > accessed 10 February 2017.

⁴³ Sean Hagan, 'Revision to the Financial Action Task Force (FATF) Standard – Information Note to the Executive Board' (IMF, July 2012) < <https://www.imf.org/external/np/pp/eng/2012/071712a.pdf> > accessed 11 May 2017.

FATF staff. In Particular, the IMF has employed FATF staff in its Financial Integrity Group (FIG), a unit of its legal department which is involved in FSAP preparations and provision of technical assistance to countries combatting ML/TF.

As expected, the relationship between these actors created a division of labour in executing the FSAP. Whilst the IFIs jointly worked on building the AML/CFT framework for developing and EEs, the IMF was solely responsible for that of developed countries. As stated, they have minimal roles to play in rule design as their task is restricted to the assessment of and compliance with FATF recommendations. However, these are crucial in highlighting policy issues that can be imputed in the modification of the recommendations. This implies that IFIs continually deal with issues related to AML/CFT rule design through their interaction with the FATF. Thus, overtime, staff of IFIs developed substantial expertise relevant to AML/CFT regulation.⁴⁴

The interaction between these institutions is further heightened by the establishment of country and regional bodies. These are crucial for resolving information asymmetry and ensuring compliance with standards. Thus, whilst the FATF established FATF-Styled Regional Bodies (FSRBs),⁴⁵ the IMF/World Bank both have regional and country offices.⁴⁶ FSRB member countries inducted after 1990 were included to ensure improved representation, because the plenary meetings grants countries an opportunity to air their opinions only through regional bodies. FSRB member countries are classed as ‘associate members’ of the FATF.

⁴⁴ IMF, ‘Intensified Work on Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT): Joint Progress Report on the Work of the IMF and World Bank’ (IMF, April 2002) < <https://www.imf.org/External/np/mae/aml/2002/eng/041702.pdf> > accessed 7 July 2017.

⁴⁵ Asia/Pacific Group on Money Laundering, ‘Financial Action Task Force & FATF Style Regional Bodies’ (APG) < <http://www.apgml.org/fatf-and-fsrb/page.aspx?p=94065425-e6aa-479f-8701-5ca5d07ccfe8> > accessed 10 July 2017; U.S Department of State: Diplomacy in Action, ‘The Financial Action Task Force and FATF-Style Regional Bodies’ (US Department of State) < <https://www.state.gov/j/inl/rls/nrcrpt/2015/vol2/239046.htm> > accessed 10 July 2017.

⁴⁶ Tine Hanrieder, *International Organization in Time: Fragmentation and Reform* (1st edn. OUP 2015) 119.

The FSRB was praised as an ingenious means of globalising the FATF without losing its decision making process. The extent to which the creation and collaboration are equitable is however questionable. This is evidenced by the composition of the FATF cadre, its decision making process and the sanctioning mechanism.

The FATF cadre, which is responsible for framing decisions on AML/CFT, is composed of the Plenary, President, Steering Group and Secretariat.⁴⁷ Within this structure, the secretariat, through the instrumentality of the Policy Development Group (PDG) is responsible for developing global policies and best practices⁴⁸ which receive assent from the plenary – the body with the authority to adopt FATF standards, guidance and reports.⁴⁹ The steering group is responsible for assisting the President in day to day activity and coordinating work groups.⁵⁰ The President convenes and chairs meetings of the Plenary and Steering group and oversees the secretariat.⁵¹

An examination of the workings of the secretariat and plenary sessions shows the lack of equity in the standards making process. For instance, the workings of the secretariat reveal the influence of OECD countries in the daily processes of the FATF. This influence is to the exclusion of ‘associate members’ whose input is only required at the plenary sessions – which hold three times a year.⁵² During these sessions, all the votes of ‘associate members’ count as one as compared to core members that exercise one vote each. This restricts the extent to which the voices of associate members are considered in the design of standards. Furthermore, the FATF, which is housed by the OECD, is mandated to employ staff only from OECD countries,⁵³ a provision which

⁴⁷ FATF, ‘Financial Action Task Force Mandate (2012-2020)’ (2012) <<http://www.fatf-gafi.org/media/fatf/documents/FINAL%20FATF%20MANDATE%202012-2020.pdf>> accessed 13 April 2017.

⁴⁸ FATF, ‘FATF Secretariat’ (FATF, 2017) < <http://www.fatf-gafi.org/about/fatfsecretariat/>> accessed 20 January 2017.

⁴⁹ FATF, ‘Financial Action Task Force Mandate (2012-2020)’ (2012) <<http://www.fatf-gafi.org/media/fatf/documents/FINAL%20FATF%20MANDATE%202012-2020.pdf>> accessed 13 April 2017.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² At these meetings, they do not get the opportunity to set the agenda or drive the discourse, thus their ability to frame recommendations or decisions of the FATF is limited.

⁵³ Organization for Economic Co-operation and Development: Better Policies for Better Lives, ‘OECD Careers’ (OECD) <<http://www.oecd.org/careers/whatwelookfor.htm>> accessed 20 January 2016.

impliedly excludes ACs/EEs from participating in the daily workings of the secretariat. This highlights the minimal input of ACs in the formulation of policies or the daily workings of the FATF. Yet, the FATF would wield coercive powers against them.⁵⁴

The disparity amongst countries in the FATF standard setting process is also commonplace in the IFIs' decision making process. For instance, in the IFIs' head offices, the voting structure of the Board is ingrained in their decision making process, which is reliant on the existing quota configuration. Thus, a country's vote is dependent on its funding contribution to the IFIs.⁵⁵ The US has the largest quota with approximately 82.99 million SDRs⁵⁶ which totals 831,406 billion dollars. The US is followed by Japan, China, Germany, France and the United Kingdom, four of which are part of the G7. Collectively, all other countries of the world hold 23.2% voting rights,⁵⁷ with Africa holding only 5.6% of the overall votes.⁵⁸ This is similar to the World Bank system where voting rights are determined by each country's agreed annual contribution to the Bank⁵⁹ which reflects how much weight the country carries in the world economy.⁶⁰ This quota diversity is also enshrined in the executive directors (EDs) spread. The Bank has 26 EDs, the largest stakeholders of this decision making organ – the US, Japan, France and the UK, together with China, Russia and Saudi Arabia each have one executive director appointed by their countries.⁶¹ Other members are grouped into 16 constituencies, each electing one ED. This structure gives European countries the second highest representation, whilst all ACs have three EDs.⁶²

⁵⁴ As members of the FATF, the BRICS countries are however privy to the plenary discussions and can sit as president of the FATF, the extent of their influence in this role is however debatable.

⁵⁵ Ngaire Woods, *The Globalizers: The IMF, the World Bank and their Borrower* (Cornell University Press, 2006) 22-24.

⁵⁶ IMF, 'IMF Members' Quotas and Voting Power, and IMF Board of Governors' (*International Monetary Fund*, 24 January 2017) <<https://www.imf.org/external/np/sec/memdir/members.aspx#U>> accessed 24 January 2017.

⁵⁷ Ibid.; IMF, 'Illustration of Proposed Quota and Voting Shares' (IMF, 2010) <http://www.imf.org/external/np/sec/pr/2010/pdfs/pr10418_table.pdf> accessed 15 July 2016.

⁵⁸ Ibid.

⁵⁹ World Bank, 'IBRD Articles of Agreement' (World Bank, 1989) <<http://siteresources.worldbank.org/EXTABOUTUS/Resources/ibrd-articlesofagreement.pdf>> accessed 20 June 2017.

⁶⁰ Ngaire Woods, *The Globalizers: The IMF, the World Bank and their Borrower* (Cornell University Press, 2006) 22-24.

⁶¹ World Bank, *A Guide to the World Bank* (Third Edition, The World Bank) 9.

⁶² Although some other ACs are merged with foreign countries in bloc 21 where Egypt and Libya are classed with middle eastern states, so also Ghana and Tunisia and Algeria in bloc 16. See International Bank for Reconstruction and Development: Voting Power of Executive Directors (Corporate Secretariat, 6 February 2017) <<http://siteresources.worldbank.org/BODINT/Resources/278027-1215524804501/IBRDEDSVotingTable.pdf>> accessed 21 February 2017.

Given that a bloc can only have one vote, developing countries and ACs have limited say in AML/CFT matters, notwithstanding that these are ML/FT-prone countries. Undoubtedly, this overarching decision making process is unreflective of the diverse membership of these institutions, a shortcoming heightened by their undemocratic decision making process.

Despite the shortcomings of these institutions, there is a trajectory of strengthened collaboration in standard-making as a step towards curbing illicit crimes. Shortcomings are however noted in the collective principal's agenda, especially as regards the absence of equitability. Nonetheless, their interaction has presented a united front for countries combatting ML/TF by instituting rules that provide for a coordinated compliance approach to illicit crimes.

4.1.2. Implementation and Compliance: Relationship between IFIs and the FATF

Legislation can only go so far in the absence of implementation and compliance. Implementation denotes the operationalization of legislative requirements, whilst compliance warrants that such actions be done in strict adherence to laws and regulations. Hence, when an FIU is established, the FATF recommendation 29 is deemed implemented; compliance is achieved when this is done in alignment with the law.

Compliance would however only be effective and accorded value where it converges with internal ethics. This implies that compliance is effective when it takes into consideration the values of a country. The effectiveness of such compliance can be gleaned from an instance where strict CDD is mandated to operate within a cash based society. Such rule would result in a regulatory paradox as it would defeat the overarching aim of financial integrity, whilst facilitating ML/TF outside the banking system. In such situations, country (A) may be adjudged to have 'low level of effectiveness' and may not evade the opprobrium of the law, whereas country (B)

adopting the CDD/KYC in a cashless society would be deemed to have a ‘high level of effectiveness’. This is worsened for country (A) as compliance comes with its costs. Although the principals (FATF/IFIs) consider these costs as necessary to protect institutions within countries from rule transgression and consequent regulatory sanction, the agents (financial and non-financial institutions) consider it unnecessary, cumbersome and a hindrance to profit.

The above scenario between the principals and country (A) agent would be classed as a conflict of interest thus warranting continuous monitoring by the principals and necessitating further collaboration between these actors to foster systematical information exchange. In theory, this may potentially guarantee the elimination of conflicts of interest and the integrity of the international financial system. It would also place an extra policing role on principals, requiring them to monitor and report on compliance activities within states. Furthermore, the principals would be privy to private information which may affect rule modifications to cure the defects faced by country (A). In practice, it may be more complex given the absence of preconditions for effective regulation.

It is pertinent to note that within the context of rule implementation and compliance, the IFIs are the principals and the agent-states institutions are the agents. Hence, the agents include, financial and non-financial institutions, regulatory bodies, enforcement bodies and the judicial and executive arm of government. As is the case in legislative interactions, the principals present a united front in their interactions with agents, to ensure a standardized approach devoid of quality disparities.

4.1.2.1 Interactions Between Principals in setting Implementation and Compliance Frameworks

Presently, there is an intimate collaboration between the IFIs and the FATF, aimed at ensuring implementation of and compliance with the FATF standards. This however was not always the case. Upon engagement in assessments of compliance levels by the FATF, the IFIs expressed that their mandate restricted them from engaging in assessments of law enforcement issues throughout the pilot programme.⁶³ This position was solidified by the IMF Board which stated that it would be ‘inappropriate’ for the IMF to become involved in law enforcement issues.⁶⁴ It therefore limited itself to assessing FATF criteria which it considered ‘macro-economically relevant’.⁶⁵ However, the rigorousness of the IFIs’ assessments of implementation to the exclusion of enforcement necessitated the FATF to call for a revision of the IMF’s decision on the ground that it hindered the production of fully integrated assessments.

This limited framework which deterred effective collaboration between principals necessitated revision. Consequently, the FATF beckoned on the IFIs to reassess this limitation and revise their evaluation approach, to become more comprehensive.⁶⁶ The IMF Board subsequently adopted the FATF recommendations as a regular component of its FSAP and OFC programs, and the World Bank⁶⁷ followed suit.⁶⁸ This has

⁶³ IMF and the World Bank, ‘Anti-Money Laundering and Combatting the Financing of Terrorism: Review of the Quality and Consistency of Assessments Reports and the Effectiveness of Coordination’ (2006) < <https://www.imf.org/external/np/pp/eng/2006/041806r.pdf> > accessed 11 April 2017.

⁶⁴ IMF and World Bank, ‘Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT): Proposals to Assess a Global Standard and to Prepare ROSCs’ (2002) < <http://www.imf.org/external/np/mae/aml/2002/eng/071702.pdf> > accessed 15 April 2017.

⁶⁵ Ibid.

⁶⁶ IMF & The World Bank, ‘Twelve Month Pilot Program of Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT): Joint Report on the Review of the Pilot Program (2004) < <https://www.imf.org/external/np/aml/eng/2004/031004.pdf> > accessed 3 April 2017.

⁶⁷ IMF, ‘Public Information Notice No.04/33: IMF Executive Board Reviews and Enhances Efforts for Anti-Money Laundering and Combatting the Financing of Terrorism’ (2 April 2004) < <https://www.imf.org/en/News/Articles/2015/09/28/04/53/pn0433> > accessed 6 April 2017; IMF, ‘Press Release No. 04/70: IMF, World Bank Enhance Efforts at Combating Money Laundering, Terrorist Financing’ (2 April 2004) < <http://www.imf.org/external/np/sec/pr/2004/pr0470.htm> > accessed 4 February 2017.

⁶⁸ 2003 – 2004 the FATF stated that a ‘key priority’ of the FATF was to develop the relationship with the IMF and the World Bank as part of its efforts to ensure global action in combatting money laundering and terrorist financing.

improved communication between both institutions and created room for expert reliance on information exchange.

This partnership has facilitated AML/CFT implementation and compliance. Blazejewski contends that collaboration between the principals contributes to AML/CFT implementation in five ways.⁶⁹ Firstly, through assessments conducted by the IFI programs which evaluate AML/CFT measures within countries. He contends that the programmes contained within the FSAP and OFC are far-reaching and comprehensive. By June 2006, IFIs had assessed over 60 jurisdictions on compliance with the FATF recommendations.⁷⁰

Secondly, the IFIs aligned their assessment methodology with that of the FATF to facilitate uniform benchmarking of recommendations.⁷¹ This was concretised by the fact that these standards became the only ROSC standards for which the IFIs accepted assessments conducted by external partners.⁷²

Thirdly, the IFIs maintain quality control, standardization and coordination of AML/CFT assessments.⁷³ These came in response to an IMF report which revealed a 'high degree of variability in the quality of reports' and between ongoing efforts to increase assessment quality.⁷⁴ Hence the IFIs have worked to ensure consistency and

⁶⁹ Kenneth S Blazejewski, 'The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Trans-governmental Networks' [2008] 22 Temp. Int'l & Comp LJ 1, 15, 31.

⁷⁰ US Department of Treasury, 'Implementation of Legislative Provisions Relating to the International Monetary Fund: A Report to Congress 11' (United States Department of the Treasury, March 2006) < <https://www.treasury.gov/resource-center/international/int-monetary-fund/Documents/2015%20IMF%20Legislative%20Mandates%20Report.pdf> > accessed 10 May 2017.

⁷¹ The World Bank and the IMF, 'Financial Sector Assessment: A Handbook' (2005) < <http://documents.worldbank.org/curated/en/306701468337879923/pdf/337970rev0Fina10Assessment01PUBLIC1.pdf> > accessed 10 June 2016.

⁷² IMF, 'Public Information Notice No.11/74: IMF Executive Board Reviews Efforts in Anti-Money Laundering and Combating the Financing of Terrorism' (27 June 2011) < <http://www.imf.org/external/np/sec/pn/2011/pn1174.htm> > accessed 6 April 2017.

⁷³ IMF, 'Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)' < <https://www.imf.org/external/np/leg/amlcft/eng/aml2.htm> > accessed 10 April 2017.

⁷⁴ IMF and World Bank, 'Anti-Money Laundering and the Financing of Terrorism: Review of Quality and Consistency of Assessment Reports and the Effectiveness of Coordination' (*International Monetary*

harmonisation across the ROSCs produced by various assessing bodies,⁷⁵ and across all methodologies for assessing compliance;⁷⁶ this avoids duplication of efforts.⁷⁷

Fourthly, the IFIs top-down perspective on AML/CFT monitoring permits their staff to analyse global trends and common weaknesses in implementation of AML/CFT measures. Such reports include the IMF Progress Report on the OFC program which provides an exhaustive profile of compliance with FATF recommendations within the offshore countries that participate in OFC programmes.⁷⁸ Its 2005 Financial Sector Assessment Handbook highlighted some common weaknesses among national AML/CFT regulatory systems; so also did the MERs of countries by the FATF.⁷⁹

Lastly, the IFIs undertake technical capacity building to enable countries to achieve maximum implementation requirements. Technical assistance, which includes training of regional⁸⁰ and country level supervisors, has focused on how to conduct mutual evaluations in compliance with the common methodology.⁸¹ What becomes evident is that the IFIs serve as a bedrock of the FATF's efforts to advance implementation of recommendations amongst non-FATF member states, as their involvement has led to a more robust fight against ML/TF. Blazejewski reveals the collaborative approach by the principals in ensuring implementation and compliance with set recommendations transcribed to national laws and regulations.

Fund and World Bank, 2006) < <http://www.imf.org/external/np/pp/eng/2006/041806r.pdf>> accessed 11 March 2017.

⁷⁵ Ibid.

⁷⁶ Mario Giovanoli, 'A New Architecture for the Global Financial Market: Legal Aspects of International Standards Setting' in Mario Giovanoli (eds.) *International Monetary Law, Issues for the New Millennium* (Oxford University Press, 2000) 3- 59.

⁷⁷ Ibid.

⁷⁸ IMF and the World Bank, 'Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Assessments: Joint Report on the Review of the Pilot Program' (IMF and World Bank, 2004) < <http://www.imf.org/external/np/aml/eng/2004/031004.pdf> > accessed 12 March 2017.

⁷⁹ Ibid.

⁸⁰ IMF, 'IMF Policy Paper: Review of the Fund's Strategy on Anti-Money Laundering and Combating the Financing of Terrorism' (IMF, February 2014) < <https://www.imf.org/external/np/pp/eng/2014/022014a.pdf> > accessed 10 May 2016.

⁸¹ IMF Legal Department, 'Suppressing the Financing of Terrorism: A Handbook for Legislative Drafting' (IMF, 2003) < <https://www.imf.org/external/pubs/nft/2003/SFTH/pdf/SFTH.pdf> > accessed 1 June 2016.

Having discussed how collective principals engage in formulating rules and in guiding implementation and compliance, it is imperative to understand how these principals engage with agent states.

4.2 Agency Theory: Interactions between the Collective Principals and Agent States in Rule Making, Implementation and Compliance

The application of the agency theory (discussed in chapter 2) provides the theoretical framework to understanding potential agency problems that can arise from the side of the principal or agent. For instance, agent states may slack in transplanting or implementing rules. Conversely, the principals may retort by engaging observatory tools, such as sanctions, technical assistance or high-level meetings. A misunderstanding of the agency slack or the agent state may however occasion misapplication of observatory tools, further perpetuating agency problems. For instance, utilising sanctions where technical assistance should be used can weaken the incentive of agent states to comply with the AML/CFT standards.

A fitting resolution of agency problems requires that any existing information asymmetry between the principals and the agent is addressed. For this to occur, two crucial factors are taken into consideration. Firstly, the level of integration of a country within the global financial market; and secondly, their perceived compliance levels with the FATF standards.⁸² The level of integration is largely dependent on quantitative factors that underscore membership of the FATF such as the gross domestic product (GDP) of a country, the size of its financial institutions market and its per-capita income.⁸³ It also encompasses qualitative factors such as the openness of the financial sector and the potential of that country's systemic risk on the global financial

⁸² This conclusion was reached through an examination of the compliance pattern of countries assessed by the FATF.

⁸³ FATF, 'FATF Membership Policy' (FATF) < <http://www.fatf-gafi.org/about/membersandobservers/fatfmembershippolicy.html> > accessed 11 October 2017

architecture.⁸⁴ Countries with these attributes are classed as ‘systematically important’ by the IMF, signifying the need for heightened supervision to avoid risk of contagion should a crash occur.

The second factor, the perceived compliance level of countries addresses the attainment by countries of the necessary pre-conditions for effective regulation and incorporates the legal development of countries according to the FATF recommendations.

The table below shows the extent to which these factors play a role in triggering or addressing agency problems:

S/No	Priority Level	Level of Integration ⁸⁵	Compliance level	Effect on financial stability and integrity ⁸⁶
1.	High Priority	High	Low	Elevated
2.	Low Priority	Medium	High	Minimal
3.	Mid Priority	Low	Low	Minimal
4.	Low Priority	Low	High	Very Minimal
5.	High Priority	High	High	Very Minimal

Table 2: *Factors that influence/trigger information asymmetry between principals and agents in AML/CFT regulation.*

⁸⁴ Ibid.

⁸⁵ Level of integration is dependent on factors such as country GDP, size of financial institutions, per-capita income and openness of the financial sector. High integrated countries are developed countries and/emerging economies such as India and China. Medium integrated countries are certain emerging economies. Low integrated countries are developing countries and under-developed countries.

⁸⁶ *Elevated* = situation where the effect or risk of ML/TF lapses would have heightened effect on financial stability and integrity. *Minimal* = situation where the risk of ML/TF materializing would have marginal impact on financial stability and integrity. *Very minimal* = where the risk of ML/TF would have very marginal impact on financial stability and integrity.

The following three conclusive categories can be drawn from examining Table 2:

- a) High priority (HP) is associated with countries with high level of integration despite their compliance levels; indicating a need for sustained surveillance, assessment and reduced information asymmetry. However, information asymmetry may exist where a HP country has low compliance with the AML/CFT rules, as opposed to where such country has high compliance.
- b) Low priority (LP) is associated with medium or low level of integration with high level of compliance. In those countries, the risk to financial stability and integrity is low; there is minimal need to hinder information sharing.
- c) Mid priority (MP) is associated with countries with low level of integration and low compliance levels. The risk these countries pose to global financial stability and integrity is considered minimal. There is however a high incentive to hinder information sharing so as to avoid sanctions. Most ACs fall within this category.

HP countries which are ‘highly integrated’ but with perceived low level of compliance to the AML/CFT standards would be a concern to the collective principals. Such concern stems from the fact that low compliance can have an effect on financial stability and integrity. Brazil, a member of the FATF falls within this category. To ascertain how compliant a country is with the standards, the principals would have to carry out a mutual evaluation to ascertain the true compliance levels. Appreciating that a mutual evaluation report may occasion sanctions with the effect of financial exclusion, HP countries may choose to engage strategically with the principals. Supporting this assertion, Crawford and Sobel argue that when governments anticipate correction strategies by the principals which threaten capital flow and access to market, they may decide to omit or manipulate statistics.⁸⁷ With the IMF, these countries may simply

⁸⁷ Crawford Vincent and Sobel Joel, ‘Strategic Informational Transmission’ [1982] *Econometrica: Journal of the Econometric Society*, 1431, 1451; Manne Henry G, *Insider Trading and the Stock Market* (First Edition, Free Press, 1996).

request nonpublication of the FSAP report, hence destroying any potential harm the market may read into their low compliance level. In a bid to document compliance in context, the mutual evaluation methodology requires that countries inform IFIs of any significant problems that arise in compliance. Whilst this ensures that the shortcomings are understood, agents are aware that these are not necessarily taken into consideration by the market or the IFIs, hence their strategic communication.

Where, however, HP countries are classed as ‘highly integrated’ within the global financial system and have high compliance levels, they would still be classed as high priority although they pose minimal risk to the economy.⁸⁸ This decision is necessary given that supervision is continuous, hence their placement on the IMF’s article IV surveillance. The IMF understands that though the risk these countries pose is minimal; crisis may escalate if a bubble exists. This may have a catastrophic effect on other countries. The role of the US in the global financial crisis exemplifies the situation, where vulnerability in the US financial market had a catastrophic global effect. Consequently, given the high compliance levels to formulation of legislative standards and implementation, these countries are less likely to have an incentive to omit or hinder information sharing, thereby limiting the chances of information asymmetry.

The limited asymmetry or agency slack in this circumstance can be attributed to the fact that however limited their roles are, these countries, particularly EEs, are part of the rule making. Additionally, their FIs are strongly consulted in the re-modelling of standards due to the growing maturity of their finance industry. Most practices introduced as part of the FATF rules are not necessarily very foreign to them due to their rate of economic growth that has mandated numerous changes. Therefore, compliance does not require extensive re-modelling or re-learning.

LP countries that have medium or low degree integration with potential high compliance levels pose minimal risk to global financial stability or integrity. Hence

⁸⁸ India and China fall within this category.

their classification as ‘low priority’.⁸⁹ The IMF has not classed these country as systematically important given their limited contribution to the global world product (GWP) and per capita income, coupled with their limited openness and transparency. In such countries where potential compliance is high, the possibility of information asymmetry is reduced except in instances where compliance is a charade.

MP countries with low degree of integration with the global financial economy coupled with low compliance levels are considered to have limited impact on financial stability and integrity.⁹⁰ Despite their low degree of integration, they are considered mid priority because money laundering is a borderless crime and money from HP or LP countries can be laundered through these countries and vice versa. Additionally, agency concerns are raised because these countries are willing to protect their fragile space within the financial market, attract businesses and provide career advancement opportunities for their politicians. Hence, these countries are likely to find themselves manipulating information during mutual evaluations, sometimes leading to regulatory capture. EENA2, a staff at a global multilateral bank mentioned that he did not trust the report of certain FSRBs – a concern that was pervasive within these institutions, even with the quality assurance standards.⁹¹

The IFIs usually engage in technical assistance programmes in recognition that low compliance is sometimes attributable to lack of human and technical resources. However, in certain instances, low compliance may be attributable to the agent acting in his own interest as opposed to the interest of the principal which is financial stability and integrity. Thus, are there any conflicting goals between governments of countries and IFIs/FATF? Intuitively, it would be expected that they share the same goals. Dijkstra however finds that politicians do not necessarily follow the national interest, but act opportunistically to maximize their economic benefits, such as salary, public

⁸⁹ South Africa falls within this category, although it is one of the largest economies in Africa and a member of the FATF. However, the IMF has not classed South Africa as systemically important given its limited contribution to the global world product (GWP) and per capita income, coupled with its limited openness and transparency.

⁹⁰ This category includes Nigeria, Ghana, Togo and other AC with low compliance levels.

⁹¹ EENA2, Interview with EENA2, ‘Telephone Call’ (2017).

reputation and power.⁹² Therefore, there is usually no political will. Such countries can be likened to the amoral calculator, requiring sanctions in addition to technical assistance.

Low compliance may be because countries that are not well integrated into the global financial system largely focus on home-grown issues, such as financial exclusion. Consequently, these countries may issue standards that fall below the FATF's CDD expectations. Thus, where compliance levels are deteriorating, countries will have incentive to delay information sharing or de-escalate the gravity of information, issues potentially solvable by observatory tools.

Clearly, a high degree of integration and high compliance is the only conclusive category where countries have a strong incentive to share information that allows the principal make informed decisions. However, countries are not isolated and efforts by the FATF to reduce conflicts between MP/LP and HP has proved difficult.

4.2.1 Agency Theory: Integration Between High Priority (A) and Mid Priority Countries (C) - The domination of Self Interests?

Integration gives room for laundered money to flow between HP, MP and LP countries given their engagement in trade and financial transactions. This engagement is mutually beneficial as foreign investors from HP countries are keen on investing in MP countries to maximise profit. MP countries also want to attract, protect and retain foreign investments to enhance their integration into the global financial market. Thus, as the interests of countries converge, the need for collaboration and information sharing for continued trade becomes higher. MP countries' interest causes them to comply and

⁹² Robert J. Dijkstra, 'Accountability of Financial Supervisory Agencies: An Incentive Approach' [2010] 11 (2) Journal of Banking Regulation 115,122.

share information on AML/CFT to avoid de-risking. Conversely, HP countries comply and share information to ensure profit maximisation.

Yet, HP countries do not necessarily profit, even when the self-interest of countries converge. Rather, they engage in a balancing act between profit maximisation and ensuring compliance via information sharing, an exercise that does not necessarily make economic sense. This is because the terrain of MP countries makes it difficult for HP countries to apply the FATF measures strictly, else they lose profit. For this reason, HP countries usually engage in de-risking. Where they decide not to, for instance, because of the importance of the business in question, an agency relationship may be established where, as principal, HP countries set conditions for compliance and information sharing with the FI in MP countries they wish to enter into a relationship with. Where the business is perceived as crucial to the country or institution in question, the MP country would align with the conditions. But, to what extent can MP countries comply?

Compliance by agents may largely be undermined by their capacity deficit. For instance, agents strive to accede to conditions set by their principal, particularly where the countries have historical, economic and cultural ties. This can be exemplified with the UK (principal) and the Commonwealth states (agent) given their colonial history. This history has engendered migration from the Commonwealth to the UK, leading to increased remittances from the UK migrants to relatives in their home countries.⁹³ Such cash flow requires increased collaboration in the interest of both parties, as these channels can be used to launder funds. Remittances are however more in the interest of agent states. Without true reciprocal interest, the interest of developed countries takes precedence. For this reason, whilst their laws aim to ensure transparency through the licencing and regulation of remittances,⁹⁴ they also hinder remittances flowing out of

⁹³ Carlos Vargas-Silva, 'Migrant Remittances to and from the UK' (The Migration Observatory at the University of Oxford, 24 February 2016) <<http://www.migrationobservatory.ox.ac.uk/resources/briefings/migrant-remittances-to-and-from-the-uk/>> accessed 10 March 2017; Catalina Amuedo-Dorantes, 'The Good and the Bad in Remittance Flows' (IZA World of Labor, November 2014) <<https://wol.iza.org/uploads/articles/97/pdfs/good-and-bad-in-remittance-flows.pdf>> accessed 10 May 2017.

⁹⁴ The Payment Services Regulations 2017.

the country. Conversely, given lack of regulatory resources in manpower, skills and finances, unlicensed remittance operators thrive in the Commonwealth.⁹⁵ The regulatory approach of the UK may hinder information sharing and instead facilitate underground remittances across jurisdictions. This indicates that institutional capacity becomes an issue when states are integrated. Hence, it is needful to identify overlapping interests that would drive compliance and resolve agency issues.

It is arguable that reciprocal interest is present when there is a continuous business that is of systemic importance to both countries – such as in the case of correspondent banking (CB). CB ‘is the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third party payments and trade finance, as well as its own cash clearing, liquidity management and short term borrowing or investment needs in a particular currency.’⁹⁶ It ensures that ‘respondent’ banks extend their services using foreign ‘correspondent’ banks as a proxy in places where the ‘respondent’ bank has no physical presence, but the correspondent bank does.⁹⁷ CB however poses ML/TF risks, as the correspondent bank does not have direct contact with the customer, but relies on the CDD processes of the respondent bank, which may be inadequate. The effect is that the correspondent bank may unintentionally allow other FIs with inadequate AML/CFT systems and their customers direct access to the global banking landscape.

⁹⁵Central Bank of Nigeria, ‘Press Release: Activities of Illegal International Money Transfer Operators’ (*Central Bank of Nigeria*, 2016) < <https://www.cbn.gov.ng/out/2016/ccd/press%20release%20on%20illegal%20imtsos.pdf> > accessed 10 July 2017; The Economist, ‘Africa Money Transfers, Let them Remit’ (*The Economist*, 20 July 2013) < <https://www.economist.com/news/middle-east-and-africa/21581995-western-worries-about-money-laundering-are-threatening-economic-lifeline> > accessed 10 November 2017.

⁹⁶The Wolfsberg Group, ‘Wolfsberg Anti-Money Laundering Principles for Correspondent Banking’ (The Wolfsberg Group 2014) < [https://sic.gov.lb/intorg/Wolfsberg%20Correspondent%20Banking%20Principles%20\(2014\).pdf](https://sic.gov.lb/intorg/Wolfsberg%20Correspondent%20Banking%20Principles%20(2014).pdf) > accessed 10 March 2016.; Bank for International Settlements, ‘Committee on Payments and Market Infrastructure: Correspondent Banking’ (Bank for International Settlement, July 2016) < <https://www.bis.org/cpmi/publ/d147.pdf> > accessed October 2016; Michaela Erbenova, Yan Liu, et al, ‘The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action’ (IMF Staff Discussion Note, June 2016) < <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf> > accessed 10 October 2016.

⁹⁷ This is done in exchange for a fee.

Usually, the business is crucial to both countries and in line with the FATF Guidance on ‘Private Sector Information Sharing’,⁹⁸ institutions would be incentivised to share information and illustrate compliance. This is especially so where the banking relationship is sustained and not ‘ad hoc’. However, this is not always the case, particularly where legal or operational challenges hinder information sharing and compliance. This is best illustrated by Table 3 below.

	Principal (High priority)	
Agent (Mid priority) Respondent Bank	Sustained Correspondent Banking Correspondent Bank	Ad hoc Correspondent Banking
Sustained Correspondent Banking	(a) Potential for coordination	(b) Conflicts of interest and potential for coordination problems
Ad hoc Correspondent Banking	(c) Conflicts of interests and potential for coordination problems	(d) Lack of compliance incentive

Table 3. *Determination of Self-Interest: Interaction between HP and MP countries.*

In category (a) both the principal and agent would share information and comply with the FATF recommendations, given their mutual best interest to do so. Compliance is however unlikely to be fool-proof due to legal and operational challenges in respondent bank’s country. Some legal issues that currently undermine the respondent bank’s ability to facilitate compliance include lack of clarity about the legal position on information sharing and differing regulatory requirements. These coupled with issues such as when the policy objectives at variance with the FATF’s can undermine compliance. This may also include the preference for data protection over national

⁹⁸ FATF, FATF Guidance: Private Sector Information Sharing (FATF, November 2017) < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/Private-Sector-Information-Sharing.pdf> > accessed January 2018.

security by the respondent bank, at variance with the principal's preference. Operational challenges include inadequate IT tools, varying data formats and the cultural disposition towards the value of information. Herring noted that the asymmetries of human and natural resources, coupled with weak legal infrastructure and corrupt processes may hinder the ability of the respondent bank to align with the correspondent's standards.⁹⁹ Instead, this entrenches conflict of interest.

In category (b), where the CB relationship is ad hoc for the principal, but sustained for the agent. The agent has a stronger incentive to comply. The principal may not have an incentive to investigate the agent's books to ensure compliance, and this may undermine the agent. Given the HP position of the principal, even an ad hoc arrangement may be caught by their home country regulators or the culture of the FI institution in question, thereby facilitating information sharing and compliance.

In category (c), the principal has a higher incentive to comply, but the agent has relatively low incentive to comply and may slack to the dissatisfaction of the principal, who may then be forced to de-risk. Agency slack by the respondent bank may be due to capacity challenges on the part of the supervisory body or staff of the financial institution.

In category (d), the principal and agent both lack compliance incentive given the ad hoc nature of their business. However, where the principal is not an amoral calculator or is subject to strict 'in-country' regulation, it would be in its interest to comply. This may indeed propel the compliance of the agent.

In the four different scenarios, the correspondent banks, as principal, are willing to enable their FIs to be used by the respondent for a fee. The principal is however subject

⁹⁹ Richard Herring, 'Conflicts between Home and Host Country Prudential Supervisors' < <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.543.1482&rep=rep1&type=pdf> > accessed 19 March 2018

to more rigorous regulation given their location within ‘high priority’ countries. Therefore, it is more in their interest to comply to standards. For this reason, institutions in these countries usually exercise some form of control over the agent countries by setting down conditions necessary to establish and maintain business relationships, particularly where the respondent country has significant reputational risk factors, such as corruption.

Regulatory institutions such as FIUs or central banks in MP and HP countries also collaborate on information sharing due to the traffic of transactions between their countries. Resultantly, institutions usually converge on information sharing when it is in their interest and diverge when it is not. For instance, in line with the Consolidated FATF Standards on Information Sharing,¹⁰⁰ the UK and Nigeria have entered into a memorandum of understanding to facilitate the return of stolen assets from Nigeria.¹⁰¹ This process has been frustrated by the conditions the UK has put in place before any such return can be made. EENA6 argues that the mandatory requirement for Nigeria to make a formal request, as well as numerous legal requirements that follow has stifled the process for repatriation of funds.¹⁰² Whilst some scholars have attributed this to the need to ensure that returned stolen wealth is utilised judiciously by Nigeria,¹⁰³ various experts have argued that the UK has stifled this process because it is not in its interest to return stolen wealth.¹⁰⁴ This shows how as principal, the strategic interest of the HP

¹⁰⁰ FATF ‘The Consolidated FATF Standards on Information Sharing: Relevant Excerpts from the FATF Recommendations and Interpretative Notes (FATF, November 2017) < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/Consolidated-FATF-Standards-information-sharing.pdf> > accessed 10 February 2017.

¹⁰¹ Channels Television, ‘Nigeria, UK Sign Agreement on Stolen Assets’ (Channels Television, 30 August 2016) < <https://www.channelstv.com/2016/08/30/nigeria-uk-sign-agreement-stolen-assets/> > accessed 10 February 2017; Vanguard, ‘Nigeria, UK Sign MOU on Return of Stolen Assets’ (Vanguard, 30 August 2016) < <https://www.vanguardngr.com/2016/08/nigeria-uk-sign-mou-return-stolen-assets/> > accessed 10 February 2017.

¹⁰² EENA6, Inter-Governmental Action Group Against Money Laundering (GIABA), Interview with EENA6, ‘Telephone Call’ (2017)

¹⁰³ United Nations and the World Bank, ‘Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan’ (United Nations and World Bank, June 2007) < <https://siteresources.worldbank.org/NEWS/Resources/Star-rep-full.pdf> > accessed 10 June 2016.

¹⁰⁴ For instance, due to the cost involved in the process. See Natanel Abramov, ‘Why States Struggle to Repatriate looted assets’ (*Financial Times*, 11 May 2016) < <https://www.ft.com/content/322c1854-dcb9-3e31-a191-6651afd5776b> > accessed 10 October 2016; Adamu Abuh, ‘British Envoy Gives Conditions for Repatriating Stolen Funds to Nigeria’ (*The Guardian*, 21 January, 2016) < <https://guardian.ng/news/british-envoy-gives-condition-for-repatriating-stolen-funds-to-nigeria/#comment-section> > accessed 10 July 2016.

countries continue to colour compliance and implementation, illustrating how economic interest can shape the political interest of powerful countries.

The convergence pattern of FIs and regulatory bodies indicate that these institutions converge better when they have the same objective of financial stability, legal powers and processes, similar supervisory tools and capacity.¹⁰⁵ Divergence on any of these factors would occasion gap in information sharing, even when the MP country is desirous of converging. Therefore, there is need to bring in players to facilitate compliance by all parties, including other countries and the IFIs/FATF. For instance, the US gave Pakistan some funding in order to incentivise the country to stop terror on Afghanistan.

To circumvent agency issues, the principals (IFIs/FATF) engage agent states (MP/HP/LP) in various ways. These are, high level meetings, assessments, technical assistance and sanctions. These supervisory or monitoring engagements to cure agency issues would be discussed in the context of rule formulation and compliance/implementation.

4.2.2 Interaction Between Principal(s) and Agents (Country Legislators)¹⁰⁶

As discussed in the previous chapter, local laws usually mirror society. Hence, inherent in the role of the legislature is to ensure that legislations are contextualised whilst also

¹⁰⁵ Kal Raustiala 'The Architecture of International Cooperation: Trans-governmental Networks and the Future of International Law' [2002] 43 (1) Va. J. Int'l L 1, 61.

¹⁰⁶ Andrew Cornford, 'Basel II and Developing Countries' [2008] 2 (31-32) Finance & Bien Commun, Cairn Info 69 - 78; Rainer Hulse and Dieter Kerwer, 'Global Standards in Action: Insights from Anti-Money Laundering Regulation' [2007] 14 (5) Organization 625, 625; Independent Evaluation Office of the IMF, 'The IMF's Interactions with Its Member Countries: Issues Paper for an Evaluation by the Independent Evaluation Office (IEO)' (IMF, 2008) <<http://www.ieo-imf.org/ieo/files/issuespapers/051508.pdf>> accessed 10 May 2017; Independent Evaluation Office of the International Monetary Fund, 'Evaluation Report: IMF Interactions with Member Countries' (IMF, 2009) <<http://www.ieo-imf.org/ieo/files/completedevaluations/A.%20%20Full%20Text%20of%20Main%20Report.pdf>> accessed 20 May 2017.

acting as checks on the executive arm of government.¹⁰⁷ In combatting ML/TF, legislators have to imbibe international rules which may potentially mean compromising the contextualization of the law. Legislators may have to serve two masters – their local constituencies and global financial integrity and stability. Whilst the latter is projected to serve the global good, the former may be protectionist and competitive. Hence, in transplanting AML/CFT rules, legislators have the arduous task of striking a balance, ensuring that recommendations are carefully crafted into law, to ensure effective implementation.

Transplantation is necessary because rules are not always home-grown to certain states. For instance, the FATF recommendations were derived from the combination of national strategies from Switzerland, the United Kingdom and the United States, in collaboration with the international recommendations of the Basel Committee from 1988 which was drafted by the United States.¹⁰⁸ Despite the fact that ACs/EEs did not partake in the process of moulding these laws, the FATF, backed by the IFIs mandates implementation. This requirement places an onus on the legislatures of these countries to give such recommendations the force of law by imbedding them in their national systems.¹⁰⁹

The collaborative efforts of the principals give the agent-states little leeway to contest or amend rules produced by the FATF and its cohorts. This is despite the fact that recommended rules affect domestic affairs, inter alia, banking policies and ML/TF regulation of recipient countries. Therefore, the interaction between principals and agents is not aimed at formulation of global rules. Most recommendations promulgated in 1990 have not been scrapped; they have only undergone some modifications, most

¹⁰⁷ The Parliamentary Network, ‘Parliamentary Workshop at the Annual Meetings 2016’ (World Bank Group, International Monetary Fund 2016) < <http://www.parlnet.org/sites/default/files/Agenda-MP-workshop-annual-meetings2016.pdf> > accessed 21 January 2017.

¹⁰⁸ Mark Pieth and Gemma Aiolfi, ‘The Private Sector Becomes Active: The Wolfsberg Process’ [2003] 10 (4) *Journal of Financial Crime* 359, 359-360; Braithwaite John and Peter Drahos, *Global Business Regulation* (1st edn, Cambridge University Press, 2000).

¹⁰⁹ *Ibid.*

profoundly – following the 9/11 attack, and later on, the global financial crisis.¹¹⁰ This illustrates that there is room for ex-post rule making which entails the modification of international standards for efficiency and effective transplantation.

The ex-post rule modification process necessitates interaction between the FATF/IFIs (principals) and country legislators (agents). The purpose is to facilitate information exchange geared towards contextual global standards and efficient in-country structures. The interaction process, which employs the use of observatory tools and incentives, is usually facilitated by the principal. This process occurs through different methods:

1. High-level meetings;
2. Technical assistance; and/or;
3. Sanctions.

While there is no clear sequence, the principals do not usually commence interactions with the imposition of sanctions.

High-level meetings (HLMs), as an observatory tool, provides an avenue for information exchange between actors to facilitate rule modification processes. These take into consideration the underlying factors that precipitate legislative compliance differentials amongst countries. For instance, a country may have financial secrecy laws that prohibit the extraterritorial application of laws of other states. This situation actively hinders efforts to combat global ML/TF.¹¹¹ Thus, the principals would seek to understand the underlying reason. Where non-compliance stems from lack of structures unanticipated by the FATF at its drafting stage, such as the cash-based economy or

¹¹⁰ Ben Hayes, 'Counter-Terrorism, "Policy Laundering" and the FATF: Legalizing Surveillance, Regulating Civil Society' < <http://www.statewatch.org/analyses/no-171-fafp-report.pdf> > accessed 10 January 2017.

¹¹¹ See James M. O'Kane, *The Crooked Ladder: Gangsters, Ethnicity and the American Dream* (New Brunswick: Transaction Publishers, 1992).

the solid minerals ML/TF trade risk, the principals will seek to amend its recommendations or guide documents to take these into considerations. Thus, HLMs are a two-way process, usually organised by the principals, agents or third parties (civil societies).

As the PP, the FATF engages in HLMs with its members, FSRB members and country legislators in order to resolve legislative deficiencies. Sometimes, such meetings hold through intermediaries. This occurred in the case of the FATF's review of Nigeria's proposed legislation. An intermediary was employed to engage in HLMs with the FATF officials who appraised the draft and found it suitable for the purpose intended.¹¹² The decision to appoint an intermediary was most likely because he was best-positioned to get information the other party would not necessarily give out.

A more intense relationship exists between the IFIs and country legislators. Their engagement occurs at multiple levels, sometimes through the IMF's Article IV surveillance, and gives IFIs the opportunity to familiarise legislators with the FATF recommendations whilst listening to their concerns.¹¹³ This is usually achieved through dealings with in-country legislative committees focused on economic issues and/or interactions with parliamentary networks.¹¹⁴ Whilst the former occurs through seminars, briefings, mission visits or visiting delegations at the IMF/Bank, the latter occurs through organised conferences and workshops in partnership with parliamentary umbrella groups.¹¹⁵ Both processes are targeted at ensuring compliance with the FATF standards on sturdy legislations.

¹¹² Scoop Independent News WikiLeaks, 'Cablegate: Nigeria: Economic and Financial Crimes Act Passed' (Scoop Independent News WikiLeaks, 24 February 2004) <<http://www.scoop.co.nz/stories/WL0402/S00051/cablegate-nigeria-economic-and-financial-crimes-act-passed.htm>> accessed 1 April 2017.

¹¹³ IMF, 'Guide for IMF Staff Outreach to Legislators' (IMF, 4 January 2006) <<https://www.imf.org/external/np/exr/leg/eng/guide.htm>> accessed 1 April 2017.

¹¹⁴ The Parliamentary Network on the World Bank & International Monetary Fund <<http://www.parlnet.org/node>> accessed 10 April 2017; The Global Organisation of Parliamentarians Against Corruption (GOPAC) <<http://gopacnetwork.org>> accessed 10 April 2017; The NATO Parliamentary Assembly and the Commonwealth Parliamentary Association (CPA) <<http://www.nato-pa.int>> accessed 1 April 2017.

¹¹⁵ IMF, 'Guide for IMF Staff Outreach to Legislators' (IMF, 4 January 2006) <<http://www.imf.org/external/np/exr/leg/eng/guide.htm>> accessed 10 May 2018

In a 2004 report, the Executive Working Group stressed that the IMF should ‘expand its outreach and listen to legislators to improve the understanding of the political and social context in which economic decisions are taken....(and) help build understanding of the IMF’.¹¹⁶ Consequently, there has been improved interactions between the IFIs and states, as illustrated by the yearly parliamentary network workshop meetings,¹¹⁷ the July 2015 Vienna workshop for MP countries across Central Asia and the Caucasus. In 2014, programmes for parliamentarians were held in Mozambique and Tanzania. These meetings give the IFIs an improved understanding of the socio-economic and political context in which transplantation occurs.¹¹⁸

Additionally, at the African Union’s *High Panel on Illicit Financial Flows from Africa*,¹¹⁹ experts from the United Nations Economic Commission for Africa (ECA) worked with African Heads of States, legislative leaders, representatives of the World Bank, IMF and United Nations to recommend actions aimed at combatting illicit crimes within the continent. A key recommendation that resulted from this was that ‘clear and concise laws’ should be passed to regulate trade mispricing (TM). TM is the deliberate over-invoicing of imports or under-invoicing of exports by local entities, usually for the purpose of avoiding tax or levies.¹²⁰ Although TM is a predominant means of laundering in ACs, it is only highlighted by the FATF Best Practices Paper for

¹¹⁶ IMF, ‘Factsheet: The IMF and Legislators’ (IMF, 9 January 2017) < <http://www.imf.org/external/np/exr/facts/leg.htm> > accessed 1 May 2017.

¹¹⁷ World Bank Group and the International Monetary Fund, ‘Parliamentary Workshop at the Annual Meetings 2016’ (The Parliamentary Network on the World Bank & International Monetary Fund) < <http://www.parlnet.org/sites/default/files/Agenda-MP-workshop-annual-meetings2016.pdf> > accessed 10 April 2017.

¹¹⁸ IMF, ‘Factsheet: The IMF and Legislators’ (IMF, 17 April 2017) < <http://www.imf.org/en/About/Factsheets/The-IMF-and-Legislators> > accessed 18 April 2017; Daily Post, ‘Full Text of Saraki’s Speech as Lagarde Visits Senate’ (Daily Post, 6 January 2016) < <http://dailypost.ng/2016/01/06/full-text-of-sarakis-speech-as-lagarde-visits-senate/> > accessed 11 March 2017.

¹¹⁹ Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development, ‘Report of the High Level Panel on Illicit Financial Flows from Africa’ < http://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf > accessed 10 April 2017.

¹²⁰ Ann Hollingshead, ‘The Implied Tax Revenue Loss from Trade Mispricing’ [2010] *Global Financial Integrity* 1, 13.

combatting Trade-Based Money Laundering (TBML)¹²¹ and not given the focus required through the FATF recommendations. Delston and Walls contend that the Best Practices Paper for TBML and FATF recommendations should be harmonised, as the recommendations should demand that traders adopt CDD, KYC and STR reporting protocols. Otherwise companies may ignore the risk TBML poses.¹²² This proposal contradicts the FATF's Best Practice Paper which cautions against undue regulatory burdens on legitimate businesses. The FATF viewpoint is supported by McSkimming who asserts that there is minimal evidence of the ill-effect of TBML and little consideration as to whether systematic monitoring of trade systems would be cost-effective.¹²³ Nevertheless, the findings of this HLM cannot be discarded, given their impact on Africa's financial integrity.

The extent to which these interactions promote strategic AML/CFT standards and effective transplantation is however debatable. Although highly promoted, it assumes that its agents (legislative members) are well versed on political and socio-economic situations within countries and have the expertise required to draft. This is not necessarily the case, as elected legislators usually have minimal knowledge of social circumstances surrounding drafted/sponsored bills.¹²⁴ They are more concerned with the procedure for assent, a shortcoming attributable to nepotistic election process. This is usually remedied by working with experts from different agencies or third sectors who do not usually accompany legislators to such HLMs. In the process of briefing and debriefing, information may get lost in transmission.

¹²¹ FATF, 'FATF Guidance Document: Best Practices Paper, Best Practices on Trade Based Money Laundering' (FATF, 2008) <<http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP%20Trade%20Based%20Money%20Laundering%202012%20COVER.pdf>> accessed 10 July 2017.

¹²² Ross Delston and Stephen C Walls, 'Reaching Beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing outside the Financial Sector' [2009] 41 *The Case Western Reserve Journal of International Law* 85, 103.

¹²³ McSkimming Samuel, 'Trade Based Money Laundering: Responding to an Emerging Threat' [2010] 2 *Deakin LR*. 37.

¹²⁴ Robert Rotberg, 'Africa Legislative Effectiveness' (Africa and Asia: The Key Issues) <<https://robertrotberg.wordpress.com/2013/10/16/african-legislative-effectiveness/>> accessed 5 July 2017.

Furthermore, political will is usually absent, because of fear of getting trapped by enacted legislations on AML/CFT. EENA4 noted this, stating that Angola is yet to institute checks against politically exposed persons (PEPs).¹²⁵ This shortcoming is remediable by HLMS, which provide a platform for networks between legislators and their interactions with IFIs/FATF. This may engineer some competitive pressure amongst agents to comply, however, this may elicit varying responses based on resources, expertise and political will.

Additionally, HLMS have revealed a top-down approach where developing and emerging countries meet the principals to seek solutions for their home-grown questions, rather than quizzing them on the suitability of recommendations or laws.¹²⁶ However, this is an inconclusive statement given that HLMS are not only sparsely held but are rarely publicised. There is therefore insufficient evidence on interactions between principals and agents. Nonetheless, the practice has continued because it is capable of generating political will from the legislatures of low income countries. It also empowers them with requisite information¹²⁷ to push for increased resources in combatting ML/TF, challenge the executive arm of government, and facilitate national co-ordination amongst agencies.¹²⁸

Secondly, technical assistance (TA) bridges information asymmetry between the principal and the agent in the re-modification and transplantation of standards. TA, which is carried out at national and regional levels, can be defined as ‘non-financial assistance provided by local and international specialists which take the form of information sharing, expertise dissemination, transmission of working knowledge and

¹²⁵ EENA4, Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA4, ‘Telephone Call’ (2017).

¹²⁶ As noticed in the IMF/WB Spring Meetings 2017 – A representative from the Central Bank of Ghana sought recommendations on how current financial issues in Ghana could be resolved.

¹²⁷ Such as predicate offence in other countries so as to ensure that legislations cover predicate offences in originating countries. In addition, legislators would review reports of assessment of their country, identify their own shortcomings and make amendments.

¹²⁸ FATF, ‘Guidance on Capacity Building for Mutual Evaluations and Implementation of the FATF Standards within Low Capacity Countries’ (29 February 2008) < <http://www.fatf-gafi.org/media/fatf/documents/reports/Capacity%20building%20LCC.pdf> > accessed 10 June 2017; GOPAC Anti-Money Laundering Action Guide For Parliamentarians (GOPAC, March 2012) <http://www.gopacnetwork.org/Docs/GOPAC_AML_ActionGuide_EN.pdf > accessed 10 April 2017.

consulting services.’¹²⁹ The IMF refers to this as ‘building human and institutional capacity within a country to help government implement more effective policies, leading to better economic outcomes.’¹³⁰ This description unveils a two-way stream; while it provides an opportunity for the agent to learn from principals and improve their drafting compliance levels, it also allows the principals to build their knowledge base on the agent so as to tailor their assistance programmes.

TA is mainly employed because IFIs/FATF recognize that low capacity countries struggle to translate standards to legislation.¹³¹ For instance, in Nigeria, concerns were raised that ‘lawmakers and stakeholders in the financial sector are generally unfamiliar with AML/CFT issues.’¹³² Consequently, the FATF advocated for, and implemented robust interactions through a national coordination committee that included legislators and justice ministries/agencies that are also involved in legal policy, legislative drafting and mutual legal assistance. This robust national level TA recognises that although legislators are at the forefront of enacting laws, they are supported by other institutions that play a vital role in drafting and formulating legislation in accordance with international standards.

At the regional level, the FSRB are also involved in training justice ministry/agencies staff. For instance, inbuilt in the Eastern and Southern Africa Anti-Money Laundering Group (ESAMMG) strategic plan for 2012-15 was the need to consolidate regional AML/CFT capacity building, training and awareness raising programmes.¹³³ This position resonates with GIABA. However, training is usually provided on request from

¹²⁹UNESCO, ‘Technical Assistance in Cultural Governance’ (UNESCO) <<http://www.unesco.org/new/en/culture/themes/cultural-diversity/cultural-expressions/programmes/technical-assistance/what-is-technical-assistance/>> accessed 10 April 2017.

¹³⁰IMF, ‘Factsheet: IMF Capacity Development’ (IMF, 19 April 2017) <<http://www.imf.org/en/About/Factsheets/Capacity-Development-Technical-Assistance-and-Training>> accessed 1 April 2017.

¹³¹ Financial Action Task Force, ‘Guidance on Capacity Building For Mutual Evaluations and Implementation of the FATF Standards Within Low Capacity Countries’ (29 February 2008) <<http://www.fatf-gafi.org/media/fatf/documents/reports/Capacity%20building%20LCC.pdf>> accessed 4 February 2018; It however carries this out in conjunction with or prior to a mutual evaluation.

¹³²The Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA).

¹³³Eastern and Southern African Anti-Money Laundering Group (ESAAMLG), ‘Strategic Plan April 2012–March 2015’ <http://www.esaamlg.org/documents_storage/2013-1-4-16-4-51_strategic_plan_2012-2015.pdf> accessed 9 April 2017.

the FSRB. Thus, although GIABA noted that countries like Benin, Mali and Cote d'Ivoire needed support to strengthen their AML/CFT framework, it did not provide direct assistance because there was no formal request.¹³⁴ To forestall information asymmetry through TA, the FATF Training and Research Institute (TRIEN) was established with the aim of granting government officials in FATF member countries access to comprehensive training and research programmes.¹³⁵

The specialised TA provided by the IMF is a sequel to surveillance which identifies areas where TA can have the greatest impact. Thus, in certain countries, TA is focused on building institutional and human capacity for effective policy drafting. Although granted voluntarily, countries must pass the IMF guidelines which are in the form of prioritisation filters to engage in TA.¹³⁶ IMF staff do not proceed on a one-way training stream but provide tailor-made assistance through engagement with countries over a period of time, thus, potentially resolving asymmetries.¹³⁷

The IMF has also included regional and country approaches in technical assistance through the establishment of 9 regional centres and various country offices.¹³⁸ Thus, TA can be tailored to legislative guidance, such as enabling countries legislate

¹³⁴Inter-Governmental Action Group Against Money Laundering in West Africa, 'Member States: Republic of Benin' (GIABA) < <http://www.giaba.org/member-states/benin.html> > accessed 7 April 2017; Inter Governmental Action Group Against Money Laundering in West Africa, 'Member States: Republic of Mali, ' (GIABA) <<http://www.giaba.org/member-states/mali.html> > accessed 10 June 2016; Inter-Governmental Action Group Against Money Laundering in West Africa, 'Member States: Republic of Cote d'Ivoire' < http://www.giaba.org/member-states/cote_divoire.html> accessed 10 March 2017.

¹³⁵FATF, 'FATF Training and Research Institute (TREIN)' (FATF, 20 September 2016) < [http://www.fatf-gafi.org/fr/publications/recommandationsgafi/documents/trein-institute.html?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/fr/publications/recommandationsgafi/documents/trein-institute.html?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 1 March 2017.

¹³⁶ Requests are prioritized based upon filters such as Program areas, policy initiatives, impact and commitment, availability of external financing and regional diversity.

¹³⁷ Bretton Woods Project, 'IMF Technical Assistance' (*Bretton Woods Project*, 13 March 2014) < <http://www.brettonwoodsproject.org/2014/03/inside-institutions-imf-technical-assistance/> > accessed 10 March 2017.

¹³⁸ Since 1993, the IMF included a regional approach towards technical assistance, establishing nine regional centers across the world, allowing for quicker dissemination and specific tailoring of assistance to meet the needs of the regions. The first of these regional centers was established in the Pacific region in 1993, followed by the Caribbean regional center. Since 2002, five further centers have been established in the Sub-Saharan Africa region as part of the IMF's Africa Capacity Building Initiative, to improve the coordination of capacity building technical assistance in the Poverty Reduction Strategy Paper (PRSP) process. Two further regional centers were established in the Middle East in 2004 and in Central America and the Dominican Republic in 2009.

effectively on pertinent issues such as laws guiding the formation of the FIUs or restricting ML/TF through PEPs. The World Bank has done this, as evidenced by its sponsorship of the Joint Initiative by the Bank of Sierra Leone and Transnational Organised Crime Unit (TOCU) in drafting a National Procedure on Anti-Terrorism and Proliferation Financing.¹³⁹ This was facilitated during a three-day workshop attended by relevant stakeholders such as the UN and other key bodies, where steps were agreed to curb illicit crimes. The interaction between IFIs/FATF and countries illustrates continuous engagement with agents.

There are however difficulties in the effectiveness of TA projects in promoting successful AML/CFT strategies. For instance, TA is mostly led by regional and international bodies, usually in the form of workshops which hold for about two days per session. Such sessions are facilitated using a top-down approach where experts from developed countries provide technical-knowhow without being conversant with the full socio-economic and political issues in the host country. This prevents national stakeholders from contributing to the global standards or transplanting effectively and thus hinders the ‘global’ nature of the FATF recommendations. For example, the FATF’s TRIEN pulls government officials from member countries to engage in comprehensive training and research – which is then disseminated to low capacity countries with less mature AML/CFT regimes.¹⁴⁰

TA for each country usually occurs once within a five-year time-frame, the last in Africa being in 2012. This is ineffective given the fast changes in ML. For instance, cryptocurrencies are a new and evolving way for ML, a subject scarcely considered in 2012. As already noted, training is usually offered to legislators who delegate drafting responsibilities to expert bodies or staff. This creates another agency relationship where information asymmetry thrives. However, follow-up MERs and ROSCs usually reveal an improvement in legislative drafts post TA, illustrating that despite the limitations of

¹³⁹ GIABA, (*GIABA*) < http://www.giaba.org/member-states/sierra_leone.html > accessed 10 March 2017.

¹⁴⁰ Attendance is also extended to the judicial ministries and agencies involved in rule making and the legal drafters within the regulatory bodies inter alia, the central bank, Securities and Exchange Commission - as input is necessary from both the legislative and regulatory fronts.

this observatory and information exchange tool, it has provided a platform for improved law making, which is vital in combatting ML/TF.

Thirdly, principals also interact with agents through sanctions, incentives or conditionalities. The distinction between incentives and sanctions are not always clear. Wagner states that, ‘incentives are often considered to be weak sanctions.’¹⁴¹ This perspective, which reveals the potential overlap between incentives and sanctions, indicates that, given that both ideals are in pursuit of the same goals, they are not necessarily opposites.¹⁴² Some differences exist between them. Incentives, which are usually in form of the granting of political and economic benefit to a country in exchange for specific policy adjustments are soft instruments.¹⁴³ They are used to foster and maintain cooperative goodwill amongst states. This is evidenced by the fact that any grant of benefit usually involves interactions and agreements aimed at encouraging legislators to enact the requisite laws that would avoid the FATF’s listing. Conversely, sanctions are hard, hostile instruments or penalties which mandate a country to carry out a specific activity when there is a breach of international standards. Sanctions are usually achieved by taking away from such country rather than granting a specific advantage. At this level, there is minimal interaction. Consequently, Wagner has argued that sanctions are more effective than incentives because states value the marginal unit of a good taken away through sanctions than the benefit of the same amount added through incentives.¹⁴⁴ Although closely related, conditionalities are neither sanctions or loans. Rather, they are conditions attached to the provision of benefits such as loans, debt relief or bilateral trade.¹⁴⁵

¹⁴¹ Harrison Wagner, ‘Economic Inter-Dependence, Bargaining Power and Political Influence’ [1988] 42 (3) *International Organisation* 461 – 483.

¹⁴² David Cortright, *The Price of Peace: Incentives and International Conflict Driven Prevention* (Lanham, MD: Rowman and Littlefield, 1997).

¹⁴³ Ibid.; Han Dorussen, ‘Mixing Carrots with Sticks: Evaluating the Effectiveness of Positive Incentives’ [2001] 38 (2) *Journal of Peace Research* 251, 260.

¹⁴⁴ Harrison Wagner, ‘Economic Inter-Dependence, Bargaining Power and Political Influence’ [1988] 42 (3) *International Organisation* 461 – 483.

¹⁴⁵ Carlos Santiso, ‘Good Governance and Aid Effectiveness: The World Bank and Conditionality’ [2001] 7 (1) *The Georgetown Public Policy Review* 1, 12; Alexander Kentikelenis, Thomas Stubbs and Lawrence King, ‘IMF Conditionality and Development Policy Space 1985 - 2014’ [2016] 23 (4) *Review of International Political Economy* 544, 548.

The instrument used by the principal to enhance the agent's compliance to the FATF standards depends on level of compliance and intensity of interactions. For instance, conditionalities may be issued to remedy a breach or simply to build interactions with agents to prevent a breach from occurring. Sanctions are however restricted to post-breach occurrence. This can be typified with the case of a developing country failing to comply with the FATF recommendations 3 and 5, which mandates the criminalisation of ML/TF on the basis of the Vienna and Palermo Conventions. In such case, the principals would most likely issue a sanction or mandate compliance through conditionalities.¹⁴⁶ Such hard stance may unearth the low level of interaction prior to, and during assessments which occasioned a low compliance level. Hence, sanctions in form of listing would merit public censure through the placement of such countries on the FATF's 'high risk and non-cooperative jurisdictions lists'. Countries placed on this list would have to engage with FATF officials to facilitate de-risking as public censure may threaten financial flow and hinder market access.

The level of engagement is however dependent on the specific list on which a jurisdiction is placed. Firstly, 'jurisdiction with serious strategic deficiencies for which the FATF has called its members to apply counter-measures based on substantial risk to the international financial system'. This means that the country must show FATF officials that significant measures are being taken to remedy deficiencies.¹⁴⁷ Secondly, 'jurisdictions with strategic deficiencies that have developed an action plan'. This means the FATF would only seek to ensure that the country implements its action plans whilst calling on its members to apply enhanced due diligence proportionate to the risk posed. Although it seems likely that countries with legislative deficiencies would be placed on the first list only, in the absence of legislative guidance, implementation would be problematic.

¹⁴⁶ FATF, 'High-Risk and Non-Cooperative Jurisdictions' (FATF) < <http://www.fatf-gafi.org/countries/#high-risk> > accessed 10 February 2017; Note: This breach is considerably severe as membership of the FATF is dependent on satisfactory compliance with these recommendations.

¹⁴⁷ FATF, 'Improving Global AML/CFT Compliance: On-going Process – 24 February 2017' (FATF, 24 February 2017) <<http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-february-2017.html>> accessed 12 March 2017.

To avoid being listed, a number of countries have improved their interactions prior to assessments and ensured that their laws are properly transplanted. This was the case in Nigeria, where last minute efforts were initiated to avert sanctions over money laundering.¹⁴⁸ After being blacklisted, Ghana strengthened its interactions and was delisted the next year.¹⁴⁹ The effectivity of this interaction in ensuring transplantation and contributing to improved FATF standards is however questionable, because of conflict of interest and information asymmetry. For instance, in rushing to evade blacklisting, countries may engage in sham compliance by drafting legislation deemed suitable on paper. However, legislators may not follow up on other legislative roles, such as ensuring checks on the regulators and executive. Furthermore, legislators who work hand in hand with the government may also draft legislation to combat supposed enemies of the government or target opponents, safe in the knowledge that the ‘immunity cloak’ prevents certain government officials from facing the wrath of the law.¹⁵⁰ This information may be fed to the principal as improved compliance, whereas in actual fact it is the roadmap to implementing ML/TF.

4.2.3 Interaction Between Principals and Agents in implementation and compliance

The interaction between principals on the implementation of, and compliance with, AML/CFT standards fosters a unified approach towards agent states. Within the model of agency adopted by this chapter, the principal delegates standards by which regulatory and enforcement bodies ensure implementation and compliance. Such delegation grants authority to agents to carry out tailored projects in accordance with the principal’s objective post legislation. This illustrates the continuous need for interaction between actors to forestall agency slack post-legislation. The delegated and uninterrupted interaction further illustrates the ‘disaggregation of the state’. Although the state is

¹⁴⁸ Martins Oloja, ‘Nigeria Rushes to Avert Sanction over Money Laundering Law’ (The Guardian, 27 September 2012) < <http://odili.net/news/source/2012/sep/27/16.html> > accessed 10 March 2017.

¹⁴⁹ Modern Ghana, ‘Ghana Exits Blacklist; Nigeria Enacts Terrorism (Prevention) (Amendment) Act 2013’ (Modern Ghana, 22 February 2013) < <https://www.modernghana.com/news/447311/1/ghana-exits-fatf-blacklist-nigeria-enacts-terroris.html> > accessed 20 June 2016.

¹⁵⁰ Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (1st edn, Routledge 2016).

preserved as sovereign, the primary body responsible for implementation and compliance, the agents derive authority from the principal's mandate which has been concretised via national legislation. This legitimises the interaction and network between principals and agents.

As stated, agents within states include regulatory bodies such as, the Securities and Exchange Commission, Central Banks, FIUs, etc. These institutions, each answerable to their own global principals who are concerned about ML/TF issues, have dual roles in ensuring compliance with AML/CFT regulations. Firstly, they ensure the construction and synchronisation of regulatory rules for robust supervision of financial institutions that pose ML/TF risk. Secondly, they interact with financial institutions through supervisory and enforcement powers, utilised to checkmate non-compliance and protect the integrity of the international financial system. These institutions not only have enforcement divisions within their offices to enable swift response to cases of ML/TF alert, but also work in collaboration with other agents, such as the state's enforcement officers and the judiciary. The issue then is how the principals, particularly the FATF/IFIs interact with the agents to ensure the resolution of conflict of interests for effective compliance with AML/CFT rules.

As earlier stated, the interaction between the principal(s) and the agent is mainly through;

1. High-level meetings
2. Assessments
3. Technical assistance
4. Enforcement actions

HLM, as discussed, gives the principal and the agents the opportunity to meet and exchange information on implementation and compliance strategies. The idea is that such meetings would inform effective transplantations and also input into the FATF rules update. Such high-level meetings occur through conferences, seminars, workshops or in-country meetings. Conferences may be organised by the Principal, agent or a third party. For instance, the Cambridge International Economic Crime

Symposium which is usually attended by regulatory /enforcement officers and Principal representatives is organised by academics to foster high-level interaction to curb financial crime.¹⁵¹

The IFIs spring meetings also gather private sector executives, regulators, lawyers and third parties to discuss regulatory and compliance issues.¹⁵² The 2017 spring meetings saw intense focus on Fintech and digital financial inclusion, with discussions on tackling regulatory issues that these raise.¹⁵³ In-country meetings are also held as a prelude to technical assistance, with staff and members of various ministries and institutions – financial and non-financial. These meetings provide networked interaction between connected parties, a step towards strengthening the relationship of regulators and institutions with the enforcement agencies – such as the police who are considered extraneous to institutions profit ratio.¹⁵⁴

The interaction between various actors is premised on the fact that combatting ML/TF requires a co-dependent relationship between these institutions. In certain instances, the IFIs hold inter-ministerial meetings with country representatives, especially where it perceives that political will is the main issue at hand. The translation of these meetings to improved compliance and input into the FATF rules is plausible, but remains contentious. This is because although networked interactions may ensure that regulators and enforcement officers have a better relationship, a financial institution may remain unwilling to work effectively with enforcement officers at the expense of prosecutions or profit expected from ML transactions.¹⁵⁵ Moreover, as would be seen, home-grown

¹⁵¹ CIDDEC, ‘The Cambridge International Symposium on Economic Crime’ (CIDDEC) < <http://www.crimesymposium.org> > accessed 01 May 2017.

¹⁵² IMF Blog, ‘IMF Spring Meetings 2017: Keeping Growth on Track’ (IMF Blog, 28 April 2017) < <https://blogs.imf.org/2017/04/28/imf-spring-meetings-2017-keeping-growth-on-track/> > accessed 2 May 2017.

¹⁵³ Ibid.

¹⁵⁴ Jack Harvey and Simon Ashon, ‘Regulatory Capture: Anti-Money Laundering Policy: A Response to the Activity of Criminals or of Agencies?’ in Petrus C. van Duyne, Almir Maljevic, Georgios A. Antonopoulos, Jack Harvey, Klaus von Lampe (eds) *The Relativity of Wrongdoing: Corruption, Organized Crime, Fraud and Money Laundering in Perspective* (The Authors, Wolf Legal Publishers, 2015) 300.

¹⁵⁵ EENA6, Inter-Governmental Action Group Against Money Laundering (GIABA), Interview with EENA6, ‘Telephone Call’ (2017)

compliance/enforcement solutions may sometimes be best suited to resolve compliance difficulties. In such situations, the FATF may seek to ensure that its rules reflect other means of compliance.

IFIs/FATF carry out assessment of implementation or compliance to monitor adherence to set FATF standards.¹⁵⁶ However, their modes of operation differ. The difference is predicated on the intrusiveness of their projects. For instance, the FATF carries out mandatory assessments through its mutual evaluation of a country's compliance level to its standards.¹⁵⁷ This exercise is usually carried out by secretariat staff and member country assessors¹⁵⁸ or in particular cases, a composition approved by the FATF President.¹⁵⁹ These may include pre-trained FSRB members or in cases of joint evaluations, staff of IFIs. These officials spend a period of 10 days within countries, assessing their private and public sector offices for technical compliance, and recently, the effectiveness of their AML/CFT regime.¹⁶⁰ These in-country assessments do not occur in a vacuum but are based on prior research at the secretariat. This includes reviews of reports from countries via the '*technical compliance update questionnaire*' which, combined with the previous MERs, follow-ups and '*information on effectiveness*' of countries AML/CFT regime is utilised to pre-assess a country's compliance level.¹⁶¹ The country, sometimes in collaboration with the assessment team makes a risk-based decision on focus areas during the onsite visits.¹⁶² Findings from these time-bound evaluations are however, rarely discussed with countries in order to understand reasons for non-compliance. Instead, discussions are based on the need to justify findings. The short period allotted to a country's representative during the

¹⁵⁶ Kenneth S Blazejewski, 'The FATF and Its Institutional Partners': Improving the Effectiveness and Accountability of Trans-Governmental Networks' [2008] 22 Temp. Int'l & Comp. LJ 1, 23.

¹⁵⁷ Ibid. 1, 16.

¹⁵⁸ FATF, 'Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations' (FATF, October 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf> > accessed 1 May 2017.

¹⁵⁹ Ibid.

¹⁶⁰ Ibid; FATF, 'Mutual Evaluations' (FATF) <[http://www.fatf-gafi.org/publications/mutualevaluations/more/more-about-mutual-evaluations.html?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/mutualevaluations/more/more-about-mutual-evaluations.html?hf=10&b=0&s=desc(fatf_releasedate))> accessed 01 April 2017.

¹⁶¹ FATF, 'Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations' (FATF, October 2013)< <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf> > accessed 1 May 2017.

¹⁶² Ibid.

plenary session reflects this;¹⁶³ although countries engage in discussions on the initial two drafts of the MERs and are permitted to respond, evaluation reports published post-adoption by the plenary session rarely reflect changes to the MERs.¹⁶⁴ Thereafter, the MERs are published, a process designed to publicly shame the agents within a country into compliance. This step signals agency slack, with resultant interaction between the principal and agent to remedy defects. Although the FATF assessment process facilitates interaction with countries, it is intrusive, usually reporting on technical compliance and effectiveness from a perspective of non-ownership. This position may actually shroud the true compliance level of a country.

Conversely, the IFIs interact with agents through FSAP programmes¹⁶⁵ which test the soundness of a member state's financial systems. The tests identify risks and vulnerabilities that hinder compliance to FATF standards.¹⁶⁶ BRICs, along with 25 other countries with systemically important financial sectors are however required to undertake mandatory financial assessments under FSAP. This decision warranted the inclusion of the FSAP under the IMF Article IV surveillance. It acknowledges that ML/TF may cause macroeconomic and financial instability which can be facilitated by these countries that are largely connected and pose contagion risk.¹⁶⁷ In such cases the IMF enters discussions with the central bank governor or financial ministers of such countries in order to generate political support to combat ML/TF. This suggests that the IMF has greater interaction with these countries. Conversely, the Evaluation Report of the Independent Evaluation Office of the IMF illustrates that IMF interactions are least

¹⁶³ Ibid (n 161).

¹⁶⁴ Ibid.

¹⁶⁵ IMF, 'Review of the Financial Sector Assessment Program: Further Adaptation to the Post Crisis Era' (*IMF*, September 2014) < <https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Review-of-the-Financial-Sector-Assessment-Program-Further-Adaptation-to-the-Post-Crisis-Era-PP4893> > accessed 10 December 2017.

¹⁶⁶ Ibid.

¹⁶⁷ IMF, 'Financial Sector Assessment Program (FSAP)' (*IMF*, 03 April 2017) <<http://www.imf.org/external/NP/fsap/fssa.aspx>> accessed 10 April 2017.; IMF, 'Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance' (*IMF*, 27 August 2010) <<http://www.imf.org/external/np/pp/eng/2010/082710.pdf> > accessed 27 March 2017; IMF, 'Press Release No14/0: IMF Executive Board Reviews Mandatory Financial Stability Assessments Under the Financial Sector Assessment Program' (13 January 2014) <<https://www.imf.org/external/np/sec/pr/2014/pr1408.htm> > accessed 10 May 2016.

effective with advanced and large EEs.¹⁶⁸ They were most effective with developing countries.¹⁶⁹ This may be attributable to the fact that instead of discussions, the IFIs impose conditionalities on certain developing countries to mandate legislation and subsequent compliance with FATF standards. These conditionalities are usually beneficial in ensuring actual compliance, but have the disadvantage of altering the democratic ideal and accountability model of governance.¹⁷⁰

Nevertheless, the FSAP has remained largely voluntary in developing countries. Through its creation of the ROSC, the FSAP reports on member states implementation of AML/CFT recommendations.¹⁷¹ Reports produced from the assessment exercises are also reviewed in partnership with countries. As publication of such reports are at the discretion of the country in question,¹⁷² a country may withhold publications that might have disastrous consequences for it. This illustrates how IFIs uphold and respect sovereignty.

Furthermore, interaction between countries and IFIs is largely dependent on the stage of assessment. At the pre-assessment stage, IFIs are usually involved in extensive research on countries, thus, interaction is usually limited to exchange of information which arms the IFIs with additional material data on the country in question.¹⁷³ The provision of this information entails a process of self-reflection, which gives the regulatory/enforcement bodies and FIs sufficient time to plan the assessment procedures. Interaction between principals and agents is more intense during the

¹⁶⁸ Independent Evaluation Office of the International Monetary Fund, 'IMF Interactions with Member Countries' (*Independent Evaluation Office of the International Monetary Fund*, 2009) <<http://www.ieo-imf.org/ieo/files/completedevaluations/A.%20%20Full%20Text%20of%20Main%20Report.pdf> > accessed 2 April 2017.

¹⁶⁹ Ibid.

¹⁷⁰ Ngaire Woods, 'Unelected Government: Making the IMF and the World Bank More Accountable' (Brookings, March 1 2003) < <https://www.brookings.edu/articles/unelected-government-making-the-imf-and-the-world-bank-more-accountable/> > accessed 1 July 2017; John Hilary, 'Africa: Dead Aid and the Return of Neoliberalism' [2010] 52 (2) *Race & Class* 81, 83.

¹⁷¹ IMF, 'List of Standards, Codes and Principles Useful for Bank and Fund Operational Work and for which Reports on the Observance of Standards and Codes are Produced' (IMF, November 2002) <<http://www.imf.org/external/standards/scnew.htm> > accessed 10 May 2016.

¹⁷² Ibid.

¹⁷³ IMF, 'Financial Sector Assessment Program: Frequently Asked Questions' (IMF, 01 August 2016) <<https://www.imf.org/external/np/fsap/faq/#q20> > accessed 9 January 2017.

assessment, as the IFIs usually engage with regulatory bodies, FIs and other market participants (e.g., insurance agencies, pension funds, mutual funds) to gain a robust understanding of market developments, structure, outlook and risk management practices.¹⁷⁴ This requires a two-way communication for robust understanding of the purpose of the FSAP and the importance of participation for propelling international financial stability. This project is usually carried out in collaboration with the country representative of IFIs, thus making for a more responsive assessment. Additionally, although assessment occurs within a 2-week time frame, the presence of a country representative of the IFIs resident in host countries significantly bridges existent information asymmetry, as these actors can furnish assessors with adequate context and information.

The results of assessments are crucial in determining the direction of the principal's relationship with the agent-state. Thus, where the agent is considered an 'amoral calculator'¹⁷⁵ in the sense that the regulatory body and institutions are purely driven by profit or the probability of being caught, the principal may categorise the agent-state under 'high-risk and non-cooperative jurisdictions'. This 'list' sanction requires FATF core members and other jurisdictions to apply counter-measures to protect the international financial system from the ongoing and substantial ML/TF risk emanating from that country.¹⁷⁶ Conversely, an agent-state may be considered to be either a 'political citizen' who will adhere to regulations considered of public interest, even in the absence of political will. Or 'organisationally incompetent', where it has ineffective internal governance to propel compliance. In these cases, the principal will interact with these agent-states through continuous monitoring and TA. Sometimes, there is no clear-cut solution and the deficiency of a country falls within grey areas. The IFIs may then decide that a country needs both sanctions and TA.

¹⁷⁴ Ibid.

¹⁷⁵ Robert A. Kagan and John T Scholz, 'The Criminology of the Corporation and Regulatory Enforcement Strategies' in J.T in Hawkins K and Thomas J. (eds.) *Enforcing Regulation* (Boston, Kluwer-Nijhoff Publishing 1984).

¹⁷⁶FATF, 'Public Statement 24' (FATF, 24 February 2017) < <http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-february-2017.html> > accessed 4 March 2017.

When an agent-state is intimated of the need for TA, it may or may not request for this service. When it is requested, the principals (IFIs) have to approve before the service can be provided. In offering this service, the IFIs interact mainly with regulatory and supervisory bodies. Training is offered on how to scrutinise financial and non-financial institutions under their purview without falling prey to ‘regulatory capture’, as well as how to maintain confidence in the financial system.¹⁷⁷ Such training ensures that these regulatory bodies are knowledgeable on how to identify credible data from institutions and respond effectively to ML/TF risk, by drafting or updating regulations to fill any regulatory vacuum.

Training is also offered on how to synchronise efforts with enforcement agencies such as FIUs, the police and courts to ensure swift and effective measures to combat ML/TF. The IFIs also train judges and judicial agencies to handle ML/TF evidence, so as to bring every case to an even-handed end. Such training is however not country-bound given the borderless nature of illicit crimes. The IFIs also encourage cross-border interactions via FIUs for real-time exchange of information in cases of cross-border crimes. The FATF wields sanctions with the IFIs’ backing when an agent is in breach of its recommendations. In such cases, the principal publicly ‘lists’ non-compliance. It also requires the submission of a progress report from the country and requests that FIs in other member countries give special attention to any transaction involving the ‘listed’ country. Where the country is a member, the membership is suspended. Osborne notes that the allied influence of observer members of the FATF would ensure that recalcitrant states bear the consequences of their actions.¹⁷⁸

¹⁷⁷ Jack Harvey and Simon Ashon, ‘Regulatory Capture: Anti-Money Laundering Policy: A Response to the Activity of Criminals or of Agencies?’ in Petrus C. van Duyne, Almir Maljevic, Georgios A. Antonopoulos, Jack Harvey, Klaus von Lampe (eds) *The Relativity of Wrongdoing: Corruption, Organised Crime, Fraud and Money Laundering in Perspective* (The Authors, Wolf Legal Publishers, 2015) 300. Regulatory capture is where the regulated system is operated in the interests of regulatory firms rather than the general public, see Martin Ricketts, ‘Economic Regulation: Principles, History and Methods’ in Michael A Crew and David Parker (eds.) *International Handbook on Economic Regulation* (Edward Elgar Publishing, 2016) 34 – 62.

¹⁷⁸ Duncan E Osborne, ‘The Financial Action Task Force and the Legal Profession’ [2014-2015] 59 NYL Sch. LR 421.

Despite the harsh stance taken against non-compliant countries, the problem-solving capacity of principals has been thrown into question as a result of cases of alleged agent-state failure. For instance, despite sanctions and training offered to the appropriate agents, money is still moved without any report being flagged for follow-up. In Nigeria, the Central Bank, NFIU and the Economic and Financial Crimes Commission received training from the principals to fortify their staff with skills against ML/TF risk. These engineered the indigenous political will to come up with home-grown solutions to combat financial crimes. The Bank Verification Number (BVN) exercise, one of such schemes, interlinks all financial accounts held by one individual.¹⁷⁹ The aim is to promote transparency within the financial system and combat illicit crimes.¹⁸⁰ Also, a single treasury account was introduced by the Federal Government of Nigeria to ensure that all funds belonging to government parastatals are kept with the Central Bank.¹⁸¹ The aim is to prevent diversion of state funds and enable the Central Bank keep track of disbursements. These solutions received support from civic organisations such as BudgIT which applies technology to track financial disbursement and expenditure.¹⁸²

Nevertheless, there remained a gap in implementation and compliance. A news report uncovered through financial whistleblowing revealed that with approval from the presidency, government parastatals had received sums in excess of \$50 million in cash, which were stored in apartments.¹⁸³ This indicates that such solutions just encouraged cash circulation amongst PEPs. This gap reveals the limit of the FATF recommendations in combatting ML/TF. Whilst GIABA focused solely on financial/non-financial institutions as a conduit of funds for PEPs, there is limited focus on the origin of these funds – the government coffers itself.

¹⁷⁹ Ehi Eric Esoimeme, 'A Critical Analysis of the Bank Verification Number Project Introduced by the Central Bank of Nigeria' [2015].

¹⁸⁰ Ibid.

¹⁸¹ Okechukwu Innocent, Chukwurah Daniel, Iheanacho Emmanuel, 'An Analysis of Pros and Cons: Treasury Single Account Policy in Nigeria' [2015] 5 (4) *Arabian Journal of Business and Management Review* (OMAN Chapter) 20, 23.

¹⁸² BudgIT, 'budgiT' (BudgiT, 2017) < <http://yourbudgit.com/about-us/> > accessed 10 July 2017.

¹⁸³ Sani Tukur, 'How Nigerians Can Make Money, be Protected in New Whistle Blowing Policy – Finance Minister' (Premium Times, September 21 2016) < <http://www.premiumtimesng.com/news/headlines/218643-nigerians-can-make-money-protected-new-whistle-blowing-policy-finance-minister.html> > accessed 16 July 2017.

Furthermore, institutions responsible for overseeing governmental laundering have repeatedly failed to work hand-in-hand with the NFIU or the EFCC to see cases to conclusion. Indigenous actions taken on the back of political will further illustrate the positive agency slack that exist within the actors. It reveals that TA programmes do not necessarily facilitate information exchange that inculcates the peculiarities of states which principals are sometimes unaware of. Rather, it cultivates a top-down approach where principals delegate to agents without fully contracting on unknown issues.

Additionally, the interaction between principal and agent-states fails to capture the complex dual role of regulatory compliance officers who are charged with combatting ML/TF whilst maintaining confidence in the financial market. These roles are however conflicted in states where the regulator decriminalises, choosing instead to ridicule a company publicly by exposing the financial crime. The general public may lose confidence in the integrity of such a market. This implies treading a line between enforcing adherence to the FATF recommendations whilst evading release of information that would possibly damage the reputé of the institution. Contrary to the tenets on which the FATF was built, regulatory bodies may be slacking from their delegation when protecting FIs from a ‘run’ and ensuring financial stability. Such slack may be corrected by finding a balance through TA and high-level meetings, as sanctions would prove unsuitable. This shows the interaction between various instruments employed by the principal to monitor the agent and improved technical compliance and effectiveness.

4.3 Conclusion

This chapter commences by examining the relationship between the collective principals, (IFIs and the FATF). The evolution of their relationship is examined in light of AML/CFT rulemaking, coupled with the implementation and compliance measures. It argues that the synergy between the CPs was crucial in expanding the FATF's reach. This was a catalyst for division of labor and specialization in the assessment of AML/CFT standards, whilst also allowing the CPs present a united front devoid of quality disparities. This synergy, driven by the FATF was however undermined by the inherent exclusion of ACs from contributing to the standards-making process despite being subjected to enforcement measures.

The interaction between agent-states and CPs is then examined. It argued that two factors are crucial for understanding information asymmetry between these actors on ML/TF issues: the level of a country's integration with the global financial system and its perceived compliance levels. It finds that the incentive for information sharing is highest when a country is 'highly integrated' with perceived high compliance levels. In opposite situation, the countries would usually engage strategically with the principal in other to evade observatory tools or sanctions. However, whilst robust, this perspective is limited in its inability to consider the borderless nature of crime given that laundering can originate from 'low integrated' countries to other countries. Acknowledging this flow of money between countries, this chapter examines the interaction between 'highly integrated' and 'mid-integrated' countries. Through a pictorial representation, it illustrates that these set of countries share information only when it is in their self-interest to, particularly when there is a continuous financial business that is of systemic importance to both parties. It however argues that even when countries are willing to exchange viable information, they may be limited by capacity challenges.

It also argues that where information asymmetry continually thrives, the CPs are privy to tools to rein in the agent-states. The tools utilized are dependent on the circumstances

in question and the application of the inappropriate tool may indeed lead to an under-regulation, as the tool would at best be inadequate.

Chapter 5

Determinants of Africa's Compliance Levels to the Global Anti-Money Laundering Regime

5. Introduction

The efficiency of the global AML/CFT regime is largely dependent on the capability of countries to adopt and implement it. Majority of ACs are however beset with socio-economic, legal and political challenges which impede their ability to transplant and comply, notwithstanding the FATF's introduction of the risk-based approach. Consequently, the question is whether the commitment of ACs to the AML/CFT regime can be aligned with their compliance interests and capacity. Whilst the FATF argues that socio-economic, political and legal challenges should have no impact on compliance outcomes, these factors cannot be divorced, because, empirically, the absence thereof hinders the compliance trajectory of states.

Section 1 examines ACs, acknowledging the historical and socio-economic dissimilarities between them. These considerations are not unconnected to the challenges faced by ACs in meeting the AML/CFT standards. Rather, they reinforce the need for a framework that would facilitate compliance, given that Africa serves as a fertile ground for ML/TF. Section 2 examines the seemingly indigenous attempt to combat illicit crimes through the framework of the African Union (AU) and the FSRBs. Section 3 explores the regulatory environment across ACs, illustrating that majority of ACs are inundated by an interaction of legal and non-legal factors which affect or determine their compliance levels and regulatory responses. Section 4 presents the compliance levels of countries to the FATF recommendations and empirically evaluates the factors that influence the attainment of such compliance levels. It

illustrates that pre-mature regulatory environments coupled with socio-economic challenges may indeed affect compliance. Section 5 knits the other sections together and concludes.

5.1 African States: Context

Examining Africa's socio-economic history reveals a chronology of setbacks, arguably from the pre-colonial era. Hence, although commodities trade was buoyant between ACs and the industrialized world during the early 19th century, there were structural inadequacies which hindered the continent's economic growth.¹ This argument, advanced by Davidson, is however limited to the extent that it perceived Africa's setbacks as internal and distinct from colonialism.² This perspective fails to acknowledge that prior to formal colonialism, there were external institutions that affected Africa's interrelationship with developed countries.³ Dike agrees that the trading activities that preceded colonization occasioned the political subjugation of parts of Africa to Europe.⁴ Rodney adds that pre-colonial relations led to conquest of Africa by Europe.⁵ Analyzing the opposing arguments indicates that whilst internal structural shortcomings might have affected Africa's economy, the role of external forces cannot be discounted.

Perhaps, the socio-economic issues were exacerbated during the colonial era, where all

¹ Basil Davidson, *The African Genius: An Introduction to African Social History* (Little, Brown and Company, 1969). West African countries traded in salt, gold, cola nut and slaves, whilst Southern Africa developed trade with China and India in iron, ivory and gold. In return, they received porcelain, heads and Persian/Arab Pots. As a result of Islamic influence, Northern Africa traded with Arab countries. See Randall L. Pouwels, *The African and Middle Eastern World, 600 – 1500* (OUP, 2005).

² Basil Davidson, *The African Genius: An Introduction to African Social History* (Little, Brown and Company, 1969).

³ Edward Alpers, 'Rethinking African Economic History: A Contribution to the Discussion of the Roots of Under-Development' [1973] 3 (3) *Ufahamu A Journal of African Studies* 97, 100; A.G Hopkins, 'The New Economic History of Africa' [2009] 50 (2) *Journal of African History* 155, 166.

⁴ K.O. Dike, *Trade and Politics in the Niger Delta* (OUP, 1956); James Fenske, 'The Causal History of Africa: A Response to Hopkins' [2010] 25 (2) *Economic History of Developing Regions* 1, 17.

⁵ Walter Rodney, *How Europe Underdeveloped Africa* (Bogle-L'Ouverture Publications, 1972).

ACs, barring Ethiopia and Liberia, were subjected to colonial rule.⁶ Refuting the effect of colonialism, scholars have argued that Asian countries suffered a similar colonial fate, but their economies improved within a generation after independence.⁷ The merits of this argument cannot be discounted; it however fails to take account of the history of economic exploitation and psychological damage which ravaged Africa.⁸ The later part of the 19th century evidenced this; it was marked by capital and labor shortage, a catalyst of slave trade.⁹ Slave trade however did not only involve the trade of persons for goods, but settlement of the colonizers within Africa. Africans were used as laborers to harvest export items. Okigbo postulates that colonized states became exporters of goods such as minerals and commodities.¹⁰ Nunn validates this point through empirical findings which indicate that slave trade hindered the economic performance of countries.¹¹ Colonial banks within ACs were also complicit in preserving the monopolistic position of colonies in the export-import trade, through the provision of less favorable bank credit to Africans, than to Europeans.¹² Such limited credit, coupled with the export trend which still subsists, has made ACs more susceptible to vagaries of changing global prices and external shocks than most diversified economies.¹³

The subsequent introduction of neoliberal policies such as privatization, increased integration and deregulation in the 1980s worsened Africa's position within the global financial system, as countries became more susceptible to external shocks.¹⁴ This

⁶ Leigh Gardner, 'Was Independence Really Better than Colonial Rule? A Comparative Study of Liberia and Sierra Leone' [2013] 1, 3.

⁷ The Economist, 'The Heart of the Matter' (*The Economist*, 11 May 2000) < <http://www.economist.com/node/333437> > accessed 20 October 2017.

⁸ Ibid.

⁹ Biodun Olamosu and Andy Wynne, 'Africa Rising? The Economic History of Sub-Saharan Africa' (*International Socialism*, 2015) < <http://isj.org.uk/africa-rising/#footnote-263-14> > accessed 18 October 2017.

¹⁰ Pius Okigbo, 'Problem, Crisis or Catastrophe: Any Exit for African Economies in the 1990s?' [1993] 3 Nigerian National Merit Award Lectures (Fountain Publications).

¹¹ Nathan Nunn, 'The Long-term Effects of Africa's Slave Trades' [2008] 123 (1) *The Quarterly Journal of Economics* 139, 144.

¹² Chibuike Ugochukwu Uche, 'Foreign Banks, Africans, and Credit in Colonial Nigeria, c. 1890 -1912' [1999] 4 *Economic History Review*, LII 699, 699; Chibuike Uche, 'Indigenous Banks in Colonial Nigeria' [2010] 43 (3) *The International Journal of African Historical Studies* 467, 472.

¹³ Thankdika Mkandawire and Charles C Soludo (eds.) *Our Continent, Our Future: African Perspectives on Structural Adjustment* (Codesria, 1999) 42.

¹⁴ Cull Robert, Lemma Senbet and Macro Sorge, 'Deposit Insurance and Financial Development' (2005) World Bank Policy Research Working Paper 2682, 16 < <http://documents.worldbank.org/curated/en/813041468739789102/pdf/multi0page.pdf> > accessed 18 November 2017.

occasioned inequality within the continent.¹⁵ For instance, economically, the continent is dominated by Nigeria with 405.1 billion dollars of nominal gross domestic product (GDP).¹⁶ Nigeria is followed by Egypt, Algeria, Morocco and Angola with a cumulative GDP of 679.6 billion dollars,¹⁷ whilst Sao Tome and Principe, Comoros, The Gambia and Guinea-Bissau rank the least with a cumulative GDP of 2.98 billion dollars.¹⁸ Regionally, North Africa is the least poor region, closely followed by Southern Africa.¹⁹ Findings also reveal that 90% of the poorest people in Africa live in East, Central and West Africa.²⁰ These statistics illustrate the inequalities triggered by a combination of external and internal factors.

More disturbing is the economic inequality that liberalization has created between Africa and the industrialized world. Africa holds only 4.4% of the world's GDP based on purchasing power-parity (PPP) share of world total.²¹ This is negligible when compared to the BRICS's cumulative 32.02% share, with China alone holding 18.26%.²² These statistics provide a prism to examine the degree of integration with the global economy. Contrary to EEs, ACs have a lower degree of financial integration with the global economy.²³ This demonstrates Africa's challenges to creating an

¹⁵ Biodun Olanosu and Andy Wynne, 'Africa Rising? The Economic History of Sub-Saharan Africa' (*International Socialism*, 2015) < <http://isj.org.uk/africa-rising/#footnote-263-14> > accessed 18 October 2017.

¹⁶ AfDB, 'African Economic Outlook 2017' (AfDB, 2017) < https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/AEO_2017_Report_Full_English_h.pdf > accessed 18 October 2017.

¹⁷ IMF, 'World Economic Outlook: Subdued Demand, Symptoms and Remedies' (IMF, October 2016) < <http://www.imf.org/external/pubs/ft/weo/2016/02/#front> > accessed 18 October 2017; The World Bank, 'The World Bank in Africa' (*The World Bank*, 2017) < <http://www.worldbank.org/en/region/afr/overview> > accessed 18 October 2017.

¹⁸ IMF, 'World Economic Outlook: Subdued Demand, Symptoms and Remedies' (IMF, October 2016) < <http://www.imf.org/external/pubs/ft/weo/2016/02/#front> > accessed 18 October 2017.

¹⁹ Sabrina Alkire, Christoph Jindra, Gisela Robles and Ana Vaz, 'Multidimensional Poverty in Africa' (*OPHI Briefing 40*, 2016) < <http://www.ophi.org.uk/wp-content/uploads/Global-MPI-2016-8-pager.pdf> > accessed 18 October 2017.

²⁰ Ibid.

²¹ IMF, 'IMF DataMapper: GDP Based on PPP, Share of World' (*IMF World Economic Outlook Database*, April 2017) < <http://www.imf.org/external/datamapper/PPPSH@WEO/OEMDC/WEOWORLD/ADVEC/MAE> > accessed 10 October 2017.

²² Ibid.

²³ Benedicte Vibe Christensen, 'Financial Integration in Africa: Implications for Monetary Policy and Financial Stability' [2014] 76 BIS Paper 11, 11; African Development Bank Group, 'Financial Sector Integration in Three Regions of Africa' (*African Development Bank*, 2010) < <https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and->

inclusive financial system, a factor crucial for financial sector development and improved economic performance.²⁴ The effect is that ACs are more likely to suffer from poverty and stunted financial growth.²⁵

The resulting shortcomings from integration deficit is further revealed by examining Africa's banking system. It is characterized by a high interest margin²⁶ usually triggered by low competition in domestic banking, weak property rights and lack of financial infrastructure.²⁷ Additionally, African financial systems only deliver on a limited range of products at high costs. The financial sector reforms in the 80's was however not all bad news. Stirred by improvements in global conditions and the advent of technology, these reforms connected Africa to the rest of the world and led to improved performance in the real and financial sectors.²⁸ Consequently, until recently, Africa's finance and stock markets experienced slow but uninterrupted growth, irrespective of low capitalization and liquidity.²⁹ Surprisingly, the continent proved resilient during the global financial crisis. ACs, particularly the East Africa Community (EAC), have taken to regional financial integration, with blocks of countries establishing a common market, custom union and common currency.³⁰

[Operations/AfDB%20Regional%20Financial%20Integration%20REPORT_EN.pdf](#) > accessed 19 October 2017.

²⁴Lemma W Senbet and Isaac Otchere, African Stock Markets (*IMF*, 2008) < <https://www.imf.org/external/np/seminars/eng/2008/afrfin/pdf/senbet.pdf>> accessed 20 October 2017.

²⁵ Benedicte Vibe Christensen, 'Financial Integration in Africa: Implications for Monetary Policy and Financial Stability' [2014] 76 BIS Paper 11, 20; African Development Bank Group, 'Financial Sector Integration in Three Regions of Africa' (*African Development Bank*, 2010) < [https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-](https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/AfDB%20Regional%20Financial%20Integration%20REPORT_EN.pdf)

[Operations/AfDB%20Regional%20Financial%20Integration%20REPORT_EN.pdf](#) > accessed 19 October 2017; Cyn-Young Park and Rogelio V. Mercado, 'Financial Inclusion, Poverty and Income Inequality in Developing Asia' (2015) ADB Economics Working Paper Series 426, 7 < <https://www.adb.org/sites/default/files/publication/153143/ewp-426.pdf> > accessed 19 November 2017; Ross Levine, 'Finance and Growth: Theory and Evidence' (2004) NBER Working Paper Series 10766, 84 < <http://www.nber.org/papers/w10766.pdf> > accessed 19 November 2017.

²⁶ Benedicte Vibe Christensen, 'Financial Integration in Africa: Implications for Monetary Policy and Financial Stability' [2014] 76 BIS Paper 11, 19.

²⁷ Ibid.

²⁸ Lemma W Senbet and Isaac Otchere, African Stock Markets (*IMF*, 2008) < <https://www.imf.org/external/np/seminars/eng/2008/afrfin/pdf/senbet.pdf>> accessed 20 October 2017

²⁹ Ibid.; Allen Franklin et al, 'The African Financial Development and Financial Inclusion Gaps' [2014] 23 (5) *Journal of African Economies* 614, 621.

³⁰ Christensen Benedicte Vibe, 'Financial Integration in Africa: Implications for Monetary Policy and Financial Stability' [2014] 76 BIS Papers 11, 15

Notwithstanding the laudable performance in terms of regional financial integration, financial markets in Africa are significantly less well-developed than other markets around the world on all indicators of financial development.³¹ Hence, regulators have sought to achieve financial broadening and inclusion through adherence to the Basel III requirements whilst also facilitating improved access to financial products or services.³² However, it is indeed questionable if the level attained by Nigeria or Egypt in terms of financial growth can be replicated in other countries given the diversity of countries within Africa.³³ Other financial markets within Africa are relatively underdeveloped and fragmented, further hindering effective replication.

Notwithstanding the low degree of integration of ACs to the global economy, certain countries pose a risk to the global financial system given the high rate of corruption and financial crimes. Sub-Saharan Africa countries were recently ranked with an average score of 31³⁴, with 0 meaning highly corrupt and 100 meaning clean.³⁵ Country-by-country differences also exist; whilst Botswana and Cape Verde rank as the least corrupt ACs, Somalia, Sudan, South Sudan and Guinea-Bissau rank highest on corrupt standard globally.³⁶ Consequently, there is increased poverty, injustice and stunted development of food security, health facilities, educational services and infrastructure in these countries, and Africa as a whole.³⁷

³¹ Christopher J Green, Colin Kirkpatrick and Victor Murinde, 'Finance for Small Enterprise Growth and Poverty Reduction in Developing Countries' [2006] 18 (7) *Journal of International Development* 1017, 1027.

³² Beck Thorsten and Samuel Munzele Maimbo, (eds.) *Financial Sector Development in Africa: Opportunities and Challenges* (World Bank Publications, 2012) 4.

³³ Christopher J Green, Colin Kirkpatrick and Victor Murinde, 'Finance for Small Enterprise Growth and Poverty Reduction in Developing Countries' [2016] 18 (7) *Journal of International Development* 1017, 1027.

³⁴ This is lower than the global average score of 43. See, Transparency International, 'Corruption Perceptions Index 2016' (*Transparency International*, 25 January 2017) < https://www.transparency.org/whatwedo/publication/corruption_perceptions_index_2016 > accessed 19 October 2017.

³⁵ *Ibid.*

³⁶ *Ibid* (n 34).

³⁷ Mohamed Sultan, 'How Illicit Financial Flows Drain African Economies' (*Open Society Foundations*, 21 April 2014) < <https://www.opensocietyfoundations.org/voices/how-illicit-financial-flows-drain-african-economies> > accessed 20 October 2017; Theophilous Chiviru, 'Panama Papers Reveal Africa Losing Billions to Corruption and Bribery' (*One.org*, 16 August 2016) < <https://www.one.org/international/blog/panama-paper-reveals-africa-losing-billions-to-corruption-and-bribery/> > accessed 19 October 2017.

For the above reason, *The Economist* once referred to Africa as a ‘hopeless continent’ that would continually suffer series of crises until it was able to develop a consciousness to resolving corruption.³⁸ More unflattering is the United Nations Economic Commission for Africa (UNECA) estimates that the continent loses about US\$50 billion annually to illicit dealings, most of which is looted by government officials and business leaders to developed countries.³⁹ This demonstrates the lax structures and culture in Africa that permit and foster laundering. More interestingly, it also illustrates that developed countries provide gateways for illicit transfers in the shape of anonymous offshore companies and investment entities which enable the facilitation of stolen funds overseas.⁴⁰ Such gateways however have catastrophic effects on developed economies, contributing directly or indirectly to the financing of crime or terror.⁴¹

Undoubtedly, a correlation exists between Africa’s historical context and its current socio-economic structures. Examining the relationship between these factors reveals how Africa’s colonial history has catalyzed lack of robust FIs, redundant political will, corruption, financial inequality and lack of education. Although the IFIs/FATF view these as factors that hinder countries attaining full compliance with the FATF recommendations, these factors are somewhat peculiar to ACs and reinforce the need for a suitable framework that allows ACs combat illicit crimes within a structure that has not set it up to fail.

³⁸ The Economist, ‘Hopeless Africa’ (*The Economist*, 11 May 2000) < <http://www.economist.com/node/333429> > accessed 20 October 2017.

³⁹ The Guardian, ‘Africa Losing Billions from Fraud and Tax Avoidance’ (*The Guardian*, 2 February 2015) < <https://www.theguardian.com/global-development/2015/feb/02/africa-tax-avoidance-money-laundering-illicit-financial-flows> > accessed 20 October 2017. Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development, ‘Illicit Financial Flows: Report of the High Level Panel on Illicit Financial Flows from Africa’ (*Track it! Stop It! Get It!*, 2014) < https://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf > accessed 20 October 2017.

⁴⁰ Aljazeera, ‘How to Rob Africa’ (*Aljazeera*, 8 November 2012) < <http://www.aljazeera.com/programmes/peopleandpower/2012/11/2012111714649852604.html> > accessed 19 October 2017; Roberto Saviano, ‘The Real Threat to Britain’s Borders is the Flow of Dirty Money’ (*The Guardian*, 23 June 2016) < <https://www.theguardian.com/commentisfree/2016/jun/23/real-threat-britain-borders-flow-dirty-money-eu> > accessed 20 October 2017.

⁴¹ Peter Reuter (eds), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries* (The World Bank, 2012).

Importantly, given the threat that illicit crimes pose to the global economy and the sustainability of Africa's economic growth, Africa has developed a framework to combat ML/TF.

5.2 Africa's Response to AML/CFT

Responding to international pressures and certain homegrown factors, some ACs have taken reactive steps by formulating, signing and domesticating conventions⁴² via national legislations. Consequently, in 2002, action plans were developed to ensure compliance to ML/TF in Africa.⁴³

The African Peer Review Mechanism (APRM), an initiative of the New Partnership for Africa's Development (NEPAD),⁴⁴ was launched to reinvigorate the African voice in decisions concerning Africa. The APRM recognized the relationship between ML and corruption (ML/C) and put in place a corruption control mechanism aimed at fostering the implementation of banking and financial standards under its thematic area of economic governance.⁴⁵ A brainchild of Africa's experience, the APRM illustrates that poor governance in one country can have far-reaching negative implications on a region or continent.⁴⁶

⁴² In 1999, the Organization of African Unity (OAU, now AU) adopted a Convention on the Prevention and Combating of Terrorism (the Algiers Convention).

⁴³ See Charles Goredema and Anneli Botha, 'Africa's Commitment to Combating Crime and Terrorism: A Review of Eight NEPAD Countries' [2004] 3 African Human Security Initiative 1, 3. In 2004, the AU adopted a protocol to the Algiers Convention, which addressed commitments to implement the Algiers Convention and criminalize the financing of terrorism.

⁴⁴ Similar to the OECD reviews, the APRM entails periodic reviews of policies and practices of participating states to measure progress made towards achieving the mutually agreed goals and compliance with adopted economic goals.

⁴⁵ Anthony Afful-Dadzie, et al, 'Tracking Progress of African Peer Review Mechanism (APRM) Using Fuzzy Comprehensive Evaluation Method' [2014] 43 (8) Kybermetes 1193, 1194.

⁴⁶ Charles Goredema and Anneli Botha, 'Africa's Commitment to Combating Crime and Terrorism: A Review of Eight NEPAD Countries' [2004] 3 African Human Security Initiative 1, 1.

The ML/C objective is assessed against the standards and codes of the United Nations and African Union on ML/C, the FATF recommendations and the International Standards on Auditing.⁴⁷ Participating countries are subject to a 5-stage review process.⁴⁸ The risk-based approach⁴⁹ benchmarks backed by indicators come in form of open questions requiring documentary evidence in certain instances.⁵⁰ Examining the APRM processes shows that it synchronized international and regional standards with the aim of propelling implementation of standards, thus revealing external influence.⁵¹

Nonetheless, the language of the APRM, which lacked precision, and its assessment processes warranted subjective and conflicting interpretations, thus lacking measurability. Also, staff of universities and research institutions are responsible for filling out assessment questionnaires.⁵² Thus, contrary to the objectivity portrayed by the APRM process,⁵³ the resulting Country Review Reports (CRR) are prejudiced. For

⁴⁷ NEPAD Secretariat, 'NEPAD/ HSGIC/03-2003/APRM/Guideline/OSCI, 6th Summit of the NEPAD Heads of State and Government Implementation Committee; Nigeria Objectives, Standards, Criteria and Indicators for the African Peer Review Mechanism' (NEPAD Secretariat, 2003) < http://www.chr.up.ac.za/chr_old/hr_docs/arpm/docs/book5.pdf > accessed 20 July 2015.

⁴⁸ AU and NEPAD, 'Guidelines for Countries to Prepare for and Participate in the African Peer Review Mechanism (APRM)' (African Union and NEPAD, 2003) < <http://www1.uneca.org/Portals/nepad/Documents/Guidelines-for-Countries-to-APRM.pdf> > accessed 10 March 2015; Ukertor G.M. and Gabriel A.G, 'African Peer Review Mechanism: Nigeria's Democracy and Good Governance' [2009] 7 (1) Journal of Research National Development; Ross Herbert and Steven Gruz, 'Taking Stock of the African Peer Review Mechanism' [2007] 14 (1) South Africa Journal of International Affairs 5, 5; Kanbur Ravi, 'The African Peer Review Mechanism (APRM): An Assessment of Concept and Design' [2004] 31 (4) Politikno 1, 3.

⁴⁹ It recognizes that participating countries are at different levels of development and thus each country's assessment and the assistance granted is tailored to its developmental level. APRM Base Document, Paragraph 17 in Guidelines for Countries to Prepare for and to Participate in the African Peer Review Mechanism (APRM).

⁵⁰ Kanbur Ravi, 'The African Peer Review Mechanism (APRM): An Assessment of Concept and Design' [2004] 31 (4) Politikno 1, 3.

⁵¹ African Union and African Peer Review Mechanism, 'Revised Country Self-Assessment Questionnaire for the African Peer Review Mechanism' (African Union and African Peer Review Mechanism) < http://aprm-au.org/admin/pdfFiles/aprm_questionnaire.pdf > accessed 10 July 2017.

⁵² The APRM requires that its questionnaires be filled by a cross-section of the society, thus involving government bodies, civil societies, etc.; Anthony Afful-Dadzie, *et al.*, 'Tracking Progress of African Peer Review Mechanism (APRM) Using Fuzzy Comprehensive Evaluation Method' [2014] 43 (8) Kybermetes 1193, 1169.

⁵³ The requirement that questionnaires be filled by a cross-section of the society.

instance, the cases of Burkina Faso⁵⁴ and Nigeria⁵⁵ illustrate characteristic differences. Whilst both countries had evident ML/TF threats given their porous borders and cash-based economy, the 2008 CRRs, assuming that ML/TF were alien to ACs, reported that ML did not seem to be a concern for both countries; TF was also unmentioned in the reports.⁵⁶ Nigeria however interpreted the standards differently and took action to combat ML/C by legislating and putting legal structures in place to ensure enforcement.⁵⁷ Consequently, Nigeria introduced laws on TF and fortified its regulatory policies. Subsequently, Burkina Faso also promulgated laws on ML.⁵⁸ Whether the legislative progress was due to the APRM cannot be ascertained, particularly given the initial flippant attitude by Burkina Faso and the fact that Nigeria wanted to leave the FATF's blacklist.⁵⁹

Furthermore, it is indeed disputed whether the independent panel or heads of states were able to call Burkina Faso to order during its non-compliance period resulting from the misrepresented CRR. The APRM was a voluntary consensus-oriented mechanism.⁶⁰ Unlike the FATF or the IMF/WB, the APRM does not issue sanctions or impose conditionalities through aid. It does not blacklist or threaten suspension⁶¹ when countries fail to meet the required benchmark on AML/CFT. The APRM mechanism presumes that voluntary participation entrenches sovereignty and indicates political

⁵⁴ APRM, 'Country Review Report of Burkina Faso: Country Review Report No 9' (*African Peer Review Mechanism*, May 2008) < <http://www1.uneca.org/Portals/aprm/Documents/CountryReports/BurkinaFaso.pdf> > accessed 10 July 2016.

⁵⁵ APRM, 'Country Review Report of Nigeria: Country Review Report No 8' (*African Peer Review Mechanism*, June 2008) < <http://www1.uneca.org/Portals/aprm/Documents/CountryReports/Nigeria.pdf> > accessed 10 July 2016.

⁵⁶ APRM, 'Country Review Report of Burkina Faso: Country Review Report No 9' (*African Peer Review Mechanism*, May 2008) < <http://www1.uneca.org/Portals/aprm/Documents/CountryReports/BurkinaFaso.pdf> > accessed 10 July 2016.; APRM, 'Country Review Report of Nigeria: Country Review Report No 8' (*African Peer Review Mechanism*, June 2008) < <http://www1.uneca.org/Portals/aprm/Documents/CountryReports/Nigeria.pdf> > accessed 10 July 2016.

⁵⁷ Agu Bertram Onyebuchi, Simon Nwankwo and Onwuka Ifeanyi Onuka, 'Combating Money Laundering and Terrorist Financing – The Nigerian Experience' [2016] 4 (1) *International Journal of Business and Law Research* 29, 35.

⁵⁸ Law No. 026 – 2006/ AN of 28 November 2006 (AML Act)

⁵⁹ Patrick Bond, 'Removing Neo-colonialism's APRM Mask: A Critique of the African Peer Review Mechanism' [2009] 36 (122) *Review of African Political Economy* 595, 602.

⁶⁰ Rachel Mukamunana and J.O Kuye, 'Revisiting the African Peer Review Mechanism: The Case for Leadership and Good Governance in Africa' [2005] 3 (40) *Journal of Public Administration* 590, 596.

⁶¹ See Ross Herbert and Steven Gruzd, 'Taking Stock of the African Peer Review Mechanism' [2007] 41 (1) *South African Journal of International Affairs* 1, 8.

will and would thus facilitate good governance, peace and security.⁶² In practice, lack of compulsion may occasion difficulties in accession and compliance.⁶³ This demonstrates why eighteen (18) ACs have refused to subject themselves to the APRM evaluations⁶⁴ and, more fundamentally, erring countries have the opportunity to withdraw.⁶⁵ Contrary to expectations, the non-enforcement approach of the APRM is likely to reinforce non-compliance and thus fail to incentivize political will. This informs why Hammed and Kobo advocate for sanctions,⁶⁶ emphasizing the imperative need for an indigenous mechanism to ensure compliance.⁶⁷ Without an appropriate monitoring and evaluation structure to ensure data analysis, the APRM will remain a cosmetic exercise without effect in the real world of policy and decision-making.⁶⁸

The APRM is further critiqued on the ground that its review process is a measure to assure international creditors of Africa's determination to repudiate intolerable practices.⁶⁹ It therefore appears as a donor imposed plan, repackaged under an alleged African ownership.⁷⁰ This argument indicates that sovereignty is not necessarily

⁶² Hanafi A Hammed, Sarinus E Kabo, 'African Peer Review Mechanism and Crisis of Good Governance in Africa' [2013] 19 *Journal of Law, Policy and Globalization* 1, 25.

⁶³ Jackie Cilliers, 'Peace and Security through Good Governance? A Guide to the NEPAD African Peer Review Mechanism' [2003] 70 *Pretoria: Institute for Security Studies* 1, 14; Ross Herbert, 'Becoming my Brother's Keeper' [2003] 1. *E-Africa: Electronic Journal of Governance and Innovation* 7, 9.

⁶⁴ AfricLaw, *The African Peer Review Mechanism at Ten: From Lofty Goals to Practical Implementation* (2013) < <http://africlaw.com/2013/03/19/the-african-peer-review-mechanism-at-ten-from-lofty-goals-to-practical-implementation/> > accessed 14 May 2015.

⁶⁵ Rachel Mukamunana and J.O Kuye, 'Revisiting the African Peer Review Mechanism: The Case for Leadership and Good Governance in Africa' [2005] 3 (40) *Journal of Public Administration* 590, 596.

⁶⁶ Hanafi A Hammed, Sarinus E Kabo, 'African Peer Review Mechanism and Crisis of Good Governance in Africa' [2013] 19 *Journal of Law, Policy and Globalization* 1, 25.

⁶⁷ Kanbur Ravi, *The African Peer Review Mechanism (APRM): An Assessment of Concept and Design* [2004] 31 (2) *Politikon* 1, 2.

⁶⁸ Karen Odhiambo, 'Evaluation Capacity Development in Kenya' (Paper Presented at the Workshop Organized by the Development Bank of Southern Africa, the African Development Bank and the World Bank, Johannesburg 2000); Appiah Koranteng, 'Evaluation Capacity in Ghana' (Workshop by the Development Bank of Southern Africa, the African Development Bank and the World Bank, Johannesburg 2000).

⁶⁹ Sommet Kananaskis Summit Canada, 'G8 Africa Action Plan' (Sommet Kananaskis Summit, 2002) < <http://www.owen.org/wp-content/uploads/G8-AAA.pdf> > accessed 11 April 2015; G8 countries, through the Africa Action Plan (AAP), have promised *enhanced partnerships* if ACs can hold themselves to the principles of democratic and economic reform and social investment, through the self-monitoring instrument of the APRM. Paragraph 7 of the AAP is very informative: "The peer review process will inform our considerations of eligibility for enhanced partnerships."

⁷⁰ Patrick Bond, 'Removing Neo-colonialism's APRM Mask: A Critique of the African Peer Review Mechanism' [2009] 36 (122) *Review of African Political Economy* 595, 600; Adejoke Babington-Ashaye, 'The African Peer Review Mechanism at Ten: From Lofty Goals to Practical Implementation' (*AfricLaw*, 19 March 2013) <<http://africlaw.com/2013/03/19/the-african-peer-review-mechanism-at-ten-from-lofty-goals-to-practical-implementation/>> accessed 10 May 2016.

preserved, as supposed ‘African’ decisions are subject to external influence. This is further reflected given that the engineering of NEPAD by ACs was supported by the G8.⁷¹ It is however realized that Africa cannot combat ML/TF in isolation. Thus in 2002, the APRM’s steering committee proposed an action plan aimed at adopting and strengthening AML/CFT laws and promoting compliance with international AML/CFT standards.⁷² Further to this, the APRM forum approved the African Development Bank (AfDB) as one of the categories of partners to support the peer review process.⁷³ The AfDB comes with a form of compulsion given that its Articles of Association entrust it with fiduciary responsibility to ensure that the proceeds of any loan it makes or guarantees are used only for the purpose of the loan.⁷⁴ The aim is to prevent fraudulent transactions that may disguise the origins of proceeds of crimes/profits from corruption and use of the banks.⁷⁵ Additionally, the AfDB has assisted in ensuring that laws and strategies are in compliance with international standards and norms.⁷⁶ It has also intervened to guarantee that FIUs work together, thus promoting a unified approach to combatting AML/CFT.⁷⁷

Notwithstanding its shortcomings, the APRM has been lauded for appreciating the historical contexts and developmental stages of ACs. Upon this premise, it has stated that all countries are not expected to reach their highest level of performance simultaneously. This has however not encouraged countries to ratify and implement its processes. For instance, although the AU AML convention was adopted in 2003, at the

⁷¹ Sommet Kananaskis Summit Canada, ‘G8 Africa Action Plan’ (Sommet Kananaskis Summit, 2002) < <http://www.owen.org/wp-content/uploads/G8-AAA.pdf> > accessed 11 April 2015.

⁷² Charles Goredema and Anneli Botha, ‘African Commitments to Combating Terrorism: A Review of Eight NEPAD Countries’ [2004] AHSI Paper 3. Pretoria: African Human Initiative 1, 9.

⁷³ NEPAD Secretariat, ‘African Peer Review Mechanism Organization and Process’ (*NEPAD Secretariat*, 2003) < <http://www1.uneca.org/Portals/aprm/Documents/book4.pdf> > accessed 10 May 2016. Also approved were the Organs/Units of the AU, the United Nations Economic Commission for Africa (UNECA) and the UN Development Program Regional Bureau for Africa.

⁷⁴ AfDB/African Development Fund, ‘Bank Group Strategy for the Prevention of Money Laundering and Terrorist Financing in Africa’ (African Development Bank/African Development Fund, May 2007) < https://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/10000012-EN-STRATEGY-FOR-THE-PREVENTION-OF-MONEY-LAUNDERING_01.pdf > accessed 10 May 2015.

⁷⁵ *Ibid.*

⁷⁶ *Ibid* (n 74).

⁷⁷ *Ibid.*

same time as the UN convention,⁷⁸ evidence has shown that the AU convention has been ratified by fewer states, illustrating no respect for the AU's likely reactions.⁷⁹

Hence, FSRBs, headed and run by African nationals (with international organizations as observers), have been perceived as more promising for curbing regional and continental ML. It is assumed that the African nationals are well versed in local issues, thus giving regions leeway in deciding their risk-based approach (RBA) in line with their peculiarities. For instance, the Central Bank of Nigeria and Kenyan regulators are supervising the niche created by mobile banking within the context of a more relaxed CDD.⁸⁰ So far other regions in Africa have set up their regional bodies. These regional efforts signify Africa's willingness to comply, but compliance levels have been far from impressive.

5.3 Compliance by African States

IFIs have argued that despite the internal factors that propel compliance to international standards, ACs are subject to the same standards as other countries. The logic is that the AML/CFT regime is only as strong as the weakest link in the chain. Given the borderless nature of ML/TF crimes, astute criminals would reroute their finances to countries with weaker regimes.⁸¹ Consequently, failure to meet the compliance levels

⁷⁸Humphrey P.B Moshi, 'Fighting Money Laundering: The Challenges in Africa' [2007] 152 Institute for Security Studies Papers 1, 10-12.

⁷⁹ In November 2005, at the first Pan-African meeting of national anti-corrupt bodies in Lusaka, it was recommended that AU member states be given assistance in identifying the areas of convergence and divergence between the multilateral anticorruption instruments so as to facilitate their implementation at national level.

⁸⁰ Central Bank of Nigeria, 'Regulatory Framework for Mobile Payments Services in Nigeria' (*Central Bank of Nigeria*) <<http://www.cenbank.org/OUT/CIRCULARS/BOD/2009/REGULATORY%20FRAMEWORK%20FOR%20MOBILE%20PAYMENTS%20SERVICES%20IN%20NIGERIA.PDF>> accessed 21 December 2014; CGPA, 'Update on Regulation of Branchless Banking in Kenya' (CGAP, January 2010) < <https://www.cgap.org/sites/default/files/CGAP-Regulation-of-Branchless-Banking-in-Kenya-Jan-2010.pdf> > accessed 21 December 2014.

⁸¹ However, this is not always the case as criminals know that even if they move it to such states the odds might not favor them, it is not a veritable land for investment as opposed to countries like England where their investment returns would be higher. Jason C Sharman, 'Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developing States' [2008] 52.3 International Studies Quarterly

required in acceding to those standards would warrant financial isolation and reputational damage. This hard stance does not take into consideration the historical or socio-economic peculiarities of ACs that hinder compliance. By using the same benchmarking structure for every country, it can be argued that ACs are simply set up to fail, a catalyst for unmerited sanctions.

Scholars have increasingly sought to understand the reason for varying compliance levels across ACs.⁸² Flowing from the pre-conditions for effective regulations and the compliance drivers discussed in this thesis, this chapter argues that ACs are inundated by legal and non-legal factors which affect compliance to international instruments. These factors may be subject to a balancing act between internal and external drivers which determine the degree of compliance.⁸³ However, whilst external drivers may propel formal or creative compliance due to the implementation resistance, internal drivers may propel proactive compliance if properly guided. EENA1 argues that this is not always correct, given that ‘change from within is often impossible, sometimes because of vested interest and – often time – it’s because of habit...[and] it is difficult to change habit.’⁸⁴ This indicates the need for a balancing act between internal and external drivers for compliance, given that where external drivers push for compliance

635, 641; Peter Romaniuk, ‘Institutions as Swords and Shields: Multilateral Counter-terrorism Since 9/11’ [2010] 36 *Review of International Studies* 591, 596; Humphrey P.B Moshi, ‘Fighting Money Laundering: The Challenges in Africa’ [2007] 152 *Institute for Security Studies Papers* 1, 10-12. Probably due to institutionalized corruption, ACs refused to recognize the damaging effects of increased laundering on their economy. This is more the case with ML than with TF. See Abayomi Mumuni, *Global Terrorism and Its Effects on Humanity* (Wsgf Pty Limited, 2016); Amado Philip de Andre, ‘Organized Crime, Drug Trafficking, Terrorism: The New Achilles’ Heel of West Africa’ (*Fride*, 2008) <http://fride.org/descarga/COM_Achilles_heel_eng_may08.pdf> accessed 10 July 2016.

⁸² Beth Simmons, ‘International Law and State Behavior: Commitment and Compliance in International Monetary Affairs’ [2000] 94 (4) *American Political Science Review* 819, 819; Harold Hongju Koh, ‘Review: Why Do Nations Obey International Law?’ [1997] 106 (8) *The Yale Law Journal* 2598, 2645-2659; Andrew T Guzman, ‘A Compliance Based Theory of International Law’ [2002] 90 (6) *California Law Review* 1823 – 1887; Benedict Kingsbury, ‘The Concept of Compliance as a Function of Competing Conceptions of International Law’ [1998] 19 *Mich. J. International Law* 345, 346; Oran R Young, *Compliance with Public Authority* (Baltimore: John Hopkins University Press, 1979); Ronald B Mitchell, ‘Regime Design Matters: International Oil Pollution and Treaty Compliance,’ [1994] 48 (3) *International Organizations* 425-458.

⁸³ Beth Elise Whitaker, ‘Compliance among Weak States: Africa and the Counter Terrorism Regime’ [2010] 36 *Review of International Studies* 639, 644.

⁸⁴ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

in a manner that does not encapsulate the peculiarities of ACs, it may occasion a regulatory paradox – where standards adopted are counterproductive.

5.3.1 Compliance as a Function of Legal Factors

As a function of legal factors, however debatable, compliance is chiefly influenced by three factors:

1. Law reflecting society;
2. Enforcement driven compliance; and
3. Compliance engineered by democracy and rule of law.

Evaluating these factors in turn illustrates how a robust regulatory environment backed by sturdy legal factors are crucial determinants for effective compliance. Where, however, these factors are not effectively ingrained within a country, they hinder the degree of compliance to AML/CFT recommendations that that country can attain notwithstanding external factors.

5.3.1.1 Law: Mirroring Society to Combat ML/TF

As discussed, the indigenous attempt by ACs to curtail ML/TF proved unsuitable and recorded limited success. It was modelled on the existing international standards alongside the perception that illicit crimes, particularly terror funding was alien to the ACs. Hence, ACs did not proactively legislate or implement frameworks to combat these crimes.⁸⁵ This lackadaisical attitude, which reflects law as ‘mirroring society,’

⁸⁵ GIABA, ‘Overview of GIABA Operations from 2004 to 2013’ (*Giaba*, 2014) < https://www.giaba.org/media/f/693_599_GIABA-Overview-2004-2013-English.pdf > accessed 10 July 2016.

was further aided by the voluntary consensus decision making process which lacked sanctions to call countries to order.

Yet, there remained an urgency to curtail these illicit crimes, which worsened with the liberalization of markets. Consequently, ACs paid more attention to the vast range of general and specialized international institutions established to ensure that every country transplanted and implemented the FATF recommendations via legislation.⁸⁶ This shift in attention focused on the ‘transplantation of laws’ was not voluntary or through rational responses to material incentives. Rather, it can be attributable to external pressure to fulfil obligations under international agreements.⁸⁷ Sharman attributes the willingness of states to transplant laws to the diffusion of policies.⁸⁸ He argues that the diffusion of the AML/CFT regime amongst ‘weak states’ is driven by discursive power-based mechanism, a combination of direct coercion, mimicry and competition.⁸⁹ Whilst direct coercion works to ensure legislation and implementation through sanctions, mimicry is focused on the transplantation of standards to law within states. The fact that mimicry backed by coercion can elicit compliance in ACs gives credence to how compliance may be influenced by powerful states through international institutions and not the growing indices of ML/TF in the African terrain.

The extent to which this external influence served as a catalyst for proactive compliance is questionable. Mainly because, although the international regulatory standards proved largely workable in developed jurisdictions, they have proved unsuitable and ineffective in stimulating proactive compliance in various ACs. This compliance deficiency is further perpetuated by the weak legal and institutional structures,

⁸⁶ Wechsler, William F, ‘Follow the Money’ (*Foreign Affairs*, 2001) <<https://www.foreignaffairs.com/articles/2001-07-01/follow-money>> accessed 10 May 2015.

⁸⁷ Only few ACs legislated on AML/CFT prior to the FATF recommendations. See the Ethiopian Anti-Terrorism Law of 1954; The Penal Code No 85 of the Arab Republic of Egypt 1937 which contains AML/CFT provisions in Article 86 – 102.

⁸⁸ Jason C Sharman, ‘Power and Policy Diffusion: Anti-Money Laundering in Developing States’ [2008] 52 (3) *International Studies Quarterly* 635, 636.

⁸⁹ *Ibid.*; This is in line with Daniel W. Drezner’s, *All Politics is Global: Explaining International Regulatory Regime* (Princeton: Princeton University Press, 2007) 5, 75.

embedded in a culture of pervasive corruption. These challenges beg the question, to what extent can laws be transplanted in a way that stimulates compliance?

Legal comparativists have engaged in a discourse on the practicality of transplantation. Watson strongly argues that the idea that law mirrors society is a fallacy, as change in the law is divorced from the workings of any historical, socio-economic or cultural substratum – but is rather a function of rules imported from another legal system.⁹⁰ Consequently, he argues that legal transplantation is not only practical but easy. Differences within jurisdictions do not limit the transferability of laws.⁹¹ It is against this backdrop that Sharman postulates that developing or perceived ‘weak countries’ mimic laws and implementation strategies of developed countries. This perspective sees laws or rules as culture neutral and assumes that they can be transported across countries. Consequently, Sharman argues that developing countries adopt laws and implementation strategies for two distinct but interrelated reasons: to replicate recorded successes of pioneering countries and as a mere symbolic exercise to avoid a penalty or receive associated benefits.⁹² The results of these are seen in marginally improved compliance ratings granted to countries that have replicated laws which were not modified to fit into a country’s local context by a comprehensive risk assessment.⁹³

Legrand however disputes Watson’s perspective. He argues that rules are more than a series of inscribed words, but rather, are contextual.⁹⁴ Hence, words cannot be divorced from their historical, socio-economic, cultural or ideological underpinnings. Therefore, when rules are technically integrated into a different legal order, the host jurisdiction will understand it differently because of cultural differences and distance between the

⁹⁰ Alan Watson, *Legal Transplants: An Approach to Comparative Law* (Scottish Academic Press, 1974).

⁹¹ *Ibid.*

⁹² Jason C Sharman, ‘Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developing States’ [2008] 52 (3) *International Studies Quarterly* 635, 647. It helps to reassure policy makers that they are in sync with shared value. It is a mere symbolic exercise driven by the fear of losing social acceptance. Organizations shape their policies through the desire of national regulators not to be seen as backward, substandard or derelict in their duties. See Anne-Marie Slaughter, *A New World Order* (Princeton University Press 2004) 6.

⁹³ See the FATF Country reports, countries that have adopted legislations have better compliance ratings than countries that have not.

⁹⁴ Pierre Legrand, ‘The Impossibility of “Legal Transplants”’ [1997] 4 *Maastricht J. Eur. & Comp.L* 111, 115.

originator and host jurisdiction. Thus, the interpretation of a rule within a different context would at best be subjective, given the insensitivity of the originator to the cultural dissimilarities of the host jurisdiction.⁹⁵ Consequently, the crucial element of the meaning of the rule does not in fact survive the journey from one legal system to another. Therefore, as the understanding of the rule changes, so does the meaning.⁹⁶ Against this background, Legrand argues that legal transplantation does not take place.⁹⁷

The AfDB supports this position, arguing that locally researched policies are better suited to ensure sustainable development for Africa than the transplantation of international laws or standards.⁹⁸ Spataru-Neguru further contends that there is evidential proof that transplanted laws usually cannot achieve the same results or fulfill the same aims.⁹⁹ This argument assumes that results caused by laws are limited to a specific time and place. Sharman buttresses this with evidence that the effectiveness of AML policies in developing countries have remained marginal, whether categorized as successful in disrupting criminal finance and illegal activities, or in terms of greater benefit for the society which overrides the cost of regulation itself.¹⁰⁰ Thus, although transplantation leads to improved compliance ratings, the proactive compliance levels are neither unusually high nor low, illustrating that states are merely concerned with achieving minimum acceptable standards.¹⁰¹

⁹⁵ Ibid (n 94) 111, 117.

⁹⁶ Ibid 111, 114.

⁹⁷ Ibid 111, 118.

⁹⁸ AfDB, 'Africa Must Develop Relevant Knowledge for Its Problems' 2014 <<http://www.afdb.org/en/news-and-events/article/africa-must-develop-relevant-knowledge-for-its-problems-13692/>> accessed 16 April 2015. Contrary to what is assumed, transplantation is a healthy sign that a country is actively looking for solutions and options, rather than waiting for the host country to impose conditions, which do not fit their needs; see María Paula Reyes Gaitán, 'The Challenges of Legal Transplants in a Globalized Context: A Case Study on 'Working' Examples' (2014) Dissertation, University of Warwick.

⁹⁹ It is further evidenced by the fact that apart from the United States, the AML/CFT regime has not proved effective or cost effective in other developing countries that participated in building the regime

¹⁰⁰ A majority of OECD countries routinely carry out or even legally mandate the use of Regulatory Impact Assessments or Regulatory Impact Statements (OECD) 2007. The OECD has advanced the latter approach as the most revered international practice in assessing regulation.

¹⁰¹ This argument is supported by the relatively low conviction or confiscation rates in OECD countries; see Mariano-Florentino Cueller, 'The Tenuous Relationship Between the Fight Against Money Laundering and the Disruption of Criminal Finance' [2003] 93.2 Journal of Criminal Law and Criminology 311, 465. In sub-Saharan ACs where there is large reliance on cash transfers and threshold for the transfer of money is set too high that it goes unnoticed; see Jake Kendall and Jan Sonnenschein,

However, other scholars have argued that treaties and conventions can be easily transplanted, since they are rooted in negotiations amongst countries reflecting general interests. They argue that given the convergence of countries to address AML/CFT, such laws cannot be designed in isolation. Barak-Erez contends that legislations on AML are not necessarily ‘mimicked’ as it is expected that the international model or conventions can lead to similar laws in host countries.¹⁰² These arguments fail to take into consideration the composition of international AML/CFT standard setting bodies, which excludes ACs and thus suffers from democratic deficit. According to Legrand, this restricts host states (which in this case are ACs) from realizing the originators’ vision of their world.¹⁰³ This deficit hinders the originator’s ability to decipher how its circumstances differ from the host states. Instead of organising diversity of discourse around varying cultural forms, what is noticed is a crowding towards uniformisation.¹⁰⁴ It can be argued that a more democratic standard setting body would ensure an inclusive strategy that takes into consideration the perspective of less developed states, making ACs more inclined to comply proactively.

Berliner asserts that transplantations along regional lines are more effective.¹⁰⁵ Whilst this might be true, it constitutes a facilitating condition rather than a causal mechanism. The AU model illustrated a lack of indigenous enthusiasm in combatting ML/TF. Nonetheless, the establishment of the FSRBs has, even if in a limited way, created the context to ensure that transplanted laws work effectively.

‘Many Transactions in Sub-Saharan Africa Still in Cash’ (*Gallup*, June 11 2012) <<http://www.gallup.com/poll/155126/transactions-sub-saharan-africa-cash.aspx>> accessed 28 April 2015.

¹⁰² Daphne Barak-Erez, ‘The International Aspects of Comparative Law’ [2008] 13 *Colum. J. Eur. L.* 477, 484.

¹⁰³ Pierre Legrand, ‘The Impossibility of “Legal Transplants”’ [1997] 4 *Maastricht J. Eur. & Comp. L.* 111, 114.

¹⁰⁴ *Ibid* 111, 118.

¹⁰⁵ Berliner Daniel, ‘Follow Your Neighbor? Regional Emulation and the Design of Transparency Policies’ (2013) KFG Working Paper 55, 17 < http://userpage.fu-berlin.de/kfgeu/kfgwp/wpseries/WorkingPaperKFG_55.pdf > accessed 10 May 2016; Daniel Berowitz, Katharina Pistor and Jean-Francois Richard, ‘Economic Development, Legality and the Transplant Effect’ [2003] 41(1) *European Economic Review* 165, 167; Beth A Simmons and Zachary Elkins, ‘The Globalisation of Liberalisation: Policy Diffusion in the International Political Economy’ [2004] 98 (1) *American Political Science Review* 171, 187.

5.3.1.2 Enforcement Driven Compliance

In the absence of an adjudicatory structure, the FATF ‘list’ non-compliant/high risk countries publicly. This soft law sanctioning strategy is aimed at ensuring observance to prescribed standards.¹⁰⁶ Resolving or circumventing this ‘stick’ which occasions attendant reputational damages and financial isolation warrants some measure of compliance.¹⁰⁷ Nigeria recorded history as the first West African country to fall into the category of non-compliant countries.¹⁰⁸ Nigeria was blacklisted following the FATF’s realization that it was unwilling to legislate on, or implement the AML/CFT legislation.¹⁰⁹ Furthermore, at the national level, the FATF noticed that prosecutions against persons or sanctions against banks for failing to carry out their duties as scripted by the FATF were rare.¹¹⁰ The lackadaisical nature and willingness to hide information were also demonstrated by the reluctance of Nigerian officials to cooperate with the FATF evaluation team during their fact-finding mission. Egypt was also blacklisted on similar grounds.¹¹¹

To avoid the harsh repercussions associated with this sanction, these countries aligned with the request of the AML/CFT regime by legislating and subsequently

¹⁰⁶ Tam Christian, ‘Enforcement’ in Ulfsein G, Marauhn T and Zimmermann (eds). *Making Treaties Work* (Cambridge University Press, 2007) 391 – 410.

¹⁰⁷ Chr. Michelsen Institute, ‘Profiting from Corruption: The Role and Responsibility of Financial Institutions’ [2009] 31 U4 Brief; Jason C Sharman, ‘The Bark Is the Bite: International Organizations and Blacklisting’ [2009] Review of International Political Economy 1, 15; Dieter Kerwer and Rainer Hulsse, ‘Explaining International Organizations: How International Organizations Rule the World: The Case of the Financial Action Task Force on Money Laundering’ [2011] UN Studies Association, Berlin 61; Rainer Hulsse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 (4) Regulation and Governance 459, 465. ‘Blacklisting’ now known as the ‘*call on members to apply counter-measures list*’ or the ‘*call for enhanced due diligence risk proportionate to the risk arising from defaulting countries.*’ However, the implication remains the same.

¹⁰⁸ Rainer Hulsse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 (4) Regulation and Governance 459.

¹⁰⁹ Jubril Olabode Aka, *Blacks Greatest Homeland* (IUniverse, 2006) 210; Jubril Olabode Aka, *Great Presidents of Nigeria 4th Republic* (Trafford Publishing 2012) 276.

¹¹⁰ GIABA, ‘Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism: Nigeria’ (*Inter-Governmental Action Group against Money Laundering in West Africa*, 2008) 95 < https://www.giaba.org/media/f/299_Mutual%20Evaluation%20Report%20of%20Nigeria.pdf > accessed 9 April 2015.

¹¹¹ Jeanne Giraldo and Harold Trinkunas, *Terrorist Financing and State Responses: A Comparative Perspective* (Stanford University Press, 2007).

institutionalizing structures to combat illicit crimes.¹¹² Training was also provided to improve the capability of judges to bring cases to an equitable end. Subsequently, these countries were delisted. However, although blacklisting has been able to secure formal compliance, its ability to secure proactive compliance has been questioned.¹¹³ This indicates that although countries may comply with the ‘black letter’ laws, they might remain deficient in reality. This is the case with most ACs that remain largely deficient despite their expected compliance. (*See Figure 1**) Put simply, external pressure on a country with weak enforcement institutions does not translate to robust AML/CFT regulation, implementation and compliance.

Moreover, countries that are unconcerned with the adverse effect of blacklisting may remain uncooperative and thus non-compliant. This is evident in the response of certain ACs that remained on the NCCTs list without taking the requisite steps to correct the situation.¹¹⁴ Conversely, there is evidence that the sanction system itself is fallible, as international institutions do not discontinue aid transfers to failing countries.¹¹⁵ Neither do FIs cease transactions with erring countries.¹¹⁶ For this reasons, arguments have been advanced in favor of non-coercive means of compliance.

Non-coercive compliance measures are usually induced through instruments of active management, such as monitoring or review.¹¹⁷ These oversight measures are instituted

¹¹² Mail & Guardian, Africa’s Best Read, ‘Nigeria A Risky Prospect for South African Banks’ (*Mail & Guardian*, 31 August 2005) <<http://mg.co.za/article/2005-08-31-nigeria-a-risky-prospect-for-sa-banks>> accessed 12 March 2015. This aligns with the functionalist argument that states comply with out of reputational concerns, see Robert O Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton University Press 1984); Jason C Sharman, ‘The Bark is the Bite: International Organizations and Blacklisting’ [2009] 16 (4) *Review of International Political Economy* 1, 3.

¹¹³ Rainer Hulsse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 (4) *Regulation and Governance* 459, 467.

¹¹⁴ This may however be more structural than deliberate given that internal institutions may be unable to support their activities.

¹¹⁵ This applies to Pakistan which although by 14 February 2018 was regarded as a country with serious deficiencies in formulating an AML/CFT action plan, has remained a perpetual recipient of foreign aids, so also Ghana.

¹¹⁶ For instance, see Ralph Orlowski, ‘Commerzbank Fined \$1.5bn for Doing Business With Sanctioned Iran and Sudan’ (*RT*, 13 March 2015) < <http://rt.com/business/240353-commerzbank-billion-fine-sanctions/>> accessed 14 May 2015.

¹¹⁷ Abram Chayes and Antonia Handler Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Harvard University Press, 1995).

through the FATF's MER which entails the gathering and review of information on the compliance levels of all countries.¹¹⁸ Information derived from such exercises usually form the basis for further interactions with countries and inform decisions on sanctions. This indicates that active management and enforcement sanctions are interrelated and cannot be divorced. For instance, prior to the blacklisting of Nigeria – the FATF pushed for active management to comply. However, this was hindered by bureaucracy in Nigeria and lack of political will, which culminated in the FATF sanctioning Nigeria. This sanction propelled Nigeria to become subservient to the instruments of active management. This works vice versa: countries may be unresponsive to the threat of sanction in the absence of some measure of persuasiveness.

Collectively, the enforcement and management models are sometimes largely dependent on the degree to which rule of law is entrenched in a country, as well as the operationalization of democracy. A country without these factors may undermine the effectivity of the AML/CFT compliance regime.

5.3.1.3 Compliance Engineered by Democracy and Rule of Law

The rule of law is the notion that powers of state and government can only be exercised legitimately if such actions are in accordance with applicable laws and laid down procedures.¹¹⁹ This connotes that government officials and citizens are bound to act consistently with the law.¹²⁰ It can then be argued that the rule of law is not just a prerequisite for democracy and democratic practice, it also protects democracy.¹²¹

¹¹⁸ FATF, 'Mutual Evaluations' (FATF) < [http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 5 January 2017.

¹¹⁹ Peter Shivute, 'The Rule of Law in Sub-Saharan Africa – An Overview' [2009] Human Rights and the Rule of Law in Namibia 213, 213.

¹²⁰ Francis Fukuyama, 'Why is Democracy Performing So Poorly' [2015] 26 (1) Journal of Democracy 11, 18; Brian Tamanaha, *On the Rule of Law: History, Politics Theory* (Cambridge University Press, 2004).

¹²¹ Francis Fukuyama, 'Why is Democracy Performing So Poorly' [2015] 26 (1) Journal of Democracy 11, 18.

Against this backdrop, Simons argues that governments with respect for the rule of law and stable democracy are unlikely to harm their reputation by breaching commitments to standards.¹²² These arguments strongly establish a link between the rule of law and democracy. These factors are crucial in determining the degree of compliance with the AML/CFT recommendations through the enhancement of institutional and government staff capacity.

Hence, it is unsurprising that the presence of domestic and democratic political institutions have been identified as key internal factors that influence government's compliance with international instruments.¹²³ This is backed by studies which suggest that undemocratic governments are less likely to comply than liberal democratic governments.¹²⁴ The reasons for this include the democratic government's respect for the legal process, human rights, electoral processes or the presence of domestic interest groups.¹²⁵ Domestic interest groups, including civil societies and democratic political constituencies, are usually constrained within undemocratic governments and can pressurize democratic governments to comply. The limitations of governmental institutions and civil groups in ensuring compliance by ACs can be gleaned from the 2016 Democracy Index which demonstrates that no AC has attained full democracy.¹²⁶ Rather, most ACs fall within the purview of hybrid or authoritarian democracy.¹²⁷ Whilst the former refers to countries with weak rule of law, civil society and judiciary, the latter refers to states where political pluralism is absent or highly circumscribed, with no free or fair elections, and government-controlled media.¹²⁸

¹²² Beth Simmons, 'Compliance with International Agreements' [1998] *Annual Rev. Polit. Sci.* 1, 13; Anne-Marie Slaughter, 'International Law in a World of Liberal States,' [1995] *EJIL* 503, 511.

¹²³ Helen Milner, *Interest, Institutions and Information: Domestic Politics and International Relations* (Princeton University Press, 1997).

¹²⁴ Beth Simmons, 'Compliance with International Agreements' [1998] *Annual Rev. Polit. Sci.* 1, 13; Anne-Marie Slaughter, 'International Law in a World of Liberal States,' [1995] *EJIL* 503, 511.

¹²⁵ Andrew T Guzman, 'International Law: A Compliance Based Theory of International Law' [2002] 90 (6) *California Law Review* 1823, 1886. This is not always the case, given the recent rise in use of social network, sometimes the loudest voice counts and not necessarily the perception of pressure groups.

¹²⁶ The Economist, 'Democracy Index 2016: Revenge of the "Deplorables"' (A Report by The Economist Intelligence Unit, 2016) < <http://felipesahagun.es/wp-content/uploads/2017/01/Democracy-Index-2016.pdf> > accessed 11 November 2017.

¹²⁷ *Ibid.*

¹²⁸ *Ibid.* (n 126).

For example, Nigeria, as a hybrid democracy, disregarded its growing corruption index and resulting capital flight between 2010 – 2015.¹²⁹ The growing incidences of terrorism, kidnaps and economic inequality resulting from corruption compelled civil societies to champion the ‘Bring Back our Girls’ campaign. The Goodluck Jonathan-led administration fearing it would not be re-elected during the next election, took more active steps to arrest the situation in Nigeria, sadly the efforts could not salvage the defeat at the polls.¹³⁰

The recent backlash against the Kenyan election which occasioned threats of internet shutdown is also another example.¹³¹ The Kenyan judiciary salvaged the election irregularities by annulling the election and declaring a re-run.¹³² This illustrates that certain institutions within hybrid-democracy countries are driven by the rule of law. Conversely, in authoritarian governments the restriction on human rights would prevent interest groups from pushing the government for results,¹³³ however other political factors may propel their compliance. These arguments suggest that proper democracies are more reliable partners in ensuring compliance with AML/CFT, a shortcoming in ACs.¹³⁴

¹²⁹ Ibid.

¹³⁰ Arit John, ‘What’s Wrong with Our Well Intentioned Boko Haram Coverage’ (*The Wire*, 9 May 2014) < <http://www.thewire.com/politics/2014/05/whats-wrong-with-our-well-intentioned-boko-haram-coverage/361993/> > accessed 2 June 2015; Monica Mark, ‘Obiageli Ezekwesili: When They Took The Girls, Our Government Went Under’ (*The Guardian*, 28 December 2014) < <http://www.theguardian.com/world/2014/dec/28/obiageli-ezekwesili-bring-back-our-girls-boko-haram-school-kidnapping> > accessed 12 May 2015; Faith Karimi, ‘24 Killed in Post-Election Violence in Kenya, Rights Group Says’ (CNN, 13 August 2017) < <http://edition.cnn.com/2017/08/12/africa/kenya-elections-protests/index.html> > accessed 21 October 2017.

¹³¹ Njeri Wangari, ‘Kenyans Fear a Possible Internet Shutdown During 2017 Presidential Election’ (*Mail & Guardian Africa*, 16 January 2017) < <http://mgafrica.com/article/2017-01-16-kenyans-fear-a-possible-internet-shutdown-during-2017-presidential-election> > accessed 10 May 2017.

¹³² Jason Burke, ‘Kenyan Election Annulled after Result Called Before Votes Counted, Says Court’ (*The Guardian*, 20 September 2017) < <https://www.theguardian.com/world/2017/sep/20/kenyan-election-rerun-not-transparent-supreme-court> > accessed 1) November 2017.

¹³³ For instance, Cameroon and Chad have been ineffective in ensuring compliance due to the dictatorial nature of their governments.

¹³⁴ The Economist, ‘Democracy Index 2016: Revenge of the “Deplorables”’ (A Report by The Economist Intelligence Unit, 2016) < <http://felipesahagun.es/wp-content/uploads/2017/01/Democracy-Index-2016.pdf> > accessed 11 November 2017. Interestingly, an authoritarian government may be best suited to comply with international agreements on ML/TF, for instance, China’s case.

ACs' inability to embrace full democracy is further buttressed by their low rating on the Rule of Law Index, particularly in relation to the Regulatory Enforcement factor.¹³⁵ Botswana, Senegal, Ghana and Morocco are the only ACs ranked among the top 50 countries globally.¹³⁶ Others are ranked in the bottom 100, with Ethiopia, Egypt and Zimbabwe ranking the lowest.¹³⁷ There is evidence that the rule of law has declined for 70% of ACs over the past decade.¹³⁸ This shortfall indicates that the mere existence of formal laws does not translate to unbiased implementation or enforcement. The law may in certain instances be used to perpetuate inequality. For example, in non-liberal regimes, like Zimbabwe, political leaders can legitimize undemocratic rules, such as tenure elongation amendments to the constitution.¹³⁹ In more liberal democracies, like Ghana, the law can be used to ensure that political leaders have prolonged immunity to enable them evade prosecution for illicit transactions, at the expense of the country's economic development. Consequently, it may be overgeneralizing to assume that only undemocratic countries would be antagonistic to compliance pressures, or that countries with entrenched rule of law would comply. Other factors, like culture, the country's imperative need or sanctions, affect compliance.

Whilst external sanctions may potentially be crucial in remedying the shortcomings of democracy and rule of law – a step which can alter countries' incentive to comply, impact-related challenges must be considered. Sanctions are largely expensive for ACs. The law and economics approach that the rule of law will be adhered to if the cost of non-compliance is higher than benefits illustrates the position of ACs. For example, certain ACs may comply with the FATF recommendations in the belief that 'associate

¹³⁵ World Justice Project, 'Rule of Law Index' (*World Justice Project*, 2016) < https://worldjusticeproject.org/sites/default/files/documents/RoLI_Final-Digital_0.pdf > accessed 9 November 2017.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ Karen McVeigh and Kate Hodal, 'Rule of Law Declines for 70% of Africans over Past Decade, Warns Ibrahim Index' (*The Guardian*, 3 October 2016) < <https://www.theguardian.com/global-development/2016/oct/03/rule-of-law-declines-70-per-cent-africans-over-past-decade-ibrahim-index-governance> > accessed 9 November 2017; Mo Ibrahim Foundation, 'A Decade of African Governance 2006 – 2015' (*Ibrahim Index of African Governance Index Report*, 2016) < http://s.mo.ibrahim.foundation/u/2016/10/01184917/2016-Index-Report.pdf?_ga=2.32642366.1457805273.1510188763-1322237499.1510188763 > accessed 9 November 2017.

¹³⁹ Aljazeera, 'Zimbabwe's Mugabe Signs New Constitution' (Aljazeera, 22 May 2013) < <http://www.aljazeera.com/news/africa/2013/05/2013522105015147596.html> > accessed 10 May 2016.

membership’ through the FSRBs may outweigh the alternative of financial exclusion. Some considerations include: enhanced financial integration, improved FIs and regulatory space or the attraction of foreign investments to strengthen their economies. Forced ‘benefits’ through sanctions may however trigger sham compliance which may be formal or creative, as opposed to proactive compliance.

Given the shortcomings of external sanctions, IFIs more readily utilize the management models. Notwithstanding, the effectiveness of monitoring and evaluation is dependent on the validity of laws, regulations and institutions. The rule of law is not necessarily just symbolic; it catalyzes practical changes. As a ‘pre-condition for effective regulation’, law is one of the critical primary basis upon which institutions can ensure compliance with the AML/CFT regulations.

5.3.2 Non Legal Factors that Affect Compliance

Law and other legal factors may not always be a determinant of compliance with AML/CFT standards, even when non-compliance would result in reputational damages. Black argues that it would be overly simplistic to assume that putting laws in place will result in improved compliance, solely on the basis of reputational concerns.¹⁴⁰ For this reason, this section argues that there are non-legal factors which support the legal factors that ensure compliance. These are:

1. Compliance based on reputational concerns;
2. Political will, domestic conditions and policy priorities;
3. Technical capacity and resources;
4. Legitimacy and its effect on compliance; and
5. Globalization and integration.

¹⁴⁰ Julia Black, Martyn Hopper and Christa Band, ‘Making a Success of Principles-Based Regulation’ [2007] 1 (3) Law and Financial Markets Review 191 – 204.

5.3.2.1 Compliance based on Reputational Concerns

Despite their reputational damage, some ACs usually undertake speedy transplantation or unreasoned copying of unsuitable rules to avert sanctions. Nigeria was recently suspended from the Egmont Group for failing to automate its FIU through legislation. Facing an impending expulsion, Nigeria is yet to comply. As earlier mentioned, Chukwuma Utazi, Nigeria's Senate Committee Chairman on Anti-Corruption has expressed the view that 'they (Egmont) already said that if we did not comply, they would expel us, so there is no fresh news there...we are working towards it, nothing has been done.'¹⁴¹ Given the pendency of the issue for over five years, such a response from a high-ranking legislator indicates scarce concern for reputational damage. Conversely, Nigerian FIs are pushing for the adoption of legislations to evade sanctions, recognizing that sanctions would not only adversely affect their continued service and expansion plans, but may possibly lead to the devaluation of their assets. This shows a stark misalignment of the objectives of FIs, regulators and legislators, which must converge for reputation concerns to have the desired effect.

The reputational damage of being blacklisted include limiting foreign investments, increased cost of remittances or hindering correspondent banking relationships (CBR), given the high level of regulatory checks required to conduct business with 'listed countries.'¹⁴² The AfDB stated that 'the existence of money laundering would reflect poorly on (a) country's governance reputation and would be taken into account in decisions about future lending in the country.'¹⁴³ This would impact the private sector,

¹⁴¹ Damilola Oyedele, 'Egmont: Senate, House Disagree on NFIA as Threat of Nigeria's Expulsion Looms' (*Thisday*, 6 February 2018) < <https://www.thisdaylive.com/index.php/2018/02/06/egmont-senate-house-disagree-on-nfia-as-threat-of-nigerias-expulsion-looms/> > accessed 11 February 2018.

¹⁴² Clay Lowery, 'Unintended Consequences of Anti-Money Laundering Policies in Poor Countries – A CGD Working Group Report' (*Centre for Global Development*, 2015) < <https://www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf> > accessed 7 November 2017; William Lawrence, 'Money Laundering Compliance for Africa?' (*bbrief*, 9 June 2017) < <https://www.bbrief.co.za/2017/06/09/money-laundering-compliance-africa/> > accessed 10 July 2017.

¹⁴³ World Bank and IMF Global Dialogue Series, 'Anti-Money Laundering and Combating the Financing of Terrorism – Regional Videoconference: Anglophone West Africa Region – The Gambia, Ghana, Nigeria and Sierra Leone' (World Bank and IMF Global Dialogue Series) < <http://documents.worldbank.org/curated/en/620291468751786123/pdf/271830Anti1money0launderin00West0Africa.pdf> > accessed 15 May 2017.

affecting risk views and investment ratings. Nash states that ‘[w]estern investors and banks are currently reducing the number of correspondent banks they interact with that are based in Africa...due to their (in)ability to demonstrate that they have the right AML procedures and systems in place.’¹⁴⁴ This severance of CBR or other transactional engagements, known as ‘de-risking’, recently occasioned the termination of CBR between Deutsche Bank (HP countries) and Africa (MP countries).¹⁴⁵ This was done chiefly to avoid reputational risks to the bank.¹⁴⁶ The SWIFT report indicates a more dire picture, showing that de-risking in Africa is on the rise with Angola losing 37% of foreign counterparties and Mauritius losing at least 18% between 2013 and 2015.¹⁴⁷ Nigeria has however managed to maintain limited international de-risking, although there is evidence that local banks have severed relationships with other African banks or services deemed risky – such as bureau de change and money transmission companies.¹⁴⁸ The de-risking exercise has a negative impact on the African economy, as such relationships strengthen financial integration.¹⁴⁹

The adverse effect of de-risking includes the challenge of accessing products and services, such as international wire transfers – a predicament which can result in consumers engaging in alternative, less regulated channels. To avoid this, ACs are pressured into compliance with AML/CFT to retain their clients.¹⁵⁰ This pressure may

¹⁴⁴ Imogen Nash, ‘Why Financial Institutions based in Africa Should Have Robust Compliance Systems in Place’ (*Accuity*, 10 August 2016) < <https://accuity.com/accuity-insights-blog/why-financial-institutions-based-in-africa-should-have-robust-compliance-systems-in-place/> > accessed 7 November 2017.

¹⁴⁵ The Economist, ‘A Crackdown on Financial Crime Means Global Bank Are De-risking’ (The Economist, 8 July 2017) < <https://www.economist.com/news/international/21724803-charities-and-poor-migrants-are-among-hardest-hit-crackdown-financial-crime-means> > accessed 10 August 2017.

¹⁴⁶ Michaela Erbenova, Yan Liu, et al, ‘The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action’ (*IMF Staff Discussion Note*, 2016) < <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf> > accessed 10 January 2017.

¹⁴⁷ Swift, ‘De-risking in Africa on the Rise, according to Latest SWIFT Data’ (*Swift*, 24 August 2016) < <https://www.swift.com/insights/press-releases/de-risking-in-africa-on-the-rise-according-to-latest-swift-data> > accessed 10 March 2017.

¹⁴⁸ Ibid.; Note that this can also be attributed to the Central Bank of Nigeria’s stipulated guidelines on investments that banks can hold.

¹⁴⁹ SWIFT, ‘Addressing the Unintended Consequences of De-Risking - Focus on Africa’ (*Swift*, Information Paper, August 2016) < <https://www.swift.com/node/35121> > accessed 10 March 2017; Otaviano Canuto and Veronica Ramcharan, ‘De-Risking is De-Linking Small States from Global Finance’ (*HuffPost*) < https://www.huffingtonpost.com/otaviano-canuto/de-risking-is-de-linking_b_8357342.html > accessed 11 March 2017.

¹⁵⁰ The Commonwealth, ‘Disconnecting from Global Finance: The Impact of AML/CFT Regulations on Commonwealth Developing Countries’ (*The Commonwealth*, 2016)

facilitate increased compliance or may in fact occasion a paradox, thus worsening compliance in certain countries. Where the latter occurs, it usually indicates challenges within a country's regulatory environment that warrants internal changes. These may include improvements in regulatory processes in order to build reputation within the global financial market. This would counteract the paradox of de-risking as a catalyst for financial exclusion or the ousting of customers.

Management of FIs may also project the need to protect banking activities, as a means of leveling the playing field. These institutions may then force regulatory bodies to adopt uniform regulations so as to avoid a race to the bottom as competitors' price each other out on the international markets. Thus, banks with domestic and international competitive advantages pressure regulators to implement the law in order to attract international business. Whereas banks with high compliance that acknowledge the irrevocable harm which ML/TF can do to reputation and integrity will advertise their compliance levels to attract investors and depositors. However, although banks or countries with compliance challenges which nevertheless still attract financial investment may remain immune to reputational concerns. In the long run, lapses in such countries by FIs are noticed by the markets and regulators. This will inevitably attract sanctions or in some cases – withdrawal of licenses. These external pressure points expose the reputational concerns that occasion non-compliance,¹⁵¹ which adversely affects the banking industry.

5.3.2.2 Political Will, Domestic Conditions and Policy Priorities

It is expected that appreciation of the adverse effect of ML/TF on an economy would cultivate political will; which would effectively facilitate compliance and thereby build a nation's economy. This suggests that when government leaders appreciate, by

<<http://thecommonwealth.org/sites/default/files/inline/DisconnectingfromGlobalFinance2016.pdf>> accessed 10 March 2017.

¹⁵¹ Michael Imeson and Alastair Sim, 'Regulation and Your Reputation' White Paper <http://www.sas.com/resources/whitepaper/wp_24359.pdf> accessed 1 June 2015.

empirical evidence, that ML/TF occasions capital flight¹⁵² and hinders the effectiveness of monetary policies, they would actively curtail such crimes.¹⁵³ Such assumptions are premised on the rational perspective that countries want to curtail macroeconomic issues that hinder economic development.¹⁵⁴

Yet, evidence has shown that this is not always the case. For instance, indices in Nigeria show capital flight in billions of dollars to Dubai and Washington by chief executive officers of banks.¹⁵⁵ According to a former governor of the Central Bank of Nigeria, such ‘bank officials had economic power...(and) had bought political protection...they had financed elections of officers...every time I said it was time for us to take action, people said to me, you can’t touch these people, you’ll be sacked...they will kill you....’¹⁵⁶ This revelation shows the interrelationship between heads of FIs and government officials, a situation which creates regulatory arbitrage, and undermines the regulator’s ability to generate political will. This position of arbitrage is however not constant, particularly in countries where there is perceived threat of terror by the government in power,¹⁵⁷ significant loss of government revenue or proactive civil societies. In such cases, there is political will to combat ML/TF and meet international standards.¹⁵⁸ For example, the national assembly of Kenya recently enacted the Proceeds of Crime and Anti-Money Laundering (Amendment) Act 2017, imposing stiff penalties on those guilty of economic crime. This law, coming shortly before a pivotal

¹⁵² Liliana Rojas-Suarez, ‘Risk and Capital Flight in Developing Countries’ (1990) International Monetary Fund, IMF Working Paper 0440, 15 < https://www.cgdev.org/doc/experts/Risk_Cap_Flight_Dev_Countries.pdf > accessed 19 November 2016.

¹⁵³ Hippolyte Fofack and Leonce Ndikumana, ‘Capital Flight and Monetary Policy in African Countries’ (2014) Political Economy Research Institute, Working Paper Series 362, 2 < <https://www.africaportal.org/publications/capital-flight-and-monetary-policy-in-african-countries/> > accessed 17 November 2016.

¹⁵⁴ S.Ibi Ajayi, ‘Capital Flight and Economic Development in Africa’ [2014] 55 Capital flight from Africa: Causes, Effects and Policy Issues 1, 20.

¹⁵⁵ Premium Times, ‘Sanusi Lamido Explodes: How Vested Interests are Killing Nigeria’ (Premium Times, 13 January 2014) < <https://www.premiumtimesng.com/news/153212-sanusi-lamido-explodes-how-vested-interests-are-killing-nigeria.html> > accessed 10 March 2016.

¹⁵⁶ Ibid.

¹⁵⁷ Thus leaders from countries like Nigeria, Kenya and Mali, who have experienced previous terror attacks will be more willing unlike states that have not had the experience, for instance Botswana; see Beth Elise Whitaker, ‘Compliance Among Weak States: Africa and the Counter Terrorism Regime’ [2010] Review of International Studies 639, 646.

¹⁵⁸ Sojin Lim, ‘Compliance with International Norms: Implementing the OECD DAC Principles in South Korea [2014] 11 (6) Globalisation 859 - 874; Anna Markovska and Nya Adams ‘Political Corruption and Money Laundering: Lessons from Nigeria’ [2015] 18 (2) JMLC 169, 169.

Kenyan election, may indicate strong political will accelerated by civil societies and threats by the electorates.

Political will is however not always internally generated at the domestic level; it may also be externally engendered through a hub that facilitates cross country regulatory interactions. Such a hub, usually created by soft law bodies like the FATF, produces a competitive atmosphere where national authorities start to perceive international banking regulation as a technique for guarding against systemic risk or threat of ML/TF. Hence, national authorities in ACs may start to impose additional pressure on governments to implement laws, knowing that FIs with reduced fraud are less likely to experience collapse which may trigger systemic risk. This provides security but also works to facilitate the repatriation of capital laundered back to the country of origin. In certain instances, political will may be foisted on a country through its external agreements, such as the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.¹⁵⁹

The extent to which a combination of soft and hard law can propel political will within states with weak institutional structures is debatable. Notwithstanding how political will is generated, it may be hindered by domestic conditions, such as thriving corruption, cultural and socio-political contestation. In ACs, for instance, there is a thriving culture of ‘man-know-man’ within and between FIs, regulatory bodies and customers, which facilitates illicit transactions. It is not surprising that corruption indexes reveal that 92% of all ACs score below 50% of 100% – averaging 33%, considerably lower than the global average.¹⁶⁰ Africa cannot achieve improved compliance with this level of corruption, which cripples the continent’s ability to effectively adhere to the AML/CFT regime. It compromises the efficiency of various

¹⁵⁹ See the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) < https://www.unodc.org/pdf/convention_1988_en.pdf > accessed 10 July 2016.

¹⁶⁰ TI, ‘Corruption Perception Index 2014’ (*Transparency International*) <<https://www.transparency.org/cpi2014/results>> accessed 10 July 2016.

institutions, including the judiciary, the executive. It also affects the ability of private institutions to hold erring customers to account.¹⁶¹

By way of illustration, the banking sector's effectiveness as gatekeepers requires identification and prevention of the influx of illicit funds into the economy. This is largely dependent on the tone or culture set by senior management of banks. But, in certain ACs countries, senior management have fallen short of this responsibility. This is evidenced by the KPMG survey which revealed that 34% of boards of directors do not take active interest in AML issues,¹⁶² the weakest region being West Africa. This is reflected in Nigeria where bank managers have aided and promoted corrupt practices by permitting secrecy, authorizing the doctoring of or refusing to disclose statements of suspicious account holders who are subject to investigation by regulatory bodies.¹⁶³ The endorsement of these acts is enshrined in the 'big man culture', which entices bank officials to aid politically exposed persons (PEPs) transfer illicit funds without reporting a breach of AML/CFT requirements.¹⁶⁴ These acts furnished some directors lavish lifestyles until the perpetrators were charged for corruption.¹⁶⁵ It is startling to note that no FI has been sanctioned for lapses in its ML practices,¹⁶⁶ though the FCA

¹⁶¹ David Chaikin and Jason C Sharman, *Corruption and Money Laundering: A Symbiotic Relationship* (Palgrave Macmillan, 2009); see also World Bank, 'World Development Report 2011: Conflict, Security and Development' 264 (*The World Bank*, 2011) <https://siteresources.worldbank.org/INTWDRS/Resources/WDR2011_Full_Text.pdf> accessed 10 July 2016.

¹⁶² KPMG, Africa AML Survey 2012 (KPMG) <<https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%202012%20Africa%20Anti-Money%20Laundering%20Survey.pdf>> accessed 1 June 2015.

¹⁶³ Sani Turkur, 'Nigerian Banks Aid Corruption – EFCC' (*Premium Times*, 10 September 2012) <<http://www.premiumtimesng.com/business/99682-nigerian-banks-aid-corruption-efcc.html>> accessed 3 June 2015; Boldwin Anugwara, 'Curbing Corruption in Banking Sector' (*Newswatch Times*, 22 March 2014) <<http://www.mynewswatchtimesng.com/curbing-corruption-banking-sector/>> accessed 5 May 2015.

¹⁶⁴ Alexandra Evans, 'The Utility of Informal Networks to Policy Makers' in David Martin Jones, Ann Lane and Paul Schulte (eds.) *Terrorism, Security and the Power of Informal Networks* (Edward Elgar, 2010) 18.

¹⁶⁵ Marwan Haruna Abdulkarim, 'The Nigerian Banking Revolution' <<http://www.gamji.com/article8000/NEWS8790.htm>> accessed 10 March 2017.

¹⁶⁶ Benson Esomajumi, NFIU to Sanction Banks over Money Laundering (*Nigeria Communications Week*, 30 August 2013) <<http://nigeriacommunicationsweek.com.ng/e-financial/nfiu-to-sanction-banks-over-money-laundering>> accessed 14 April 2015.

has fined a Nigerian subsidiary bank for failures in its AML controls.¹⁶⁷ Sanctions on a bank would not only cause reputational damage in a competitive market,¹⁶⁸ it would also alter the tolerant culture of bank officials to ML/TF cases.

Corruption is also rife within the judiciary in ACs. In Nigeria, serious cases of ML have not reached their expected conclusion.¹⁶⁹ This is usually the case with PEPs who bribe their way to freedom.¹⁷⁰ Certain landmark cases have revealed the corruption in the judiciary as regards ML in Nigeria; for instance, the case of former Governor James Ibori of Delta State. Despite overwhelming evidence, a Nigerian judge dismissed the case ‘for lack of merit.’¹⁷¹ Other instances in Nigeria have illustrated that cases concerning PEPs who are cronies of the government are usually not seen to a conclusive end¹⁷² or ex-convicts are subsequently pardoned.¹⁷³ Other ACs have similar instances, albeit to a smaller extent. Angola has had no record of enforcement or prosecution of ML-related offences to date. Botswana, Niger, Sierra Leone, Kenya and Uganda are reported to have poor prosecutions or conviction levels despite the numerous investigations carried out.¹⁷⁴

Also, cases of TF have not received the right attention from the courts. Prominent cases against businessmen on the allegation of laundering funds aimed at financing a terrorist

¹⁶⁷ FCA, ‘FCA Fines Guaranty Trust Bank (UK) Ltd £525,000 for Failures in its Anti-Money Laundering Controls’ (*Financial Conduct Authority*, 17 September 2013) < <http://www.fca.org.uk/news/fca-fines-guaranty-trust-bank-uk-ltd> > accessed 21 March 2015.

¹⁶⁸ Antoinette Verhage, ‘Between the Hammer and the Anvil? The Anti-Money Laundering – Complex and its Interactions with the Compliance Industry’ [2009] 52 *Crime Law Soc. Change* 1, 12.

¹⁶⁹ Abdullahi Shehu, *Strategies and Techniques of Prosecuting Economic and Financial Crimes* (GIABA Secretariat, 2012) 61 -76.

¹⁷⁰ *Ibid.*

¹⁷¹ Bolaji Akinola, *Authority Stealing: How Greedy Politicians and Corporate Executives Loot the World’s Most Populous Black Nation* (AuthorHouse, 2012) 122.

¹⁷² GIABA, ‘Annex to Nigeria 2nd Follow Up Report, Money Laundering Convictions’ (GIABA) - < https://www.giaba.org/media/f/305_Annexe > accessed 12 March 2015.

¹⁷³ Nnenna Ibeh, ‘US Threatens Sanctions Against Nigeria over Pardon for Ex-Convict Alamiyeseigha, Bulama’ (*Premium Times*, 16 March 2013) <<http://www.premiumtimesng.com/news/125112-u-s-threatens-sanctions-against-nigeria-over-pardon-for-ex-convict-alamiyeseigha-bulama.html> > accessed 21st May 2015.

¹⁷⁴ Tanzania recently reported that it had 14 cases instituted in its subordinate courts since the promulgation of the AML legislation in 2006. Whilst ahead of its neighboring states, a continued failure to prosecute is an issue which must be addressed in both Tanzania and other ACs. Conversely, it can be argued that corruption level is not a determinant factor to the level of compliance. Botswana is the least corrupt AC, yet it remains deficient in AML/CFT regulations.

organization – Hezbollah.¹⁷⁵ These cases were however struck out on the application of the prosecutor.¹⁷⁶ Following the striking out of these cases, the United States Government stated that it had frozen all assets owned by the accused persons and banned them from dealing with any US person. Similarly, a former Nigerian senator was charged with assisting and funding Boko Haram. The judge dismissed the case on the grounds of insufficient evidence, disregarding evidence that may have warranted a finding of guilt beyond reasonable doubt.¹⁷⁷

Notably, the attitude of the judiciary is not solely reflective of corruption; it also illustrates the absence of judicial independence. Judges may be pressured into dispensing unmerited decisions through coercion or bribery, a practice rife in ACs. These constraints are however not unusual as legal scholars posit that domestic regimes uncharacterized by rule of law and the independence of the judiciary are less likely to comply with international obligations.¹⁷⁸ Conversely, empirical evidence has also confirmed that countries with sturdier legal and regulatory systems have better developed financial intermediaries¹⁷⁹ - indicating that law does matter.¹⁸⁰

Private and public sectors' actions on ML/TF reflect the mind of the executive body of the country. Some past corrupt PEPs accused of ML/TF were later granted state

¹⁷⁵ Hezbollah Financer in Nigeria Exposed (*Money Jihad*, March 3, 2015) < <https://moneyjihad.wordpress.com/2015/03/03/hezbollah-financier-in-nigeria-exposed/> > accessed May 1 2015.

¹⁷⁶Nnenna Ibeh, 'America Bans Owners of Amigo Supermarket, Wonderland Amusement Park over Alleged Terrorist Activities' (*Premium Times*, June 15 2015) <<http://www.premiumtimesng.com/news/top-news/177962-america-bans-owners-of-amigo-supermarket-wonderland-amusement-park-over-alleged-terrorist-activities.html> > accessed March 7 2015.

¹⁷⁷Senator Ndume Contacted Boko Haram Leader 73 Times In One Month Says SSS – Premium Times (*Sahara Reporters*, 12 December 2012) <<http://saharareporters.com/2012/12/12/senator-ndume-contacted-boko-haram-leader-73-times-one-month-says-sss-premium-times;>> accessed 12 April 2015.

¹⁷⁸ Concepcion Verdugo-Yepes, 'Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis' (2011) International Monetary Fund Working Paper WP/11/177, 9 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578 > accessed 19 April 2015.

¹⁷⁹ Ross Levine, 'Law, Finance and Economic Growth' [1999] 8 (1) *Journal of Financial Intermediation* 1,10.

¹⁸⁰ Brian Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2000) ERSC Centre for Business Research, University of Cambridge Working Paper 172 < https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp172.pdf > accessed 19 April 2015.

pardon,¹⁸¹ with the right to run for public office. Efforts to demolish businesses of alleged terror funders were rejected by the government.¹⁸² The constitutional cloak of immunity, which insulates some PEPs from judicial proceeding while in office, also presents difficulties for developing countries.¹⁸³ These instances reveal the absence of political will to curb ML/TF in Africa, which aids and perpetuates non-compliance.

Treatises on corruption in FIs, the judiciary and executive arms of government may suggest that internal domestic factors drive and affect compliance to international AML/CFT standards. Scholars accede to the effect of discursive mechanism in pressurizing countries to adopt AML/CFT regime, but have argued that this in itself does not equate to straightforward success.¹⁸⁴ They argue instead that countries themselves, through regulatory regionalism, dictate the process of implementation and enforcement, which is shaped by their wider socio-political contestations.¹⁸⁵ This argument recognizes that trans-governmental regulatory networks like the FATF do not operate by establishing and empowering supranational authorities to oversee issues directly, but rather by transforming regulatory apparatuses and processes that states must adopt. They posit that regulatory regional governance occurs by transforming rather than supplanting statehood so that states enact regional governance initiatives domestically.¹⁸⁶ Thus submitting that the FATF only dictates but does not implement

¹⁸¹ Emmanuel Edukugho, 'Alamieyeseigha: Unpardonable Pardon' (Vanguard, 23 March 2013) < <https://www.vanguardngr.com/2013/03/alamieyeseigha-unpardonable-pardon/> > accessed 10 April 2015.

¹⁸² Nnenna Ibeh, 'America Bans Owners of Amigo Supermarket, Wonderland Amusement Park over Alleged Terrorist Activities' (PremiumTimes, 5 March 2015) < <https://www.vanguardngr.com/2013/03/alamieyeseigha-unpardonable-pardon/> > accessed 10 April 2015.

¹⁸³ Ngozi Okonjo Iweala, *Reforming the Unreformable: Lessons from Nigeria* (The MIT Press, Cambridge Massachusetts, London 2012) 82.

¹⁸⁴ ACs have shown resistance towards imbibing international policies that they suppose impinge on their sovereignty. See Navin Beekarry, 'The International Anti-Money Laundering and Combatting the Financing of Terrorism Regulatory Strategy: A Critical Analysis of Compliance Determinants in International Law' [2010] 31 Nw. J. Int'l L. & Bus 137, 190.

¹⁸⁵ By the FATF standards, compliance and enforcement is measured by the number of confiscation and convictions – Shahar Hameiri and Lee Jones, 'Regulatory Regionalism and Anti-Money Laundering Governance in Asia' [2014] Australian Institute of International Affairs 1,4.

¹⁸⁶ Shahar Hameiri and Lee Jones, 'Regulatory Regionalism and Anti-Money Laundering Governance in Asia' [2014] Australian Institute of International Affairs 1, 7; Hameiri Shahar and Kanishka Jayasuriya, 'Regulatory Regionalism and the Dynamics of Territorial Politics: The Case of the Asia-Pacific Region' [2011] 59 Political Studies, 1, 21.

or enforce these recommendations, rather enforcement is reserved to FSRBs to coordinate mutual peer reviews aimed at eliciting compliance.¹⁸⁷

Myanmar, which shares similarities with certain ACs,¹⁸⁸ typifies the cultural and socio-political contestations which determine a country's compliance. Myanmar legislated on AML/CFT and was subsequently de-blacklisted. However, it remained on the FATF's list of countries with AML/CFT strategic deficiencies. Myanmar was not especially known as a country complacent with the culture of laundering through banks.¹⁸⁹ The adopted legislations were instruments to undermine groups considered disloyal to the ruling regime as opposed to tackling predicate crimes, indicating deliberate flouting of the FATF recommendations.¹⁹⁰ Certain ACs, like Myanmar, use their structures of AML/CFT regimes to witch-hunt opposition parties or past military dictators. This demonstrates why though ACs have been removed from the watch list, they are still largely deficient. Funds are lost through the low level of compliance and the rates of corruption and terrorist activities leave much to be desired.

States that are predominantly financial inclusive tend to be more compliant to AML/CFT regimes.¹⁹¹ ACs however operate cash-based economies,¹⁹² which leave room for uncontrolled and unregulated cash movement, thus perpetuating laundering

¹⁸⁷ Cf with Drezner Daniel, 'The New World Order' [2007] 86.2 Foreign Affairs 34 - 46 (Realist argument) who argues that it reflects the capacity of the great powers—mainly the USA and European Union—to use sanctions to coerce weaker states to adopt their preferred rules, via regional organizations like the APG, of which the USA is a member. Hameiri and Jones disagree, arguing that FATF and FSRBs are not supernatural institutions overriding natural sovereignty as assumed, rather the hubs of a regional network, coordinating domestic agencies to manage transnational problems. See Shahar Hameiri and Lee Jones, 'Regulatory Regionalism and Anti-Money Laundering Governance in Asia' [2014] Australian Institute of International Affairs.

¹⁸⁸ In terms of unsophisticated legal systems, corruption, unemployment, basic and undeveloped infrastructures etc.

¹⁸⁹ Shahar Hameiri and Lee Jones, 'Regulatory Regionalism and Anti-Money Laundering Governance in Asia' [2014] Australian Institute of International Affairs 1, 4.

¹⁹⁰ Ibid 1, 5.

¹⁹¹ Hennie Bester, Doubell Chamberlain, Louis de Koker, Christine Hougaard, Rayn Short, Anja Smith and Richard Walker, 'Implementing FATF Standards in Developing Countries and Financial Inclusion: Findings and Guidelines' (*First Initiative*, 2008) <http://cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf > accessed 10 May 2015.

¹⁹² States where more than 50% of their economic transactions are conducted in cash and majority of the populations are unbanked.

and the financing of terror.¹⁹³ An empirical study by Verdugo-Yepes illustrates that developing countries most likely to be cash-based economies comply to a lesser degree with the AML/CFT standard.¹⁹⁴ Hence, the limitations in compliance do not rest so much in imperfect laws as in the lack of capability to monitor and counter ML through the informal sector.¹⁹⁵ The poor enforcement levels in the informal sector, which Norton Rose Fulbright describes as ‘lackluster or non-existent’, are attributable to absence of information to prompt prosecution.¹⁹⁶ Paradoxically, the AML/CFT regime itself prompts financial exclusion by barring the financially vulnerable and marginalized citizens from the financial system.¹⁹⁷ This is because persons in the lower economic strata may not possess banks’ requirement for requisite ID’s, address or proof of address.¹⁹⁸ Thus, the prospects of ML are increasingly rife, with criminals able to move dirty money within and across borders. Many ACs, rich in either oil or precious stones, frequently launder funds around the continent using these commodities,¹⁹⁹ thereby hindering the economic development of Africa.

¹⁹³ Ronald H Mynhardt and Johan Marx, ‘Anti-Money Laundering Recommendations for Cash Based Economies in West Africa’ [2013] 11 (1) Corporate Ownership and Control 24, 25.

¹⁹⁴ Concepcion Verdugo-Yepes, ‘Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis’ (2011) International Monetary Fund Working Paper WP/11/177, 13 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578 > accessed 19 April 2015. Humphrey P.B Moshi, ‘Fighting Money Laundering: The Challenges in Africa’ [2007] 152 Institute for Security Studies Papers 1, 10 -12.

¹⁹⁵ Ronald H Mynhardt and Johan Marx, ‘Anti-Money Laundering Recommendations for Cash Based Economies in West Africa’ [2013] 11 (1) Corporate Ownership and Control 24, 29.

¹⁹⁶ Norton Rose Fulbright, ‘Prominence of Money Laundering in Africa, 10 things to know’ (*Norton Rose Fulbright*, February 2014) <<http://www.nortonrosefulbright.com/knowledge/publications/113161/prominence-of-money-laundering-in-africa-br-ten-things-to-know> > accessed 1 June 2015.

¹⁹⁷ Hennie Bester, Doubell Chamberlain, Louis de Koker, Christine Hougaard, Rayn Short, Anja Smith and Richard Walker, ‘Implementing FATF Standards in Developing Countries and Financial Inclusion: Findings and Guidelines’ (*First Initiative*, 2008) <http://cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf > accessed 10 May 2015.

¹⁹⁸ Verdugo-Yepes agrees that compliance is correlated with a country’s economic development; see Concepcion Verdugo-Yepes, ‘Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis’ (2011) International Monetary Fund Working Paper WP/11/177, 6 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1899578 > accessed 19 April 2015.

¹⁹⁹ Norton Rose Fulbright, ‘Prominence of Money Laundering in Africa, 10 things to know’ (*Norton Rose Fulbright*, February 2014) <<http://www.nortonrosefulbright.com/knowledge/publications/113161/prominence-of-money-laundering-in-africa-br-ten-things-to-know> > accessed 1 June 2015; GIABA Report, ‘The Nexus Between Small Arms and Light Weapons and Money Laundering and Terrorist Financing in Africa’ (GIABA, 2013) < https://www.giaba.org/media/f/613_519_GIABA%20SALW%20Nexus-final.pdf > accessed 10 May 2015.

Corruption, financial exclusion and other socio-political contestations illustrate the arguments put forward by scholars who recognize that domestic factors determine the likelihood of actual or proactive compliance.²⁰⁰ This underscores the inability of ACs to effectively converge. Furthermore, the discourse on political will and domestic conditions and their relationship with compliance illustrates that the narrative behind policies and political change is set within the broader culture of a country which determines what is most deserving of focus, from a scale of varying socio-political and economic interests.²⁰¹ The policy priorities of a country or region can be evaluated by its budgetary focus.²⁰² Countries like Kenya and Nigeria apportion their highest budgetary allocation to security with a focus on ensuring stability and economic growth. This focus is however undermined by corruption solidified through ‘immunity’ granted to PEPs and issues concerning financial inclusion – a key determinant of AML/CFT compliance.²⁰³ Thus, whilst the FATF recommendations focus on FIs – the real damage is done outside these institutions. Hence, the current FATF recommendations and other international standards do not appear to advance practical and realistic methods of preventing and detecting ML/TF in a predominantly cash-based economy, or in countries reliant on a parallel banking system and informal value transfer. These issues are prominent in Africa and deserve tailored solutions.

5.3.2.3 Technical Capacity and Resources

The capacity of regulatory and institutional officers to carry out their duties efficiently determines the degree of compliance. The AML/CFT regime has progressively

²⁰⁰ Andrea Lenschow, Duncan Liefferink, and Sietske Veenman., ‘When the Birds Sing. A Framework for Analyzing Domestic Factors behind Policy Convergence’ [2005] 12 (5) *Journal of European Public Policy* 797, 800. This accords with the realist argument that regimes have little effect on state behavior and that compliance is simply a reflection of existing power structures and convergent interest; see John Mearsheimer, ‘The False Promise of International Institutions’ [1994 - 95] 19 (3) *International Security* 5 -49.

²⁰¹ Andrea Lenschow, Duncan Liefferink, and Sietske Veenman, ‘When the Birds Sing. A Framework for Analyzing Domestic Factors behind Policy Convergence’ [2005] 12 (5) *Journal of European Public Policy* 797, 801.

²⁰² *Ibid* 797, 807.

²⁰³ Transparency International, ‘When Immunity Becomes a License to Break the Law’ (*Transparency International*, 29 April 2013) < https://www.transparency.org/news/feature/when_immunity_becomes_a_licence_to_break_the_law > accessed 10 July 2017.

expanded from banks to encompass other businesses that criminals might explore to launder or transfer illicit funds. Thus, insurance companies, lawyers, accountants, bureau de change and casinos are mandated to be actively involved in ensuring compliance with the FATF recommendations.²⁰⁴ This requirement particularly encompasses suspicious transaction reporting (STR) and CDD.²⁰⁵ However, carrying out these tasks in Africa requires technical skills to deal with complicated software,²⁰⁶ which staff of financial and non-financial institutions may not be well acquainted with.

The dearth of technical capacity can be illustrated with the inability to use or objectively translate reports of software generated STRs.²⁰⁷ For example, reports forwarded to the FIUs by officials are those that raise suspicion of ML/TF activity. However, this is not always the case due to the subjectivity of officials in filtering STR which can lead to erroneous judgments; thus permitting some cases of ML/TF to go unnoticed. This shortcoming was highlighted by the FATF MER report on Nigeria, which underscored instances of inappropriate filing of Cash Transaction Report (CTR) and worse still, instances where CTR were filed in place of STR.²⁰⁸ These illustrate how the pressure to provide reports to regulators are attributed to reputational benefits as opposed to the main aim of combatting illicit crimes.²⁰⁹ The FATF evaluation team echoed their fears

²⁰⁴FATF, 'FATF Recommendation 20 and 21' (FATF, 2012) < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 10 February 2017.

²⁰⁵ FATF, 'FATF Recommendation 10' (FATF, 2012) < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 10 February 2017.

²⁰⁶ For instance, SAS, Norkom, World Check, etc, see Antoinette Verhage, 'Between the Hammer and the Anvil? The Anti-Money Laundering-Complex and Its Interactions with the Compliance Industry' [2009] 52 *Crime Law Soc. Change* 1, 18; Gandy Oscar Jr, 'Data Mining, Surveillance and Discrimination in the Post 9/11 Environment' in Haggerty Kevin and Ericson Richard (eds) *The New Politics of Surveillance and Visibility* (Toronto: University of Toronto Press 2006) 381.

²⁰⁷ Antoinette Verhage, 'Between the Hammer and the Anvil? The Anti-Money Laundering-Complex and Its Interactions with the Compliance Industry' [2009] 52 *Crime Law Soc. Change* 1, 18; Margaret Rouse, 'Anti-Money Laundering Software (AML)' (*Tech Target*) <<http://searchfinancialsecurity.techtarget.com/definition/anti-money-laundering-software-AML>> accessed 15 April 2015; Gilles Favarel - Garrigues, Thierry Godefroy, Pierre Lascoumes, 'Reluctant Partners? Banks in the Fight against Money Laundering and Terrorism Financing in France' [2011] 42 (2) *Security Dialogue* 179, 183.

²⁰⁸ GIABA, 'Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism: Nigeria' (*Inter-Governmental Action Group Against Money Laundering in West Africa*, 2008) 95 < https://www.giaba.org/media/f/299_Mutual%20Evaluation%20Report%20of%20Nigeria.pdf > accessed 9 April 2015.

²⁰⁹ Ericson, Richard, 'Ten Uncertainties of Risk Management Approaches to Security' [2006] 48 (3) *Canadian Journal of Criminology and Criminal Justice* 345, 352.

that FIs did not have a clear understanding of how to determine suspicious activity or the significance of incorrect CTRs reporting on the effectiveness of AML/CFT regulation.²¹⁰

Furthermore, illicit transactions still go unnoticed as departments within banks operate in silos, meaning the compliance department may be oblivious of the business of the retail or business banking divisions.²¹¹ This creates a risk where links between a customer and an account used for illicit crimes are missed, particularly with the exclusion of the compliance department from the business of banking. This has been exacerbated by the risk assessment criterion, which diminishes the standard requirements for opening or maintaining a bank account in cash-based economies,²¹² where a large segment of the population may not have proper verification documents.²¹³ The ability of FIs to effectively ascertain the extent of documentation that suffices determines to a large extent the level of compliance of ACs to AML/CFT requirements.

Research has also indicated that the compliance of the regulated may be undermined by ineffective regulatory supervision.²¹⁴ The regulator's ability to enhance compliance may be hindered by limited knowledge, technical capacity, resources and evaluation

²¹⁰ Banks' response will determine the area of the FIU's risk matrix in order to identify the areas within the financial sector that would require increased supervision.

²¹¹ William Lawrence, 'Money Laundering Compliance for Africa?' (*bbrief*, 9 June 2017) <<https://www.bbrief.co.za/2017/06/09/money-laundering-compliance-africa/>> accessed 10 July 2017.

²¹² See for instance the Central Bank of Nigeria's KYC requirement for mobile banking – Central Bank of Nigeria, 'Regulatory Framework for Mobile Payments Services in Nigeria' (Central Bank of Nigeria) <

<http://www.cbn.gov.ng/out/circulars/bod/2009/regulatory%20framework%20%20for%20mobile%20payments%20services%20in%20nigeria.pdf>> accessed 11 April 2015.

²¹³ KPMG, 'Global Anti-Money Laundering Survey 2011, How Banks Are Facing up to the Challenge' (KPMG, 2011) <

<https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Advisory/global-aml-survey-2011-main-report.pdf>> accessed 2 June 2015 highlighting this, the KPMG report noted that 'some countries in Africa have no national identity system and no proper verification documentation'; Hennie Bester, Doubell Chamberlain, Louis de Koker, Christine Hougaard, Rayn Short, Anja Smith and Richard Walker, 'Implementing FATF Standards in Developing Countries and Financial Inclusion: Findings and Guidelines' (*First Initiative*, 2008) <http://cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf> accessed 10 May 2015.

²¹⁴ Jun Tang and Lishan Ai, 'Combating Money Laundering in Transition Countries: The Inherent Limitations and Practical Issues' [2010] 13 (3) *Journal of Money Laundering Control* 215-225; Lovina Ttudor, 'The Possibility of Anti-Money Laundering Laws Convergence at the Global Level' (Dissertation, Institute of Advance Legal Studies 2013).

mechanism.²¹⁵ For instance, the FATF report on Nigeria noted that regulatory authorities did not appear aware of the FATF standard of \$1000 for off-wire transactions and were unable to cite a reference illustrating that a lower threshold for occasional wire transfers existed.²¹⁶ This knowledge gap illustrates difficulties in enforcing proper sanctions. Additionally, evaluation by regulators is usually preceded by formal information to the regulated on the proposed period of evaluation. This gives the regulated institutions time to prepare their books to meet the regulator's requirements, making it more difficult to identify pitfalls and issue sanctions. Currently, none of the related regulatory bodies in Nigeria has issued sanctions for AML/CFT, a situation which prompted the US to threaten action.²¹⁷ These shortcomings evidence that resources are to be directed at training and re-training to ensure compliance – short of this, the ability of ACs to meet the regime's requirements will be challenged.

Capacity deficit is also evident in the various arms of government. Across ACs, legislators fail to grasp the fundamentals of the law, prosecutors fail to ensure admissible evidence is retrieved and preserved and the judiciary has insufficient training to effectively address cases of ML/TF. In the absence of properly crafted laws, criminals will use the existing lacunae to their advantage, thus weakening compliance. This is also the case with the judiciary and law enforcement agencies. Consequently, the IMF, World Bank, International Bar Association and various other global organizations have embarked on training in various ACs, to improve the capacity of staff to deal with AML/CFT cases.

However, capacity deficit is not only based on human error. There is also the problem of inadequate infrastructure to effectively monitor information received by the various

²¹⁵Jun Tang and Lishan Ai, 'Combating Money Laundering in Transition Countries: The Inherent Limitations and Practical Issues' [2010] 13 (3) *Journal of Money Laundering Control* 215-225.

²¹⁶Inter-Governmental Action Group against Money Laundering in West Africa, 'Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism: Nigeria' (*Inter-Governmental Action Group against Money Laundering in West Africa*, 2008) 95 < https://www.giaba.org/media/f/299_Mutual%20Evaluation%20Report%20of%20Nigeria.pdf > accessed 9 April 2015.

²¹⁷ The Guardian, 'U.S May Probe Nigerian Banks over Terror Funding' (*The Guardian*, 2014) < <http://theguardianmobile.com/readNewsItem1.php?nid=29350> > accessed 12 April 2015.

agencies responsible for analyzing and reporting instances of AML/CFT. The FIUs across countries have repeatedly decried lack of necessary infrastructures to effectively carry out their duties.²¹⁸ The primary reason is lack of requisite funding to boost institutional capacity and promote interagency coordination and international cooperation.²¹⁹ It is therefore unsurprising that given the relatively low GDP and weak framework for financial regulation, ACs have low compliance levels. Moreover, externally sourced funds may influence operations. To this extent, Uganda and Tanzania's dependence on foreign aid marginally improved their compliance levels, as these funds have conditionality to be fulfilled prior to the release of tranches.²²⁰ Lack of funding or sudden reduction in funds can adversely affect compliance levels.²²¹

5.3.2.4 Globalization and Integration

Globalization and strengthening financial integration occasioned a degree of financial exposure and openness that ACs were not prepared for. The resulting neo-liberal policies worsened Africa's position within the global financial market, making countries more susceptible to shocks. With low GDP economies, coupled with laxity towards resolving AML/CFT deficiencies, ACs have not been classed as 'strategically or systemically important'. They are thereby excluded from the core FATF membership status. Consequently, their agency relationship with the IFIs permits agency slack which manifests in formal or creative compliance aimed at avoiding sanctions that further isolate them from the market. This slack is particularly through their communication strategy with IFIs which may be geared at projecting sham compliance to avert sanctions.

²¹⁸ George Klay Kieh and Kelechi Kalu, *West Africa and the U.S. War on Terror* (Routledge, Taylor & Francis Group, London and New York, 2013); Musonda Simwayi and Muhammed Haseed, 'The Role of Financial Intelligence Units in Combating Money Laundering: A Comparative Analysis of Zambia, Zimbabwe and Malawi' [2011] 15 (1) *Journal of Money Laundering Control* 112–134.

²¹⁹ International Monetary Fund, 'Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Report on the Review of the Effectiveness of the Program' (*International Monetary Fund*, 11 May 2011) < <http://www.imf.org/external/np/pp/eng/2011/051111.pdf> > accessed 11 May 2015.

²²⁰ Beth Elise Whitaker, 'Compliance among Weak States: Africa and the Counter Terrorism Regime' [2010] 36 *Review of International Studies* 639, 654.

²²¹ *Ibid* 647.

Yet, ACs already have a limited degree of integration and may only comply given their trade or capital interests. Coupled with the lack of political will and other domestic factors that hinder compliance, this facilitates illicit crimes.²²² Moreover, it can be argued that these class of countries with limited connection to the global financial market may indeed defer compliance, knowing that sanctions would have a limited effect on them.

Debunking this argument, scholars have argued that globalization and integration drive competition amongst countries and this may catalyze proactive compliance with the AML/CFT regime.²²³ This aligns with the position that countries that have implemented the AML/CFT regime are more attractive to foreign investors, than countries which have not. This may however not always be the case, as countries with lax regulations may attract investments, a situation that can lead to a race to the bottom. Given the global minimum standards to which all countries are mandated to adhere to, there is a mechanism of competition which creates policy interdependence, as countries implement AML/CFT laws to avoid the adverse effects of non-compliance.²²⁴ This is however not peculiar to AML/CFT regulations, it obtains in other policy areas like tax and expatriate laws.

Nevertheless, the ability of ACs who are not classed as ‘systemically important’ to renege on AML/CFT compliance is somewhat curtailed by the involvement of IFIs. For instance, as a pre-requisite condition for financial assistance, IFIs have incorporated law reforms and compliance requirements.²²⁵ Additionally, multilateral institutions and FIs use compliance with accredited standards to determine potential finance opportunities or threats.²²⁶ Whilst this may suggest that the scope for slack is addressed, this is not necessarily correct. For instance, if a FI within a HP country is entering into

²²² Garrett Geoffrey, ‘Global Markets and National Politics: Collusion Course or Virtuous Circle?’ [1998] 52 (4) *International Organization* 787, 823.

²²³ Jason C Sharman, ‘Power and Policy Diffusion: Anti-Money Laundering in Developing States’ [2008] 52 (3) *International Studies Quarterly* 635, 649.

²²⁴ *Ibid.*

²²⁵ Ian Fletcher, Loukas Mistelis, and Marise Cremona, (eds.) *Foundations and Perspectives of International Trade Law* (London: Sweet & Maxwell, 2001)

²²⁶ *Ibid.*

a business with another FI in a MP country, the domination of self-interests may resurface, particularly if the transaction is ad hoc for the principal and agent. In such situations, the incentive to comply is low for both institutions, although it is higher for the HP country FI due to its mandated adherence to international standards and subjection to high regulatory standards. Where however, it is a continuous transactional relationship for both FIs, both countries are incentivized to comply to maximize profit. However, differing legal framework, policies and capacity means that the MP FI is less able to comply, thereby forcing the HP FI to de-risk so as to avert any possible home or international sanction. This serves as another explanation for the de-risking of African banks by Deutsche bank.²²⁷

This difficulty is further exacerbated by the delegation of gatekeeper responsibilities to private institutions. Sharman notes that similar to the Basel 2 requirement where the task of determining capital requirements was assigned to banks, assigning and guarding against AML/CFT risk has been increasingly delegated to private firms.²²⁸ These firms are required to flag up high-risk countries and ensure extra scrutiny to guarantee safe transaction with such countries. However, due to their subjectivity, firms may fall back on casual impressions and shared stereotypes in making conclusions as to which countries are high and low risk.²²⁹ On this basis, FIs in regulated states are assumed to be more risk averse than in unregulated states. Sharman argues that the effect is ousting a country from an 'in group' thus warranting reputational damage.²³⁰ He bases this on the argument that AML standards are not in themselves effective in lowering risk, but serve as an indicator of membership of an 'in group'. His argument suggests that compliance response to competition is an involuntary measure; thus without competition and occasioning loss, some countries would not implement AML/CFT

²²⁷ The Economist, 'A Crackdown on Financial Crime Means Global Bank Are De-risking' (The Economist, 8 July 2017) < <https://www.economist.com/news/international/21724803-charities-and-poor-migrants-are-among-hardest-hit-crackdown-financial-crime-means> > accessed 10 August 2017.

²²⁸ Zoe Lester, 'Risk Management and the Risk Attached to Money Laundering and Terrorist Financing' (Money Laundering Risk Conference, Sydney, Australia, July 2006); KPMG, 'Global Anti-Money Laundering Survey 2011, How Banks Are Facing up to the Challenge' (KPMG, 2011) < <https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Advisory/global-aml-survey-2011-main-report.pdf> > accessed 2 June 2015.

²²⁹ Firms are usually unconcerned with the result of sanctions caused by their wrongful assessments.

²³⁰ Jason C Sharman, 'Power and Policy Diffusion: Anti-Money Laundering in Developing States' [2008] 52 (3) International Studies Quarterly 635, 649.

laws. It is however not independent from coercion, which in itself forms the ‘in group’ membership.

Whilst there are indications that ACs are keen to integrate with the global financial market, this aspiration is hindered by their culture and capacity. For instance, FIs in developed or EEs are owned by shareholders with dispersed ownership. Conversely, African FIs are usually family-owned and run.²³¹ Hence, customers do not have the same political recourse to demand regulatory reform as opposed to countries. The absence of recourse for stakeholders largely undermines compliance. More so, these countries do not have the needed technological or expert capacity to ensure compliance.

The literature on globalization and integration has indicated that supranational influences can only determine compliance level of ACs to a limited extent. Homegrown factors are paramount to ensuring effective compliance to AML/CFT. Given this fact, the FATF, the IMF/WB have intensified efforts to ensure compliance, by providing the assistance required to ensure effective capacity building and training in Africa. The extent to which this has ensured compliance would require a cross-country analysis based on country review.

5.3.2.5 Legitimation

Legitimacy of institutions and standards is considered crucial for stimulating proactive compliance with regulatory standards.²³² This is predicated on the perception of its ownership, inclusiveness and procedural fairness ingrained in its processes and standards.²³³ Given the establishment and formulation of FATF standards by a non-

²³¹ Gomiluk Otokwala, ‘Wither Family Shareholding in Developing Countries’ (2010) available at SSRN 1714526.

²³² Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (2008) LSE Law, Society and Economy Working Papers < <http://www.lse.ac.uk/law/people/academic-staff/julia-black/Documents/black2.pdf> > accessed 10 March 2015.

²³³ Gregory Shaffer, *Transnational Legal Ordering and State Change* (Cambridge Studies in Law and Society, 2014); cf with Bodnasky who asserts that legitimacy can be viewed in terms of

inclusive club of G7 countries to the exclusion of ACs, ACs postulated that a global hegemony exists.²³⁴ The subsequent attempt at resolving this ‘legitimacy crisis’ through the FSRBs has been deemed inadequate.

Buttressing the absence of legitimacy in GIABA, EENA5 mentioned that GIABA did not evolve from rational incentives, but rather, as a result of external pressure from the blacklisting of Nigeria.²³⁵ EENA5 stated that ‘one of the conditions to be removed from that list was (for Nigeria) to become a strong pillar in dealing with the problem of ML/TF in West Africa’.²³⁶ Such expectation was bestowed on Nigeria given its economic influence in Africa and the involvement of its citizens in illicit crimes across West Africa. But given the lack of ownership or inclusion in the FATF standards making process at the time, GIABA remained dormant for a period of four years, due to limited understanding of the FATF’s standards. Consequently, compliance, which required adherence to ‘dead letter standards’ was met with scarce observance.

The absence of legitimacy is further evidenced by the processes involved in the reevaluation of standards. EENA5 asserts that the recommendations review process is based on a participatory process where all countries, divided into groups, discuss and contribute to proposals by the PDG during the plenary sessions. However, when making final decisions ‘there are powers and opinions that supersede the others’, with opinions from developed countries dwarfing those of ACs.²³⁷

representativeness, procedures and effectiveness. Bodansky, ‘The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?’ [1999] 93 (3) *American Journal of International Law* 596, 604.

²³⁴ Mark C Suchman, ‘Managing Legitimacy: Strategic and Institutional Approaches’ [1995] 20 (3) *Academy of Management Review*, pp. 571, 588; Eric Helleiner, ‘State Power and the Regulation of Illicit Activity in Global Finance. In FrimanRH, AndreasP (eds) *The Illicit Global Economy and State Power* (Rowman & Littlefield, Lanham, 1999).

²³⁵ EENA5, Researcher, GIABA, Interview with EENA5 ‘Telephone Call’ (2017).

²³⁶ *Ibid.*

²³⁷ *Ibid* (n 235).

Furthermore, FIs from ACs are rarely ever consulted given their perceived pre-mature status.²³⁸ This perspective illustrates the semi-exclusive nature of the FATF decision making process regarding its standards and how that challenges the sovereignty of countries. Accordingly, EENA5 asserts that any review process is belated as ‘no review will take the interest of African states into consideration.’²³⁹ His perspective is predicated on the fallibility of the FATF in encapsulating the input of African states in its standards. Acceding to this, Singer argues that in heterogeneous societies, for substantive legitimacy, the law must strike a balance between recognizing differences in worldviews and enabling society to function as a cohesive entity.²⁴⁰ The FATF does not currently have this provision.

What becomes evident is that from ACs’ perspective, the FATF’s recommendations and processes lack legitimacy. This shortcoming is heightened by FATF sanctions which singles out countries for financial isolation and reputational damage. This perspective aligns with Shaffer’s stance that in the absence of input, output and throughput legitimacy, countries would be hindered from voluntary proactive compliance to international law.²⁴¹ Instead, they would engage in formal or creative compliance to evade sanctions. This would necessitate higher enforcement cost to ensure compliance through coercion, but the result would be limited progress on effectiveness.²⁴²

Vibert scrutinizes the perception that proactive compliance is subject to the institution of legitimacy, asserting that bodies such as the FATF have epistemic authority, which is based on expertise that confers legitimacy.²⁴³ This position is blindsided to the internal politics of the institution and its effect on the FATF’s rude design and

²³⁸ Ibid.

²³⁹ Ibid.

²⁴⁰ Michael Singer, ‘Legitimacy Criteria for Legal Systems’ [2006] 17 (2) Kings Law Journal 229 -53.

²⁴¹ Gregory Shaffer, *Transnational Legal Ordering and State Change* (Cambridge Studies in Law and Society, 2014).

²⁴² Cf with Rainer Hulse who argues that coercion may be more cost effective and simpler for institutions to disseminate an unpopular regime. Rainer Hulse, ‘Even Clubs Can’t Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended’ [2008] 2 (4) Regulation and Governance 459, 466.

²⁴³ Frank Vibert, ‘Reforming International Rule Making’ [2012] 3 (3) Global Policy 391, 392.

compliance. The politics is evident in the composition of experts from the private and public sector who are mainly representatives of developed countries, a configuration that does not encompass or represent the views of developing countries. It is thus capable of stifling the effectiveness of these countries to the FATF standards. This indicates that any re-structuring should de-politicise the FATF and ensure a truly ‘expertise’ process that include the views of developing countries.

5. 4 Cross Country Analysis of Compliance to AML/CFT Regime: FSAP and FATF.

5.4.1 Assessing the Financial Sector Assessment Program Reports (FSAP): The Procedure

The FSAP assesses a country’s financial stability by measuring its compliance with international standards. The aim is to evaluate the attainment of minimum standards on rules and a country’s ability to absorb stress. The result of the FSAP is the Financial System Stability Assessment (FSSAs), a vital document in the IMF’s Surveillance process and Financial Sector Assessment (FSA) for the World Bank. The FSAP report signals the respect the IMF/World Bank have for sovereign boundaries given that countries are not mandated to partake in the FSAP process. Even upon participation, countries have a say in whether the FSAP is published and what part can be excluded from publication.²⁴⁴ The justification for this is to promote country ownership of financial stability reform and encourage voluntary rather than pressured participation in the process.²⁴⁵ A further rationale was that it would encourage compliance from countries wishing to be assessed in order to attract foreign capital. This rationale propels

²⁴⁴ Paul Kupiec, ‘The IMF-World Bank Financial Sector Assessment Program: A View from the Inside’ in Douglas D Evanoff and George G Kaufman (eds), *Systematic Financial Crisis, Resolving Large Bank Insolvencies* (World Scientific, 2005) 71.

²⁴⁵ Leonard Seabrooke and Eleni Tsiongou, ‘Revolving Doors and Linked Ecologies in the World Economy: Policy Locations and the Practice of International Financial Reform’ (2009) CSRG Working Paper 260/09, 15 <
<https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgp/papers/workingpapers/2009/26009.pdf>
> accessed 10 July 2015.

countries to prepare adequately to ensure they are fit for assessments that will illustrate their conformity with the IMF/World Bank designs.²⁴⁶

5.4.2 Assessment of FSAP Country Review

AML/CFT regulation is an aspect of the FSAP review program; however, its concentration is wider as it encompasses prudential supervision and management. Thus, its focus on AML/CFT in this context is usually sparse; hardly concentrating on all areas and has neither depth nor any particular approach. This is evident in country reports. For instance, in Nigeria the AML/CFT focus was on pensions and insurance,²⁴⁷ which largely differed from Algeria, which focused on AML/CFT as a means of facilitating financial deepening across all sectors.²⁴⁸ Country assessment reports vary based on content, quality and institutional findings, which complicate the ability to make effective cross-country analysis and comparisons.²⁴⁹

By February 2015, only 18 of the 54 ACs had undergone the FSAP procedure and had their FSSA published.²⁵⁰ Among them, only 11 had AML/CFT discussed in their reports,²⁵¹ indicating the apathetic attitude of ACs towards AML/CFT regulations. Conversely, it may indicate the incapability of ACs to adequately adopt or implement the AML/CFT recommendations or the FSAPs focus on other areas. This is paradoxical

²⁴⁶ Leonard Seabrooke and Eleni Tsiongou, 'Revolving Doors and Linked Ecologies in the World Economy: Policy Locations and the Practice of International Financial Reform' (2009) CSGR Working Paper 260/09, 15 <
<https://warwick.ac.uk/fac/soc/pais/research/researchcentres/csgr/papers/workingpapers/2009/26009.pdf>
> accessed 10 July 2015.

²⁴⁷ IMF, 'Nigeria: Financial Sector Stability Assessment' (IMF, 2013) <
<https://www.imf.org/external/pubs/ft/scr/2013/cr13140.pdf> > accessed 10 July 2015.

²⁴⁸ IMF, 'Algeria: Financial System Stability Assessment' (IMF, June 2014) <
<https://www.imf.org/external/pubs/ft/scr/2014/cr14161.pdf> > accessed 10 July 2015.

²⁴⁹ Marco Arnone and Pier Carlo Padone, 'Anti-Money Laundering by International Institutions: A Preliminary Assessment' [2008] 26 (3) European Journal of Law and Economics 361, 369.

²⁵⁰ Algeria, Cameroon, Central Africa Republic, Chad, Comoros, Congo, Gabon, Ghana, Morocco, Mozambique, Namibia, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Tunisia and Uganda.

²⁵¹ Algeria, Central African Republic, Congo, Ghana, Morocco, Mozambique, Namibia, Nigeria, Rwanda, South Africa, and Tunisia.

as the FSAP was assumed to have a wider reach, able to ensure uniform widespread application of recommendations.²⁵²

Despite the lack of participation, the FSAP reports illustrate resonating themes cutting across countries. These include strategic deficiencies in the AML/CFT legal framework, weak regulatory supervision, absence of a robust enforcement and implementation apparatus, absence of the technical ability to combat ML/TF especially in banks where the CDD and STR were defective, the presence of new laws which could not be assessed and the absence of FIU links across countries. It is difficult to comprehensively evaluate the merits, shortcomings and impact of the AML/CFT programme and implementation, nor draw founded conclusions due to the summary nature of the assessment reports.

5.4.3 Assessment of the Financial Action Task Force Country Reports

The FATF monitors a country's implementation and compliance with its recommendations in two main ways: a self-assessment and a mutual evaluation.²⁵³ The self-assessment exercise is carried out by the countries themselves. This exercise, which requires completing questionnaires, enables them evaluate their progress in the implementation of specialist standards.²⁵⁴ Officials of the FATF who undertake the on-site mutual evaluation task in countries depend on the self-assessment reports for preliminary information.²⁵⁵ An analysis of the information garnered forms the bedrock

²⁵² This can be attributed to the voluntary nature of the FSAP.

²⁵³ FATF, 'Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of the AML/CFT Systems' (FATF, February 2013) <<http://www.fatf-gafi.org/media/fatf/documents/methodology/fatf%20methodology%2022%20feb%202013.pdf>> accessed 21 May 2015; AML/CFT Evaluations and Assessments, Handbook for Countries and Assessors, (April 2009) <<http://www.fatf-gafi.org/media/fatf/documents/reports/Handbook%20for%20assessors.pdf>> accessed 1 June 2015.

²⁵⁴ Ibid.

²⁵⁵ FATF, 'Mutual Evaluations' (FATF) <<http://www.fatf-gafi.org/topics/mutualevaluations/>> accessed 1 June 2015.

of the discussions at plenary meetings, where the compliance level of the country is decided.

Unlike the FSAP, the only point where countries can influence the content of this resulting MER is during the self-assessment stage and to a limited extent during the country dialogue concerning the MER. The FATF does not require consent from a country to publish its extensive findings. To that extent, it can be argued that it encroaches on the sovereignty of countries.

5.4.3.1 Empirical Assessment of FATF Country Reports

An assessment of countries' MER is carried out to determine the level of compliance to AML/CFT. Each qualitative assessment is recoded into a number to permit a quantitative analysis. Officially each recommendation (rec.) can be scored based on one of five possible assessments methodology as follows:

- NA (0) = Not Applicable (A requirement or part of it does not apply due to the structural, legal or institutional features of a country)
- NC (1) = Non-Compliant (There are shortcomings, with a large majority of the essential criteria not being met)
- PC (2) = Partially Compliant (The country has taken some substantive action and complies with some of the essential criteria)
- LC (3) = Largely Compliant (There are minor shortcomings, with a large majority of essential criteria being fully met)
- C (4) = Compliant (Recommendation is fully observed with respect to all essential criteria)

The assessment of each recommendation is mapped out into a 5-valued measure where 0 is the minimum and 5 is the maximum.

5.4.3.2 Analysis of AML/CFT by countries and geographical distribution

Figure 1 represents a plot indicating the percentage score of compliance of 38 ACs with the 40 FATF recommendations. Data is derived from each country's mutual evaluation reports spanning 2007 through 2015. Consequently, changes in updated MERs have been reflected in the compliance levels to the exclusion of post-2015 MERs. Of the countries examined, 30 of them are deemed to be < 50% compliant with the FATF recommendations. Only 7 are deemed to be > 50% compliant. The statistics indicate low level of compliance by ACs. Figure 1 shows that Egypt is the highest compliant AC, followed by Tunisia, Mauritius, the Gambia, Malawi, Senegal and then Zimbabwe. The weakest frameworks are those of Burkina Faso, Liberia, Tanzania, Sierra Leone, Kenya, Swaziland, Mozambique and Mali.

The weakest frameworks were mainly in the area of TF regulation, and sanctions related thereto.²⁵⁶ Thus, since TF was added to the FATF recommendations, ACs are yet to comprehend and implement these requirements for compliance purposes. Weakness is also noted in recommendation 10 (CDD), thus bolstering the argument about absence of capacity to effectively address the requirements of this recommendation.²⁵⁷ Countries also contend with recommendations relating to the additional measures for specific customer control,²⁵⁸ indicating the pervasive nature of corruption and

²⁵⁶ See FATF Recommendation 5, 6, 7 and 8, The FATF Recommendations, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' (*The FATF Recommendations*, February 2012) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 20 April 2015.

²⁵⁷ KPMG, 'Global Anti-Money Laundering Survey 2011, How Banks Are Facing up to the Challenge' (KPMG, 2011) <<https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Advisory/global-aml-survey-2011-main-report.pdf>> accessed 2 June 2015. Highlighting this, the KPMG report noted that 'some countries in Africa have no national identify system and no proper verification documentation'; Hennie Bester, Doubell Chamberlain, Louis de Koker, Christine Hougaard, Rayn Short, Anja Smith and Richard Walker, 'Implementing FATF Standards in Developing Countries and Financial Inclusion: Findings and Guidelines' (*First Initiative*, 2008) <http://cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf> accessed 10 May 2015.

²⁵⁸ FATF, 'FATF Recommendation 12, 13, 14, 15 and 16' (*FATF*, 2012) <<http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>> accessed 10 February 2017.

ineptitude in African financial regulatory institutions. Regarding Recommendation 14 ('money or value transfer services'), it is doubtful that the vast efforts required to identify, register and monitor these services are likely to be an immediate priority.

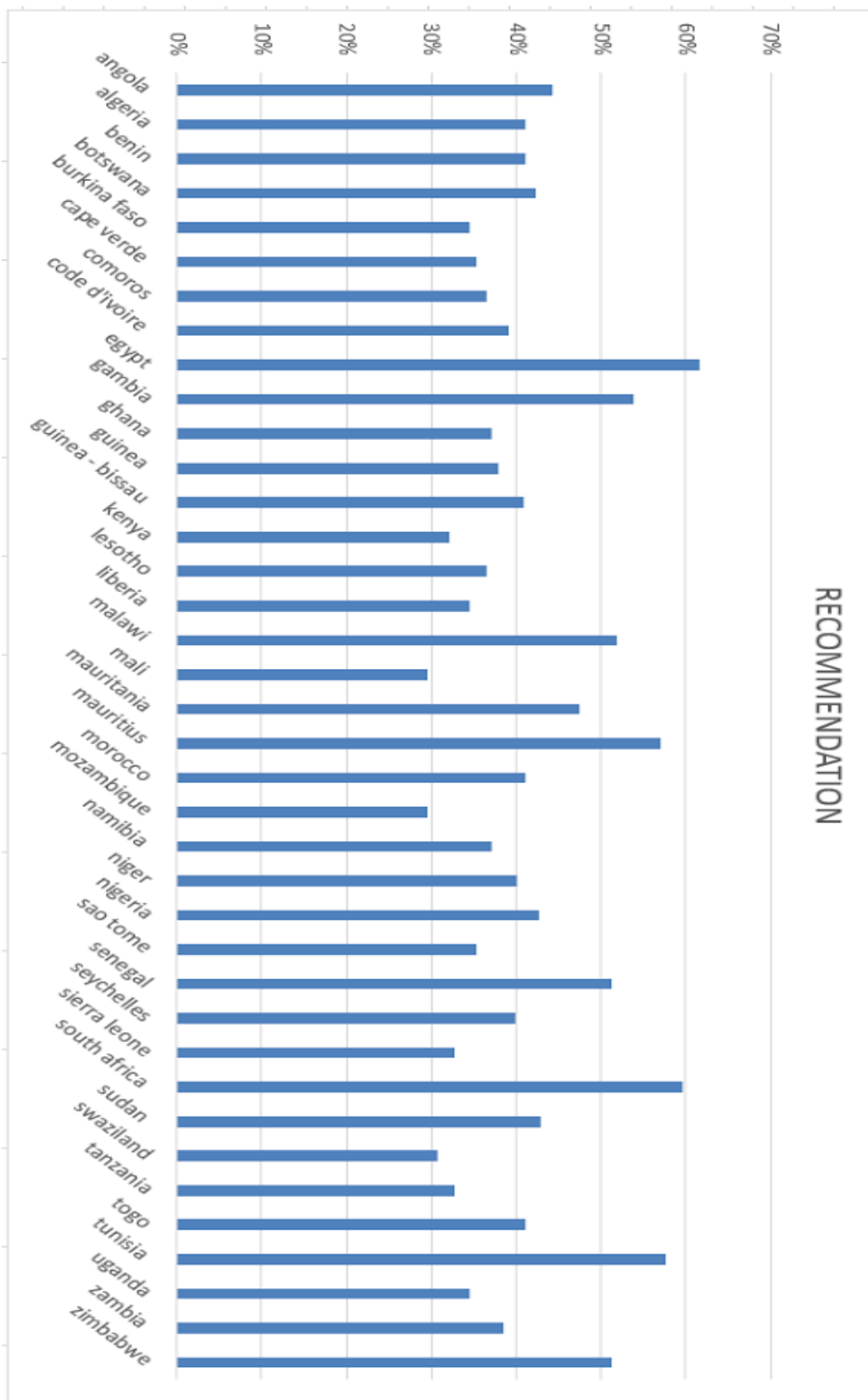


Figure 1. *Technical Compliance Levels of African Countries to the FATF Recommendations (Derived from the FATF's countries MERS)*

Figure 2 presents a plot of the average score based on detailed assessments. Countries are grouped according to the following geographical category: North Africa (Region 9), South Africa (Region 8), West Africa (Region 6) and East Africa (Region 7). On a 100% scale, it emerges that no region achieves a compliance level of 50%. East Africa with a compliance level of 34% is the lowest compliant region in Africa,²⁵⁹ followed by Western Africa²⁶⁰ with 39% compliance. Southern Africa is 43% compliant,²⁶¹ whilst North Africa is the highest compliant region in Africa with 49%.²⁶² It is however imperative to note that an estimated assessment is not reflective of the actual compliance levels of the regions. Certain regions have more countries than others and some countries in particular regions were not assessed. It is therefore inappropriate to conclude that East Africa is the worst compliant region in Africa.

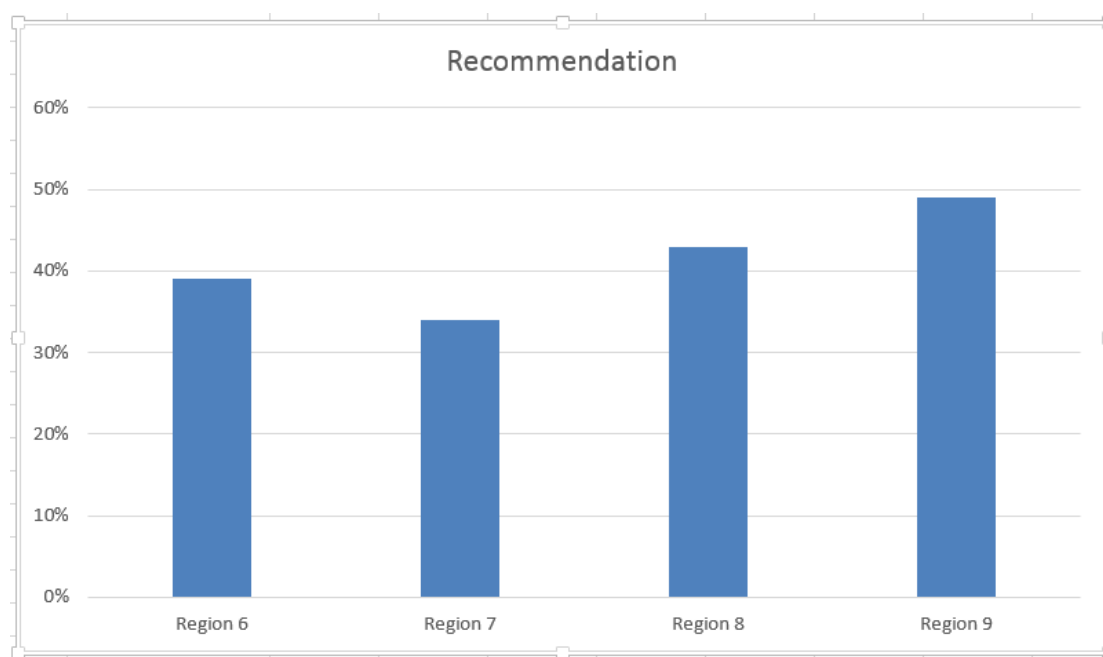


Figure 2: *Africa's Compliance to the FATF Recommendations by Regions*

²⁵⁹ Comoros, Uganda, Tanzania and Kenya.

²⁶⁰ Gambia, Senegal, Nigeria, Benin, Guinea Bissau, Togo, Niger, Cote d'Ivoire, Guinea, Ghana, Cape Verde, Liberia, Sao Tome & Principe, Burkina Faso, Sierra Leone and Mali.

²⁶¹ Mauritius, Malawi, Zimbabwe, Angola, Botswana, Seychelles, Zambia, Lesotho, Namibia, Swaziland and Mozambique.

²⁶² Egypt, Tunisia, Mauritania, Sudan, Algeria and Morocco.

5.4.3.3 Analysis by FATF recommendations

Figure 3 highlights the compliance levels in accordance with the FATF recommendations. The clearest deficiencies noted regarding country compliance levels are mainly in ‘Designated Non-Financial Businesses and Professions.’²⁶³ These recommendations mandate effective regulation by casinos, real estate agents, dealers in precious metals and stones, lawyers, and trust and company service providers, to ensure that their businesses do not aid ML/TF. This recognizes that money launderers and terror funders are exploiting other lucrative and less regulated or licensed avenues to transfer illicit funds.²⁶⁴ For activities like casinos, there are differences in regulatory climates in each AC. Whilst countries like South Africa suffer from discrepancies in its supposed casino regulation,²⁶⁵ in Nigeria casino regulation is relatively recent, accounting for the huge number of unlicensed casinos. Contrariwise, in Kenya and Zimbabwe, gambling is encouraged; however its regulation is growing due to internal conflicts.²⁶⁶

This is particularly worrisome because they relate to actions and procedures, which require the identification of customers both domestically and across borders. This illustrates the need for more determined action on the side of non-financial sector regulators and supervisors. This also applies to recommendation 25, which requires

²⁶³ See FATF Recommendation 22, 23, 28 - The FATF Recommendations, ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation’ (*The FATF Recommendations*, February 2012) <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/fatf_recommendations.pdf> accessed 20 April 2015, with the score of 1.05, 1.12, and 1.1 respectively, lower than the average of 1.66.

²⁶⁴ Jan Mcmillen, ‘Online Gambling: Challenges to National Sovereignty and Regulation’ [2000] 18 (4) *Prometheus* 391 – 410. Casinos are lucrative in Africa and have continued to grow at healthy rates – see PwC page 9, *Raising the stakes in Africa Gambling Outlook: 2014 – 2018 South Africa • Nigeria • Kenya 3rd Annual Edition* November 2014 <http://www.pwc.co.za/en_ZA/za/assets/pdf/gambling-outlook-2014.pdf> accessed 10 May

²⁶⁵ Professor Sphiwe Nzimande, Dr. Stephen Louw, Mr Clement Mannya, Ms Adheera Bodasing, Ms Astrid Ludin, ‘Review of the South African Gambling Industry and its Regulation, a report prepared by the Gambling Review Commission – Final Report submitted to the Minister of Trade and Industry, September 2010.

²⁶⁶ Tonderayi Mukeredzi, ‘Young Zimbabweans Warming up to Gambling’ (*AfricaRenewal Online*) <<http://www.un.org/africarenewal/web-features/young-zimbabweans-warming-gambling>> accessed 17 May 2015.

countries to put in place measures to curb unlawful use of persons and legal arrangement by launderers. It states that ‘countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities’, indicating that specific actions are required to be taken by the government to support both regulatory bodies and FIs. That this is the lowest scoring recommendation shows the lackadaisical attitude of the authorities.

Surprisingly, the statistics reveal that the recommendation with the highest level of compliance in Africa is recommendation 31 on the power of law enforcement and investigative bodies, with the score of 2.7, well above the average of 1.66. This is followed by recommendation 9 on financial institution secrecy laws, with a score of 2.6. If this is correct, it can be interpreted to mean that financial secrecy laws are not inhibiting implementation. It is therefore paradoxical that recommendation 25 on ‘transparency and beneficial ownership’ is low given that beneficial ownership can only really thrive where there is financial secrecy. Compliance literature reveals that Africa’s investigative and enforcement structures are weakly developed.²⁶⁷ It is therefore worrisome when weakly developed areas are considered the most complied to by ACs.

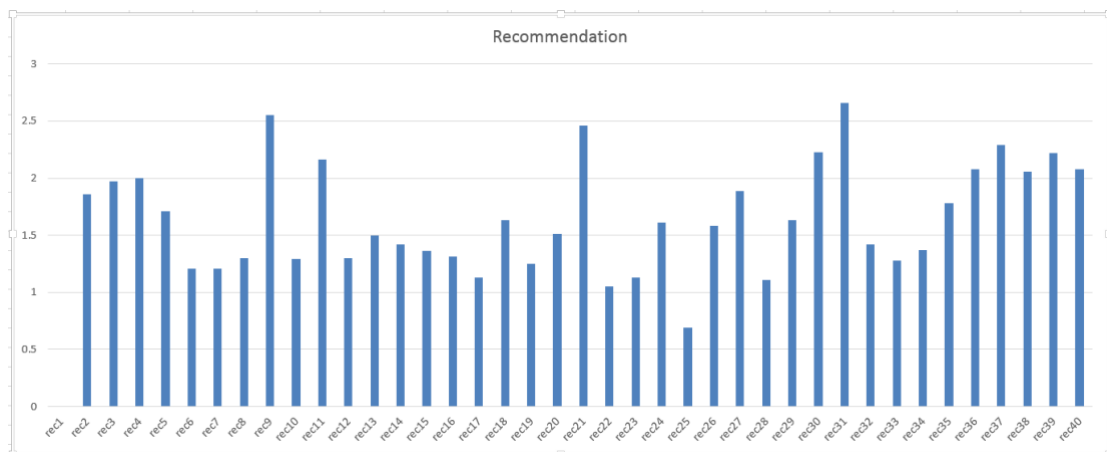


Figure 3: Analysis by compliance to FATF Recommendations

²⁶⁷ Abdullahi Shehu, *Strategies and Techniques of Prosecuting Economic and Financial Crimes* (GIABA Secretariat, 2012); Beth Elise Whitaker, ‘Compliance among Weak States: Africa and the Counter Terrorism Regime’ [2010] 36 *Review of International Studies* 639, 655.

5.4.3.4 Analysis by Compliance Drivers

The compliance levels attained by ACs are plotted against five compliance drivers to illustrate empirically the relationship between compliance and these variables. This is achieved by using the Pearson correlation coefficient (PCC). The PCC presents a range of values from +1 to -1. An r-value of 0 indicates that there is no association between the variables. A value greater than 0 indicates a positive association. However, a value of -1 is a negative linear correlation.

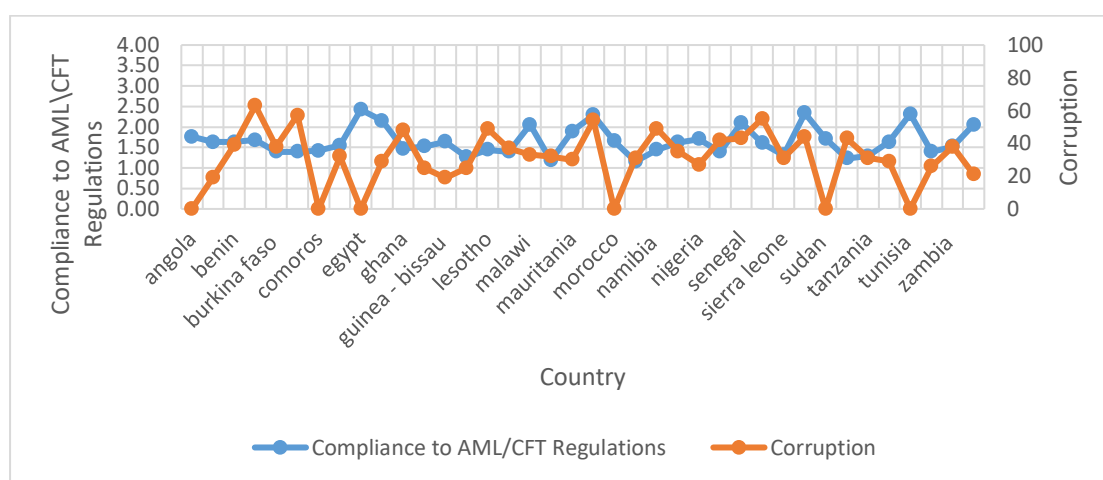


Figure 4: Analysis by corruption index ²⁶⁸

The r-value of -0.20153 indicates that corruption is negatively correlated to country's compliance with AML/CFT regulations.²⁶⁹ The correlation reveals that the higher the compliance, the lower the corruption levels and vice versa. This indicates that reduced corruption in ACs would lead to improved compliance, thereby strengthening Africa's financial system.

²⁶⁸ Correlation is done using the Transparency International, 'Corruption Perception Index 2014: Results' (Transparency International, 2014) < <https://www.transparency.org/cpi2014/results> > accessed 10 July 2015. The compliance index is derived from the FATF data gathered.

²⁶⁹ = CORREL(AX2:AX39:AX39:AU2:AU39)

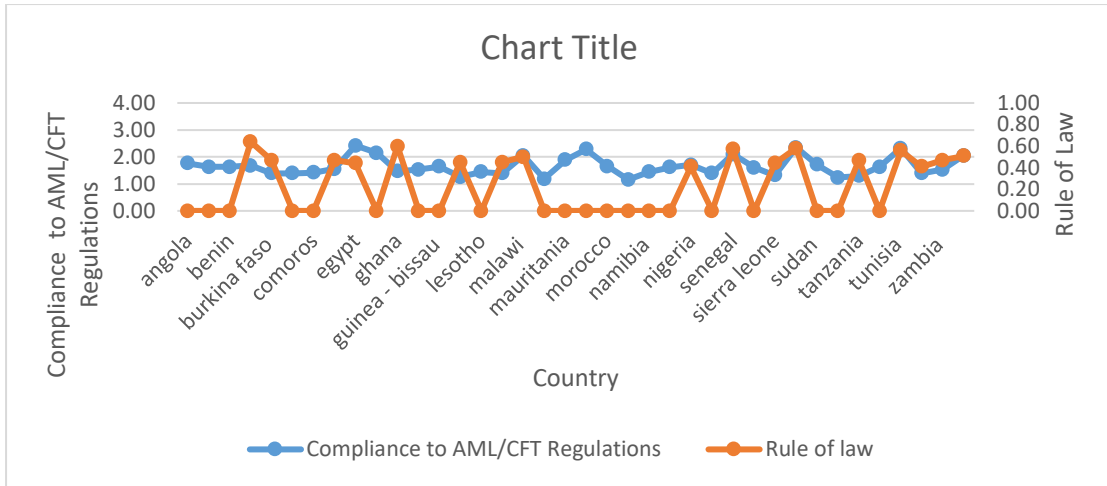


Figure 5: Analysis by rule of law index ²⁷⁰

The r-value of 0.3641826 is indicative of a positive correlation between rule of law and compliance to AML/CFT recommendations, signifying that the more advanced a country's rule of law, the higher its compliance levels.²⁷¹ This correlation is however not blind to exceptions. For instance, although Zimbabwe is the lowest ranked AC in the rule of law index, it is the 7th most compliant AC to the AML/CFT recommendations, indicating that the indexes employed by this evaluation body may be subjective.

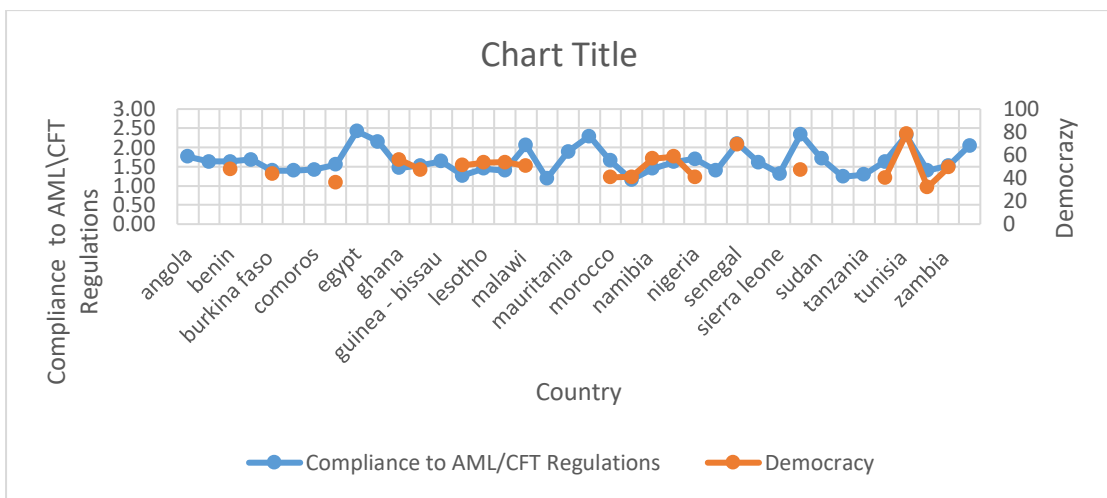


Figure 6: Analysis by Democracy Index ²⁷²

²⁷⁰ World Justice Project Rule of Law Index 2015.

²⁷¹ =CORREL(AX2:AX39,AW2:AW39).

²⁷² David Campbell, Paul Polzlbauer, Thorsten Barth, Georg Polzlbauer, 'Democracy Ranking 2015 (Scores)', (Democracy Ranking, 2015) <

Democracy index is positively correlated to AML/CFT recommendations indicating that countries with a democracy rating above the average exhibit minimal uncertainty as to implementation and compliance with the recommendations.²⁷³ The r-value of 0.5023856 indicates this.

These findings indicate that FATF compliant ACs are more democratic, less corrupt and structure rule of law system.

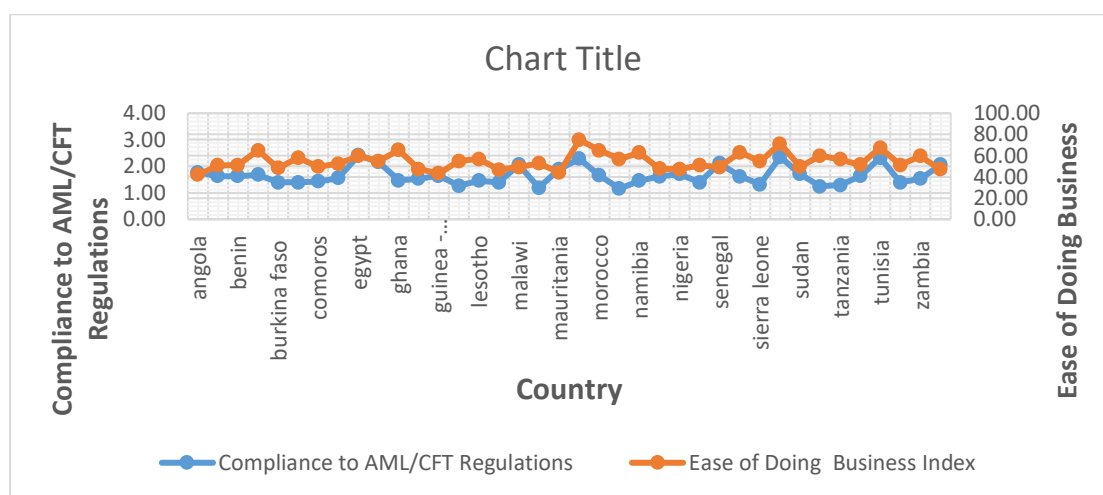


Figure 7: Analysis by ease of doing business²⁷⁴

The r-value 0.242 shows a weak positive correlation between the ease of doing business index and compliance to AML/CFT recommendations. The graph shows that when AML/CFT compliance is high, the ease of business is likely to increase and vice versa. Indicating that ease of doing business is higher in countries with higher compliance. Indicating that with increasing AML/CFT compliance there is reduced corruption in the processes of starting a business and, the legal structures are sturdier to protect

http://democracyranking.org/ranking/2015/data/Scores_of_the_Democracy_Ranking_2015_A4.pdf > accessed 30 December 2015.

²⁷³ =CORREL(AX2:AX39,AV2:AV39).

²⁷⁴ See World Bank Group, 'Doing Business 2015: Going beyond Efficiency' (World Bank Group, 12th Edition, 2015) < http://www.doingbusiness.org/reports/global-reports/~/_media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB15-Chapters/DB15-Report-Overview.pdf > accessed 10 October 2017.

stakeholders. The outcome however varies by country. Angola and Nigeria, for instance, show a negative correlation between the variables whilst Cote d'Ivoire and Egypt show a positive correlation.

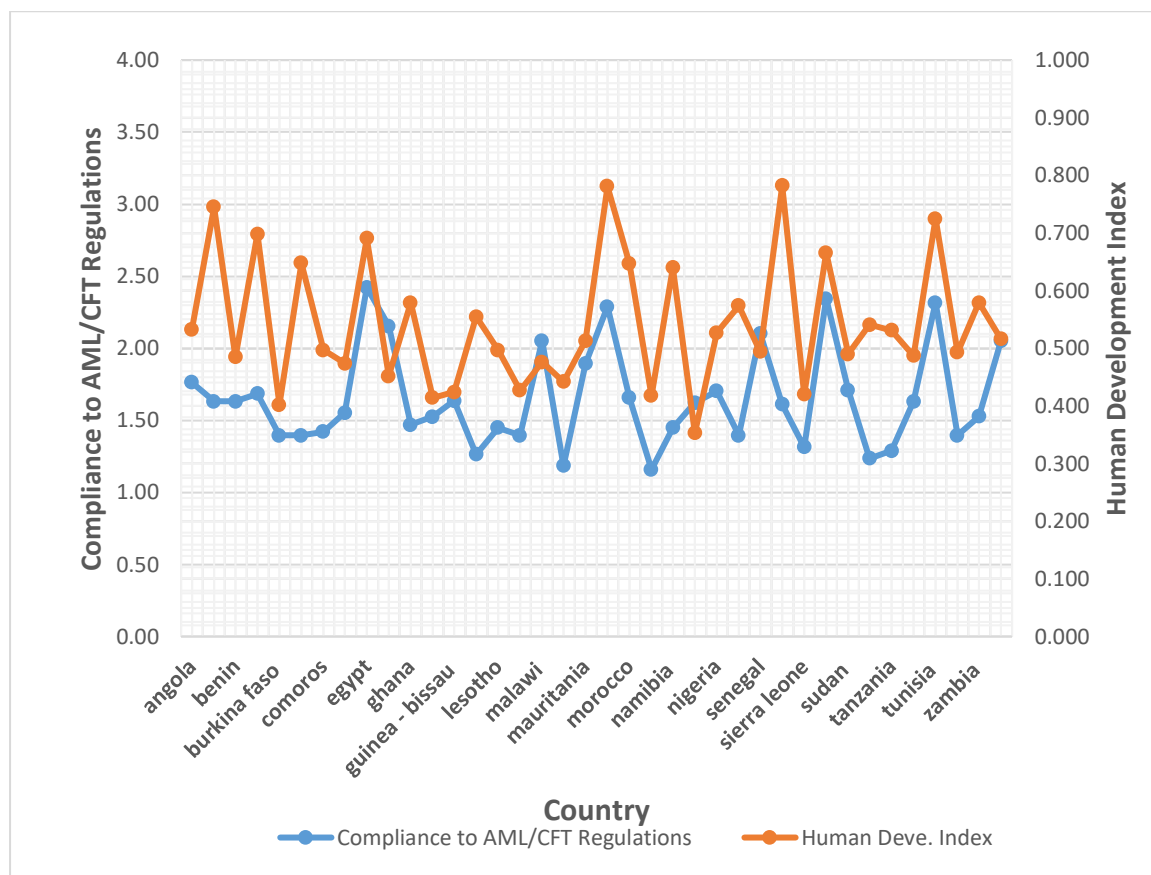


Figure 8: Analysis by human development index²⁷⁵

There is a positive correlation between compliance with AML/CFT standards and human development index (HDI). The higher the compliance standard, the higher the HDI and vice versa. However, external factors are key which explains why, although Zimbabwe recorded increasing compliance to AML/CFT standards, its HDI was negatively correlated.

²⁷⁵ United Nations Development Programme, 'Human Development reports' (United Nations Development Programme) < <http://hdr.undp.org/en/composite/HDI> > accessed 10 October 2017.

5.4.3.5 Caveats

It is noteworthy that there are limitations associated with the general applicability of this study. Firstly, the FATF data quality is questionable, given that the data sources, usually gathered from national regulatory institutions, are subjected to limited regulation. Thus, recommendations are often interpreted in a manner that makes them appear compliant. Secondly, due to resource constraints, as regards finances and human capacity, intelligence and data supplied by these regulatory bodies may not reflect the accurate compliance level with the regulatory standards. Thirdly, only 38 countries have undertaken an MER, as opposed to 54 ACs. This indicates limited representativeness, illustrating the difficulties with undertaking a meaningful cross-country comparison using the limited sample of countries with published detailed assessments. Thus, the FATF's recommended course of action may not always be consistent with the trajectory of domestic law and any measurement for compliance is deficient

Additionally, the variables on democracy index, corruption index and rule of law have 18, 6 and 20 missing variables which may indicate a non-conclusive study. Also, the indices utilised, particularly rule of law and democracy, take into consideration the strength of the laws or legal structure in a country, which the FATF considers in assigning compliance levels. To avoid duplication of results, HDI and ease of doing business are considered.

Lastly, there is a disconnect between how FATF views these compliance indices in comparison to other institutions. This can be typified with the position of Transparency International (TI) on corruption. For instance, the FATF narrowly perceives corruption as bribery or theft of public funds for obtaining private gain.²⁷⁶ Conversely, TI adopts a broader perspective which inculcates grand, political and petty corruption.²⁷⁷ Petty

²⁷⁶ FATF, 'Topic: Corruption' (FATF) < [http://www.fatf-gafi.org/publications/corruption/?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/corruption/?hf=10&b=0&s=desc(fatf_releasedate)) > accessed 10 May 2018.

²⁷⁷ TI, 'What is Corruption' (Transparency International) < <https://www.transparency.org/what-is-corruption#define> > accessed 10 May 2018.

corruption refers everyday abuse of power by low and mid-level public officials, political corruption involves the manipulation of policies or rules to facilitate abuse of power. Grand corruption is referred to as acts committed at a high level of government that distorts policies, enabling leaders to benefit at the expense of the public good. Indicating that whilst the FATF's perspective indicates a focus on PEPs through financial institutions, this is not the case with the TI. However, the FATF does take into consideration the indices of the TIs, and hence any further comparison may be an overlap of numbers difficult to distinguish. What this section indicates is that - although corruption still remains prevalent, compliance is a starting point for a conversation.

5.5 Conclusion

The socio-economic history of Africa reveals the effect of liberalization on the African economy and the resulting diversity amongst countries. For ACs, liberalization was premature and placed considerable pressure on their trade and finance. This worsened Africa's position within the global financial system as countries became more susceptible to external shock. Consequently, this led to inequality amongst countries in Africa, with certain banking and financial markets performing better than others. The rein of the colonial exploits which had ingrained corruption, lack of political will and financial inequality in countries across Africa further restricted the growth of markets, whilst facilitating illicit crimes.

Yet, Africa's response to combatting illicit crimes were tailored to meeting international standards that did not recognize their challenges. This necessitated a homegrown approach that would preserve the sovereignty of ACs whilst remedying the democratic deficit at the international level. The APRM which was created by the AU for this purpose was however unable to meet up with demands. This was due to its lack of enforcement powers, dependence on international bodies, procedural difficulties and the absence of a truly indigenous approach to curtailing illicit crimes.

Therefore, ACs have remained subject to international standards despite their compliance challenges. The FSAP and the FATF evaluation reports buttress this, as only 7 countries achieved over 50% compliance rate, with only Egypt achieving over 60% but less than 70%. An examination of the compliance drivers within ACs as a function of legal and non-legal factors however illustrate that despite the drive to comply to evade sanctions, internal factors challenge compliance in ACs. This is further illustrated through empirical findings utilizing corruption, rule of law, democracy, ease of doing business and human development indexes. Surprisingly, with the exception of corruption, all these factors indicate a positive correlation with Africa's compliance levels. Against the backdrop of these findings, subjecting ACs to the same standards, methodology and sanctions would be to ignore their heritage and socio-economic challenges. It would be setting them to fail.

Albeit restricted in scope, it is hopeful that the recent AU partnership with the AfDB will improve compliance levels of ACs. However, the proper functioning of the AML/CFT regime in Africa would require a more active involvement of properly coordinated national regulatory bodies.

Chapter 6

AML/CFT Regime: Compliance Within Emerging Economies (EE)

6. Introduction

The BRICS economies (Brazil, Russia, India, China and South Africa) have created newer inequalities of power and influence regionally and globally. Although inherently diverse in terms of socio-economic and political structures the BRICS's agreement is perceived as a threat to the existing IFIs. This is particularly due to the BRICS's accelerating economic progression. Against this backdrop, the BRICS were conferred the FATF membership in order to drive compliance regionally, whilst facilitating financial stability. Compliance drivers within the BRICS however indicate a possible misalignment between the expectations of the FATF and the reality of the BRICS to deliver on compliance. Consequently, the extent to which the BRICS membership translates to improved compliance and perception of legitimacy is debatable.

Section 1 provides a brief background to the BRICS and their emergence as an economic bloc. It highlights the interrelationship of the BRICS with reference to their socio-economic and political position with the United States. Section 2 focuses on the inclusion of the BRICS as FATF members, examining whether such inclusion, however belated, propelled improved compliance with the FATF recommendations. Section 3 examines determinants of BRICS's compliance with the FATF's standards, through the lens of legal and non-legal factors, that may be internal or external to EEs. Section 4 presents empirically the BRICS's compliance to AML/CFT standards. The relevant data is used to quantitatively assess correlation to certain determinants of compliance and consequential results. Section 5 draws the strands together.

6.1 Background to BRICS Countries

Although recognized as developing countries by Kenny Chiu and Dominic Wilson et al,¹ Lord Jim O’Neil accorded the BRICS the status of ‘emerging economies’ given their economic growth.² The global power and influence that EEs wield justifies such status. EEs house a large percentage of the world’s publicly owned banks and account for about forty percent of the world’s population.³ China is recognized as the world factory, Brazil as the raw material base, Russia as a hub of petrol, India as the white collar center and South Africa as a resource reservoir.⁴ Collectively, the BRICS account for thirty percent (30%) of global GDP⁵ and control forty-three percent (43%) of global foreign exchange reserves.⁶ Admittedly, these features distinguish the BRICS from developing countries that have low GDP, underdeveloped industries and low standard of living levels.⁷

¹Kenny Chiu, ‘Analysis of the Economic Development Prospects of BRICS Countries’ (*ENSAfrica*, 28 July 2014) <<http://www.mondaq.com/southafrica/x/330536/international+trade+investment/Analysis+Of+The+Economic+Development+Prospects+Of+BRICS+Countries> > accessed 23 February 2016; Dominic Wilson and Roopa Purushothaman, ‘Dreaming with BRICS: the Path to 2050’ [2003] 99 *Global Economic Paper* 1, 3.

² Jim O’Neil, ‘Building Better Global Economic BRICS’ [2001] 66 *Global Economics Paper* S.04; Ellen Brown, ‘Just who is Responsible for Deregulation?’ (*Illusion2Reliality* at www.moreyroots.co.uk, 5 September 2015) < <http://www.moneyroots.co.uk/#/the-banksters/clny7> > accessed 23 February 2016; Gillian Tett, ‘The Story of the BRICS’ (*Financial Times*, 15 January 2010) < <https://next.ft.com/content/112ca932-00ab-11df-ae8d-00144feabdc0> > accessed 15 May 2016; Leslie E. Armijo, ‘The BRICS Countries (Brazil, Russia, India and China) as Analytical Category: Mirage or Insight?’ [2007] 31 (4) *Asian Perspective* 1, 2; Dominic Wilson and Roopa Purushothaman, ‘Dreaming with BRICS: The Path to 20150’ [2003] 99 *Global Economic Paper* 1, 3.

³ Leszek Niewdana, *Money and Justice: A Critique of Modern Money and Banking System from the Perspective of Aristotelian and Scholastic Thoughts* (1st Published, Routledge Taylor & Francis Group 2015) 140.

⁴ Pavnesh Kuman, ‘BRICS: The Rise of Sleeping Giant’ [2013] 2 (1) *Voice of Research* 66, 66.

⁵ BRICS Russia UFA 2015, ‘BRICS Reach 30 Percent of Global GDP’ (*BRICS RUSSIA UFA*, 7 July 2015) < <http://en.brics2015.ru/news/20150707/277026.html> > accessed 23 February 2016

⁶ Van Agtmael, A. ‘Think Again: The BRICS’ (*Foreign Policy*, 8 October 2012) <<http://foreignpolicy.com/2012/10/08/think-again-the-brics/>> accessed 21 May 2016.

⁷ The World Bank, ‘Data: World Bank Country and Lending Groups’, (*The World Bank*, 2018) < <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups> > accessed 2 February 2018.

Given the characteristics and stage of development of BRICS,⁸ the implications are that they are already creating newer inequalities of power and influence in relation to smaller or developing African and Asian states.⁹ Additionally, the BRICS is attempting to checkmate western supremacy through its augmented position in the global economy. The financial crisis catalyzed this agenda, stimulating investors looking for alternative investment destinations to diversify their portfolio into the BRICS.¹⁰ This amplified the position of the BRICS in the global economy and within IFIs/TGNs.

However, the BRICS's political disconnect has raised concerns that their clustering as EEs was an awkward fusion.¹¹ The BRICS have individual and divergent political ambitions¹² somewhat linked to the United States (US). The strategic triangular relationship between India, China and the United States epitomizes the US link, which, although tense, is necessary to combat terrorism occasioned by financial liberalization.¹³ The strains in the relationship are evident in differences between China and the US on issues such as human rights, product pirating and unfair trading practices.¹⁴ The US-India relationship is equally strained, given India's opposition to

⁸ Mohsin Habib and Leon Zurawwicky, 'Corruption in Large Developing Economies: The Brazil, Russia, India and China' in Subhash C Jain (eds) *Emerging Economies and the Transformation of International Business – Brazil, Russia, India and China* (BRICS) (Edward Elgar, Cheltenham, UK, 2006) 452.

⁹ Robert J Holton, *Global Inequalities* (1st Published, Macmillan Palgrave, 2014) 20; European Parliament, Directorate-General for External Policies, *The Role of BRICS in the Developing World* (European Parliament, 2012) 34.

¹⁰ Gillian Tett, 'The Story of the BRICS' (Financial Times) < <https://next.ft.com/content/112ca932-00ab-11df-ae8d-00144feabdc0> > accessed 15 May 2016.

¹¹ Vidya Nadkarni, 'Introduction' in Vidya Nadkarni and Norma C Noonan, *Emerging Powers in a Comparative Perspective: The Political and Economic Rise of the BRIC* (First published 2012, Bloomsbury 2013) 3.; Colin Sparks, 'How Coherent is the BRICS Grouping' in Kaarle Nordenstreng, Daya Kishan Thussu (eds.) *Mapping BRICS Media* (Routeledge 2015). This fusion was originally faulted for excluding South Africa, given its economic prominence in Africa. South Africa was later added in 2010, a move opposing scholars have viewed as a mismatch. Although South Africa has a relatively sophisticated financial service base, it is not poised to become a driver of global economic growth given its GDP of \$351 billion, see Frank William, 'International Business Challenge: Does Adding South Africa Finally Make the BRIC Countries Relevant' [2013] 12 (1) *Journal of International Business Research* 1, 5; Economic Development & Growth in Ethekwini, 'Building Better BRICS: South Africa's Inclusion into the Bloc' (*Ethekwini Municipality*, 2012) < http://www.durban.gov.za/Resource_Centre/edge/Documents/Building%20Better%20BRICS%20-%20South%20Africa%27s%20Inclusion%20into%20the%20BI.pdf > accessed 10 May 2016.

¹² Vidya Nadkarni, 'Introduction' in Vidya Nadkarni, Norma C Noonan (eds) *Emerging Powers in a Comparative Perspective: The Political and Economic Rise of the BRIC* (First Published 2012, Bloomsbury 2013) 3.

¹³ Ananya Chatterjee, 'India-China-United States: The Post-Cold War Evolution of a Strategic Triangle' [2011] 5 (3) *Political Perspectives* 74, 75.

¹⁴ *Ibid.*

the US movement against communism and the US's subsequent uncertainties about India's nuclear program.¹⁵ Despite their differences, India and China are mending fences to develop stronger ties, but the US remains uncomfortable with these developments.¹⁶

As protagonists of the cold war, the historical disagreements between Russia and the US were deepened by the US-led North Atlantic Treaty Organization (NATO) alliance to combat the Soviet Union,¹⁷ a recognized nuclear superpower.¹⁸ More recently, the US alliance against Russia facilitated its suspension from the G8 given Russia's annexation of Crimea.¹⁹ Consequently, Russia has intensified its political and trade agreement with China.²⁰ Russia has however shown little evidence that it intends to backtrack on its human rights stance, which the US does not agree with.²¹ However, the US and Russia work together to counter global terrorism.²²

Brazil and South Africa have dissimilar relationships with the US. Although historically perceived to be pro-American given its role in the second world war, Brazil has had a relatively distant relationship with the US and is currently seeking equality

¹⁵ Ibid.

¹⁶ Tridivesh Maini, 'What the US Gets Wrong about India's Relationship with China' (*The Diplomat*, March 13 2016) <<http://thediplomat.com/2016/03/what-the-us-gets-wrong-about-indias-relationship-with-china/>> accessed 13 May 2016

¹⁷ Pravdu Ru, 'NATO: Built Against USSR, doomed to Lose Battle Against Russia' (*Pravdu Ru*, 2016) <http://www.pravdareport.com/news/world/europe/05-04-2016/134065-nato_bloc-0/> accessed 21 May 2016

¹⁸ Jim Nichol, 'Russian Political, Economic and Security Issues and U.S Interests' (Congressional Research Service, 31 March 2014) <<https://fas.org/sgp/crs/row/RL33407.pdf>> accessed 21 May 2016

¹⁹ Oleg Remizov, 'Discourses and Emotions in Narration of the Annexation of Crimean Peninsula by the Russian Federation' (Master's Thesis, University of Tartu 2015); Braun Aurel, 'Tougher Sanctions Now: Putin's Delusional Quest for Empire [2014] 177 (2) World Affairs 34, 40

²⁰ Mark N Katz, 'The Big Winner from Ukraine Crisis? China' (*Fareed Zakaria GPS, Special to CNN*, 6 June 2014) <<http://globalpublicsquare.blogs.cnn.com/2014/06/06/the-big-winner-from-ukraine-crisis-china/>> accessed 21 April 2016

²¹ For instance, banning of gay marriage

²² United States Department of State, 'Country Reports on Terrorism 2012' (*United States Department of State Publication*, May 2013) <<https://www.state.gov/documents/organization/210204.pdf>> accessed 30 May 2016; Brazil and China have become partners in commodity trading, allowing Brazil to triangulate US interest in the region with China. It also reduced US leverage in the region, given china's willingness to finance projects and engage with leaders therefore acting outside the previous hemispheric consensus. See, Eric Farnsworth, 'America Must Take Brazil Seriously' (*The National Interest*, June 15, 2015) <<http://nationalinterest.org/feature/america-must-take-brazil-seriously-13111?page=2>> accessed 1 January 2016

with the US.²³ South Africa (SA) however has a unique relationship with the US given its influence in combatting apartheid.²⁴ The US and SA have also maintained bilateral trade agreements,²⁵ despite their diplomatic minefield on issues such as SA's oil trade with Iran²⁶ and the recently resolved poultry import duties.²⁷ Additionally, an examination of the US-SA relationship reveals that SA depends on the US for aid.²⁸ Conversely, Brazil has minimal aid dependence but its relationship with the US is defined along the lines of trade/investment.²⁹

The BRICS's political and economic systems vary. China and Russia are authoritarian regimes, as opposed to Brazil, India and SA which are democratic.³⁰ It is therefore problematic for BRICS to unite on shared political values. Their economic ambitions and systems also differ. History reveals that SA's capitalism, which was racially driven, is now dipped in socialist interventions.³¹ Russia and China share a special economic

²³ Giselle Datz and Joel Peters, 'Brazil and the Israeli-Palestinian Conflict in the New Century: Between Ambition, Idealism and Pragmatism' [2013] 2 (2) *Journal of Foreign Affairs* 1, 12; Luiz Alberto Moniz Bandeira, 'Brazil and the United States: From Dependency to Equality' (*Open Democracy*, 20 November 2003) <https://www.opendemocracy.net/democracy-americanpower/article_1599.jsp> accessed 10 January 2017.

²⁴ Christopher J McCoy, America's Role in the End of South African Apartheid [2011] *Journal of International Affairs at UCSD* <<https://prospectjournal.org/2011/10/21/americas-role-in-the-end-of-south-african-apartheid/>> accessed 13 January 2017.

²⁵ Such as the Trade and Investment Framework Agreement (TIFA) and other agreements backed by the Africa Growth and Opportunity Act (AGOA).

²⁶ Scott Firsing, 'A New "Rough Patch" in U.S.-South Africa Relations' (*International Policy Digest*, 4 May 2012) <<https://intpolicydigest.org/2012/05/04/a-new-rough-patch-in-u-s-south-africa-relations/>> accessed 13 January 2017.

²⁷ William Watson, 'Antidumping Fowls Out: U.S.-South Africa Chicken Dispute Highlights the Need for Global Reform' (*Free Trade Bulletin No. 62 Cato Institute*, 19 October 2015) <<https://www.cato.org/publications/free-trade-bulletin/antidumping-fowls-out-us-south-africa-chicken-dispute-highlights>> accessed 10 January 2017.

²⁸ Peter Pedroncelli, '12 Biggest African Recipients of Foreign Aid from the United States' (AFK Insider, 12 May 2017) <<https://afkinsider.com/139167/12-biggest-african-recipients-of-foreign-aid-from-the-united-states/4/>> accessed 10 February 2018; U.S. Department of State, 'U.S. Relations with South Africa' (U.S. Department of State, 12 January 2018) <<https://www.state.gov/r/pa/ei/bgn/2898.htm>> accessed 10 February 2018.

²⁹ Bronti DeRoche, 'The Ways the US Benefits from Foreign Aid to Brazil' (The Borgen Project, 26 January 2018) <<https://borgenproject.org/u-s-benefits-from-foreign-aid-to-brazil/>> accessed 10 February 2018.

³⁰ Laetitia Mottet, 'Cooperation and Competition among the BRICS Countries and other Emerging Powers', (French Centre for Research on Contemporary China, March 2013) <<http://www.cefc.com.hk/uf/file/researchpapers/BRICS%20report/BRICS%20report.pdf>> accessed 10 January 2017.

³¹ Marian L. Tupy, 'The Myth of Social African Capitalism' (*Cato Institute*, 12 May 2004) <<https://www.cato.org/publications/commentary/myth-south-african-capitalism>> accessed 13 January 2017; Richard Sklar, 'Beyond Capitalism and Socialism in Africa' [1988] 26.1 *The Journal of Modern African Studies* 1, 20.

relationship in their investment as capitalist economies.³² Larry Ong and Lee Edwards, however, disagree, arguing that China and Russia run communist economies.³³ Recent developments and evidence contradict this stance.³⁴ Moreover, undisputedly, Brazil and India are capitalist economies.³⁵ The underlining economic structures in the BRICS have revealed varying levels of economic development, with China leading the other countries in the league.³⁶

Liberalization and the resulting heightened integration of the BRICS in the global economy have precipitated discussions on whether economic development can be solely attributed to a phase of radical reregulation.³⁷ Holton contends that it can partly be attributed to state managed basis of selection and partial regulation.³⁸ Partial deregulation has heightened the importance of these markets, especially regarding the risk of ML and consequent risks to financial stability. These partial deregulations, in the form of relaxed exchange control³⁹ and a move away from current account convertibility, pose risks to the financial system, especially through the erosion of the foreign exchange reserves and increase volatility. These risks are also present in the move towards the privatization of public monopolies. The deregulation of the financial system has been accompanied by a simultaneous reform in the capital market, leading to increasing integration and rapid technological changes, which amalgamates markets

³² Young Choul Kim, 'Economic Transition in China and Russia' [2015] 1 *European Scientific Journal* 355, 364.

³³ Larry Ong, 'Is China Still Communist?' (*Epoch Times*, 11 January 2017) < <http://www.theepochtimes.com/n3/2208716-is-china-still-communist/>> accessed 13 January 2017; Lee Edwards, 'Yes Communism is Still with us' (*The Heritage Foundation*, 23 June 2015) < <http://www.heritage.org/research/commentary/2015/6/yes-communism-is-still-with-us>> accessed 13 January 2017.

³⁴ Colin Clark, 'Economic Development in Communist China' [1976] 84 (2) *Journal of Political Economy* 239, 239; Pranab Bardhan, 'The Contradictions of China's Communist Capitalism' (*Project Syndicate*, 16 July 2015) < <https://www.project-syndicate.org/commentary/china-stock-market-crash-communism-capitalism-by-pranab-bardhan-2015-07?barrier=accessreg> > accessed 13 January 2017.

³⁵ Sibal Rajeev, 'Varieties of Capitalism and Firm Performance in Emerging Markets: An Examination of the Typological Trajectories of India and Brazil' (PhD Dissertation, The London School of Economics and Political Science, 2014).

³⁶ Cynthia Roberts, 'Building the New World Order BRIC by BRIC' [2011] 6 *The European Financial Review* 4.

³⁷ N.K Singh, 'New Money Laundering Threats for Emerging Economies' (Global Programme Against Money Laundering, United Nations, Office for Drug Control and Crime Prevention – Attacking the Profits of Crime: Drugs, Money and Laundering).

³⁸ Robert J Holton, *Global Inequalities* (1st Published, Macmillan Palgrave, 2014) 20.

³⁹ Morris Goldstein, Nicholas R. Lardy, 'China's Exchange Rate Policy: An Overview of Some Key Issues' (China Exchange Rate Policy Peterson Institute for International Economics, October 2007).

and increase capital flows within the global arena. This illustrates how the risk of ML/TF to EEs are multifaceted and not peculiar to only one financial sector.

Given their historically entrenched differences in economic and political interests,⁴⁰ coupled with global integration, scholars have argued that the credibility and longevity of a sturdy BRICS union is uncertain.⁴¹ The doubt is mainly in the ability of the BRICS to bring about lasting change in the global economic and political order.⁴² This perspective highlights the inherent heterogeneity of BRICS and casts doubt on their ability to champion change in the global economy and political order. Despite these divergences, the BRICS have exhibited a remarkable degree of cohesion, providing a peaceful and stable international environment, conducive to economic modernization and growth.⁴³ They also share a common aspiration for greater representation in international organizations, heightened by their traditional conceptions of state sovereignty.⁴⁴ This has led to improved positioning and voting slots within international organizations and network bodies.⁴⁵

⁴⁰ Laetitia Mottet, 'Cooperation and Competition among the BRICS Countries and other Emerging Powers', (French Centre for Research on Contemporary China, March 2013) < <http://www.cefc.com.hk/uf/file/researchpapers/BRICS%20report/BRICS%20report.pdf> > accessed 10 January 2017.

⁴¹ Ramesh Thakur, 'How Representative are BRICS' [2014] 35 (10) *Third World Quarterly* 1791, 1792.

⁴² Marko Juutinen, Jyrki Kakonen 'Battle for Globalization? BRICS and US Mega-Regional Trade Agreements in a Changing World Order' (New Delhi: Observer Research Foundation, 2016) < http://www.orfonline.org/wp-content/uploads/2016/03/Book_Battle-For-Globalisation.pdf > accessed 10 May 2017.

⁴³ Glosny Michael, 'China and the BRICs: A Real (but Limited) Partnership in a Unipolar World' [2010] 42 (1) *Polity* 100, 126; Roberts Cynthia, 'Challengers or Stakeholders? BRICs and the Liberal World Order' [2010] 42 (1) *Polity* 1, 5.

⁴⁴ Glanville Luke, 'The Antecedents of "Sovereignty as Responsibility"' [2011] 17 (2) *European Journal of International Relations* 233-255; Christian Brutsch and Mihaela Papa, 'Deconstructing the BRICS: Bargaining Coalition, Imagined Community or Geopolitical Fad?' [2013] 6 (3) *Chinese Journal of International Politics* 299, 308.

⁴⁵ Martin Muller, *How Brazil, Russia, India and China view BRIC in Yvette Sanchez, Claudia Franziska Bruhwiler, Transculturalism and Business in the BRIC States: A Hand Book* (Routledge 2014). For instance, voting patterns have improved in the past years at the UN General Assembly, with BRIC countries having a higher say.

6.2 The BRICS Membership of the FATF

Brazil was the first EE to become a FATF member in 2000, 11 years after the FATF's formation. Other countries became members between 2003 and 2006.⁴⁶ The BRICS belated membership of the FATF has raised questions as to whether such positioning can foster improved compliance with the AML/CFT recommendations.⁴⁷ The agency engagement approach which may be involuntary or voluntary can unearth a robust response to this question. On one hand, the agency-involuntary engagement approach advances the public interest perspective. An examination of the membership pattern reveals the coercive inclusion of EE's in exchange for the perceived gains of reputational advancements. It would argue that membership facilitates compliance regionally, therefore making financial integrity a key aspiration for a majority of countries. Additionally, membership places countries on a pedestal that improves their compliance drive given the competition that arises between the networked staff. For this reason, the BRICS were granted membership on the basis of their economic growth, efforts in combatting illicit crimes and regional influence.⁴⁸

Conversely, the agency-voluntary engagement perspective advances the argument that membership can only facilitate compliance when it is voluntary and legitimate. Inherent in this viewpoint is the interrogation of the FATF's membership strategies which are deemed coercive. This is based on the acknowledgement that the EEs' agenda of financial growth largely conflicts with the IFIs/TGNs agenda for financial integrity. Hence membership through sanctions is considered necessary. Yet, this has proved unworkable as it is only when such strategies are perceived as legitimate that they can promote the acceptance of transnational norms and convey state change. Such voluntary

⁴⁶ FATF Membership Timeline for EEs: South Africa (2003), Russia (2003), China (2005) and India (2006).

⁴⁷ Maira Rocha Machado, 'Financial Regulation and International Criminal Policy: the Anti-Money Laundering System in Brazil and Argentina' (2007) Law & Society Association Annual Conference 7/2007, 50 < <https://bibliotecadigital.fgv.br/dspace/bitstream/handle/10438/2777/WP7.pdf> > accessed 19 October 2015.

⁴⁸FATF, 'Process and Criteria for Becoming a FATF Member' (*FATF*) < <http://www.fatf-gafi.org/about/membersandobservers/membershipprocessandcriteria.html> > accessed 1 May 2016.

membership would promote belief in the FATF as a legitimate rule maker to be complied with on the basis of appropriateness and not consequence.⁴⁹

These competing perspectives help in providing explanations regarding the emergence of the BRICS as FATF member countries. To further explore this, the section will investigate the trigger for membership, whether it was voluntary or coercive and the impact of the inclusion strategies on compliance.

A historical review of the FATF's membership pattern reveals evidence of power-play between western countries – the rule makers, and the BRICS as rule-takers. Countries classified as rule-takers were often coerced into compliance with the hope of accelerated FATF membership. For instance, Russia's membership accession was due to pressure from its placement on the NCCT list.⁵⁰ Also, the public hearing on SA's Financial Intelligence Centre bill indicated that the country's compliance and subsequent membership was due to fear of being blacklisted.⁵¹ Moreover, authors of the 1998 Brazilian Law 9613, drafted in response to the FATF's requirements noted that its creation was dependent on their contacts with US representative on drugs, a relationship which placed more onerous burden than the influence of the FATF.⁵² This provides insights into the continued hegemony of the US over other countries. Thus, the overall membership process reveals that the FATF's initial members did indeed wield authoritarian powers over non-members, indicating an encroachment on their sovereignty.

⁴⁹ Kerwer Dieter and R Hulsse, 'How International Organizations Rule the World: the Case of the Financial Action Task Force on Money Laundering' [2011] 2 J Int. Organ Stud 50, 59.

⁵⁰ Peter Lilley, 'Dirty Dealing: the FATF 'Blacklist' (www.DirtyDealing.net, 2006) <<http://www.dirtydealing.org/IMAGES/fatfblacklist/The%20FATF%20Blacklist.pdf> > accessed 15 January 2016; NewEurope, 'FATF Decides to Cross Russia off Blacklist' (*NewEurope*, 20 July 2002) <<https://www.neweurope.eu/article/fatf-decides-cross-russia-blacklist/> > accessed 21 January 2016.

⁵¹ Parliamentary Monitoring Group, 'Financial Intelligence Centre Bill: Hearings' (Parliamentary Monitoring Group, 22 March 2001) <<https://pmg.org.za/committee-meeting/418/> > accessed 10 January 2016.

⁵² The explanatory note of Law 9613 references the 40 Recommendations as a document of the "European Communities", but also quotes different national legislations, mostly from central Europe, and the Model Regulation on Drugs, issued by the Organization of American States in 1996 (EM 692/MJ); Heinrich-Boll-Stiftung and Regine Schonenberg (eds), *Transnational Organized Crime: Analyses of a Global Challenge to Democracy* (Transcript Verlag Bielefeld, 2013).

legitimacy, where democratic inclusion triumphs technical expertise.⁵⁹ Consequently, the FATF sought to enhance its input legitimacy, promoting the belief that its rules are decided in an open and fair manner.⁶⁰ Nevertheless, the extent to which the BRICS participate in the standard setting of established recommendations is questionable, given their belated inclusion coupled with the backing of IFIs.

6.2.1 The Position of the BRICS Prior to and After their FATF Membership

Prior to their inclusion as core FATF members, the BRICS were part of the FSRBs, which are classed as ‘associate members.’⁶¹ FSRBs are each regarded as one organization representing the interest of all its member countries; hence, the BRICS could not individually exert membership of the FATF, without their respective FSRB platforms. Interestingly, the relevant FSRBs (covering the BRICS) were created between 1997 and 2004. Thus, before their attainment of full FATF membership, the BRICS could also be regarded as ‘non-members’.

A gaping disparity existed in voting pattern and treatment between the FATF members and its associate/non-member. Resultantly, whilst the initial FATF members were entitled to one vote each, the FSRBs were collectively entitled to one vote.⁶² This pragmatically restrictive voting structure was designed to avoid an unwieldy consensus driven process. Therefore, membership was restricted to countries with advanced and sophisticated financial activities. These countries are perceived to have expert

⁵⁹ Dieter Kerwer and Rainer Hulsse, ‘How International Organizations Rule the World: The Case of the Financial Action Task Force on Money Laundering’ [2011] 1 (2) *Journal of International Organization Studies* 50, 58.

⁶⁰ *Ibid* 50, 56.

⁶¹ U.S. Department of State, ‘The Financial Action Task force and FATF-Style Regional Bodies’ (U.S. Department of State, 2015) < <https://www.state.gov/j/inl/rls/nrcrpt/2015/vol2/239046.htm> > accessed 4 February 2018.

⁶² Maria Rocha Machado, ‘Similar in their Differences: Transnational Legal Processes Addressing Money Laundering in Brazil and Argentina’ in Gregory Shaffer (eds.) *Transnational Legal Ordering and State Change* (Cambridge University Press, New York, 2013) 61; Domitilla Sagramoso, *Russia’s Western Orientation after 11th September: Russia’s Enhanced Cooperation with NATO and the European Union* (Rubbettino Editore 2004).

knowledge on AML/CFT, given their interactions with diverse advanced forms of illicit crimes over time. The voting consensus from these pool of states is then translated into laws and applied globally. Sidelined from the voting process, the BRICS had to contend with applying decided recommendations despite their seeming unsuitability to its local concerns.

Additionally, prior to the revision of the FATF's provisions in 2003, reputational damage through coercion was achieved through country placement on the NCCT list.⁶³ Russia was on this list till 2002,⁶⁴ resulting in reduced investment, cross border trade and banking.⁶⁵ Conversely, members were only subject to a form of peer pressure.⁶⁶ However upon the creation of most FSRBs by 2004, the coercive procedure imposed on non-members was made applicable to members also – one of self-assessment and peer-pressure.⁶⁷ This somewhat bridged the gap between FATF members and non-members. However, the practical effect has not changed, as non-compliant member states (not part of the core member countries) are subject to more intensive peer-pressure as a result of their global standing.⁶⁸

With the BRICS membership of the FATF, it remains to be seen whether there has been any substantial change their treatment by the initial members. Evident changes are expected, particularly given that the BRICS now have equal voting powers as the initial members. Mochado however contends that although the distribution of voting powers

⁶³ The NCCT process started in 2000; see, for example, Alldridge Peter, 'Money Laundering and Globalization' [2008] 35 (4) *Journal of Law and Society* 437-63; Blazejewski Kenneth, 'The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Trans-governmental Networks' [2008] 22 *Temple International and Comparative Law Journal* 1, 45; Mugarura Norman, 'The Global Anti-Money Laundering Court as a Judicial and Institutional Imperative' [2011] 14 (1) *Journal of Money Laundering Control* 60, 60.

⁶⁴ Victoria Lavrentieva, 'Russia Taken off Financial Blacklist' (*The Moscow Times*, 2002) < <http://www.themoscowtimes.com/sitemap/free/2002/10/article/russia-taken-off-financial-blacklist/242953.html> > accessed 1 December 2015.

⁶⁵ *Ibid.*

⁶⁶ Cecily Rose, *International Anti-Corruption Norms: their Creation and Influence on Domestic Legal Systems* (1st edn, Oxford University Press 2015) 199.

⁶⁷ In 2006, all non-members were de-listed. Some international organizations such as the IMF and the World Bank started to play an active role in conducting evaluations of non-member countries based on the FATF Methodology for assessing compliance.

⁶⁸ Cecily Rose, *International Anti-Corruption Norms: their Creation and Influence on Domestic Legal Systems* (1st edn, Oxford University Press 2015) 199.

although no two members can hold out the group on a particular decision.⁷⁶ Additionally, the hierarchy of the FATF's internal structure reveals that the president's role is subject to the FATF plenary decisions.⁷⁷ Furthermore, ascendency to presidency is also alleged to be voluntary, countering arguments that it was a reward for the proactivity of Brazil's FIU senior officers.⁷⁸ The voluntary nature of the presidency reveals the limits in influencing decisions or discussions at plenary meetings. Thus, the sitting president can only bring his own style in setting the agenda.⁷⁹

The marginalization of the BRICS is further emphasized by their representation in the IMF and the World Bank, IFIs which form the backbone for the FATF's enforcement process. Being late entrants to these institutions, the BRICS are sidelined in decision making given their limited quota and voting rights.⁸⁰ The BRICS voting powers at the IMF is not reflective of their tremendous economic growth.⁸¹ This is particularly because these institutions are driven by the desire of the US to ensure financial stability. The marginalization of the BRICS within IFIs is backed by a long history of G7 supremacy, individually and within the FATF or connected bodies. For instance, the Treaty of Nanking ratified by China in 1843, on the free sale of opium between the US and China placed onerous obligations on China, with none on the US.⁸² The result was that the US waged war against Chinese ports in order to open them to trade on the agreed merchandise.⁸³ Similarly, the G7 excluded India from discussions on counter-terrorism, although India had had experience in dealing with related issues.⁸⁴ Resentment by the BRICS can catalyze some level of non-compliance.⁸⁵

⁷⁶ Ibid.

⁷⁷ The Financial Action Task Force Mandate (2012-2013).

⁷⁸ Maira Rocha Machado, 'Transnational Legal Processes Addressing Money Laundering in Brazil and Argentina' in Gregory Shaffer (eds.) *Transnational Legal Ordering and State Change* (CUP, 2013).

⁷⁹ Ibid.

⁸⁰ Alonso Soto, 'BRICS Bank to Defy Western Clout in Global Finances' (*Reuters*, 11 July 2014) < <http://uk.reuters.com/article/uk-brics-summit-idUKKBN0FG1SG20140711> > accessed 14 March 2016.

⁸¹ Ibid.

⁸² Bruce Jones, *Still Ours to Lead: America, Rising Power and the Tension Between Rivalry and Restraint* (The Brookings Institution, 2014) 58.

⁸³ Ibid.

⁸⁴ Peter Romaniuk, *Multilateral Counter-Terrorism: the Global Politics of Cooperation and Contestation* (First Published 2010, Routledge) 57.

⁸⁵ Peter Andreas and Ethan Nadelmann, *Policing the Globe: Criminalization and Crime Control Control in International Relations* (1st edn, OUP, 2006); Karin Svedberg Helgesson and Ulrika Morth,

The BRICS desired to form their agenda outside Western control,⁸⁶ thus potentially altering the international order. They seek to undo biased treatments enshrined in international bodies or treaties established when they were seemingly toothless. One way to cure this is through the review of the treaties and procedures that have historically existed within international organizations.⁸⁷ An alternative is to establish a similar organization, for instance, the BRICS development bank. These options indicate the BRICS's aspiration, stemming from a history of political marginalization of the south due to colonialism and its legacies, for a multipolar, equitable and democratic world order.⁸⁸ Brazil has called for an end to American dominance,⁸⁹ whilst China has pushed for reform of IMF global currencies.⁹⁰ Western countries' advancement has placed them in the forefront of global governance, thus culminating in the perspective that their actions are laced with good intentions. However, other states perceive these actions as a threat to their sovereignty. The perception of marginalization may cause countries to resist compliance, or induce sham compliance in a bid to find favor with countries that caused the marginalization.

Furthermore, at the national level, membership does not guarantee immunity from ML/TF. The BRICS suffer from corruption, which is inextricably linked to ML.⁹¹ The

Securitization, Accountability and Risk Management – Transforming the Public Security Domain (Routledge, 2012)

⁸⁶ Christian Brutsch and Mihaela Papa, 'Deconstructing the BRICS: Bargaining Coalition, Imagined Community or Geographical Fad?' [2013] 6 (3) *Chinese Journal of International Politics* 299, 304; Miller Tyler, 'Addressing the Economic and Political Rise of the BRICS Countries through Neoliberal International Relations Theory' (Master's Thesis, Towson University, 2013).

⁸⁷ Eduardo Viola, 'The BRICS in the International System: Very Relevant Countries, but a Group of Limited Importance' in Gustavo Lins Riberio, Tom Dwyer, Antonadia Borges, Eduardo Viola (eds), *Social, Political and Cultural Challenges of the BRICS* (Langaa RPCIG, 2015)

⁸⁸ Laurence Piper, 'The BRICS Phenomenon: From Regional Economic Leaders to Global Political Players' (2015) BICAS Working Paper 3/2015, 3 <https://www.tni.org/files/download/bicas_working_paper_3_piper.pdf> accessed 15 January 2017.

⁸⁹ Andres Cala, 'Brazil's Challenge to US Dominance' (*Consortiumnews.com*, 2 October 2013) <<https://consortiumnews.com/2013/10/02/brazils-challenge-to-us-dominance/>> accessed 2 January 2016.

⁹⁰ Domenico Lombardi and Hongying Wang, (eds.) *Enter the Dragon: China in the International Financial System* (Centre for International Governance Innovation, 2015).

⁹¹ OECD, 'CleanGovBiz Integrity in Practice: Money Laundering' (OECD) <<http://www.oecd.org/cleangovbiz/toolkit/moneylaundering.htm>> accessed 21 February 2016; Money Laundering Bulletin, 'Building FATF Evaluations BRIC by BRIC' (*Money Laundering Bulletin*) <<http://www.moneylaunderingbulletin.com/legalandregulatory/governmentandinternationalbodies/building-fatf-evaluations-bric-by-bric--1.htm>> accessed 21 February 2016.

absence of sturdy political will obstructs enforcement measures to combat these ills. For instance, India's emerging status as a regional financial center, its access to drugs and the prevalence of underground banking has made it an attractive ML hub.⁹² Distinguishing between internal and international ML, Vijay argues that India's strict foreign exchange laws restrict cross-border ML.⁹³ This distinction however fails to consider how internal ML fosters cross-border ML. For instance, the exploitation of the informal remittance system to launder funds abroad,⁹⁴ or the case of PEPs who launder funds internally, but engage in cross-border investments through proxies.

In certain instances, the problem is not the absence of, but rather misguided, political will aligned with corrupt practices. Across various countries, the incumbent government dismantles opposition by alleging corruption,⁹⁵ whilst overlooking corrupt practices within its ranks. The recent Deutsche Bank laundering probe implicated close personal and political associates of Vladimir Putin,⁹⁶ revealing the public-private sector tolerant perception of laundering and corruption within Russia.

⁹² United States Department of State: Bureau for International Narcotics and Law Enforcement Affairs, 'International Narcotics Control Strategy Report: Volume II Money Laundering and Financial Crimes' (United States Department of State, March 2017) < <https://www.state.gov/documents/organization/268024.pdf> > accessed 16 August 2017; Ramanand Garge, 'Combating Financing of Terror: an Indian Perspective' (Vivekandanda International Foundation, Occasional Paper, October 2015) < <http://www.vifindia.org/sites/default/files/combating-financing-of-terror-an-indian-perspective.pdf> > accessed 10 March 2017.

⁹³ Vijay Kumar Singh, 'Controlling Money Laundering in India – Problems and Perspectives', (Annual Conference on Money and Finance in the Indian Economy, India, January 2009).

⁹⁴ Elod Takats, 'International Enforcement Issues', in Donato Masciandaro, Elod Takats, Brigitte Unger, *Black Finance: The Economies of Money Laundering* (Edward Elgar, 2007); FATF Report, Money Laundering through Money Remittance and Currency Exchange Providers (*FATF Report*, 2010) < <http://www.fatf-gafi.org/media/fatf/ML%20through%20Remittance%20and%20Currency%20Exchange%20Providers.pdf> > accessed 23 January 2017.

⁹⁵ Asian Tribune, Arrest of Yoshita a Political Witch Hunting: Police Denied Allegation (*Asian Tribune* 1 February 2016) < <http://www.asiantribune.com/node/88502> > accessed 21 January 2017; The Financial Express, BJP Describes Robert Vadra's 'Witch-Hunt' Claim As 'Farcical' (*The Financial Express*, 22 November 2015) < <http://www.financialexpress.com/article/india-news/bjp-describes-robert-vadras-witch-hunt-claim-as-farcical/169116/> > accessed 1 February 2016.

⁹⁶ The Moscow Times, Putin Associates Implicated in Deutsche Bank Moscow Laundering Probe (*Moscow Times*, October 16 2015) < <http://www.themoscowtimes.com/business/article/putin-associates-implicated-in-deutsche-bank-moscow-laundering-probe/539451.html> > accessed 15 June 2016; Martin Arnold, Deutsche Bank Eyes Russian Pullback Amid Money Laundering Probe (*Financial Times*, 11 September 2015) < <http://www.ft.com/cms/s/0/8533caca-58ae-11e5-9846-de406ccb37f2.html#axzz3z2fVDQkE> > accessed 10 May 2016

Remittances also pose compliance problems for the BRICS, especially India and China, both of which receive the largest amounts.⁹⁷ The cloak of anonymity and expediency usually makes remittances the preferred choice for launderers. Brazil faces similar issues, in a typologically different way, through the use of technology to gain anonymity and engage in sophisticated laundering activities. ML is prevalent in Brazil's various financial sectors⁹⁸ and has now come to encompass its sporting sector, particularly football.⁹⁹ Brazil's location and natural resources also make it vulnerable to drug related laundering.¹⁰⁰

Increased liberalization, coupled with partial deregulation and misguided political will, ensures that the involvement of EEs in formulation of AML/CFT standards does not translate to improved AML/CFT regulation within each sovereign state. This is partly why international prudential regulation is postulated as an antidote for AML/CFT in EEs.

The concern however that is the BRICS union is a marriage of convenience, given their conflicting interests and may not have the capacity to shape the dynamic of the international system.¹⁰¹ More recently, the slowdown of the BRICS economies has

⁹⁷ The World Bank, International Migration at All-Time High (*The World Bank*, 18 December 2015 <<http://www.worldbank.org/en/news/press-release/2015/12/18/international-migrants-and-remittances-continue-to-grow-as-people-search-for-better-opportunities-new-report-finds>> accessed 1 February 2016

⁹⁸ Watterson Colin, 'More Flies with Honey: Encouraging Formal Channel Remittances to Combat Money Laundering' [2013] 91 *Texas Law Review* 711, 712-717; Ednei Roza, 'Brazilian Banking Institution and Anti-Money Laundering Framework: Compliance with International Standards' [2005] 11 *Law and Business Review of the Americas* 299-319; Roberto Delmanto Junior, 'The World Cup in Brazil: Fighting Against Money Laundering and Corruption' *South-Western Journal of International Law* [2014] 21 *SW. J. Int'l L.* 143.

⁹⁹ Kenneth Korosi, Kristen Brown, Christina Marquez, Mauricio Salazar, Sophia Segura, 'Sporting Events as Sites of International Law, Society and Governance: the 2014 Brazilian World Cup: Forward' [2010] 21 *Southwestern Journal of International Law*, *Sw. J. Int'l L.* 1.

¹⁰⁰ Oaula Miraglia, 'Drugs and Drug Trafficking in Brazil: Trends and Policies' [2016] *Foreign Policy at Brookings*.

¹⁰¹ Eduardo Viola, 'The BRICS in the International System: Very Relevant Countries, but a Group of Limited Importance' in Ribeiro Lins Gustavo, Dwyer Tom, Antonadia Borgas and Eduardo Viola (eds.) *Socio, Political and Cultural Challenges of the BRICS* (Bamenda: Langaa RPCIG, 2015); Van Agtmael A, 'Think Again: the BRICS' (*Foreign Policy*, 8 October 2012) <<http://foreignpolicy.com/2012/10/08/think-again-the-brics/>> accessed May 2 2016.

raised questions as to whether they deserve to sit at ‘the table’.¹⁰² Notwithstanding these concerns, a new economic order is emerging,¹⁰³ which has caused the IMF to alter its structure.¹⁰⁴ China now has the third largest IMF quota (its currency was resolved); also, the BRIC economies were placed among the 10 largest members of the IMF.¹⁰⁵ Unfortunately, the US Congress only passed the bill amending the IMF quota allocation in 2016, 6 years after an agreement was negotiated with the US Congress to make the change.¹⁰⁶ The extent to which this would occasion improved compliance is yet to be seen.

6.3 The Determinants of Compliance to AML/CFT in Emerging Economies

Chapter 3 highlights certain legal factors that are crucial in understanding the compliance trajectory of countries. These are supported by non-legal factors such as political will, domestic conditions and globalization which are crucial drivers of compliance. The extent to which these factors catalyze improved compliance within EEs is dependent on their effect on EE and how this aligns with the FATF’s compliance methodologies.

¹⁰² See Laurence Piper, ‘The BRICS Phenomenon: From Regional Economic Leaders to Global Political Players’ (2015) BICAS Working Paper 3/2015, 1 <https://www.tni.org/files/download/bicas_working_paper_3_piper.pdf> accessed 15 January 2017.

¹⁰³ It has been questioned whether the potential growth of the BRICS really extends beyond China and India. It was however recognized that the US and Europe were headed for low growth, economic stagnation and recession. This indicated the need for deeper international cooperation. See Van Agtmael A, ‘Think Again: the BRICS’ (*Foreign Policy*, 8 October 2012) <<http://foreignpolicy.com/2012/10/08/think-again-the-brics/>> accessed May 2 2016; De Castro Tereza, ‘Trade Among BRICS Countries: Changes Towards Closer Cooperation?’ [2013] 16 (3) *Central European Review of Economic Issues* 131, 133.

¹⁰⁴ IMF, ‘IMF Members’ Quotas and Voting Power, and IMF Board of Governors’ (*International Monetary Fund*, 4, June 2016) <<https://www.imf.org/external/np/sec/memdir/members.aspx>> accessed June 4 2016); IMF, ‘Acceptances of the Proposed Amendment of the Articles of Agreement on Reform of the Executive Board and Consents to 2010 Quota Increase’ (*International Monetary Fund*, 31 May 2016) <<http://www.imf.org/external/np/sec/misc/consents.htm#a2>> accessed 10 May 2017

¹⁰⁵ International Monetary Fund, ‘Press Release: IMF Managing Director Christine Lagarde Welcomes U.S. Congressional Approval of the 2010 Quota and Governance Reforms’ (*International Monetary Fund*, 18 December 2015) <<https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr15573>> 4 June 2016.

¹⁰⁶ Bretton Woods Agreement Act, Section 5 [22 U.S.C. 286c] 1962, amended and effected in 2016; John Ross, ‘China’s New Position in Global Economic Governance’ (*China.org.cn*, 10 February 2016) <http://china.org.cn/opinion/2016-02/10/content_37752043.htm> accessed 10 May 2016

6.3.1 Legal factors

Chapter 3 shows that law matters. Douglass North accedes to this.¹⁰⁷ He argues that law is the main source of the formal rules and provides enforcement mechanisms that strengthen the credibility of commitments made by economic and political actors.¹⁰⁸ The position of law in setting the foundation for EE's to comply is however contestable. Within this framework, this section examines how law is decisive in determining the AML/CFT compliance levels of countries. This is examined in the context of three legal factors: law reflecting society, enforcement driven compliance, democracy and rule of law.

6.3.1.1 Law Mirroring Society

Scholars have claimed that the dissemination of the AML/CFT regime to EEs was 'illegitimate' given that it involved coercive and persuasive schemes by the G7 countries that established the FATF.¹⁰⁹ Additionally, although the BRICS were excluded from decision making processes, there was an expectation that they would translate the FATF recommendations to law via national legislation under the scrutiny of the FATF. This expectation occasioned the adoption of laws which did not necessarily 'mirror' society and hence its application and effectiveness has raised questions.

What would 'law mirroring society' look like within the BRICS? It is difficult to predict. However, one can imagine that China might have focused on laws tailored to addressing remittances and secrecy in its informal banking sector. This assumption is predicated on the slow development of China's formal banking system, which only

¹⁰⁷ See Julio Faundez, 'Douglass North's Theory of Institutions: Lessons for Law and Development' [2016] 8 (2) Hague Journal on the Rule of Law 373, 404.

¹⁰⁸ Ibid.

¹⁰⁹ Basel Committee on Banking Supervision, 'Consultative Document: Customer Due Diligence for Banks' (Bank for International Settlements, January 2001) < <https://www.bis.org/publ/bcbs77.pdf> > accessed 19 May 2016.

became operative in the 20th century.¹¹⁰ To illustrate, although China's plague with extortion and bribery can be traced back to BC 2000, it was combated with limited measures.¹¹¹ In the 19th century, the *Piaohao*, China's first traditional banking structures which operated as remittances, further escalated the avenues for illicit transfers.¹¹² These channels, although properly structured, ran largely unregulated despite the currency exchange and ML risk posed. Rather, the informal banking structures operated successfully on the culture of trust which promoted secrecy of transactional exchanges. Law mirroring the society would have indicated heightened focus on the informal sector which might have included lax regulation on remittances and laws to promote financial secrecy.¹¹³ Such regulations might simply have been a reflection of the information asymmetry between the regulator and the regulated, coupled with the culture of trust.

SA presents a different perspective. Organized crime escalated in the country given its historical transition from apartheid to democracy.¹¹⁴ The apartheid regime thrived on proceeds of illicit crimes, and the democratic government was no exception.¹¹⁵ This informed the lackadaisical attitude towards combatting illicit crimes. Additionally, the weak legal framework at the time would have frustrated attempt to combat such crimes.¹¹⁶ SA subsequently introduced criminal laws to combat organized groups that profited from crimes.¹¹⁷ Whilst this may allow for launderers to be imprisoned, it would

¹¹⁰ Robert L. Worden, Andrea Matles Savada and Roland E Dolan (eds.) *China: A Country Study* (Washington: GPO for the Library of Congress, 1987).

¹¹¹ Sterling Seagrave, *Lord of the Rim* (Bantam Press, London 1997).

¹¹² Robert L. Worden, Andrea Matles Savada and Roland E Dolan (eds.) *China: A Country Study* (Washington: GPO for the Library of Congress, 1987).

¹¹³ This provides some explanation why bank secrecy is still weak in China, see Wang Wei, 'Bank Secrecy in China' (Bank Secrecy Symposium, Singapore, March 2016) and why CDD was not carried out in Chinese banks until after 2003, when the FATF recommendations were introduced.

¹¹⁴ Jenny Irish and Kevin Qhobosheane, 'South Africa' in Peter Gastrow (eds.) *Penetrating State and Business: Organised Crime in Southern Africa, Volume 2* (Pretoria, ISS, Monograph 89, 2003).

¹¹⁵ Hennie van Vuuren, 'Apartheid Grand Corruption: Assessing the Scale of Crimes of Profit in South Africa from 1976 to 1994' (Institute for Security Studies, May 2006) < https://www.files.ethz.ch/isn/123917/2006_05_29.pdf > accessed 10 July 2017.

¹¹⁶ See O'Malley, '08 August 1998: Hofmeyr, Willie' (O'Malley, 1998) < <https://www.nelsonmandela.org/omalley/index.php/site/q/031v00017/041v00344/051v01183/061v01224.htm> > accessed 10 July 2017.

¹¹⁷ *Ibid.*; South African Law Commission, 'Issue Paper 1, Project 104, Money Laundering and Related Matters' (South African Law Commission, 24 May 1996).

hinder the ability to recover the proceeds of crime through civil confiscation. Thus, law mirroring society would at best strangulate efforts at combatting illicit crimes.

Russia painted a dire picture of absence of specific laws to ensure that illicit crimes were effectively combatted, signposting a society where absence or inadequacy of laws was symptomatic of ‘law mirroring’ acceptable societal values of corruption and organized crime.¹¹⁸

Recognizing that if law is allowed to ‘mirror society’ in the BRICS – there would be a risk to the international financial market, particularly given the growing degree of integration of the BRICS to the global economy, the discursive power-based mechanism came into play.¹¹⁹ Consequently, China adopted the Vienna and Palermo Conventions.¹²⁰ China has put laws in place to ensure convergence with the FATF standards,¹²¹ in order to maintain foreign policy relationships with the US for trade and development, particularly post the 9/11 attack.¹²² China’s convergence was also triggered by the need to remain a competitive player in the global financial market through compliance to avoid the risk of reputational damage.¹²³ Whilst China displayed some willingness to comply for intrinsic reasons, this is not necessarily the case with other countries.

¹¹⁸ Delphine Defossez, ‘The Current Challenges of Money Laundering Law in Russia’ [2017] 20 (4) *Journal of Money Laundering Control* 367-385.

¹¹⁹ Jason C Sharman, ‘Power and Policy Diffusion: Anti-Money Laundering in Developing States’ [2008] 52 (3) *International Studies Quarterly* 635, 652. This accords with Daniel W. Drezner’s, *All Politics is Global: Explaining International Regulatory Regime* (Princeton: Princeton University Press, 2007) 5, 75.

¹²⁰ The Chinese Government signed the convention on 20 December 1998, handed over the instrument of accession on 25 December 1989. The convention became effective on 11 November 1990. Note that in 1979, before the criminalization of ML internationally, Art. 312 Chinese Criminal Law criminalized activities of receiving and handling proceeds of crime.

¹²¹ In 2001, China included ‘terrorist financing,’ and in 2006 to include other financial crimes/predicate offences, it was expanded to cover only drug and organised crime, terrorism and smuggling in 1997. The Rules for Anti-Money Laundering by Financial Institutions, Administrative Rules for the Reporting of Large-Value and Suspicious RMB Payment Transactions and the Administrative Rules for the Reporting by Financial institutions of Large-Value and Suspicious Foreign Exchange Transactions have been extended to cover all financial institutions, see recent Article 6 and 9 of the Chinese Financial Institutions Anti-Money Laundering Regulation (CFLAMLR).

¹²² Xue Bin Li, ‘Money Laundering and Its Regulation in China’ (PhD Thesis, Cardiff University, 2009).

¹²³ Peter Knaack, ‘An Unlikely Champion of Global Finance: Why is China Exceeding International Banking Standards?’ [2017] 42 (2) *Journal of Current Chinese Affairs* 41, 65.

Scholars have argued that SA's convergence was predicated on some level of external coercion and mimicry, in addition to intrinsic domestic factors.¹²⁴ It is arguable that the central need to combat illicit crimes driven by the transition from apartheid to democracy led SA to enact new democratically-motivated laws. However, Zakhele argues that external mimicry was proactively brought to bear, which inspired convergence to the FATF's AML/CFT standards by SA authorities.¹²⁵ Thus, whilst domestic factors created incentives to mimic, actual actions were driven externally given threat of the FATF's enforcement processes. It was not until 1992 that SA adopted its first AML legislation which showed sturdy awareness of the Vienna convention.¹²⁶ D'Oliveira agrees that the timing of the Drugs and Drug Trafficking Act 1992 and the subsequent Proceeds of Crime Act 1996 indicated a desire to accede to the Vienna Convention post-apartheid.¹²⁷ The statement of a representative at the public hearing of the Financial Intelligence Centre Bill in 2002 exemplified external pressures on SA, thus: '[w]e have the sword of the FATF hanging over our heads and the patience of the international community is reaching its end.'¹²⁸ Undoubtedly, the external pressures may have coerced compliance with the standards, but the extent of compliance this has stimulated is debatable.

Russia's experience, although largely different from China's, was slightly similar to SA's. Given its unprecedented ML rate, capital flight and corruption, Russia was blacklisted by the FATF.¹²⁹ Failure to enact laws to curb these illicit crimes, largely exacerbated by privatization policies in 1992, exposed Russia's acquiescence to such illicit crimes at every level of government.¹³⁰ The reports of the possible laundering of IMF credits through the Bank of New York in 1999 mounted pressure to blacklist

¹²⁴ Hlophe Zakhele, 'Regulating Money Laundering in Developing Countries: A Critical Analysis of South Africa's Incorporation and Implementation of the Global FATF Standards' (PhD Thesis, Kings College London, 2013).

¹²⁵ Ibid.

¹²⁶ Drugs and Drug Trafficking Act 1992.

¹²⁷ See also Jan d'Oliviera, 'International Co-operation in Criminal Matters: the South African Contribution' [2003] 16 (3) *South African Journal of Criminal Justice* 323, 333.

¹²⁸ See Parliamentary Monitoring Group, 'Financial Intelligence Centre Bill: Hearings' (Parliamentary Monitoring Group, 22 March 2001) < <https://pmg.org.za/committee-meeting/418/> > accessed 10 January 2016.

¹²⁹ Elena Chinyeva, 'Russia and the FATF Blacklist' [2002] 1 (3) *Russia and Eurasia Review* (*The Jamestown Foundation*, 2 July 2002) < <https://jamestown.org/program/russia-and-the-fatf-blacklist/> > accessed 10 November 2017.

¹³⁰ Ibid.

Russia.¹³¹ The FATF blacklisted Russia as a direct external coercion to compel her to observe the FATF recommendations by legislating on AML/CFT. Russia then enacted the ‘Combating the Laundering of Income Obtained by Criminal Means’ in 2001.¹³² This law not only compelled FIs to report suspicious transactions above \$20,000, it also established a FIU to act on such reports. The law also compelled law enforcement agencies to prosecute cases.¹³³ Additionally, after the 9/11, Vladimir Putin tightened the illicit crime rules with a decree establishing criminal penalties for bank officials who did not report suspicious transactions. In 2002, Russia was delisted and following its economic growth and seeming adherence to the FATF’s recommendations, she gained the FATF prestigious membership in 2003.

Examining the ‘law mirroring international standards’ across countries illustrates that the FATF regime led to tailored laws and, in certain instances, harsher sanctions. It can be argued that this may have led to reduced illicit crimes. Shuceng concurs and submits that the modification of punishment regimes have contributed to reduced criminal offences in China.¹³⁴ For instance, death penalty for citizens who embezzle funds has been largely effective.¹³⁵ This supports external pressures to facilitate compliance, given harsher applicable sanctions.

Given the systemic risk of the BRICS to the global economy, they were invited to membership of the FATF, and, barring SA, have been classed as ‘systemically important’ by the IMF. Being so categorized comes with mandatory Financial Stability Assessments (FSA) under the FSAP, given the importance of their financial sectors and the impending risk of contagion they pose. It also signifies a growing relationship

¹³¹ Ibid (n 129).

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Wang Shucheng, Predictions on the Development and Direction of Legislation, in Yuwen W. Li (edn) *The China Legal Development Yearbook*, (Volume 2, 2009).

¹³⁵ Ian Jeffries, *Political Developments in Contemporary China: A Guide* (First published 2011, Routledge 2011) 386. Death Penalty was eventually ended in 2011, see also Chris Higg, China Ends Death Penalty for 13 Economic Crimes (*BBC News Shanghai*, February 2011) < <http://www.bbc.co.uk/news/world-asia-pacific-12580504> > accessed 11 February 2016. The effectiveness is however questionable as only a few people were actually executed.

between IFIs and EEs, which can ensure that EEs comply with the IFIs' requirements, and avoid agency slack.

Yet, 'law mirroring international standards' is not always necessarily ideal, as the requirements set by the FATF and backed by the IFIs do not usually indicate concrete understanding of the culture of the country within which it is to operate. Indeed, this may facilitate, rather than curb illicit crimes. For example, recommendation 14 of the FATF requirements mandates registration and licensing of remittances;¹³⁶ it is usually read with the CDD and reporting requirements. Likewise, given the inter-linkages established between remittances and terror funding, regulatory bodies have been empowered to report, freeze or confiscate terror funding when suspicion is raised or ascertained.¹³⁷ Although aimed at ensuring transparency, examining the FATF's language and purpose reveals the superimposition of existing formal financial sector regulatory and supervisory practices onto the informal transfer systems.¹³⁸ In countries like China or India, remittances are built on a culture of trust and operate through a complex web of transactions¹³⁹ which are deemed the safest means of transmitting funds. Therefore, such regulations might only succeed in pushing their services underground,¹⁴⁰ as evidenced by the growing rate of unregistered remittance intermediaries in both countries.¹⁴¹ This medium is considered the largest source of financial flows to developing countries, exceeding the foreign direct investment in some countries.¹⁴²

¹³⁶ FATF, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations' (FATF, 2012) < http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf > accessed 7 August 2012.

¹³⁷ Ibid.

¹³⁸ Samuel Munzele Maimbo, 'The Regulation and Supervision of Informal Remittance Systems: Emerging Oversight Strategies' (Current Developments in Monetary and Financial Law, November 2004).

¹³⁹ Ibid.

¹⁴⁰ Ibid.; Walter Perkel, 'Money Laundering and Terrorism: Informal Value Transfer System' [2004] 41 (1) AM Crim. L Rev. 183, 198.

¹⁴¹ Nikos Passas, 'Financial Intermediaries – Anti-Money Laundering Allies in Cash-Based Societies?' [2015] 10. U4 Brief 1,7; Michelle V. Remo, 'Stop Illegal Remittance Agents, BSP Urged' (*Inquirer.net*, 14 November 2012) < <http://business.inquirer.net/93066/stop-illegal-remittance-agents-bsp-urged> > accessed 15 March 2016.

¹⁴² Dietmar Meyer and Adela Shera, 'The Impact of Remittances on Economic Growth: an Econometric Model' [2017] 18 (2) *Economia* 147, 147.

This feeds into Legrand's argument that transplantation must be contextual, taking into consideration the cultural, historical and socio-economic sensibilities of the recipient country.¹⁴³ Otherwise, it may be rejected by the recipient state.¹⁴⁴ Supporting this position, Gonzales asserts that local conditions generate acceptance or resistance to crucial policies or practices and hence, lessons should be learned in a manner that reinforces, rather than transforms local practices.¹⁴⁵ Gonzales argues that this can be achieved by empowering local policy makers to investigate and proffer solutions to suit their domestic context, rather than applying incompatible international standards to local realities.¹⁴⁶ These analyses indicate that transplantation effected in developed-emerging economies is not necessarily suitable, but rather policy responses should be designed with recipient countries for proactive compliance. Whilst this has arguably been addressed by BRICS membership of the FATF, it does not solve the pending problem, as these countries only have minimal say in the re-formulation of standards.

Given their need for tailored solutions to addressing ML/TF, the BRICS have not only worked within regional networks,¹⁴⁷ but have also established a BRICS Council on AML/CFT. This council serves as a platform for participating countries to consolidate BRICS actions on counter terrorist financing and the intensification of training programs, especially through the Network AML/CFT.¹⁴⁸ These actions indicate

¹⁴³ Pierre Legrand 'The Impossibility of "Legal Transplants"' [1997] 4 *Maastricht J. Eur. & Comp.L* 111, 118-119

¹⁴⁴ Manuhia Barcham, 'South-South Policy Transfer: The Case of the Vanuatu Ombudsman's Office' [2003] 18 (2) *Pacific Economic Bulletin* 108 – 116.

¹⁴⁵ Eduardo T Gonzales, 'Policy Transfer in the Philippines: Can it Pass the Localization Test?' [2007] 2.1 *JOAAG*.

¹⁴⁶ *Ibid.*

¹⁴⁷ Berliner Daniel, 'Follow Your Neighbor? Regional Emulation and the Design of Transparency Policies' (2013) KFG Working Paper 55, 17 < http://userpage.fu-berlin.de/kfgeu/kfgwp/wpseries/WorkingPaperKFG_55.pdf > accessed 10 May 2016; Daniel Berowitz, Katharina Pistor and Jean-Francois Richard, 'Economic Development, Legality and the Transplant Effect' (2000) William Davidson Institute Working Paper Number 308 < <https://deepblue.lib.umich.edu/bitstream/handle/2027.42/39692/wp308.pdf?sequence=3> > accessed 10 May 2016; Simmons Beth A and Zachary Elkins, 'The Globalisation of Liberalisation: Policy Diffusion in the International Political Economy' [2004] 98 (1) *American Political Science Review* 171, 187.

¹⁴⁸ BRICS, 'The BRICS Handover Report: 2015 – 2016', (BRICS, 2016) 65/66 < en.brics2015.ru/load/885248 > accessed 10 December 2017.

increased ownership and accountability by these countries. However, the extent to which this can translate to long-term change is to be seen.

6.3.1.2 Enforcement Driven Compliance

Concerns about the possibility of enforcement actions shape behavior.¹⁴⁹ At the national level, compliance by individuals, regulators and FIs are sometimes focused on evading enforcement actions. This is because breach of certain FATF recommendations which are enshrined in national legislations are backed by sanctions ranging from fine to imprisonment. Such sanctions, when meted on an individual or institution by enforcement agencies or the court can lead to reputational damage. For this reason, it serves as a key driver of compliance with AML/CFT regulation, particularly in countries where legal structures are robust to sanction erring criminals.

At the international level, the FATF enforces its rules through measures put in place to ensure the observance of prescribed standards.¹⁵⁰ Blacklisting of erring countries is one of such measures – which comes with reputational damage and financial isolation. All EEs, but Russia, were able to circumvent this enforcement action.¹⁵¹ Whilst the other EEs transplanted the FATF recommendations to ensure a conducive environment for compliance, Russia did not. Consequently, Russia's high rate of capital flight, corruption and ML went unchecked. The sanction however propelled compliance by Russia. As earlier discussed, there is evidence that EEs simply transplanted rules and seemingly complied with same to evade sanctions.

¹⁴⁹ David G. Victor, Kal Raustaila and Eugene B. Skolnikoff (eds.), *The Implementation and Effectiveness of International Environmental Commitments: Theory and Practice* (International Institute for Applied System Analysis, 1998).

¹⁵⁰ Tam Christian, 'Enforcement' in Ulfsein G, Marauhn T and Zimmermann (eds). *Making Treaties Work* (Cambridge University Press, 2007) 391-410.

¹⁵¹ Daniel E. Ho, 'Compliance and International Soft law: Why Do Countries Implement the Basel Accord' [2002] 5 (3) *Journal of International Economic Law* 647-688.

ownership in the process of standard making, coupled with the coercive strategies employed to facilitate compliance. This counters the argument that the involvement of the BRICS in combatting illicit crime was dependent on increased financial liberalization and the need to curtail infiltration of illicit funds.¹⁵⁹ It rather illustrates that in the absence of voluntary compliance backed by ownership, formal or creative compliance will thrive, even with sturdy enforcement infrastructure to facilitate compliance.

The above argument does not however invalidate the impact of ‘listing’ on a country. Given the BRICS membership of the FATF, there is some political impetus to ensure continued compliance. Nevertheless, membership provides some shield from the consequences of non-compliance which may only be circumvented through de-risking. Hence, the member countries may be de-incentivized, given their ‘sacred’ position. To curtail this moral hazard, the FATF listed Turkey, a member country, for deficiencies in its compliance.¹⁶⁰ This rare and singular act has not provided a paradigm shift for EEs and developed countries who are resolute in their membership protection from financial isolation or reputational damage. Recognizing this shortcoming, the IMF recently identified the BRICs as countries which need a higher level of surveillance through FSAP. The reason was to heighten IMF’s interactions with BRICS’s representatives to identify and work towards curtailing any likely agency slack, such as the materialization of risks in a manner that can occasion systemic risk. This usually occurs through an intense monitoring and review of information on compliance levels of the BRICS institutions.¹⁶¹ This process of monitoring through evaluations and any resulting compliance variable usually explains the behaviors of the BRICS countries. Information derived from such exercises usually form the basis for further interactions

[evenzione reati finanziari/FATF Outcomes of the Plenary meeting of the June 2017 FATF.pdf](#) > accessed September 2017.

¹⁵⁹ Laurence Piper, ‘The BRICS Phenomenon: From Regional Economic Leaders to Global Political Players’ (2015) BICAS Working Paper 3/2015, 3 < https://www.tni.org/files/download/bicas_working_paper_3_piper.pdf > accessed 15 January 2017; Charalampos Efstahopoulos, ‘India and Global Governance: the Politics of Ambivalent Reform’ [2016] 53 *International Politics* 239 - 259; Bruce Jones, *Still Ours to Lead: America, Rising Power and the Tension Between Rivalry and Restraint* (The Brookings Institution Press, 2014).

¹⁶⁰Financial Times, ‘Turkey’s Banking Blacklist Risk’ (Financial Times, 16 October 2012) < <https://www.ft.com/content/bbfe16f0-01c8-357e-84d4-4cce12d1e6b4> > accessed 1 January 2016.

¹⁶¹ Abram Chayes and Antonia Handler Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Harvard University Press, 1995).

with countries and inform decisions on sanctions. Thus, active management and enforcement sanctions are interrelated.

6.3.1.3 Compliance engineered by Democracy and Rule of Law

The argument that rule of law and stable democracy are pre-requisites for improved compliance is challengeable when examined through the BRICS's perspective.¹⁶² This challenge can be attributed to the inherent differences amongst the BRICS and their perception of the Western values of democracy and rule of law. For instance, whilst Brazil,¹⁶³ India¹⁶⁴ and SA follow the Western notion of democracy, China and Russia do not.¹⁶⁵ Also, whereas China has an authoritarian governmental system,¹⁶⁶ Russia has a managed democracy.¹⁶⁷ Surprisingly, the governance approach of China and Russia, has not undermined their compliance to AML/CFT standards.¹⁶⁸

China's compliance position undermines Simmons's argument which suggests that non-liberal democratic governments are less likely to ensure compliance than liberal democracies.¹⁶⁹ Simmons argues that this is due to their lack of respect for human rights, legal processes and democratic political constituencies, coupled with

¹⁶² Beth Simmons, 'Compliance with International Agreements' [1998] Annual Rev. Polit. Sci.; Anne-Marie Slaughter, 'International Law in a World of Liberal States' [1995] EJIL 503, 511.

¹⁶³ Brazil, a civil law country, commenced re-democratization in 1985 after several decades of military rule.

¹⁶⁴ India is a pluralistic, common law country.

¹⁶⁵ Ernest Z. Bower, 'Economic Imperative in Southeast Asia' in Craig Cohen and Josiane Gabel (eds.) 2015 Global Forecast: Crisis and Opportunity (Centre for Strategic & International Studies) 68 <<https://cryptome.org/2014/11/csis-global-2015.pdf>> accessed 30 November 2016.

¹⁶⁶ China is a civil law country which in the 1980s became a more market-oriented mixed economy under one-party rule, with political system more decentralised, but limited democratic processes internal to the party.

¹⁶⁷ Helmut Reisen, "'Democracy" and "Corruption" in the BRICS' (*Shifting Wealth*, 5 August 2016) <<http://shiftingwealth.blogspot.co.uk/2016/08/democracy-and-corruption-in-brics.html>> accessed 16 November 2017; Russia, a civil law country, began democratization in the early 1990s post-Soviet Union. Russia's transition from command economy to market economy is still ongoing.

¹⁶⁸ Peter Knaack, 'An Unlikely Champion of Global Finance: Why is China Exceeding International Banking Standards?' [2017] 42 (2) Journal of Current Chinese Affairs 41, 65.

¹⁶⁹ Beth Simmons, 'Compliance with International Agreements' [1998] 1 (1) Annual Rev. Polit. Sci.1, 12.

acquiescence to high level of illicit activities occurring in the economic bloc.¹⁷⁰ Undoubtedly, China has these deficiencies as by the 2016 democracy index, China is classed as authoritarian and rated 136 of 160 countries.¹⁷¹ This ranking means that existing formal institutions have limited substance, non-transparent elections and disregard for civil liberties. The 2016 rule of law index ranks China as 80th of 113 countries, an indication of entrenched corruption, weak criminal justice system and fragile regulatory enforcement structures.¹⁷² Surprisingly, these shortcomings have not hindered China's compliance with AML/CFT standards.¹⁷³

Simmons's argument on democracy as a pre-requisite for compliance to international standards is further weakened by the position of Brazil and South Africa. Both countries, though with entrenched democracies steeped in political history, have failed to attain China's compliance levels with AML/CFT standards. To illustrate this, Brazil's successful historical protests for democracy for over a period of four years (1984–1988)¹⁷⁴ instilled a spirit of resilience in its people who demanded for rule of law and democratic values. Hence, civil societies unreservedly and strongly combat political corruption, particularly as regards wasteful spending.¹⁷⁵ Recently, angered by corruption allegations against President Dilma Rousseff, over one million Brazilians protested for her removal, a move strengthened by the Brazilian Congress.¹⁷⁶ SA also

¹⁷⁰ Ibid, 13; Anne-Marie Slaughter, 'International law in a World of Liberal States' [1995] EJIL 503, 511; Andrew Guzman, 'International Law: A Compliance-Based Theory of International Law' [2002] 90 (6) California Law Review 1826, 1888.

¹⁷¹The Economist, 'Democracy Index 2016: Revenge of the "Deplorable"' (A report by The Economist Intelligence Unit) < <http://felipesahagun.es/wp-content/uploads/2017/01/Democracy-Index-2016.pdf> > accessed 16 December 2016.

¹⁷²World Justice Project, 'Rule of Law Index 2016' (World Justice Project, 2016) < https://worldjusticeproject.org/sites/default/files/documents/RoLI_Final-Digital_0.pdf > accessed 10 May 2017.

¹⁷³ Roda Mushkat, 'China's Compliance with International Law: What Has been Learned and the Gaps Remaining' [2011] 20 (1) Pacific Rim Law & Policy Journal Association 41, 68; Josh Kimbrell, 'Why BRICS Are Bad for America: Inside the Effort to Undermine U.S. Predominance' (RedState, 12 April 2017) < <https://www.redstate.com/joshkimbrell/2017/04/12/brics-bad-america-inside-effort-undermine-u.s.-predominance/> > accessed 10 July 2017.

¹⁷⁴ Astrid Prange, 'Brazil Remembers its Struggle for Democracy' (DW, 10 April 2014) < <http://www.dw.com/en/brazil-remembers-its-struggle-for-democracy/a-17554707> > accessed 16 November 2017.

¹⁷⁵ Patrick Heller, 'BRICS from Below: Counter-Power Movements in Brazil, India and South Africa' (Open Democracy, 30 April 2015) < <https://www.opendemocracy.net/patrick-heller/brics-from-below-counterpower-movements-in-brazil-india-and-south-africa> > accessed 16 November 2017.

¹⁷⁶ Jill Langlois, 'Soggy Protesters Demand Impeachment of Brazil's President: 'We have to Fight for Better' (LA Times, 21 May 2017) < <http://www.latimes.com/world/mexico-americas/la-fg-brazil-protests-20170521-story.html> > accessed 10 July 2017.

evidences such resilience, propelled by Nelson Mandela, which has empowered South Africans to fight injustice, occasioned by weak political structures. Most protests have been focused on ensuring service delivery for its socially disadvantaged indigent citizens.¹⁷⁷ Remarkably, these aesthetically high levels of democracy and rule of law in Brazil and SA have not necessarily translated to high levels of AML/CFT compliance levels in excess of China's ratings.

It is however arguable that Brazil and SA provide some form of protection that allows their citizens' involvement in the democratic processes, which China does not permit. Consequently, it is arguable that China's compliance with international standards does not equate to national translation of global norms in a manner that combats illicit crimes whilst also promoting the agenda of the people. For this reason, entrenchment of democratic values in other EEs cannot be overlooked, particularly in light of their political and historical underpinnings which allow them to thrive and engineer compliance from within.

Compared with the other BRICS countries, India is a model country where compliance to AML/CFT is reflective of democracy and rule of law. India ranks 32nd out of 160 countries on the democracy index; has a robust electoral system and an independent civil liberties presence which is arguably propelled by the Gandhi movement. From the Gandhi era, Indians, disillusioned by the political class which saw itself as law, would campaign against the government to ensure its accountability.¹⁷⁸ This intensified in 2011, when members of a civil society established a political party which won 67 of the 70 seats in Delhi State Assembly in 2015.¹⁷⁹ Consequently, most protests have been focused on ensuring service delivery for its socially disadvantaged indigent

¹⁷⁷ Peter Alexander, 'Rebellion of the Poor: South Africa's Service Delivery Protests – A Preliminary Analysis' [2010] 37 *Review of African Political Economy* 25, 25.

¹⁷⁸ Sarbeswar Sahoo, *Civil Society and Democratization in India: Institutions, Ideologies and Interests* (Routledge, 2013).

¹⁷⁹ Parkes Riley and Ravi Roy, 'Corruption and Anti-Corruption: the Case of India' [2016] 32 (1) *Journal of Developing Societies* 73, 74.

citizens. Its high democracy ratings and the improving global ranking on the rule of law index,¹⁸⁰ has resulted in a steady rise in India's AML/CFT compliance levels.

Examining the BRICS indicates that China is indeed an exception. Heller argues that movement to improved compliance is usually underpinned by an environment with consolidated democracies.¹⁸¹ This perception holds that sturdy civil societies are essential for a flourishing democracy and an environment where human rights, electoral processes and accountability are paramount. Hence, they propel compliance.¹⁸² This explains Russia's struggle with compliance, given its weak political and economic institutions steeped in corruption and non-transparency or accountability at all governmental levels.¹⁸³ These shortcomings, bolstered by Russia's weak rule of law, have undermined its attempt to realize its economic potential,¹⁸⁴ trade liberalization¹⁸⁵ and compliance to international standards despite its transition into a market economy. Commenting on this, Rivkin stated that 'Russia still has considerable work to do when it comes to establishing the rule of law... (and) in the creation of a genuinely independent and technocratic judiciary...for the enforcement of judgments.'¹⁸⁶ The compliance limitations marked by external requirements and internal tensions challenge the need to monitor the dimensions of rule of law and democracy in relation to compliance.¹⁸⁷

¹⁸⁰ World Justice Project, 'Rule of Law Index 2016' (World Justice Project, 2016) < https://worldjusticeproject.org/sites/default/files/documents/RoLI_Final-Digital_0.pdf > accessed 10 May 2017.

¹⁸¹ Patrick Heller, 'BRICS from Below: Counter-Power Movements in Brazil, India and South Africa' (*Open Democracy*, 30 April 2015) < <https://www.opendemocracy.net/patrick-heller/brics-from-below-counterpower-movements-in-brazil-india-and-south-africa> > accessed 16 November 2017.

¹⁸² This is however not always the case, with the recent rise in social networking usage, sometimes the loudest voice is what counts and not necessarily the perception of pressure groups.

¹⁸³ Nandini Ramaujam et al, 'Rule of Law and Economic Development: a Comparative Analysis of Approaches to Economic Development across the BRIC Countries' (The Rule of Law and Economic Development, December 2012) < https://www.mcgill.ca/roled/files/roled/mcgill_roled_report_2012.pdf > accessed 16 November 2017.

¹⁸⁴ Ibid.

¹⁸⁵ Elvis Tankwa Ngatat, 'Trade Liberalisation within Intra-BRICS and the Rule of Law' [2016] 8 (2) *Asian Journal of Law and Economics*.

¹⁸⁶ International Bar Association, 'BRICS: Rule of law "Critically Important" to BRICS Success' (International Bar Association, 11 June 2015) < <https://www.ibanet.org/Article/NewDetail.aspx?ArticleUid=702cb343-8fdd-4b4a-962d-2f5fe40a0827> > accessed 16 November 2017.

¹⁸⁷ Nandini Ramaujam et al, 'Rule of Law and Economic Development: A Comparative Analysis of Approaches to Economic Development Across the BRIC Countries' (The Rule of Law and Economic

Recognizing the shortcomings in compliance and the inadequacy of sanctions, particularly in Russia, IFIs started using management models, including membership. Other models include the review of countries' compliance shortcoming through assessments to evaluate compliance. This governance approach is supported by studies which emphasize the weak link between democracy and economic prosperity; after all, China's authoritarianist government has created more wealth.¹⁸⁸ However, no findings have buttressed that BRICS became democratic after making economic progress. Russia's ranking even presents evidence to the contrary.¹⁸⁹ The effectiveness of this governance alternative is still largely dependent on respect for rule of law and the efficacy of democracy within countries.

6.3.2 Non-Legal factors

Legal factors are not independent components, rather they are adjunct to political and resources issues. These adjunct issues, which are also compliance drivers in EEs, are examined to see how they affect compliance with AML/CFT standards. An overview of internal factors and external pressures, that occasioned FATF membership through coercion or subtle pressure, show that the degree to which some of these factors are present, determine to a large extent, the compliance levels of countries.

6.3.2.1 Political Will, Domestic Conditions and Policy Priorities

Development, December 2012) < http://www.mcgill.ca/roled/files/roled/mcgill_roled_report_2012.pdf
> accessed 16 November 2017

¹⁸⁸ Helmut Reisen, "“Democracy” and “Corruption” in the BRICS' (*Shifting Wealth*, 5 August 2016) <http://shiftingwealth.blogspot.co.uk/2016/08/democracy-and-corruption-in-brics.html> accessed 16 November 2017.

¹⁸⁹ Ibid.

The degree of political will and institutional commitments in responding to AML/CFT regulations will determine, to a large extent, the varying degrees of compliance and accountability.

It was expected that FATF membership would translate to increased political will for EEs to comply with FATF standards, thus ensuring improved compliance levels. These expectations assumed that having emerged as strong economies, these countries must have had strong structures that promoted transparency within the government and private sector. Hence, it was hoped that EEs' FATF membership would provide the needed impetus for political will within EEs to pursue refined legislative and regulatory reforms. Brazil, however, presents a different picture. It was believed that Brazil's FATF membership would trigger improved compliance and help the FATF coordinate AML/CFT efforts of other countries in the region. This expectation, however, failed as the country was steeped in corruption, which hindered its compliance efforts. This was however short-lived.

In 2007, Brazil enacted the National Strategy to Combat Corruption and Money Laundering (ENCCLA), thereby indicating how political will drives accountability.¹⁹⁰ Adopting the ENCCLA demonstrated greater national commitment to combatting ML in light of internal corruption concerns. This was different from the US-driven transnational legal focus on TF; given that the ENCCLA demonstrated Brazil's response and accountability to national interests and concerns that were not necessarily part of transnational priorities. Brazil realized that whilst external demands are relevant, they are not the only considerations. The subsequent introduction of TF measures indicates that the ENCCLA alongside latter measures mediates between internal and

¹⁹⁰ The National Strategy against Corruption and Money Laundering (Estrategia Nacional de Combate a Corrupcao e a Lavagem de Dinheiro) established in 2013, see OECD Public Governance Reviews, 'OECD Integrity Review of Brazil: Managing Risk for a Cleaner Public Service' (OECD, 2012).

external demands for accountability.¹⁹¹ Consequently, the creation of a FIU¹⁹² and a central authority,¹⁹³ combined with the shift of international cooperation responsibilities from the judiciary to the executive, and the introduction of specialized groups on financial crimes in Brazil's judiciary and Central Bank marked the move towards improved accountability.

The Panama papers incidence highlighted the differences in the reaction of countries in addressing allegations of illicit crimes and facilitating accountability. As a result of the incidence, Brazil passed a vote of no confidence on its president, China and Russia were silent. The silence of China and Russia has not been deafening as, collectively, the BRICS have displayed enormous political will through the introduction of the BRICS Council on AML/CFT. The BRICS agreed that their collective action on counter terrorism financing should be consolidated. There was also a need to intensify training programs, especially using the Network AML/CFT.¹⁹⁴ The BRICS also approved a proposal to permanently establish a secretariat for the BRICS Council on AML/CFT in Moscow. It remains to be seen the extent to which this can be translated to long term change.

National authorities which perceive compliance with AML/CFT standards as a means of combatting un-systemic risk and ensuring security can also propel the political will for tackling ML/TF. Although ML/TF may not be the immediate catalyst for bringing sectors down, they could be the participatory reason for institutional collapse. Sectors that are AML/CFT compliant are better able to withstand risks by eliminating or reducing the un-systemic risks that accompany financial integration. A country's compliance level may however be largely dependent on that of its neighbors. For

¹⁹¹ Ana Maria Belotto and Marcelo S. Ribeiro, 'Compliance and Regulatory Developments in Brazil: Money Laundering and Corruption' (*Financier Worldwide*, June 2014) <<http://www.financierworldwide.com/compliance-and-regulatory-developments-in-brazil-money-laundering-and-corruption/#.Vz4ht2NImXR>> accessed 13 June 2016.

¹⁹² The National Strategy against Corruption and Money Laundering (Estrategia Nacional de Combate a Corrupcao e a Lavagem de Dinheiro) established in 2013, see OECD Public Governance Reviews, 'OECD Integrity Review of Brazil: Managing Risk for a Cleaner Public Service' (OECD, 2012) 72.

¹⁹³ *ibid.*

¹⁹⁴ BRICS, 'The BRICS Handover Report: 2015–2016', (BRICS, 2016) 65/66 <en.brics2015.ru/load/885248> accessed 10 December 2017.

example, in order to prevent a ‘race to the bottom’, countries with bank secrecy rules can compete more favorably internationally based on the recent Panama tax scandal example. Therefore, the activity of neighboring nations can trigger a country’s compliance or negate it.

Hence, although a country may have the political will, it cannot be underestimated that domestic conditions may still hinder compliance. One of such conditions is the ingrained culture of alternative remittances, such as Hawala, in various EEs, including China, Russia and India.¹⁹⁵ The culture’s predominance is because the economies of these countries are cash-based. Remittances are cheap, largely unregulated and can leave no paper trail. This process of transfer is facilitated by the trust existent between community members and the remittance operator aided by a long history of use.¹⁹⁶ Consequently, remittance processes have escalated the agency slack between the BRICS and the IFIs largely because it lacks a formal registration process, which makes it attractive to users who prefer privacy or lack the requisite documentation. Regulation of Hawala is however significant given its volume¹⁹⁷ and vulnerability to ML/TF.¹⁹⁸ That any commodity can be subject of Hawala further demonstrates the porousness of the system.¹⁹⁹ Various Hawala forms have evolved, including internet and mobile based systems.²⁰⁰

Regulating Hawala, for instance, presents an effective way of addressing its societal issues and ensuring compliance to FATF recommendations. However, regulatory steps must also consider competing reactions. A weak response can embolden launderers to exploit any lapses in the Hawala systems, whilst a robust response may lead to

¹⁹⁵ Collins Watterson, ‘Money Flies with Honey: Encouraging Formal Channel Remittances to Combat Money Laundering’ [2013] 91 Texas Law Review 711, 712, 720; Adil Anwar Daudi, ‘Note: The Invisible Bank: Regulating the Hawala System in India, Pakistan and the UAE’ [2005] 15 Ind. Int’l & Comp. L. Rev 619, 654; Vijay Kumar Singh, ‘Controlling Money Laundering in India – Problems and Perspectives’, (Annual Conference on Money and Finance in the Indian Economy, India, January 2009)
¹⁹⁶ Ibid.

¹⁹⁷ World Bank Group, Migration and Remittances Factbook 2016 (3rd Edn, KNOMAD, 2016).

¹⁹⁸ David Faith, ‘The Hawala System’ [2011] 2 (1) Global Studies, 23, 23.

¹⁹⁹ Gold remains the most popular.

²⁰⁰ Manuel Orozco, Elisabeth Burgess and Netta Ascoli, ‘Is there a Match Among Migration, Remittances and Technology’ (Inter-American Dialogue, 30 September 2010) < <http://archive.thedialogue.org/page.cfm?pageID=32&pubID=2501> > accessed 14 November 2016.

proliferation contrary to reduction of underground services.²⁰¹ One of the impediments to regulation and compliance is the difficulty in detecting operators, who often camouflage their activities with legitimate businesses.²⁰² This makes detection, investigation and sanctioning of illicit crimes difficult, expensive and time-consuming. The ineffective regulatory efforts to register Hawala users demonstrates this difficulty. Of the projected 160,000 to 200,000 existing Hawala users in the US, only 38,859 got registered by January 2013.²⁰³ This suggests that threats of sanctions or fines may in fact be unsuitable to compel compliance.

This situation suggests that Hawala banking systems are beyond the reach of regulation and raises questions about aligning or reconciling culture with existing regulation. Scholars have proposed the introduction of trust within the banking system using instruments for financial inclusion such as microfinance banking, mobile money²⁰⁴ or internet transfers.²⁰⁵ The extent to which these semi-regulated banking variations would be accepted by culture is however debatable. Acceptability would however provide investigative leads for law enforcement agencies, because transactions done through these means would generate an electronic record, while internet transfers generate IP addresses.²⁰⁶

²⁰¹ Ibid.

²⁰² Charles B Bowen, 'Hawala, Money Laundering and Terrorist Financing: Microfinance Lending as an End to Illicit Remittance' [2009] 37 Denv. J. Int'l and Policy 379, 393; Amos N Guiora & Brian Field, 'Using and Abusing the Financial Markets: Money Laundering as the Achilles Heel of Terrorism' [2007] 29 UPA J INT L L 59, 62.

²⁰³ FINCEN estimates that there are between 160,000 and 200,00 MSBS currently operating around the US, see Bank Secrecy Act: FinCEN and IRS Need to Improve and Better Coordinate Compliance and Data Management Efforts (GAO-07-212, 15 December 2016) <<https://www.gpo.gov/fdsys/pkg/GAOREPORTS-GAO-07-212/html/GAOREPORTS-GAO-07-212.htm>> accessed 10 March 2015.

²⁰⁴ Mobile money remains unsupported by banks as most banks have been unable to scale mobile money services and lack incentives to make necessary investments. See Mobile Money Association of India and GSMA, 'Mobile Money: The Opportunity for India' (MMAI/GSMA, 13 November 2013) <<https://www.gsma.com/mobilefordevelopment/wp-content/uploads/2013/12/MMAI-GSMA-on-Mobile-Money-in-India-for-RBI-Financial-Inclusion-Committee-Dec13.pdf>> accessed 10 November 2017 Martha Reeves, Neha Sabharwal, 'Microfinance and Mobile Banking for the Bottom of the Pyramid' [2013] 7.2 Journal of Enterprising Communities: People and Places in the Global Economy 155, 155.

²⁰⁵ Alice S Etim, 'Mobile Banking and Mobile Money Adoption for Financial Inclusion' [2014] 9 Research in Business and Economics Journal 1, 2.

²⁰⁶ FATF Report, Money Laundering Using New Payment Methods, (FATF Report, October 2010) <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20using%20New%20Payment%20Methods.pdf?TSPD_10>

In addition to the domestic conditions, policy priorities of the BRICS are crucial in determining compliance with FATF recommendations. Compliance is largely dependent on states' perception that FATF recommendations reflect their national interests and priorities.²⁰⁷ For instance, countries which sponsor state terrorism are unlikely to comply with FATF recommendations which would go against their policy priorities and domestic conditions. However, countries faced with high level predicate offences, including high crime rates, terror attacks, capital flight, tax evasion and diminishing financial stability are more inclined to comply with FATF recommendations as a means of combatting these difficulties. For instance, Brazil has extraordinary criminal rates;²⁰⁸ as the largest exporter of goods, China tackles trade-based ML. Their emergence as new market-oriented economies worsens these issues, as criminals are enabled to operate on a world-wide scale.²⁰⁹ The large volume of legitimate capital moving into the global financial economy, coupled with high remittances and insufficient regulatory controls have made it possible for funds to move around unregulated. Furthermore, countries which value bank secrecy as a determinant of compliance are faced with stiff competition by countries which do not.

The domestic conditions are also indicated in the operative system of government within a state. Scholars have argued that the level of democracy of states determine their compliance records.²¹⁰ They argue that internal structures, including budgetary allocations, reflect the policy priorities and the domestic conditions of a state.²¹¹

1_R0=9cb41d963f2572d210dd433c92353b15wI8000000000000000baeecd89ffff000000000000000000000005a8f20d10083f1a37e > accessed 10 July 2017.

²⁰⁷ Tatiana Tropina, 'Do Digital Technologies Facilitate Illicit Financial Flows?' (2016) World Development Report: Digital Dividends 102953 <
<http://documents.worldbank.org/curated/en/896341468190180202/pdf/102953-WP-Box394845B-PUBLIC-WDR16-BP-Do-Digital-Technologies-Facilitate-Illicit-Financial-Flows-Tropina.pdf> >
 accessed 10 July 2017.

²⁰⁸ Paula Miraglia, 'Drugs and Drug Trafficking in Brazil: Trends and Policies' (Foreign Policy at Brookings, 2016) <https://www.brookings.edu/wp-content/uploads/2016/07/Miraglia-Brazil-final.pdf> accessed 10 December 2016.

²⁰⁹ Moamil, 'Drug Trafficking Among One of the Major Criminal Source of Money Laundering' [2015] 2 (1) International Journal of Multidisciplinary Research and Development 33, 35.

²¹⁰ Anne-Marie Slaughter, 'International Law in a World of Liberal States' [1995] *EUR. J. Int'l L* 503-538; Helen V Milner and Andrew Moravcsik (eds.), *Power, Interdependence and Non-State Actors in World Politics* (Princeton University Press, 2009).

²¹¹ Lori Ann Post, Amber N.W. Raile, Eric D Raile, 'Defining Political Will' [2010] 38 (4) *Politics & Policy* 653, 653.

Furthermore, although debatable, domestic politics has long been understood to determine a state's decision to accept international obligations.²¹²

6.3.2.2 Compliance based on Reputational Concerns

Unlike FIs in ACs, EEs have more to lose in terms of trade and financial integration if they are not compliant with the AML/CFT regulations. This is because a tainted reputation can adversely affect their businesses. The pressure for compliance may come from large banks which are more predisposed to comply for reputational reasons.²¹³ Large banks are also keen to display their compliance with international standards in order to compete globally and establish sturdy banks in developed economies. For this reason, benchmarking for performance is valuable, as large banks usually have domestic and international competitive advantages. This may occasion positive regulatory capture whereby regulators are pressurized to ensure compliance with FATF recommendations across sectors so as to attract and ensure continued international investments and business.

The interaction between regulators and the regulated industry can occasion increased engagement in CDD requirements and other FATF recommendations, especially as these actively contribute to combatting fraud.²¹⁴ Conversely, non-compliance to CDD requirements contributes to fraud and operational risk. Given regulatory capture by large banks, CDD has increasingly become a concern for boards of directors and senior management, who are usually proactive in combatting ML/TF. These steps are taken in recognition that non-compliance to even soft law instruments can have reputational damage.²¹⁵ It indicates the FATF's standard of increased transparency and market

²¹² See also Beth Simmons, *Mobilizing for Human Rights: International Law in Domestic Politics* 23-56 (CUP 2009).

²¹³ Deloitte, 'Meeting New Expectations: Foundational Considerations When Upgrading Know Your Customer Programs' (Deloitte Centre for Financial Services, 2015) < <https://www2.deloitte.com/tr/en/pages/financial-services/articles/dafs-know-your-customer.html> > accessed 10 August 2017.

²¹⁴ Ibid.

²¹⁵ Andrew Guzman, 'A Compliance-Based Theory of International Law' [2002] 90 (6) *California Law Journal* 1826, 1888; Beth Simmons, 'Compliance with International Agreements' [1998] 1 (1) *Annu. Rev. Polit.Sci.* 1, 8.

pressure, as more domestic banks are now covered by FATF recommendations. The efforts of large banks to propel increased regulatory supervision indicate that proficient regulatory bodies are crucial in ensuring compliance.

These active steps towards improved compliance within EEs demonstrates limited reliance on their FATF membership to salvage them from the effect of non-compliance. This was particularly due to the knowledge that de-listing can be triggered in the event of dire shortcomings in compliance – a process which has almost similar effect as blacklisting.

6.3.2.3 Legitimacy and its effect on Compliance

It can be taken for granted that the BRICS membership of the FATF has changed their legitimacy perception of the institution. As earlier stated, the treatment faced by the BRICS as associate members and non-members has not been relegated to history. For this reason, the BRICS do not necessarily view the FATF as wholly legitimate irrespective of their positioning as strategically important countries. However, the BRICS persistently comply with the FATF standards. Their underlying agenda is to ensure their continued integration with the global financial market. For this reason, their compliance levels are usually above 50%.²¹⁶ However, given the internal issues faced by the BRICS, such as corruption, it is indeed questionable if their compliance levels are a true indication of their efforts to combatting ML/TF. Indeed, compliance levels can be ‘window dressed’ and BRICS can strategically engage with its principals (the IFIs) to ensure continued integration.

To ensure increased accountability amongst the BRICS, these countries developed a BRICS Council for AML/CFT. This move was aimed at facilitating improved

²¹⁶ See Figure 9.

AML/CFT structures particularly centered on corruption – a problem faced by all the BRICS.²¹⁷ Additionally, the BRICS sought a collaborative platform, free from bias which allowed for secure AML/CFT information exchange and the development of international mechanisms for confiscation and recovery of criminal assets within the BRICS.²¹⁸ The BRICS have taken on this additional responsibility because they recognize that effective AML/CFT and anti-corruption measures attract foreign direct investment and aid their global expansion plans. However, the BRICS Council for AML/CFT is recent, given its approval in 2015, and its effect is yet to be known.

6.3.2.4 Globalization and Integration

Globalization and integration comes with attendant issues such as political strife between countries with varying values or increasing inter-bank relationship between countries. To the extent that certain banks establish their physical presence in other countries. This section will illustrate how these can have an effect on a country's compliance with AML/CFT standards.

As demonstrated in chapter 3, political interrelationship is a determinant for compliance with AML/CFT regulations in the BRICS. Political strife between countries is likely to weaken external ties and internal institutions that drive regional or global compliance. For instance, the political strife between Russia and the West was arguably designed by Western states to weaken Russia geopolitically and reduce her threat to Western Europe and the NATO Alliance.²¹⁹ In pursuance of this objective, Russia was recently expelled from the G8 countries. The effect of this is that Russia would be unable to enter into memoranda of understanding with Western countries to uncover cross-border laundering or terror funding. Interestingly, Russia's political and economic stability is beneficial to the West as it could be a vital factor in international relations, particularly

²¹⁷ Clarence Samuel Joseph, 'Establishing Comprehensive, Economic and Legal Approach to Risks and Threats in Anti-Money Laundering Regime' [2016] 13 Financial Security 1, 24.

²¹⁸ Ibid.

²¹⁹ This is in relation to territorial issues with Western allies like Ukraine and Georgia.

trade and the economy of the United States. Russia's expulsion from the G8 indicates a lack of diplomacy by the US and other Western countries in dealing with perceived allies and working together for a common good. The alternative argument however is that there is a balance between condoning Russia's infringement on Ukraine's sovereignty and protecting trade/finance agreements.

China has similar issues with the West, including territorial issues in its attempt to redefine its place amongst the West and the South. Furthermore, China is not content with Western interpretation of policies, such as the Western stance on human rights which may undermine China's attempts to curb illicit crimes through criminal sanctions.

Yet, global integration has seen BRICS enter into banking relationships with developed countries, and even establish subsidiary financial institutions in those countries. Stretching the agency theory enumerated in chapter four would indicate that HP countries classed as highly integrated (such as China) would be willing to sustain a high compliance level with the sole aim of ensuring its continued integration into the global economy. Hence, one may conclude that the propensity for China or India to comply to AML/CFT standards is higher. Particularly because, on paper, their procedures follow the host country's AML/CFT policies.²²⁰

Cases however illustrate the use of Chinese subsidiary banks abroad to facilitate money laundering or capital flight.²²¹ The UK regulator (the FCA) has responded to these cases against the largest branches of the Industrial and Commercial Bank of China (ICBC) and the China Construction Bank Corp (CBB) by strengthening its inspection on

²²⁰ Nick Kochan, 'Global Concern at AML Standards of Chinese Banks Abroad' (WoltersKluwer, 20 May 2016) < <http://www.wolterskluwerfs.com/article/global-concern-at-aml-standards-of-chinese-banks-abroad.aspx> > accessed 10 May 2017.

²²¹ For instance, the CBB had enforcement actions taken against it for non-compliance to CDD requirements. The Bank of China also allegedly smuggled more than 5 billion dollars out of Italy to China. See Nick Kochan, 'Global Concern at AML Standards of Chinese Banks Abroad' (WoltersKluwer, 20 May 2016) < <http://www.wolterskluwerfs.com/article/global-concern-at-aml-standards-of-chinese-banks-abroad.aspx> > accessed 10 May 2017.

them.²²² The UK's step indicate that the compliance by Chinese overseas bank is questionable. Henry Rui, an Ernst and Young partner for China stated that 'when they do funds transfer, they don't check the source of funds, which is very important in KYC...they just do the transactions'.²²³ An indication that compliance may actually be lip service to regulation and these institutions would bypass compliance to win businesses. Rui attributes this to the recent history of AML in China which requires time for the country to be comfortable in meeting the international standards. Statistics however indicate that China's admirable compliance levels show evidence of the country's attempt to avert de-risking whilst maintaining its space within the global economy.²²⁴

This is particularly evident in China's relationship with ACs where China provides private equity for small-medium enterprises. Quite recent was the \$60 billion commitment to Africa by China between 2000 and 2015 to finance over 3000 infrastructure projects in Africa.²²⁵ The relationship between HP countries (China) and MP countries (ACs) may indicate the presence of an agency relationship which is particularly disadvantageous to China given its ability to follow – to a larger extent, the international AML/CFT standards. This situation may facilitate an agency slack where AC's engage strategically with China on their AML/CFT compliance to ensure continued investments. However, China has not always met the global standards itself, a situation that has led to sanctioning of the country's Construction Bank by South Africa.²²⁶

²²² *ibid.*

²²³ *ibid* (n 221).

²²⁴ See Figure 9

²²⁵ Yun Sun, 'Foresight Africa Viewpoint –China's Engagement in Africa: What Can We Learn in 2018 from the \$60 Billion Commitment?' (Brookings, January 30 2018) < <https://www.brookings.edu/blog/africa-in-focus/2018/01/30/foresight-africa-viewpoint-chinas-engagement-in-africa-what-can-we-learn-in-2018-from-the-60-billion-commitment/> > accessed 10 May 2018.

²²⁶ Financial Times, 'South Africa Fines China Construction Bank over Weak Laundering Controls' ((Financial Rimes, February 5, 2018) < <https://www.ft.com/content/a17d7dea-0a34-11e8-8eb7-42f857ea9f09> > accessed 10 May 2018.

experts and social engineers leading the pack, so is the level of damage and consequential losses that can accrue. For example, a Brazilian group, ‘Anonymous Brasil’, unleashed cyber terror on Brazilian FIs’ websites, including that of Citigroup in 2012.²⁴⁰ India is also plagued with similar issues; statistics reveal that 48% of Indians were cybercrime victims in 2015.²⁴¹ The damage in Russia is unprecedented, with hijackers doubling their income from USD 3.7 billion between 2011 and 2013.²⁴² Although Russian enforcement agencies have increasingly detected more cases, the effectiveness cannot be measured. This cyber-attacks have led to stock market manipulations.²⁴³

Recognizing the challenges posed by technology, Nobel Laureate Michael Spence recently stated that the BRICS slowdown is attributable to ‘the disruptive impacts of digital technology, which are set to erode developing economies.’²⁴⁴ This statement illustrates that technology, although a positive change, comes with challenges which hinder compliance to AML/CFT, puts customers at risk and challenges economic growth. Regrettably, Spence states that these countries ‘have little or no control’ over these obstacles that hinder their ability to achieve sustained high growth.

²⁴⁰ Intel Security, ‘Net Losses: Estimating the Global Cost of CyberCrime’ Economic Impact of Cybercrime II - Center for Strategic and International Studies (Intel Security, 2014) < https://csis-prod.s3.amazonaws.com/s3fs-public/legacy_files/files/attachments/140609_rp_economic_impact_cybercrime_report.pdf > accessed 15 July 2016; Rosalba O’Brien, ‘Latam Cyber Attacks Rise as Peru, Brazil Hackers Link up with Russians’ (*Reuters*, 28 August 2015) < <http://www.reuters.com/article/latam-cyberattack-idUSL5N1134W520150828> > accessed 15 July 2016.

²⁴¹ Team PG, ‘48 Percent Indians Online Were Cyber Crime Victims Last Year: Norton’ (*PGurus.com*, 20 November 2015) < <https://www.pgurus.com/48-percent-indians-online-were-cyber-crime-victims-last-year-norton/> > accessed 10 July 2016.

²⁴² Willain H Bynes, Robert J Munro, *Money Laundering, Asset Forfeiture and Recovery and Compliance – A Global Guide* (Lexis Nexis, 2016).

²⁴³ Maarten Gehem, Artur Usanov, Erik Frinking, Michel Rademaker, *Assessing Cyber Security, A Meta-Analysis of Threats, Trends, and Responses to Cyber Attacks* (Hague International Centre for Strategic Studies, 2015).

²⁴⁴ Helmut Reisen, ‘“Democracy” and “Corruption” in the BRICS’ (*ShiftingWealth*) < <http://shiftingwealth.blogspot.co.uk/2016/08/democracy-and-corruption-in-brics.html> > accessed 10 July 2016.

6.4 Cross-Country Analysis of Compliance to AML/CFT Regime: FATF

An assessment of the MER of countries is carried out to determine the level of country compliance to AML/CFT. The scoring of assessments is discussed in the previous chapter.²⁴⁵

6.4.1 Analysis of AML/CFT by Countries

Figure 9 represents a plot of the percentage score based on the FATF MER. The BRICS countries are individually represented on the basis of their MER results. Figure 9 displays India as the most compliant EE with 66.67%, closely followed by China with 66.03%. These countries are then followed by South Africa with 58.55%, Russia with 57.6% and Brazil with 54.49% compliance level. Brazil's troubling compliance level at 54% is however above that of 35 African countries, as 30 countries score below 50%.

This may be indicative that the membership within a club may promote increased compliance with its objectives. However, this chapter asserts that economic and legal development, not membership, occasions improved compliance. This is so because countries like Mexico, Indonesia, Nigeria and Turkey (MINT), who are also classified as EEs,²⁴⁶ have been able to achieve almost comparable compliance levels. Consequently, these results reflect that blacklisting and other implicit coercive measures of compliance induce potential members of the FATF to introduce high levels of supervision and enforcement structures which coincidentally is supported by their domestic structures. This can be deduced from the FATF membership policy which

²⁴⁵ See page 232.

²⁴⁶ BBC News, 'The Mint Countries: Next Economic Giants?' (*BBC News*, 6 January 2014) <<http://www.bbc.co.uk/news/magazine-25548060>> accessed 10 January 2017; Christine Easterfield, 'BRIC vs MINT – Comparing Emerging Markets Using Cambashi's Updated Country Observation' (Cambashi) <<http://www.cambashi.com/contentmgr/showdetails.php/id/2513/page/3>> accessed 3 January 2016; Daniel Harari, 'The MINT Emerging Economies' (Second Reading: The House of Commons Library Blog – UK Parliament, 14 January 2014) <<https://secondreading.uk/daniel-harari/the-mint-emerging-economies/>> accessed 10 January 2016.

emphatically states that it considers, amongst other factors: ‘the level of AML/CFT risks faced and the efforts to combat such risks... level of commitment to AML/CFT efforts.’²⁴⁷

The FATF considers these on a qualitative basis which is subjective and based on unquantifiable evidence. Although the method employed is questionable, what is evident is that the membership requirement is set at a high bar and countries are pushed to meet that bar by increased regulatory supervision and enforcement – actions which guarantee membership and warrants continuous compliance. This supports the argument that domestic factors and embedded coercion ensure compliance, not membership.

The question then is why the BRICS, why are these same measures not foisted on ACs? The response can be gleaned from the FATF membership requirement, which considers:

‘the impact (of the country’s financial system) on the global financial system...the degree of openness of the financial sector and its interaction with international markets... the level of adherence to financial sector standards and participation in international organizations.’²⁴⁸

This demonstrates that developed countries are more likely to have sophisticated financial systems and impact on the global market, thus warranting their inclusion. Furthermore, they are also more likely to have advanced infrastructure and expertise to foster compliance to AML/CFT standards. Thus, it can be argued that the criterion for membership in itself fosters improved compliance within countries that aspire to get a seat at the FATF table. This explains why mandatory compliance to certain FATF

²⁴⁷FATF, ‘FATF Membership Policy’ (FATF) < <http://www.fatf-gafi.org/about/membersandobservers/fatfmembershippolicy.html> > accessed 13 January 2016.

²⁴⁸ Ibid.

recommendations, like recommendations 3, 5, 10, 11 and 20,²⁴⁹ are easily achieved by the BRICS given their robust legal, economic and supervisory structure. IMF statistics buttresses the increased supervisory quality in the BRICS countries. These requirements indeed make the BRICS regulation more robust and prepared to ensure compliance. Thus, when membership is aspired to and supported by domestic circumstances, compliance is less likely to be problematic.



Figure 9. *Technical Compliance Levels of the BRICS to the FATF Recommendations (Derived from the FATF MERs of countries)*

6.4.2 Analysis by Recommendation and Topics

The clearest deficiency noted regarding country compliance levels is mainly as regards recommendation 17 on ‘Reliance on Third Parties’. Third parties are classified as financial institutions or Designated Non-Financial Businesses and Professions (DNFBPs). The FATF believes that when permitted to rely on third parties, the financial institution granted that permission has the ultimate responsibility of ensuring that the third party is registered and carries out adequate due diligence (CDD)/record

²⁴⁹FATF, ‘FATF Membership Policy’ (FATF) < <http://www.fatf-gafi.org/about/membersandobservers/fatfmembershippolicy.html> > accessed 13 January 2016.

keeping. This deficiency can be attributed to the high level of unregulated money transfer business given the high remittances received by BRICS. Additionally, businesses like casinos, real estate agents and dealers in precious stones face minimal regulation implementation and lack the expertise to supply adequate CDD/record keeping to the permitted institution. Lawyers, trust and service providers are also strictly regulated and owe confidentiality obligations to their clients. This explains the low level of compliance to recommendation 22 which requires DNFBPs to adhere to the FATF recommendations on CDD/record keeping.

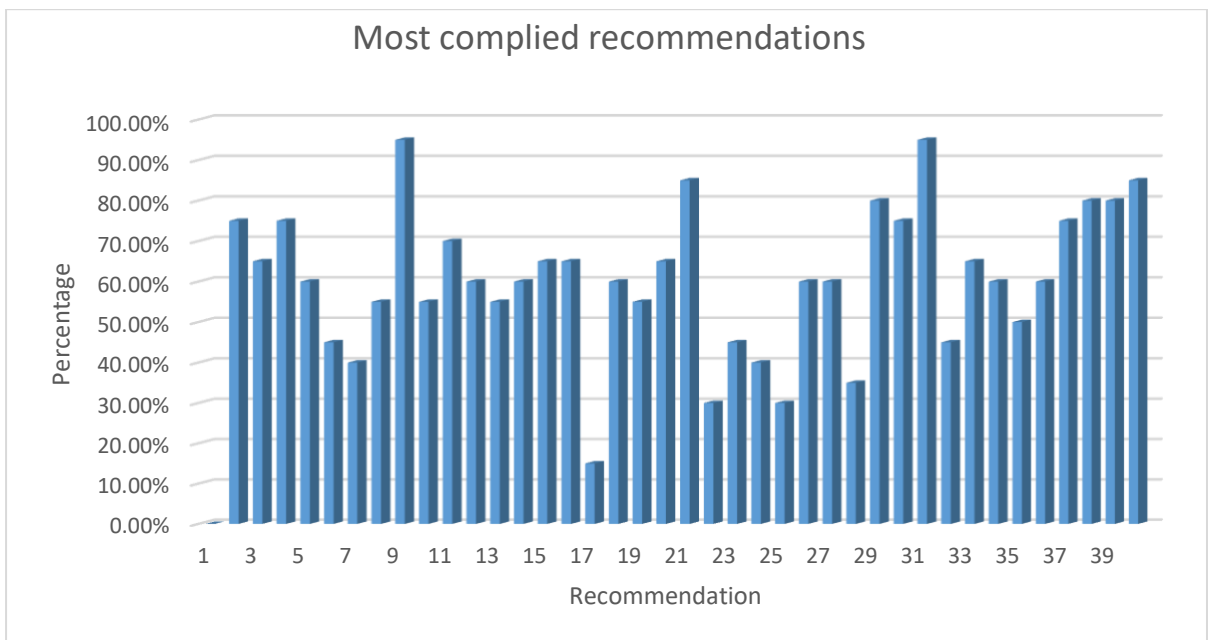


Figure 10: Analysis by compliance to FATF Recommendations

Conversely, the statistics reveal that the recommendation with the highest level of compliance is recommendation 9 on financial secrecy, with a score of 95%, well above the average 60.77%. This is followed by recommendation 31 on the powers of enforcement and investigative officers. If this is correct, it can be interpreted to mean that financial secrecy laws do not inhibit the implementation of the FATF

recommendations. It is however paradoxical that recommendation 17 is low as recommendation 31 charges countries to empower their enforcement and investigative authorities to carry out their tasks effectively. It could however mean that these authorities have narrow focus, which is not inclusive of DNFBPs. This aligns with compliance literature on EEs which revealed that EEs’ investigative and enforcement structures are sturdy, but lacking in capacity. The absence of capacity has consequently occasioned a risk-based approach which, unfortunately, is not holistic.

An evaluation of Figure 10 illustrates improving compliance levels to CFT requirements by the BRICS and sturdy compliance to CDD requirements. This is different for ACs that although combat heavy terrorism has displayed weak compliance to the recommendations. This, again, can be attributed to lack of, or weak, expertise in ACs.

6.4.3 Analysis by Compliance Drivers

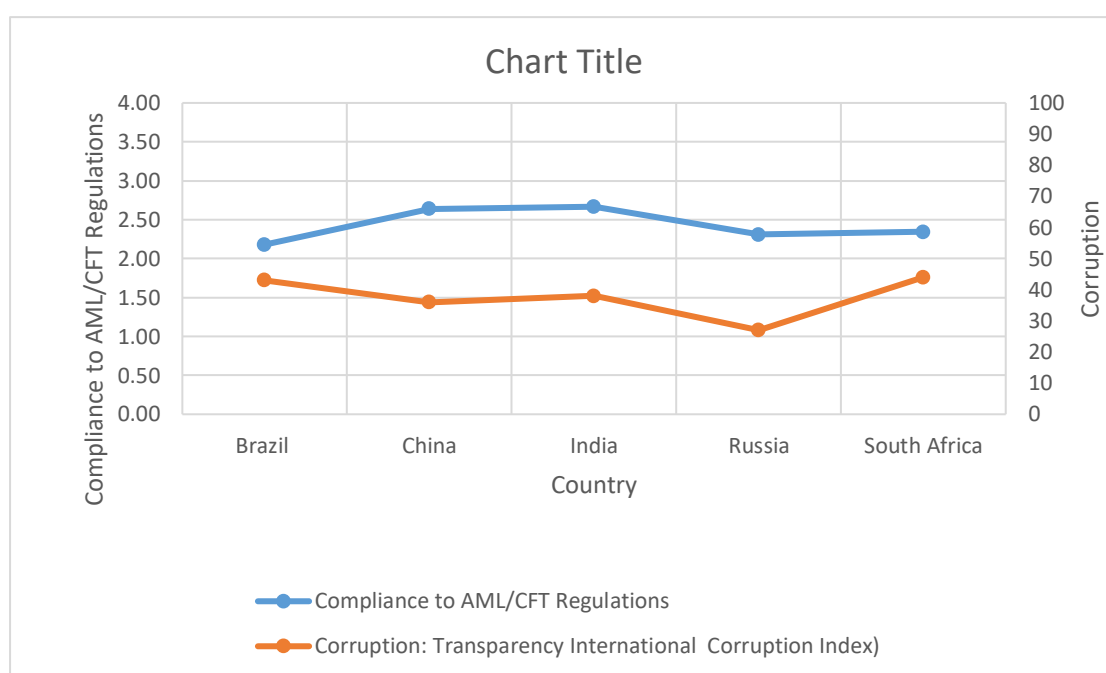


Figure 11: Analysis by corruption index ²⁵⁰

²⁵⁰ Correlation is done using the Transparency International, ‘Corruption Perception Index 2014: Results’ (Transparency International, 2014) < <https://www.transparency.org/cpi2014/results> > accessed 10 July 2015; The compliance index is derived from the FATF data.

The r-value of -1.14686 shows a very weak negative correlation. This reveals that higher corruption usually signifies low compliance rates and vice versa. This is particularly the case with China, India and Russia. Brazil and South Africa show a slightly different picture where higher standards of compliance do not necessarily lead to lower levels of corruption.

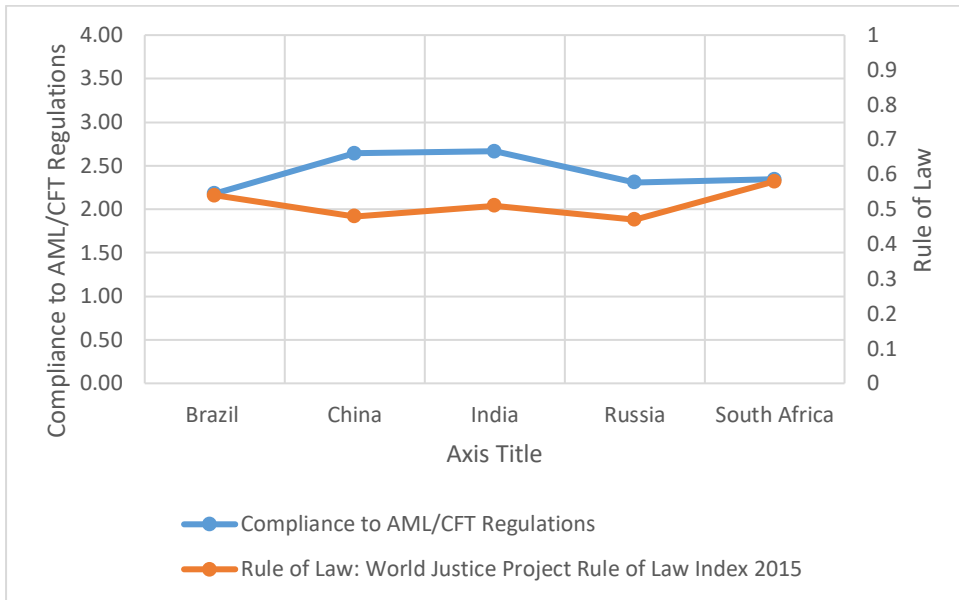


Figure 12: Analysis by rule of law index

The r-value of -0.38675 is indicative of a negative correlation between rule of law and compliance with AML/CFT standards. So when rule of law improves, compliance decreases. This is the case in Brazil and SA, indicating that ‘window dressed’ compliance usually shrouds actual compliance levels. China, India and Russia however indicate that as rule of law improves, compliance improves. China’s result is surprising in the light of the literature concerning its compliance drives which are not necessarily attributable to rule of law.

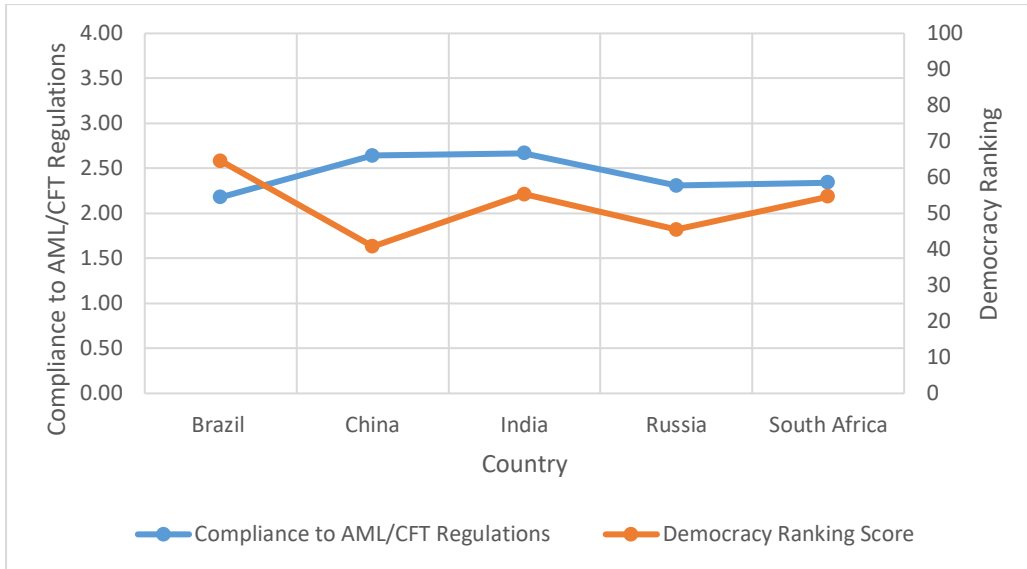


Figure 13: Analysis by Democracy Index ²⁵¹

The r-value of -0.52215 indicates a strong negative correlation, illustrating that democratic countries do not necessarily have higher compliance levels. This is demonstrated by China’s variables, and surprisingly, Brazil also indicates this. India, Russia and South Africa show a more positive relationship between democracy and compliance, albeit a weak one.

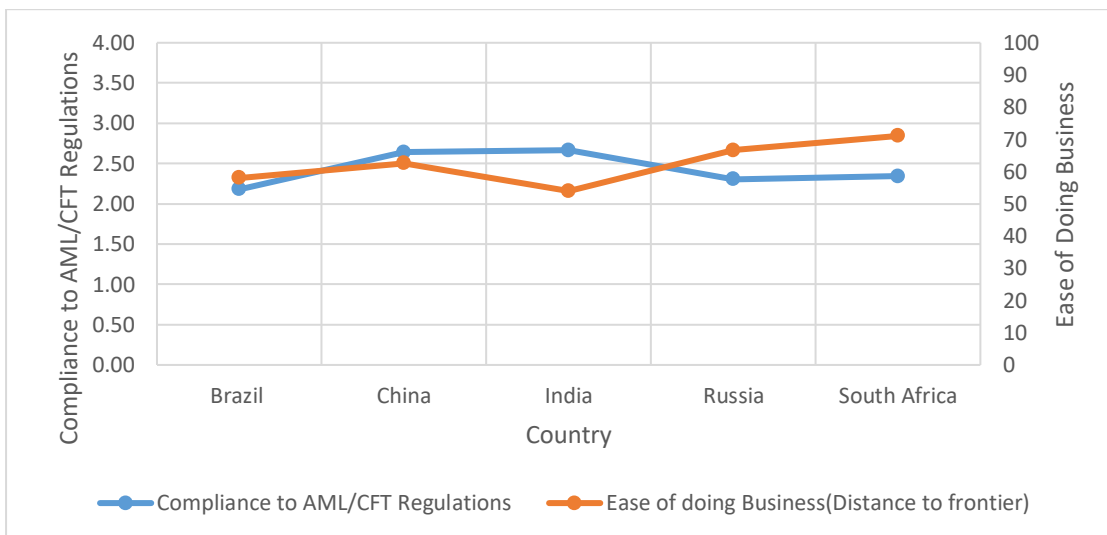


Figure 14: Analysis by ease of doing business ²⁵²

²⁵¹ David Campbell, Paul Polzlbauer, Thorsten Barth, Georg Polzlbauer, ‘Democracy Ranking 2015 (Scores)’ (Democracy Ranking, 2015) < http://democracyranking.org/ranking/2015/data/Scores_of_the_Democracy_Ranking_2015_A4.pdf > accessed 30 December 2015.

²⁵² See World Bank Group, ‘Doing Business 2015: Going Beyond Efficiency’ (World Bank Group, 12th Edition, 2015) < <http://www.doingbusiness.org/reports/global->

A weak negative correlation is indicated by the r-value of -0.3661. Countries with higher compliance levels create a less conducive environment for doing business and vice versa. Surprisingly, this is particularly the case in China and can be attributable to the strict regulatory environment.

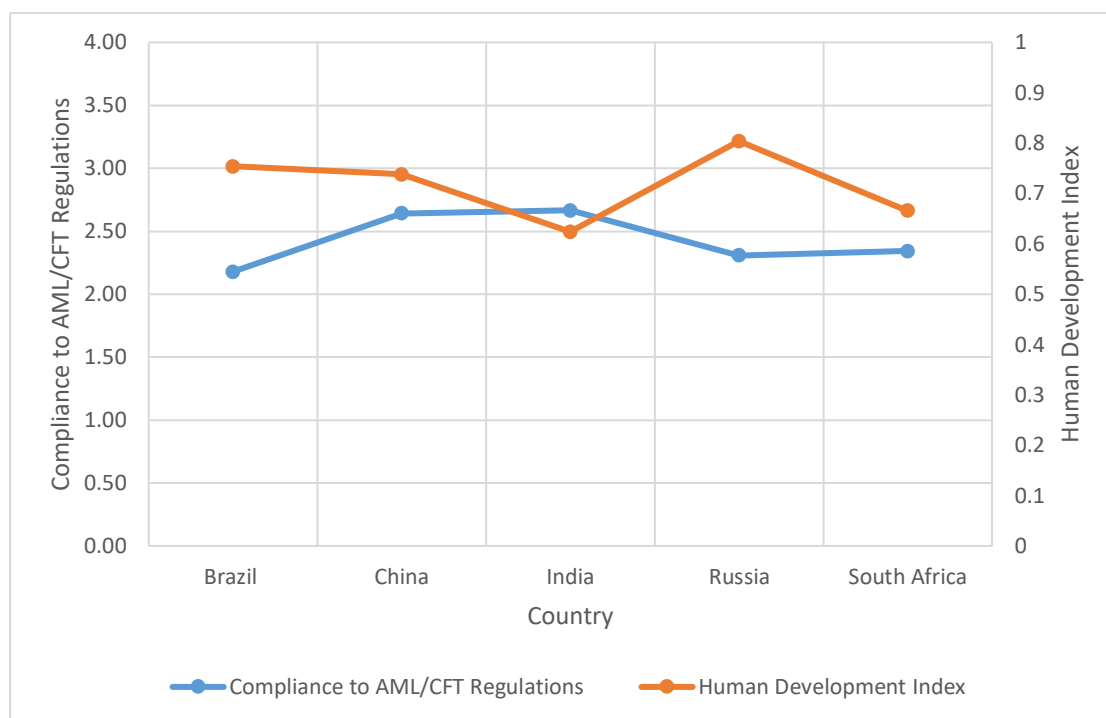


Figure 15: Analysis by human development index (HDI)

The -0.53287 r-value reveals a strong negative correlation. Where there is weaker AML/CFT compliance, there is stronger HDI and vice versa. This is especially the case in Russia. In India, with higher AML/CFT compliance, there is lower HDI. This indicates that other variables come into play in determining HDI, such as corruption and poverty levels.

6.5 Conclusion

The BRICS have created newer inequalities of power and influence regionally and globally. Although inherently diverse in terms of culture, socio-political structures and economic policies, the agreement between these countries is a perceived threat to existing IFIs due to their accelerating economic progression. On the basis of their intrinsic powers and unprecedented economic growth, the BRICS were selected as members to the FATF in a bid to drive improved compliance to AML/CFT recommendations, especially amongst regions.

Extending FATF membership to the BRICS was centered on varying jurisdictional reasons. Whilst the BRICS and the developing world viewed this membership as a means to gain increased representation within the FATF, the agenda of the West was to ensure that the financial movement to the Global South is not replete with illicit transactions. The power-play involved in negotiations between these ‘North-South strategically important countries’ was predicated on the assumption that representation would catalyze improved compliance to AML/CFT recommendations. This assumption however did not take into consideration pertinent issues peculiar to the BRICS economies, such as diverse socio-economic, political and legal developmental levels. Furthermore, the FATF continues to exercise some restraint in including EEs as true core members and thus shapers of its standards. It had merely treated them as regulation-takers. The BRICS coerced and belated membership has created a very unbalanced membership between EEs and the developed countries.

Against this background, this chapter argues that membership does not necessarily guarantee comparable representation or legitimacy; neither does it guarantee the overtly improved compliance of BRICS countries. It presents a contrary argument that ‘representation’ taints the socio-economic complexities inherent in these countries and their ability to comply. Worse still, it conceals the asymmetries occasioned by variances in the strength of legal structures reinforced by political and economic differences between members of the FATF. For membership to equate to legitimacy, there must be

existent changes along existing political and economic global structures, arguing that this would ensure improved adherence to FATF recommendations.

It then considers the determinants of compliance to AML/CFT in EEs. It finds that compliance is based on varying factors which may be external or internal to individual jurisdictions. More so, external factors influence internal determinants of compliance. This is further buttressed by the FATF compliance standards which reveal that the standards of compliance are marginally higher in EEs than in African countries. This can be attributed to improved supervision in the select countries and stronger legal and financial systems which were grounds for membership and not an offshoot of membership. This is further buttressed empirically as the five (5) variables employed indicate an inverse relationship with compliance.

Chapter 7

Legitimacy – A Means of Levelling the Playing Field?

7. Introduction

Diffusing the FATF standards to countries was achieved through a process of coercion and persuasion. Yet, ACs/EEs implement the FATF standards, partly to avert any compromise to their funding from IFIs. One reason why IFIs can wield such powers in relation to AML/CFT standards is because these standards are imbedded in their conditionalities. Nevertheless, paradoxes still result from ACs/EEs implementation. The introduction of the risk-based approach (RBA) by the FATF to incorporate the peculiarities of countries in compliance ratings, with a view to resolving some legitimacy issues and agency slack, did not completely resolve the issue. Rather, continued implementation has only occasioned formal or creative compliance. For countries to attain proactive or actual compliance to the AML/CFT standards, the legitimacy of IFIs/FATF and the resulting standards are crucial. Additionally, a shift from RBA to the uncertainty based approach (UBA) which is judgement based and forward looking may indeed be advisable.

Section 1 restates the concept and importance of legitimacy in AML/CFT regulation. Section 2 examines the FATF's strategies in rule design, implementation and compliance and the extent to which the legitimacy crisis is addressed. Additionally, it scrutinizes the RBA and the extent to which it closes compliance differentials in ACs/EEs, thereby reducing agency slack and resolving the legitimacy crisis. It also appraises the option of the UBA as an alternative to the RBA to ensure that ML/TF is combatted effectively. Section 3 scrutinises the attempts aimed at resolving legitimacy crisis and their possible feasibility. Section 4 questions why ACs/EEs still comply with AML/CFT standards, despite the legitimacy crisis and the regulatory paradoxes. Section 5 draws the strands together and concludes.

7.1 The Agency Quandary: Restating the Concept and Importance of Legitimacy

The exclusivity of FATF membership which is biased against belated and associate members' reveals complexities in the institution's processes, which has worsened the legitimacy crisis. This crisis, which is evidenced by a lack of representation or input in global regulatory standards from these countries, was facilitated by the inherent overlap in the FATF's position as both principal and agent to developed countries. As discussed earlier, the FATF is the G7's agent. The G7, whose member states are core FATF members, played an important role in formulating FATF standards. Conversely, the G7 countries remain bound by the FATF standards, which allows the FATF to evaluate their compliance and possibly issue sanctions. This places the FATF in a principal position to the G7.

Contrariwise, the BRICS only have some measure of involvement in the FATF's standards re-formulation process, which demonstrates their role as 'rule-takers' because of their belated membership. ACs suffer a worse off fate with minimal input in standards re-formulation, which restricts them from contributing to the FATF standards and adding their peculiarities, yet ACs are still subject to the FATF rules. This connotes that the FATF relationship with its members' is dependent on a hierarchy (core members, belated members and associate members). The resulting global asymmetry and the influence of G7 national/regulatory laws on international standards have raised questions about the legitimacy of the FATF.

Whilst these shortcomings also exist in treaty bodies such as the IFIs, countries have nonetheless continued to comply with conditionalities listed by them. This continued compliance can be attributable to arguments that treaty bodies derive their legitimacy from state consent¹ and thus have the power to mandate compliance. Without consent,

¹ Jan Klabbers, Anne Peters and Geir Ulfstein, *The Constitutionalization of International Law* (OUP, 2009) 39; Allen Buchanan and Robert Keohane, 'The Legitimacy of Global Governance Institutions' in Lukas H. Meyer, *Legitimacy, Justice and Public International Law* (CUP, 2009) 36; Daniel M. Bodansky, 'The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?' [1999] 93 (3) *American Journal of International Law* 596, 604; Rudiger Wolfrum,

clear legal structures to ensure accountability and democratic participation, trans-governmental institutions have continued to foster compliance to their standard. Hurd asserts that ‘legitimacy’ does not equate to ‘legal’, but rather, it is the ‘*perception of actors on the acceptability of an institution.*’² Such fluid construction of ‘legitimacy’ postulates that a soft law regulatory body that is perceived as holding normative right to govern by those on whose behalf it seeks to do so is ‘legitimate.’³ Thomas describes this ascription to an objective perspective on legitimacy by actors as ‘legitimation’, a process by which actors come to believe in the normative legitimacy of an object.⁴ This extended perception grants decentralised bodies other basis for legitimacy and acceptance, rooted in the reasons for acceptance by actors. As discussed, the basis for an institution’s legitimacy is rooted in how countries perceive their input, throughput and output.

‘Legitimacy of International Law from a Legal Perspective: Some Introductory Considerations’ in Rudiger Wolfrum and Volker Roeben (eds.), *Legitimacy in International Law* (Berlin and New York: Springer, 2008) 6; cf Nienke Grossman, ‘The Normative Legitimacy of International Courts’ [2012] 86 Temple Law Review 61,78 which argues that state consent and procedural fairness are insufficient to ground the legitimacy of institutions; Mathias Kumm, ‘The Legitimacy of International Law: a Constitutionalist Framework of Analysis’ [2004] 15 (5) The European Journal of International Law 907, 912.

² Ian Hurd, ‘Legitimacy and Authority in International Politics’ [1999] 53 (2) International Organization 379, 381; Alain Pellet, ‘Legitimacy of Legislative and Executive Actions of International Institutions’ in Rudiger Wolfrum and Volker Roeben (eds.), *Legitimacy in International Law* (Berlin and New York: Springer, 2008) 70; Chris A. Thomas, ‘The Concept of Legitimacy and International Law’ (2013) LSE Law, Society and Economy Working Papers 12/2013, 14 < http://eprints.lse.ac.uk/51746/1/libfile_repository_Content_Law%2C%20society%20and%20economics%20working%20papers_2013_WPS2013-12_Thomas.pdf > accessed 10 November 2017; Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (2008) LSE Law, Society and Economy Working Papers 2/2008, 16 < http://eprints.lse.ac.uk/23040/1/WPS2008-02_Black.pdf > 16 November 2017.

³ John Jost and Brenda Major, ‘Emerging Perspectives on the Psychology of Legitimacy’ in John Jost and Brenda Major, *The Psychology of Legitimacy: Emerging Perspectives on Ideology, Justice, and Intergroup Relations* (CUP, 2001); Ian Hurd, ‘Legitimacy and the United Nations’ (2011) Northwestern University and Niehaus Centre for Globalization and Governance at the Woodrow Wilson School, Princeton University Working Paper 2011, 3 < <https://poseidon01.ssrn.com/delivery.php?ID=813098115094007082115069029076116093024068064058019036096099068030008021112021000092025021018032000121001003085071006095028022049037039013080029099097105067124127033016071086115123015000076064122024115088003090127015087029086098069122079110014090121&EXT=pdf> > accessed 10 July 2017.

⁴ Chris A. Thomas, ‘The Concept of Legitimacy and International Law’ (2013) LSE Law, Society and Economy Working Papers 12/2013, 16 < http://eprints.lse.ac.uk/51746/1/libfile_repository_Content_Law%2C%20society%20and%20economics%20working%20papers_2013_WPS2013-12_Thomas.pdf > accessed 10 November 2017.

Without legitimacy, the FATF may be unable to inspire acceptance and compliance to its regulatory standards.⁵ This is because a body acknowledged as legitimate forms a reservoir of loyalty from which it can govern effectively.⁶ This invariably means that, if for instance, the FATF is considered legitimate by receiving actors, such actors are more likely to ensure actual or proactive compliance to set standards, as opposed to formal or constructive compliance.⁷ Formal or constructive ('sham') compliance usually results from a regulator's quagmire to engage in ensuring adherence to laws that do not necessarily mirror society so as to avoid the compulsion of penalties.

ACs are examples of where the inability of law to reflect society can be problematic. For example, a country may be sanctioned if its economy is cash-based and it fails to achieve financial inclusion necessary for meeting the FATF's standards on curbing terror funding. Penalties may include restrictions on its credit lines or limitations on its involvement in the global financial market. These penalties would further exacerbate financial exclusion, worsening the country's capability to curb terrorist funding in-country and across borders. Black refers to this situation as a regulatory paradox, whereby regulation fails to change behaviour, manage risk or achieve any stated goals, but occasions un-intended consequences.⁸ To avoid this dilemma, legal authorities usually prefer that legitimacy is established, so that it facilitates voluntary compliance. Furthermore, voluntary compliance is cost effective because it is non-compulsive.⁹

⁵ Julia Black, 'Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes' (2008) LSE Law, Society and Economy Working Papers 2/2008, 16 <http://eprints.lse.ac.uk/23040/1/WPS2008-02_Black.pdf>16 November 2017.

⁶ Tom R. Tyler, *Why People Obey the Law* (PUP, 2006) 281.

⁷ Rainer Hulsse, 'Even Clubs Can't Do Without Legitimacy: Why the Anti-Money Laundering Blacklist Was Suspended' [2008] 2 Regulation and Governance 459, 460.

⁸ Julia Black, 'Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis' [2012] 75 (6) *The Modern Law Review* 1037, 1040.

⁹ Tom R. Tyler, *Why People Obey the Law* (PUP, 2006) 4.

7.2. Propelling Legitimacy and Ensuring Compliance: The FATF's Strategies

It is crucial to understand the impact of the legitimacy crisis on the existing hierarchy of members within the context of the FATF's rulemaking and implementation processes. Countries' involvement in the FATF's processes shows a disparity— which is largely dependent on their membership hierarchy. This hierarchy determines the degree to which a particular country may engage in agency slack given the inability of standards and implementation processes to take cognisance of their historical and socio-economic peculiarities. It can be argued that this disparity not only encourages a regulatory paradox, but sets up a set of countries to fail.

7.2.1 Legitimacy in FATF Rule/Standards Design

Legitimacy in designing rules goes to the root of the FATF's drafting process. This is demonstrable by the exclusive decision making process which guides the design of the rules. The restricted membership band which holds developed countries within the inner caucus, coupled with the FATF's location within the OECD, exacerbates the exclusivity of this process.¹⁰ These are causes for concern when dealing with issues that require global convergence, as only a select group of countries are privy to the decision making process for the FATF standards.¹¹

Decisions about the content of recommendations are usually made by the secretariat and debated on during the plenary sessions.¹² This highlights difficulties in the FATF's secretariat location, given that the OECD's mandate only permits the employment of OECD nationals within the secretariat. This implies that ACs/EEs are foreclosed from partaking in the development of recommendations and may only offer consultative

¹⁰ James K. Jackson, 'The Financial Action Task Force: An Overview' (*Congressional Research Service*, 9 May 2012) < <http://fas.org/sgp/crs/terror/RS21904.pdf> > accessed 11 November 2017

¹¹ Kevin L Shepherd, 'Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transactional Lawyers' [2009] 43 (3) *Real Prop. Tr. & Est. LJ* 1.

¹² FATF, 'FATF Secretariat' (FATF, 2017) < <http://www.fatf-gafi.org/about/fatfsecretariat/> > accessed 20 January 2017.

serve as a prelude to the re-drafting of the FATF standards. They are usually drawn from institutions in developed countries given concerns about the technical capacity of FIs/supervisory body experts from ACs/EEs.¹⁹ Whilst this also affected the drafting process of the Basel II requirements, it was an unfounded fear.²⁰ Cornford argues that whereas developed countries focused on risk management due to the new financial products and services churned out periodically, developing countries usually have a narrower focus on traditional retail, private banking or investment banking.²¹ This specialisation in developing countries means the technical capacity of their expertise cannot be underestimated.²² Despite this criticism, the status quo remained. On this basis, Gathii characterises the rule making process by soft law bodies as a form of ‘regulatory imperialism’, where powerful nations dictate the pace, process and content of rulemaking.²³

The absence of an avenue for democratic consensus on the content of the rules is further demonstrated by the private interests and landmark activities that prompted the inclusion of certain FATF recommendations. For instance, by 1970, the US banks, through laws instituted by the Bank Secrecy Act, were already adherent to regulations on cash reporting. In 1988 they beckoned on the G7 to impede illegal drug market²⁴ through global application of these regulations so as to restrict countries from taking advantage of regulatory loopholes. Additionally, FIs in countries such as Switzerland and the United Kingdom already had CDD/KYC requirements ingrained in their

[fc1110000000000000000007501cd89ffff000000000000000000000000000000005a92238400b9c8d0d1](http://www.fatf-gafi.org/media/fatf/documents/publicconsultation/First%20public%20consultation%20document%20responses%20financial%20sector%20part%202.pdf) > accessed 12 November 2017.

¹⁹ See FATF, ‘Consultation on Proposed Changes to the FATF Standards: Compilation of Responses from the Financial Sector Part 1 and 2’ (FATF 2011) < <http://www.fatf-gafi.org/media/fatf/documents/publicconsultation/First%20public%20consultation%20document%20responses%20financial%20sector%20part%202.pdf> > accessed 4 June 2017; FATF, ‘Consultation on Proposed Changes to the FATF Standards: Compilation of Responses from Designated Non-Financial Business and Professions (DNFBP’s)’ (FATF, 2011) <http://www.fatf-gafi.org/media/fatf/documents/publicconsultation/First%20public%20consultation%20document%20responses%20dnfbp.pdf> accessed 4 June 2017.

²⁰ Andrew Cornford, ‘Basel II and Developing Countries’ [2008] 2 *Finance & Bien Commun* 69, 69.

²¹ *Ibid* 69, 70.

²² *Ibid* (n 20) 69, 69.

²³ James Gathii, *The Financial Action Task Force and Global Administrative Law* [2010] *J. Prof. Law* 1, 9; Jose Alvarez, *Hegemonic International Law Revisited* [2003] 97 *AM.J.Int.L* 873-887.

²⁴ Mark Pieth and Gemma Aiolfi, ‘The Private Sector Becomes Active: The Wolfsberg Process’ [2003] 10.4 *Journal of Financial Crime* 359, 359. NB: A portion of the FATF standards were also borrowed from binding international law, particularly the United Nation’s Vienna Convention of 1988, an inclusion which has occasioned the hardening of the FATF soft law.

legislations and their regulatory bodies enforced compliance.²⁵ France also mandated the inclusion of tax offences in the FATF's remit as a predicate offence as a requirement for its membership in 1989 – a position which although combatted by Switzerland, Luxemburg and Austria,²⁶ culminated in a compromise on its inclusion in 1996.²⁷ With the role played by private institutions within member countries in deciding on the foremost rules of the FATF, it would appear that it was a springboard for private institutions in developed countries to tackle global issues relating to tax, drugs and inefficient AML/CFT rules.²⁸

Reacting to landmark activities such as the 9/11 terror attack on one of its originators, the FATF expanded its regulatory rules to include recommendations on terrorist financing. Whereas evidence indicates that ACs had suffered spates of terror activities prior to the 9/11 attack, ACs' experiences were not considered severe enough to warrant alterations to the FATF recommendations. Similarly, in broadening its regulatory powers to inoculate the global financial system from exposures, the FATF reacted to the global financial crisis and not the Asian financial crisis.²⁹ This indicates a projection of the priorities and interests of the FATF founding members, with negligible focus on that of developing countries. This fails to recognise the varying nuances of developing countries, but holds an unrealistic expectation from these states to improve their laws to suit the requirements set by the developed countries.³⁰ This predicament may obstruct the distinctive progression of developing countries. This can be typified with the snail-like response of developing countries, especially ACs in legislating on issues

²⁵ Mark Pieth and Gemma Aiolfi, 'The Private Sector Becomes Active: The Wolfsberg Process' [2003]10 (4) *Journal of Financial Crime* 359, 359.

²⁶ Mark Pieth and Gemma Aiolfi, 'Anti-Money Laundering: Levelling the Playing Field' (2003) *Governance, Basel Institute on Governance* 1, 9 < https://www.baselgovernance.org/sites/collective.localhost/files/publications/biog_working_paper_01.pdf > accessed 10 November 2017.

²⁷ FATF-VII, 'Financial Action Task Force on Money Laundering Annual Report 1995-1996' (FATF, 28 June 1996) < <http://www.fatf-gafi.org/media/fatf/documents/reports/1995%201996%20ENG.pdf> > accessed 3 May 2017.

²⁸ Mark Pieth and Gemma Aiolfi, 'Anti-Money Laundering: Levelling the Playing Field' (2003) *Governance, Basel Institute on Governance* 1, 22 < https://www.baselgovernance.org/sites/collective.localhost/files/publications/biog_working_paper_01.pdf > accessed 10 November 2017.

²⁹ James K. Jackson, 'The Financial Action Task Force: An Overview' (*Congressional Research Service*, 9 May 2012) < <https://fas.org/sgp/crs/terror/RS21904.pdf> > accessed 11 November 2017.

³⁰ James Gathii, *The Financial Action Task Force and Global Administrative Law* [2010] *J. Prof. Law* 1 -18; Jose Alvarez, *Hegemonic International Law Revisited* [2003] 97 *AM.J.Int.L* 873-887.

that are perceived to hinder economic progression or go against the demands of their people. These include financial secrecy or countries not adhering to market economies.³¹ Without representation, the resulting disproportionate rules applicable to all countries indicates an imposition of asymmetrically generated ‘global standards’, which is potentially damaging to ACs/EEs.³² Gahtii contends that the FATF’s intended policy making agenda may have been overtaken by covenants of agency capture.³³ This recognises that although the FATF was commissioned to be a global AML/CFT rule setter, which warranted the later inclusion and endorsement of a RBA that takes into account the unique differences of countries into the FATF’s rules, this is not necessarily the case.³⁴

Without an option, ACs/EEs have conceded to transplanting the FATF standards through model legislations that are not necessarily fitting to their national terrain. This has come with a struggle given that these rules stifle any form of self-interest that propels proactive compliance. They also potentially set up ACs to fail on compliance levels, which subjects them to financial exclusion from the global market. Scholars have attributed this to the lack of moral, pragmatic or cognitively justifiable standards, which makes countries unwilling to accept them as legitimate.³⁵ Furthermore, the arguments on democratic deficit and legitimacy in rule design reveal that the asymmetric negotiation power between developed and developing countries continually shape FATF rules and guidance formulation.³⁶ This results in a recommended course of action that may not always be consistent with the domestic law’s explicit guidance. This asymmetry has a continued effect on the implementation

³¹ An interconnected market that requires open flow of capital may not be ideal for developing countries. However, these obligations are imposed on these set of countries by the FATF through its mandated compliance to its standards. Compliance by these countries sees a mirroring of the domestic laws of ACs/EEs to that of their western counterparts. Consequently, ACs/EEs are usually faced with difficulties and roadblocks in the functioning of their economies.

³² Jose Alvarez, *Hegemonic International Law Revisited* [2003] 97 AM.J.Int.L 873-887.

³³ James Gathii, *The Financial Action Task Force and Global Administrative Law* [2010] J. Prof. Law 1-18.

³⁴ Saby Ghoshray, ‘Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law’ [2014/15] 59 NYL. Sch.L. Rev. 521, 544.

³⁵ Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (2008) LSE Law, Society and Economy Working Papers 2/2008, 16 <http://eprints.lse.ac.uk/23040/1/WPS2008-02_Black.pdf> 16 November 2017.

³⁶ Saby Ghoshray, ‘Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law’ [2014/15] 59 NYL. Sch.L. Rev. 521, 544.

and compliance stage of FATF rules. Ghroshay states that the quandary between the two conflicting regimes can provide a window through which to view a jurisdiction's compliance deficit.³⁷

7.2.2 Legitimacy in Rule Implementation and Compliance

For implementation and compliance to be effective, principals have to resolve information asymmetries so as to understand the 'personality' of the agent state, respond accordingly and avoid agency slack. As earlier stated, when a country is organisationally incompetent, sanctions may prove ineffective, and training would be more suited to ensuring compliance. So also, when a country adopts an amoral calculator attitude towards AML/CFT regulations, sanctions may prove effective as opposed to conditionalities which may be evaded. The information needed to classify the agent-states to ensure that an effective response is given can however only be garnered during the FATF's evaluation of its member states, its mutual evaluations in partnership with FSRB or the IFI's FSAP/Art. IV surveillance. Whilst these means of fact-finding on implementation and compliance levels are seemingly legitimate, experts have argued that in reality it is not.

The FATF mutual evaluation process has been opined to be lacking legitimacy. Firstly, the process of selection of evaluators lacks transparency. The FATF, and the relevant FSRB, are responsible for choosing assessors with support and confirmation from the secretariat.³⁸ This is usually done in exclusion of inputs from the agent-state and results in a composition of external experts who although familiar with similar cross-border issues, are not necessarily conversant with pertinent issues in a particular country. The resulting asymmetry in composition was evident in the Nigerian mutual evaluation team which included assessors from the United Kingdom and the United States

³⁷ Ibid.

³⁸ FATF, 'Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations' (*FATF*, October 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf> > accessed 12 December 2017.

financial regulatory bodies together with a staff from GIABA.³⁹ Although seemingly balanced to produce an objective report, the presence of external experts from hegemonic states may tilt the discussions of all representatives in their favour.⁴⁰ This was also the case with Mali's mutual evaluation which, when carried out by the World Bank, consisted mainly of representatives from the IFIs.⁴¹ Whilst evaluating institutions may attribute the composition of evaluators to the need to guarantee neutrality of the assessment process, the absence of in-country input may colour the understanding of external experts who may not have a complete grasp of the home-grown situations of the country. The composition may thus result in biased reports that may hinder implementation and proactive compliance.

Secondly, the process and timing of fact-finding allows room for data manipulation. The pre-onsite evaluation visits mandate an export of information to the principal by the agent, based on responses to set questions.⁴² This is usually done within a short time frame. As a result of the process and timing of information harvest, EENA2, a staff member of the IMF, who had previous experience with the FATF, observed that to a large extent, reports by the FSRBs are untrustworthy.⁴³ A country's real situation is either concealed or exaggerated – somewhat to the detriment of international financial integrity. This illustrates the existing information asymmetry that hinders the ability of the IFIs/FATFs to understand the 'personality' of the agent-states.

Thirdly, the manner of evaluation is disconcerting. EENA3 noted that FATF officials on mission to developing countries are *'like policemen who have no respect for state*

³⁹ GIABA, 'Mutual Evaluation Report: Nigeria' (GIABA, 2008) <http://www.giaba.org/media/f/299_Mutual%20Evaluation%20Report%20of%20Nigeria.pdf > accessed 10 June 2017.

⁴⁰ Mushtaq Khan, 'The Political Economy of Inclusive Growth' in Luiz de Mello and Mark A Dutz (eds.) *OECD Promoting Inclusive Growth: Challenges and Policies* (OECD, The World Bank, 2012) 37 – Khan asserts that a top-down bargain ensues between contending elites; Diane Stone, 'Knowledge Networks and Global Policy' in Simon Maxwell and Diane Stone (eds) *Global Knowledge Networks and International Development*; Norman Girvan, 'Power Imbalances and Development Knowledge' (Southern Perspectives on the Reform of the International Development Architecture, 2007).

⁴¹ GIABA, 'Mutual Evaluation Report: Mali' (GIABA, 2008) <[http://www.giaba.org/media/f/252_MALI_word_MER_english\[1\].pdf](http://www.giaba.org/media/f/252_MALI_word_MER_english[1].pdf) > accessed 10 June 2017.

⁴² Principal in this case are the IFIs/FATF and FSRB.

⁴³ EENA2, Senior Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA2, 'Telephone Call' (2017).

sovereignty,⁴⁴ given the manner they barge into countries to seek and publish information with varied input from the countries listed. The IFIs however adopt a more collaborative relationship with countries during their fact-finding mission, a process simplified by the presence of their in-country offices. They also publish their findings with permission from the concerned countries. This ensures that the IFIs are better placed than FATF to evaluate a country, understand its personality and issue sanction or incentives with minimal breach to state sovereignty.

It may however be impossible to categorise a country as having or projecting a single personality, given that whilst certain institutions in a particular country may be organisationally incompetent – not all are. This difficulty is heightened by the limited scope of the evaluation process of each country, which only focuses on a set number of FIs and regulatory bodies. This further limits the ability to effectively categorise and deal with a country effectively. Thus, a wholesale sanction or incentive aimed at improving implementation or ensuring compliance may adversely affect certain institutions within a country whilst advancing others.

The trajectory of information asymmetry between countries and the IFIs/FATF reveals that the IFIs/FATF are not necessarily ‘personality’ seeking. Rather, they are driven by the faulty assumptions held by the hegemony bloc, that all countries have market economies with open flow dynamics. This supposition is the basis of the FATF’s standards and sanctions – benchmarks which may sometimes have an adverse impact on the socio-economic and political fabric of less developed countries. Despite the aggregated personality attributable to a country, no sanction or incentive would prove effective in ensuring that countries are able to imbibe standards. This is especially so where developing countries are not particularly interconnected with the global economy, neither do they pose any substantial risk of contagion. Thus, they do not feel the impact of sanctions or incentives, which would at best further impose an onerous burden on such countries.

⁴⁴ EENA3, Anti-Money Laundering Specialist (CAMS), Expert Witness and Former Banking Regulator (FDIC), Interview with EENA3, ‘Telephone Call’ (2017).

Sanctions, usually in the form of threats and public listing of non-compliant countries, may be imposed on countries alongside conditionalities, with the aim of coercing efficient implementation of rules.⁴⁵ Gahtii asserts that these are incompatible with the goal of achieving compliance across all countries.⁴⁶ This criticism flows from the shortcomings of the economic sanctions process, rooted in biased MER which highlight compliance variations across countries, thereby pressuring less compliant countries (LCCs) to offer implementation concessions even in the absence of a complete domestic ratification process.⁴⁷ LCCs are usually developing countries that are then subject to rules and sanctions manufactured by a select few wielding the FATF as a weapon to impose same on developing countries. These sanctions are blindsided to the fact that the absence of meaningful participation by LCCs in the consultation process forecloses their ability to benefit from wider cooperation and information exchange. This makes it harder to ensure effective implementation and compliance. Conversely, participation would ensure that each country's peculiarities are taken into consideration in measuring implementation and compliance.

This observed course of hegemonic imposition may not only prove counter-productive to targeted countries, it is also a slight to their sovereignty.⁴⁸ Todd condemns economic sanctions, stating that historically, they have proved incapable of achieving the desired behavioural change which they seek within punished countries, instead, they negatively impact the general populace.⁴⁹ Todd also notes that the FATF's violation of international law in imposing economic sanctions threatens the legitimacy and integrity of international efforts in combatting ML/TF, amounting to extraterritorial bullying.⁵⁰ This is because the 34-member countries of the FATF make decisions on which countries to sanction and how, whereas the member countries, despite their non-

⁴⁵ Tim Wu, 'Agency Threats' [2010] 60 Duke LJ 1841, 1845.

⁴⁶ James T. Gathii, 'The Financial Action Task Force and Global Administrative Law' [2010], J. Prof. Law.

⁴⁷ See Ben Hayes, Counter-terrorism, 'Policy Laundering' and the FATF: Legalizing Surveillance, Regulating Civil Society 11 (*Transnational Institute/Statewatch*, Mar. 2012) < <http://www.statewatch.org/analyses/no-171-fafpreport.pdf> > accessed 15 November 2017 ("[A] lack of democratic control, oversight and accountability of the FATF has allowed for regulations that circumvent concerns about human rights, proportionality and effectiveness")

⁴⁸ Doyle Todd, 'Cleaning Up Anti-Money Laundering Strategies: Current FATF Tactics Needlessly Violate International Law' [2001] 24 Hous. J. Int'l Law 279, 289.

⁴⁹ *Ibid* 279, 281.

⁵⁰ *Ibid*.

compliance, are usually excused from sanctions. Developing countries have fiercely contested this phenomenon, arguing that guidelines and sanctions manufactured by a select few are imposed on a larger majority, without their freewill, thus curtailing the long-term stability and sustainability of the global system.⁵¹

7.2.3 Risk based-approach

To address these legitimacy concerns, Ghoshay asserts that the FATF adopted a RBA system to ensure that the developmental level and peculiarities of countries are taken into consideration in the compliance assessment process.⁵² The focus of the RBA, which is aimed at aiding countries understand and prioritise their ML/TF risks,⁵³ is two-fold: to strengthen global safeguards to ML/TF and to protect the integrity of the financial system by equipping governments with adequate tools against illicit crime.⁵⁴ To achieve these, the RBA requires countries, competent authorities and FIs to identify, assess and understand the ML/TF risks they are exposed to and take commensurate measures to mitigate them effectively.⁵⁵ Additionally, countries are expected to understand the impact of the risk materialisation on their national economy, financial and non-financial sectors.⁵⁶

Explaining the RBA, EENA1 states that *‘if a country believes that 35% of its economy is informal and a substantial sum of money is laundered in cash, real estate or precious*

⁵¹ Saby Ghoshray, ‘Compliance Convergence in FATF Rulemaking: the Conflict Between Agency Capture and Soft Law’ [2014/15] 59 NYL. Sch.L. Rev. 521, 543.

⁵² Ibid 521, 544.; RBA was originally introduced in 2003 and 2007 but was restricted to certain recommendations; but it became recognised as increasingly important and a basis for all standards in 2012.

⁵³ FATF, ‘FATF Guidance: National Money Laundering and Terrorist Financing Risk Assessment’ (FATF, 2013) < http://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf > accessed 10 June 2017.

⁵⁴ Ibid.

⁵⁵ Ibid.; Abdullahi Usman Bello and Jackie Harvey, ‘From a Risk-based Approach to an Uncertainty Based Approach to Anti-Money Laundering’ [2017] 30 (1) Security Journal 1, 5.

⁵⁶ FATF, ‘FATF Guidance: National Money Laundering and Terrorist Financing Risk Assessment’ (FATF, 2013) < http://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf > accessed 10 June 2017.

stones, regulators are to allocate resources to those areas and supervise effectively...less resources should be allocated to financial institutions and insurance bodies.⁵⁷ This portrays an individualistic country-by-country approach that injects a measure of flexibility into the system, allowing the FATF standards adapt to multiple jurisdictional circumstances.⁵⁸ Acknowledging this, EENA1 states that institutions are also mandated to assess their risk, noting that ‘*if customs believe that cash couriers are utilised through the capital city airport, then they should be about ten people monitoring the airport capital and one person monitoring the land entry.*’⁵⁹ This ensures the operationalisation of the RBA at the micro level. Ghroshay argues that under the RBA system, soft law evolves into tangible standards that mandate robust compliance because assessors consider and contain structural problems that hinder compliance in the MER thus giving all countries a level playing ground.

Ghroshay’s position is however not entirely correct and may pass off as somewhat idealistic in ensuring that each country’s compliance reflects its peculiarities and risk projection. This is based on two factors: firstly, the ambiguity in the definition of risk and the conceptualisation of the RBA. Secondly, the literal interpretation of the FATF’s statement on risk and compliance in its methodology for assessing technical compliance.

⁵⁷ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

⁵⁸ FATF, FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion (FATF, February 2013) < http://www.fatf-gafi.org/media/fatf/documents/reports/AML_CFT_Measures_and_Financial_Inclusion_2013.pdf > accessed 10 June 2017.

⁵⁹ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

7.2.3.1 The Ambiguity in the Definition of Risk and the Conceptualisation of the RBA

Firstly, whilst the FATF's denotation of a 'risk-based approach' as described above seemed comprehensible, examining other FATF documents show that there is ambiguity regarding the definition of 'risk'. For instance, the FATF's National Money Laundering and Terrorist Financing Risk Assessment omits the definition of 'risk' but states that: 'Risk...(is) a function of three factors: threat, vulnerability and consequence.'⁶⁰

The evasion of a precise definition of risk is an acknowledgment that the concept is multidimensional and nuanced.⁶¹ Additionally, the absence of a definition within the concept of ML/TF may underpin poor implementation of the RBA.⁶² Hence, Bello and Harvey define risk within the context of AML/CFT as '*a situation where the probability of an occurrence of an event is known and the resulting consequences are measurable.*'⁶³ By this definition, the usage of the term 'risk', in application, will raise issues. This can be exemplified with the RBA expectations of the FATF which is evident in its Methodology for Assessing Technical Compliance. The document states that '*assessors should make clear in the mutual evaluation report...factors they have taken into account, why and how they have done so.*'⁶⁴ Indicating that, at the country

⁶⁰ FATF, 'FATF Guidance: National Money Laundering and Terrorist Financing Risk Assessment' (FATF, 2013) < http://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf > accessed 10 June 2017 - Examining these factors however reveals the porosity of the FATF's description of risk and the potential difficulties that may ensue from same. Threat, for example, focuses on people, objects and activities which may cause harm to state, society or the economy. It includes criminals, terrorist groups and their facilitators as well as their ML/TF activities. This however limits the reach of the law, as persons who do not necessarily fall in this category may inadvertently be involved in the process of laundering. See Hannah Kuchler, 'Cyber Criminals Eye Financial Markets for a Better Return on Investment' (Financial Times, 2014) < <https://www.ft.com/content/2a11ee92-3cbc-11e4-871d-00144feabdc0> > accessed 10 June 2017.

⁶¹ Yacov Y Haimes, 'On the Complex Definition of Risk: A Systems-Based Approach' [2009] 29 (12) Risk Analyst 1647, 1648.

⁶² Killick Marcus and David Parody, 'Implementing AML/CFT Measures that Address the Risks and not Tick Boxes' [2007] 15 (2) Journal of Financial Regulation and Compliance 210 – 216.

⁶³ Abdullahi Usman Bello and Jackie Harvey, 'From a Risk-based Approach to an Uncertainty Based Approach to Anti-Money Laundering' [2017] 30 (1) Security Journal.

⁶⁴ FATF, 'Methodology: For Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT System' (FATF, 2013) < <http://www.fatf->

level, the FATF assumes that in-country regulators comprehend the likelihood that a particular ‘conduit of transfer’ is likely to be used to launder money and the outcome of such decision. However, there are uncertainties to this. Firstly, it is difficult to ascertain the extent to which one conduit is being utilised by launderers in comparison to other porous conduits. Secondly, it is difficult to justify the factors that are taken into account to label a sector more risk-prone to illicit transfers. Thirdly, in the event that a conduit is categorised as being open to ML/TF risk, the likely response of the regulators in terms of risk classification (high risk or low risk) and their resource allocation is unclear. Fourthly, how legitimate customers may react to being hindered from performing their businesses is unknown.⁶⁵

However, despite the uncertainties surrounding the RBA, where in-country regulators fail to attain accurate risk valuation, it can adversely affect the country’s overall compliance levels and the external assessors would be required to make estimations on a country’s behalf.⁶⁶ Therefore, further exacerbating agency slack and a legitimacy crisis. This outcome-focused approach is predicated on the assumption that an AML/CFT regulator can foretell the outcome of his decision and hence, should bear the responsibilities resulting therefrom. This is not necessarily true given that the ‘probability of an outcome’ may not be an accurate profiling technique to streamline conduits of transfers.

Critics have also argued that the RBA is not easily comprehended or honestly applied. EENA3 states ‘*I [went] to a country known for marijuana sale on every corner. Marijuana fields are within view of the capital city and the authorities never mentioned that they grow marijuana in their country.*’⁶⁷ EENA3 attributed this to the fact that the

[gafi.org/media/fatf/documents/methodology/FATF%20Methodology%202022%20Feb%202013.pdf](http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%202022%20Feb%202013.pdf)> accessed 10 August 2017.

⁶⁵ Abdullahi Usman Bello and Jackie Harvey, ‘From a Risk-based Approach to an Uncertainty Based Approach to Anti-Money Laundering’ [2017] 30 (1) Security Journal.

⁶⁶ FATF, ‘Risk Based Approach for the Banking Sector’ (FATF, October 2014) < <http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf> > accessed 19 March 2018.

⁶⁷ EENA3, Anti-Money Laundering Specialist (CAMS), Expert Witness and Former Banking Regulator (FDIC), Interview with EENA3, ‘Telephone Call’ (2017).

RBA is not widely understood, the risk is not identified correctly, properly, or honestly by countries.⁶⁸ Moreover, he argues that this is also a problem with assessors as there is a tendency for them to demand the same thing from every country. EENA4 attributes this deficiency to a shift in operation and culture as previously ‘*regulators were used to assessing institutions with a checklist...now they have to do a risk-based supervision – it’s something that is not familiar with a lot of people*’.⁶⁹ Indicating the complexity in the application of this approach and the struggle countries have to encounter to meet the requirements. Noting this EENA5 stated that, ‘*conducting a national risk assessment is technical and resource intensive...[coupled] with risk profiling and profiling at every level...it takes about a year to get the risk status for a small country – not even a country like Nigeria*’.⁷⁰ This complexity can indeed put countries under pressure to deliver, thereby occasioning agency slack. For this reason, there has been limited impact of the RBA on risk allocation or improved strategies.

The deficiency of the RBA can be attributable to various internal factors. These include inefficient collection of tax by countries and the reluctance to engage in forfeiture and confiscation of the proceeds of crime.⁷¹ Related to those are the lack of political will, resources and political interference.⁷² For instance, Angola has some issues with corruption, but it will not want to talk about it. Also, the Nigerian President was criticised for admitting to the UK government that Nigeria is ‘fantastically corrupt’.⁷³ Fearing likely listing by the FATF, countries are usually worried about revealing the true risk they face. Practitioners have countered the arguments on the deficiency of the RBA, arguing instead that when designed and used efficiently, the RBA can indeed lead to improved, targeted compliance by countries.⁷⁴ EENA1 and EENA4

⁶⁸ Ibid.

⁶⁹ EENA4, Interview with EENA4 ‘Telephone Call’ (2017).

⁷⁰ EENA5, Researcher, GIABA, Interview with EENA5 ‘Telephone Call’ (2017).

⁷¹ Antonio – he argues that legal proceedings against launderers should recover the proceeds laundered and use the recovered funds to fight ML/TF without resort to tax.

⁷² EENA2, Senior Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA2, ‘Telephone Call’ (2017).

⁷³ Bayo Oluwasanmi, ‘Yes! Nigeria is ‘Fantastically Corrupt’ (Sahara Reporters, 16 May 2016) < <http://saharareporters.com/2016/05/16/yes-nigeria-fantastically-corrupt-bayo-oluwasanmi> > accessed 10 May 2018.

⁷⁴ EENA2, Senior Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA2, ‘Telephone Call’ (2017).

acknowledge this but argue that the issues to implementation further hinder the effectiveness of the RBA.⁷⁵ For this reason, RBA is not leading to reforms yet.

This limitations of the RBA are also demonstrated at the institutional level. The regulator's risk profiling mechanism, which is dependent on the risk assessment of FIs, presumes that the higher the suspicion of FIs in AML/CFT, the higher the perceived risk. Hence, FIs' legal departments monitor contracts, whilst the compliance departments monitor the products/agreements of FIs, to ensure that any suspicion is addressed in accordance with the law. Differentiating suspicious from non-suspicious activity is an uphill task, which faults regulatory assumptions, as launderers are not easily identified apart from legal activities.⁷⁶ On this basis, Pellegrina and Masciandaro concede that the 'risk' terminology might have simply reflected the general movement to such approach within the broader regulation of financial markets.⁷⁷ Bello and Harvey however suggest that the 'uncertainty based approach' (UBA) which focuses not on the 'outcome of the decision' but on the process leading to the decision is a more suitable means of addressing ML/TF.⁷⁸

To understand why the UBA is crucial for AML/CFT regulation, as opposed to the RBA, it is critical to distinguish these approaches. The UBA and the RBA are not mutually exclusive as they can both be incorporated within the meaning of uncertainty.⁷⁹ Thus, risk is considered as a subcategory of uncertainty, which is defined, measurable and predictable. Knight acknowledges this, stating that, whilst risk is also

⁷⁵ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, 'Telephone Call' (2017).; EENA4, Interview with EENA4, 'Telephone Call' (2017).

⁷⁶ Valsamis Mitsilegas, *Money Laundering Counter-Measures in the European Union: A Paradigm of Security Governance versus Fundamental Legal Principles* (Kluwer Law International, 2003).

⁷⁷ Dalla Pellegrina and Donato Masciandaro, 'The Risk-Based Approach in the New European Anti-Money Laundering Legislations: a Law and Economics View' [2009] 5 (2) *Review of Law and Economics* 1, 3.

⁷⁸ Abdullahi Usman Bello and Jackie Harvey, 'From a Risk-based Approach to an Uncertainty Based Approach to Anti-Money Laundering' [2017] 30 (1) *Security Journal*; John S. Hammond, Ralph Keeney and Howard Raiffa, *Smart Choices: A Practical Guide to Making Better Decisions* (Harvard University Press, 2015) 112; Boris Holzer and Yuval Millo, 'From Risks to Second Order Danger in Financial Markets: Unintended Consequences of Risk Management Systems' [2005] 10 (2) *New Political Economy*.

⁷⁹ Peter Miller, Liisa Kurunmäki and Ted O'Leary, 'Accounting, Hybrids and the Management of Risk' [2007] 33 (7-8) *Accounting, Organizations and Society* 942, 944.

uncertainty, risk is a determinate uncertainty, whilst uncertainty is indeterminate.⁸⁰ Therefore, this means that whilst risk is somewhat known and measurable, uncertainty is unknown and unknowable.⁸¹ Risk is, therefore, the residual outcome of making uncertainty manageable by setting appropriate risk limits with defined parameters to control exposure. Conversely, with uncertainty, the probability may be known but the consequences remain unknown.

Unlike the RBA, decision making within a UBA would provide a more accurate reflection of the uncertainties surrounding rationalization of a conduit being more susceptible to the risk of ML/TF. This is because, given the nature of illicit transfers, regulators usually lack information as to the possible consequences associated with their decision making. In such situations where either the probability of the exposure to illicit crime is unclear and the precise consequence of the exposure to such crime is unknown, the UBA would be fit for purpose.⁸² No doubt, this varies from the decision-making process within the RBA where it is expected that the consequence of decisions are known with certainty as to the outcome of such decisions.⁸³ Additionally, the RBA may result in misalignment of benefits and incentives between country regulators and the IFIs/FATF. This is particularly when the countries are aware that unveiling certain risk would warrant sanctions or reputational damage. For instance, countries would not be too quick to admit that they suffer from CDD deficiencies. Acknowledging this, an EENA4 stated that ‘it is difficult to get officials to agree to the risk they face.’⁸⁴ This quagmire can be attributed to the variances in interest, as whilst IFIs/FATF are focused on combatting ML/TF, regulators are more inclined to focus on protecting the safety and soundness of banks with limited attention to ML/TF risk. For this reason, an agency slack arises where countries misinform the international community.

⁸⁰ Frank Knight, *Risk, Uncertainty and Profit* (First Published 1921, Dover Publications, Inc. New York).

⁸¹ Dionysious Demetis and Ian Angell, ‘The Risk-Based Approach to AML: Representation, Paradox, and the 3rd Directive’ [2007] 10 (4) *Journal of Money Laundering Control* 412, 413.

⁸² Carole Gibbs, Meredith Gore, Edmund McGarrell, and Louie Rivers, ‘Introducing Conservation Criminology: Towards Interdisciplinary Scholarship on Environmental Crimes and Risks’ [2010] 1 (1) *British Journal of Criminology* 124, 135.

⁸³ Paul W. Glimcher and Ernst Fehr, *Neuroeconomics: Decision Making and the Brain* (2nd Edn, Amsterdam, Elsevier, 2014).

⁸⁴ EENA4, Interview with EENA4, ‘Telephone Call’ (2017).

The inability of countries to understand or even measure risk and its likely outcome can be attributed to the nature of illicit crimes. For instance, till date, studies have been unable to quantify the amount of money laundered annually. Barone and Masciandaro argue that figures are usually ‘pure speculation....or just invented’.⁸⁵ This poses a serious challenge to the RBA and largely renders its model unsuitable. For this reason, the implementation of the RBA has been criticized.⁸⁶

The shortcomings of the RBA highlight the strengths of the UBA which is a viable alternative. With the UBA, countries would not necessarily be sanctioned for not properly identifying their risk, but rather, there is an implicit understanding that the nature of ML/TF which makes it difficult to quantify risk would be taken into consideration. In such situations, there is the recognition that regulators cannot be certain of the impact of ML via a particular conduct if the risk materializes.⁸⁷ Moreover, FIs are also uncertain about the nature of transactions given that transactions can be potentially financed with laundered funds or for terrorism purposes. Demetis and Angell state that although categories of risk are itemized for FIs, in practice, uncertainty is transferred to these categories.⁸⁸ As such, any attempts to fit a square peg in a round hole would be futile.

Interestingly, the UBA can be utilized by adopting Hammond et al.’s risk profile steps⁸⁹, where in coming to a conclusion as regards areas that pose AML/CFT issues to countries, regulators can ask:

⁸⁵ Raffaella Barone and Donato Masciandaro, ‘Organised Crime, Money Laundering and legal Economy: Theory and Simulations’ [2011] 32 (1) *European Journal of Law and Economics* 115, 116.

⁸⁶ Stuart Ross and Michelle Hannan, ‘Money Laundering Regulation and Risk-Based Decision Making’ [2007] 10 (1) *Journal of Money Laundering Control* 106-115; Dionysios Demetis and Ian Angell, ‘The Risk-Based Approach to AML: Representation, Paradox, and the 3rd Directive’ [2007] 10 (4) *Journal of Money Laundering Control* 412, 413.

⁸⁷ Elod Takats, ‘A Theory of “Crying Wolf”: The Economics of Money Laundering Enforcement’ [2011] 27 (1) *Journal of Law, Economics and Organization* 32, 34.

⁸⁸ Dionysios Demetis and Ian Angell, ‘The Risk-Based Approach to AML: Representation, Paradox, and the 3rd Directive’ [2007] 10 (4) *Journal of Money Laundering Control* 412, 413.

⁸⁹ John S. Hammond, Ralph Keeney and Howard Raiffa, *Smart Choices: A Practical Guide to Making Better Life Decisions* (Boston, Mass: Havard Business School, 1999).

1. What are the uncertainties?
2. What are the possible outcomes of these uncertainties?
3. What are the chances of occurrences of each possible outcome?
4. What are the consequences of each outcome?

The crucial starting point is to identify the objective of each decision, which in this case is to prevent illicit transfers.

The first step to this risk profiling approach for regulators is to decide on the available alternatives. For regulators, the decision is how to categorize a conduit as replete with ML/TF. Identifying an alternative requires the regulator to identify the uncertainties related with their decision. For the regulator, there are two significant uncertainties - a conduit is either frequently utilized for illicit transfers or it is not frequently used. Determining this is difficult, but regulators are to be guided by available statistics – which are scarce in ACs/EEs. Upon identification, the likely outcome of each uncertainty is outlined. As envisaged, specificity is not feasible in defining the outcome of each uncertainty.⁹⁰ Consequently, what is required is a broad but unique categorization that would capture the likely outcomes. This leaves room for decision making by the regulator but may also breed mistakes as the regulator can decide that a conduit poses ML/TF challenges, whereas it does not. The margin for error can however be minimized by dependence on accurate statistics and expert consultation which involves the judgment based approach (JBA).⁹¹ JBA entails regulators looking-forward to take account of a wide range of possible risks to the AML/CFT objectives.⁹²

⁹⁰ Abdullahi Usman Bello and Jackie Harvey, 'From a Risk-based Approach to an Uncertainty Based Approach to Anti-Money Laundering' [2017] 30 (1) Security Journal.

⁹¹ John S. Hammond, Ralph Keeney and Howard Raiffa, *Smart Choices: A Practical Guide to Making Better Life Decisions* (Boston, Mass: Havard Business School, 1999).

⁹² Ellis Ferran, 'Where in the World iss the EU Going' in Eilis Ferran, Niamh Moloney, Jennifer G Hill, John Coffee (eds.) *The Regulatory Aftermath of the Global Financial Crisis* (CUP, 2012)

The information garnered can be used to decide the quantitative probability, expressed in percentages – that a conduit is largely or limitedly used to launder money. This is a very subjective approach which differs from the objective approach utilized by the RBA.⁹³ Quite unlike the UBA, the RBA does not focus on quantitative and qualitative analysis as it refers to such analysis as ‘mere collection of ...information’. RBA is largely dependent on the categorization of risk through benchmarking as either medium-high, medium-low, etc.

An incentive based system incorporated in the UBA may also ensure improved technical and effectiveness compliance to AML/CFT standards.⁹⁴ Therefore, where a conduit mainly used for regular transactions is classed as suspect, that conduit may experience withdrawal of use caused by regulators mishap. To prevent this, the regulator has a variety of choices, to either consider the conduit as suspicious and report or consider it as non-suspicious and document his position. Where it is suspicious, two uncertainties arise – the IFIs/FATF assessors may reward the regulators for curtailing the conduit’s use. Conversely, the conduit may face decline in use due to reputational damage. Where classed as non-suspicious, the conduit will not lose customers and may even gain laundering customers who believe that they will now be subject to less intense supervision. However, this latter classification may indeed be erroneous as the conduit may actually be a hub for ML/TF. In such situations, whilst the RBA, in its focus on outcome, would mark the country as non-compliance in recommendation 1, which has an effect on its effectiveness levels, the UBA would focus on the process of the decision making. This indicates that it is imperative for a country to structure a format that would allow it detect illicit transfers via various conduits, thereby curbing ML/TF.

Furthermore, an application of the RBA to countries also shows its inadequacies, particularly in securing accurate AML/CFT compliance levels. Whilst the RBA allows countries to designate resources in accordance with risk, it still categorises countries in

⁹³ Frank Knight, *Risk, Uncertainty and Profit* (First Published 1921, Dover Publications, Inc. New York.

⁹⁴ Dalla Pellegrina and Donato Masciandaro, ‘The Risk-Based Approach in the New European Anti-Money Laundering Legislations: A Law and Economics View’ [2009] 5 (2) *Review of Law and Economics* 1, 3; Elod Takats, ‘A Theory of “Crying Wolf”: The Economics of Money Laundering Enforcement’ [2011] 27 (1) *Journal of Law, Economics and Organization* 32, 34.

Black2 or grey list. This raises questions as to the arbitrary basis upon which countries are so classified.⁹⁵ Although most countries are sanctioned on the basis of the weakness of their financial and regulatory structure or the absence of political will, the FATF's mandate aims to ensure financial integrity and stability, a position which should aim at sanctioning countries with the most ML/TF activity. Coincidentally, although there are no concrete statistics, studies have indicated that the United States has the highest level of ML globally,⁹⁶ along with the United Kingdom, particularly given its porous real estate market.⁹⁷ Yet, these countries are considered low risk and countries which are remotely connected to the global financial market, with lower levels of financial crime are continually classed as high-risk due to structural issues. Bello and Harvey argue that this arbitrary designation contradicts an approach that is truly risk-based, typifying this with the case of Habib Bank, fined for not listing Pakistan and Kenya as high risk countries.⁹⁸ Furthermore, although California has been classed as high risk within the US,⁹⁹ suspicious transactions may not be flagged up as ones from Kenya would, given the FATF's asymmetrical risk basis.

7.2.3.2 The Literal Interpretation of the FATF's Statement on Risk and Compliance in its Methodology for Assessing Technical Compliance

The FATF methodology for assessing compliance states clearly that: '...however, risks, materiality and structural or other contextual factors *should not be an excuse* for poor or uneven implementation of the FATF standards....'¹⁰⁰

⁹⁵ The classification of countries may also be arbitrary.

⁹⁶ Burak Dolar and Shughart William, 'Enforcement of the USA Patriot Act's Anti-Money Laundering Provisions: Have Regulators Followed a Risk Based Approach?' [2011] 22 (1) *Global Finance Journal* 19, 20.

⁹⁷ Zlata Rodionova, 'London Property Market Turned into Money Laundering Sage Haven by Inadequate Supervision, MPs say' (*Independent*, 15 July 2016) < <http://www.independent.co.uk/news/business/news/london-property-market-real-estate-money-laundering-overseas-foreign-buyers-mps-a7138176.html> > accessed 10 July 2017.

⁹⁸ Financial Services Regulation.

⁹⁹ John S. Hammond, Ralph Keeney and Howard Raiffa, *Smart Choices: A Practical Guide to Making Better Decisions* (Harvard University Press, 2015); Boris Holzer and Yuval Millo, 'From Risks to Second Order Danger in Financial Markets: Unintended Consequences of Risk Management System' [2005] 10 (2) *New Political Economy* 223, 225.

¹⁰⁰ Financial Action Task Force, 'Guidance for a Risk-Based Approach: The Banking Sector' (*FATF*, 2014) < <http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf> > accessed 10 June 2017.

Whilst the FATF expects that structural reasons for non-compliance are highlighted in the MER document, the above statement illustrates that it does not expect such reasons to be a justification for, or a reason to condone non-compliance. EENA4 supports this line of argument, stating that *‘you need to have your framework in place...a country cannot say “we have no capacity” or “we are slow in legislating” ...[or] “we have corruption issues – so it is okay that we have not criminalised politically exposed persons” ...we can understand why they haven’t done so...but certain things cannot be excused.’*¹⁰¹ This is however a narrow perception of the factors that hinder compliance. For instance, should a country be rated lowly for not adequately complying with the CDD requirements where it was working to ensure financial inclusion? Such punishment would indicate the facilitation of continuously low compliance levels of developing countries despite the factors taken into account. Acknowledging this, EENA4 stated that *‘The recommendations are very focused on the banks and it contravenes and goes against the cash-based economy. There is a huge chunk of money that is outside the bank that you cannot really assess. The recommendations hinder those countries that are less cash-based. You can say that you need to strengthen the banking sector and ensure that wire transfers are completely regulated – but does that really capture cash-based transfers. In some countries – people will buy houses with cash – it’s only in more developed countries that you have bank transfers, cheques... It’s easier on the banking side to do CDD but maybe it’s not easy on the cash that you follow. It’s something that is a little bit more difficult.’*¹⁰² This further illustrates the continuous issue of asymmetrical compliance benchmarks which have an effect on the compliance level of countries, causing their placement on the grey or black2 list.

Furthermore, the methodology states that: *‘assessors should make clear in the MER...factors they have taken into account, why and how they have do so.’*¹⁰³

¹⁰¹ EENA4, Interview with EENA4, ‘Telephone Call’ (2017).

¹⁰² Ibid.

¹⁰³ FATF, ‘Methodology: For Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT System’ (FATF, 2013) < <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf>> accessed 10 August 2017.

This indicates that even when structural reasons for non-compliance are highlighted in the MER, without an impact on the overall compliance level, assessors are mandated to comply and explain. This illustrates the onerous burden of ensuring that compliance reflect appropriate levels and not ‘excused levels’.

Examining the conception of risk and the FATF’s approach to it reveals that the current RBA may not necessarily lead to improved legitimacy or indeed compliance by developing countries. EENA1 argues that, whilst theoretically, the RBA can ensure improved compliance, practically it is a struggle for countries. Furthermore, the impact cannot yet be ascertained because only a few countries are conducting this risk-based exercise rightly.¹⁰⁴ However, currently, it is not leading to reform yet, particularly in Africa.¹⁰⁵

7.3 Through the Lens of Legitimacy

As noted, the FATF’s rule design, implementation and compliance processes have unearthed a pervasive legitimacy crisis. This has occasioned the argument that amending power relationships through membership and inclusiveness would resolve legitimacy concerns.¹⁰⁶ This perspective assumes that currently excluded countries can obtain membership which grants participation in deliberation processes by meeting the set FATF membership criteria. This argument is however blindsided to the realities of the FATF membership configuration, which is restricted to ‘strategically important’ countries.¹⁰⁷ This has seen only OECD countries, EEs and a few others become members on the basis of an elusive subjective selection process.¹⁰⁸

¹⁰⁴ EENA1, Consulting Counsel, Financial Integrity Unit, International Monetary Fund, Interview with EENA1, ‘Telephone Call’ (2017).

¹⁰⁵ Ibid.

¹⁰⁶ Frank Vibert, ‘Reforming International Rule-Making’ [2012] 3 (3) Global Policy 391, 391.

¹⁰⁷ Why are the restrictions to strategically important countries? If the FATF does not think other countries pose serious risk, why does it add them as associate members in the first instance?

¹⁰⁸ Wesley Kirton, ‘Guyana Has Now Become a Strategically Important Country’ (Kaieteur News, 15 May 2017) < <http://www.kaieteurnewsonline.com/2017/05/15/guyana-has-now-become-a-strategically-important-country/> > accessed 21 May 2017.

Shortly after the accession of select countries, the FATF considered it expedient to close its membership doors in 1992 so as to ‘preserve the efficiency of the task force.’¹⁰⁹ This action foreclosed the participation of all countries in the decision making procedures – processes which although would have permitted dissenting viewpoints, it was alleged that it would result in bureaucracy and expensive decision-making.¹¹⁰ Thus, at this point, there was the projection of ownership and legitimacy as secondary to efficiency. This raises concerns about whether the FATF acknowledges that its rules are unfavourable and may become subject to intense scrutiny, prompting refutation or delayed transplantation by developing countries. To achieve expediency, the FATF hastens its decision making processes, which is even more detrimental to developing countries who are unable to input their perspective.

This closed membership structure poses two risks: firstly, countries excluded from ‘core’ membership positions may only render formal or creative compliance.¹¹¹ Secondly, it exposes the financial system to risk from countries not considered ‘important’. Although these countries are subject to intense scrutiny, inappropriately crafted tools are applied to mandate compliance. This can be attributable to the absence of a degree of involvement in rule design which permits agency slack, correctable only in the presence of perfect information.

Whilst the FATF has refrained from expanding its membership, the IFIs have responded by altering their membership quota, granting EEs more weight in recognition of their rising economic powers.¹¹² The G20 has also taken up some coordinating

¹⁰⁹ FATF, ‘Financial Action Task Force on Money Laundering Report 1990-1991’ (FATF, 13 May 1991) < <http://www.fatf-gafi.org/media/fatf/documents/reports/1990%201991%20ENG.pdf> > accessed 10 May 2017.

¹¹⁰ See FATF, Annual Report FATF 1990-1991 Paris, 13 May 1991 p 19.

¹¹¹ Doreen McBarnet, *Enforcing Ethics: New Strategies for Tackling Creative Compliance* [2007] Australian National University, Canberra.

¹¹² BrettonWoods Project ‘IMF & World Bank Decision-Making and Governance’ (BrettonWoods Project, 31 March 2016) < <http://www.brettonwoodsproject.org/2016/03/imf-world-bank-decision-making-and-governance-existing-structures-and-reform-processes/> > accessed 10 July 2017.

functions of the G7.¹¹³ Although seemingly more inclusive, Vibert argues that these membership changes do not address two primary weaknesses in rule design, the failing abilities of the IFIs/TGNs in problem solving and the undemocratic nature of rule-making.¹¹⁴

Vibert argues that problem-solving abilities of IFIs/FATF lie not in membership but in informed knowledge and expertise.¹¹⁵ He argues further that IFIs/TGNs belong to the knowledge world where their decision making skills are dependent on their epistemic authority.¹¹⁶ They draw on the procedure of the natural and social sciences to identify complications and frame policy responses. This is supported by Kerwer and Hulsse who argue that trans-governmental organisations such as the FATF are objectively technocratic.¹¹⁷ For this reason, Vibert asserts that changes to membership arrangements may confound the problems of input legitimacy, confusing epistemic failure and democratic deficit.¹¹⁸ The limitation to this argument is that it fails to recognise that improved membership representation may be crucial for a more robust knowledge bank at the IFIs/TGNs.

Discounting the possibility of a robust knowledge bank, Vibert advances the argument that there is no true democracy in international rule making.¹¹⁹ He postulates that changing quotas in IFIs reflect government and not the people. This defeats the argument on inclusivity from the start, for if they are democratic, IFIs/TGNs should reflect the preferences of the people.¹²⁰ This recognises the complex high-level interactions that precede transplantations, whereby decisions applicable to the entire

¹¹³ Gordon S. Smith, 'G7 to G8 to G20: Evolution in Global Governance' (CIGI G20 Papers, 6 May 2011) < <https://www.cigionline.org/sites/default/files/g20no6-2.pdf> > accessed 14 July 2017.

¹¹⁴ Frank Vibert, 'Reforming International Rule-Making' [2012] 3 (3) *Global Policy* 391, 391.

¹¹⁵ *Ibid.*

¹¹⁶ *Ibid.*

¹¹⁷ Dieter Kerwer and Rainer Hulse, 'How International Organisations Rule the World: The Case of the Financial Action Task Force' [2011] 2 (1) *Journal of International Organisation Studies*.

¹¹⁸ Frank Vibert, 'Reforming International Rule-Making' [2012] 3 (3) *Global Policy* 391, 392

¹¹⁹ *Ibid.*

¹²⁰ In order to make the case that international decisions reflect the people's preferences, a huge number of assumptions have to be made about the way in which preferences are aggregated by government from the bottom up. Frank Vibert, 'Reforming International Rule-Making' [2012] 3.3 *Global Policy* 391, 392

government are usually made to the exclusion of persons at the grassroots level. This illustrates how state and local governments are usually barraged by influences of international law. Furthermore, many citizens of countries who are unaware of FATF standards are subjected to the existence of the FATF's disclosure mandate laid out by its CDD/ KYC requirements.

Nevertheless, it is acknowledged that the absence of democracy in IFIs/TGNs may trigger hesitation in transplantation of standards by democratic and undemocratic countries alike. This is why these institutions continually declare their neutrality and legitimacy by projecting the tenets of democracy through their undertakings. These undertakings include ensuring equitable labour or intellectual property rights. However, the declaration of legitimacy is not a sufficient 'ingredient' for democracy, as without a dissenting opinion in governments or IFI/TGNs decision making processes, democracy cannot be said to exist. Contrariwise, in undemocratic regimes, opposing voices are subdued.

What becomes evident is that hegemonic subservience and agency capture shapes FATF policy making – resulting in democratic deficit. Democratic deficit in agency rulemaking is born out of the fundamentals of the underlining participatory conflict and is manifested in the data regarding the lack of meaningful participation by the majority of jurisdictions.¹²¹ This in turn impacts countries ability to close the compliance differential as they are not part of the process – whilst also foreclosing their ability to benefit from the wider cooperation and information exchange of a regulatory framework. The result is that affected jurisdictions may be compelled to comply with rules with which they have no participatory linkage.¹²² Conversely, when a country is part of the process, its compliance differential is less. This can be typified with the BRICS; although their level of participation in the FATF is questionable – their compliance differential is less.

¹²¹ James Gathii, 'The Financial Action Task Force and Global Administrative Law' [2010] 10 (10) Albany Law School Research Paper.

¹²² Todd Doyle, 'Cleaning Up Anti-Money Laundering Strategies: Current FATF Tactics Needlessly Violate International Law' [2002] 24 Hous. J. Int'l L. 279, 307.

To ensure that standards and laws by international bodies are respected, every aspect of decision making must be democratic, in the sense that an option is provided to allow a contestation of the rule design or compliance process. What becomes evident is the need for a global platform that permits democracy. Whilst Vibert envisions this to be a global platform with a parliament, Mugarura envisages an adjudicatory framework.¹²³ Vibert concedes that Mugarura's approach may be a preferred option as an international juridical body would safeguard some form of legal pluralism which would allow for delegation and fairness. The practicalities are however uncertain. Political elements may hinder the ability to rely on judicial structures, for example, when a court in one jurisdiction defers to another. Additionally, efforts to combine both political and juridical elements may result in 'cosmopolitan democracy'¹²⁴ which satisfies neither side.

Hence Vibert projects the alternative of an 'international agreement on international administrative procedure'. The idea is that international administrative procedures will apply to international rule makers, where each institution would be bound to adhere to evidence based procedures that underpin their epistemic authority. Additionally, each institution would be subject to external judicial review for recommendations and decisions. Finally, any such agreement would not only be subject to executive agreement of ministers or senior officials but also to the approval of national legislators – the bodies with the greatest claim to democratic legitimacy. Vibert argues that this would mark the process of bringing constitutional order into the international level of decision making. Apparently, this approach would ensure that all voices are brought to the table and expertise is no longer the most crucial factor in decision making. However, in practice, the need to ensure the perspectives of various governments are taken into account during the review process would slow things down. Additionally, the belated

¹²³ Norman Mugarura, *The Global Anti-Money Laundering Regulatory Landscape in Less Developed Countries* (1st ed Routledge 2016) 209.

¹²⁴ Daria Jarczewska, 'Critical Assessment of Cosmopolitan Democracy' (International Relations Students , 22 January 2013) < <http://www.e-ir.info/2013/01/22/critical-assessment-of-cosmopolitan-democracy/> > accessed 10 June 2017.

involvement of countries may simply be a replication of the hegemonic agenda within these institutions.

This indicates the need to correct ownership, legitimacy and expertise simultaneously. A more inclusive platform, such as that of the International Association of Deposit Insurers¹²⁵ would ensure effective combative strategies, rather than an undemocratic platform with coercive powers. This would aid in reversing the debilitating financial consequences on non-compliant countries that were simply set up to fail, whilst enabling them achieve true financial stability and integrity.

7.4 Regulatory Paradox: A Motive for Halting Continued Implementation of the FATF Standards by ACs/EEs?

One thing the RBA will not do is permit non-compliance with any of the recommendations. ACs have to remain compliant with the FATF's technical and effectiveness recommendations to the same degree, only with narrowed focus on issues considered to pose higher AML/CFT risk. The problem with this is that the FATF standards, particularly on CDD/KYC, can propel socio-economic exclusion which have serious consequences for socio-economic development. This effect is averse to the FATF's financial inclusion objective. For the FATF, this is an unintended consequence, as driving an economy 'underground' can affect the regulators' ability to effectively monitor the abuse of financial systems and hinder their capability to detect crime. Furthermore, this regime which is external to ACs/EEs, can widen the gap between social classes whilst degenerating socio-economic exclusion in these countries. This is particularly so within ACs given the excesses of colonisation in form of social and economic ills which the continent still grapples with.

¹²⁵International Association of Deposit Insurers, 'Sharing Deposit Insurance Expertise with the World' (IADI, 2016) <<http://www.iadi.org/en/>> accessed 10 July 2017.

These arguments portray the regulatory paradox that occurs in the absence of legitimacy of standards, a situation that weakens the effectiveness of standards and the compliance ratings of ACs/EEs. Consequently, it is imperative to ask, why ACs/EEs continue to implement the FATF standards. As discussed, ACs/EEs face a case of ‘double illegitimacy’¹²⁶ that hinders their ability to ‘opt out’ of compliance given the inclusion of the FATF’s recommendations within the IFIs funding conditionalities. Alexander et al find that IFIs use standard setting bodies, including the FATF, to determine and set conditionalities that countries have to adhere to.¹²⁷ The implication of this is that compliance with the IFIs’ conditionalities are benchmarks against which decisions can be made about a country’s credit worthiness.¹²⁸ This invariably means that when countries receive unfavourable ratings from credit rating agencies, which is highly likely with ACs, their ability to raise or issue debts at affordable rates may be compromised. The effect of this is worse for ACs and their private sector institutions, which rely largely on foreign investments and IFIs for capital. Going by the ratings which offer the international financial markets an estimate of the probability that borrowers will meet their debt obligations, it can be argued that ACs will be unable to access funding or even when they do, they will be subject to higher interest rates.¹²⁹ The IFIs involvement necessitates a form of mandatory compliance, with the possibility of sanctions, severer than the FATF’s blacklisting process.

Whilst acknowledging the regulatory paradox inherent in the compliance process that occasions unintended consequences, the pros of implementation cannot be undermined. ACs/EEs acknowledge that ML/TF pose adverse consequences to their economies and compliance can not only engineer, but also institute good governance practices within their financial and regulatory institutions. This will ensure that with adequate practices, sturdy institutions and resources, regulatory bodies would be able to promote financial

¹²⁶ This is given that developed countries have a lesser quota, and hence, a lesser voice in the decision making processes. Thus, it can be argued that some measure of ‘double-illegitimacy’ exists, particularly towards ACs.

¹²⁷ Alexander K, Dhumale R and Eatwell J, *Global Governance of Financial Systems: The International Regulation of Systemic Risk* (OUP, New York, 2006).

¹²⁸ Nadeem Haque, Donald Mathieson and Nelson Mark, ‘Rating the Raters of Creditworthiness’ (Finance & Development, March 1997)

¹²⁹ Ferri G, Lui L-G & Stiglitz J.E, ‘The Procyclical Role of Rating Agencies: Evidence from the East Asia Crisis’ [1999] 28 (3) Economic Notes: Review of Banking, Finance and Monetary Economics 335, 335.

integrity whilst enhancing market integrity. There is also the recognition that compliance can improve their integration with the global financial market, whilst reducing the high interest rates associated with loans. Finally, there is the argument that compliance would strengthen the ability of countries to curb financial crime such as corruption. Although seemingly logical, this position is not necessarily correct. For instance, whilst Zimbabwe has an AML/CFT compliance level of over 50%, it remains one of the most corrupt countries in Africa and globally.¹³⁰ This further indicates that compliance may be creative as opposed to actual. There is evidence that even developed countries are yet to accurately ascertain how much is laundered yearly, as such, it would be difficult to determine whether compliance to AML/CFT standards aids in fighting financial crime.

The shortcomings identified in the pros may indicate that countries may not find tangible reasons or output to combat AML/CFT, but will continue to comply to ensure that their borrowing capabilities are not restrained. Hence, the integration of the FATF standards into the FSAP has no doubt aimed to utilise its root in state consent to enhance their legitimacy.¹³¹ Consequently, the FATF standards have increasingly become perceived as legitimate by ACs/EEs. Whilst this would ensure that ACs strive to preserve their credit lines, ingraining the FATF standards within the IFIs conditionalities may have consequences. Such pessimism is born out of the failings of the IFI's structural reforms, most of which, due to their unsuitability to the terrain – facilitated underdevelopment whilst hardly addressing the key issue it aimed to resolve – poverty.¹³² This begs the rhetorical question, would the FATF recommendations achieve their intended output given the lack of legitimacy?

Against the backdrop of arguments which illustrate the coercive drive that engineer's compliance in the presence of 'illegitimacy', this thesis argues that any further

¹³⁰ Transparency International, 'Corruption Perceptions Index 2016' (Transparency International, 2017) < https://www.transparency.org/news/feature/corruption_perceptions_index_2016 > accessed 19 December 2017.

¹³¹ Saby Ghoshray, 'Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law' [2014/15] 59 NYL. Sch.L. Rev. 521, 544.

¹³² Ibid.

restructuring to include legitimacy must ensure that all actors (states), notwithstanding their hierarchy, are ingrained in the process of standard making and implementation. Including such fairness in procedures that are devoid of coercion would ensure that countries, particularly ACs, are voluntarily proactive towards convergence and meeting set goals.¹³³

7.5. Conclusion

Although ACs/EEs' adopted the FATF's standards, they have continued to implement them particularly due to the instrumentality of the IFIs. Their continued implementation has however only resulted in formal or creative compliance. The FATF's attempts to resolve this through the introduction of the RBA which was hoped to address the legitimacy crisis and resolve agency slack has proved futile. Scholars have promoted other options to resolving this. However, the UBA does hold some promise in resolving issues on legitimacy, in addition to ingrained changes within institutions.

This chapter starts by re-emphasizing the existence of a legitimacy crisis in AML/CFT regulation processes, as evidenced by the operations and strategy of IFIs/FATF in combatting these illicit crimes. It argues that the absence of legitimacy is most notable in the application of standards to 'belated members' and associate members, which are 'rule-takers', with limited room to contribute to rules making. Hence, resulting laws do not necessarily mirror society. This occasions a regulatory paradox, for in certain cases, the standards, when translated to laws, achieve unintended consequences.

The legitimacy crisis is then examined in the context of rulemaking and implementation. It argues that belated attempts to include later members in rulemaking is a façade, a situation which leaves associate members in a worse off position given their limited ability to contribute to final decisions. The legitimacy crisis is further

¹³³ *ibid.*

exacerbated by the implementation process, which mainly sees ACs penalised for compliance shortcomings. This is despite evidence that indicates that most compliance issues are within developed countries.

Whilst the RBA recently adopted by the FATF was aimed at resolving AML/CFT compliance differentials by taking into consideration the peculiarities of countries, its flawed conceptualisation has hindered its ability to achieve this aim. Rather, this has aggravated the agency slack between IFIs/FATF and ACs/EEs particularly due to the difficulty in implementing the RBA which is outcome focused. Consequently, the argument advanced is that a UBA would be more suited to addressing the current agency slack as it shifts the focus to the process of decision making as opposed to the outcome. Moreover, it can better incorporate the priorities of ACs/EEs. This would aid in resolving the legitimacy crisis which also requires a remodelling at the FATF level to mirror the IADI.

Chapter 8

Explanations and Conclusion

8. Introduction

This thesis questions empirically, how the evolution of the AML/CFT framework has occasioned an agency slack which has an impact on attained FATF compliance levels of countries. The aim of this chapter is to pull together the main insights and conclusions from the previous chapters. This chapter sets out to explain what compliance drivers ACs/EEs respond to, how the agency relationship explains their behaviour and how the RBA may indeed not resolve the existing legitimacy crises.

It is imperative to state that the conclusion drawn from findings is that the FATF has a significant impact on AML/CFT governance in EEs even though their compliance level is still not at the optimum level. Whilst its impact is negligible in ACs. These findings confirm the theoretical argument of the thesis that the hierarchy of countries determines their compliance levels and communication strategy with IFIs/FATF. One possible explanation for this is that the AML/CFT policies are less reflective of the socio-economic and political terrain of ACs which is below the hierarchy and therefore, are less suitable in projecting proactive compliance within these countries.

8.1. Explanations and Conclusions by Research Questions

At the heart of this thesis are four research questions;

1. Has the evolution of IFIs/FATF facilitated an agency slack between these international institutions and ACs/EEs with resulting legitimacy crises?
2. Do the compliance drivers and level of compliance attained in ACs/EEs indicate a misalignment of incentives between these countries and IFIs/FATF?
3. What factors exacerbate information asymmetry between IFIs/FATF and ACs/EEs? Can the agency slack that arises from countries acting in their self-interest to hinder information sharing with other countries be resolved?
4. Does the risk-based approach sufficiently take into consideration the peculiarities of countries and facilitate increased legitimacy of the FATF?

The first question on the evolution of the IFIs/FATF, its resulting AML/CFT standards and the likely impact of this in creating an agency slack between these institutions and ACs/EEs was explored extensively through literature in chapter two. This chapter examined the evolution of AML/CFT standards, the institutions central to its administration and the influences of these on state compliance. It argued strongly that these standards were crucial to facilitating financial integrity in cross-border relations. However, it found that the AML/CFT standards only inculcated the perspectives of a select group of developed countries (the G7), and hence, was better suited at combatting illicit crimes within these countries. Given the lack of transparency, accountability and legitimacy in the standards creation processes, this chapter asserts that ACs/EEs are more inclined to suffer a compliance deficit. This quandary is understood through the lens of the agency theory which unearths an agency slack in the relationship between IFIs/FATF and ACs/EEs, backed by a legitimacy crisis, showing that although ACs/EEs are disproportionately involved, there is a mandate for their compliance – an indication of hegemonic subjugation.

The second question on whether compliance drivers and the level of compliance attained in ACs/EEs indicate a misalignment of incentives between these countries and the IFIs/FATF was addressed in chapter three, five and six. The statistics on compliance levels in ACs shows far from impressive attainments. Of the 37 ACs are examined, only 7 are deemed to be more than 50% compliant, and 30 are less than 50% compliant. A slightly improved image is seen with EEs with compliance levels ranging from 54% to 66.67%. Literature, however, indicates that these compliance levels may be suggestive of the fact that whilst ACs primarily strive for financial inclusion and EEs struggle for improved global integration – the FATF’s focus is on integrity which may sometimes be tangential to the primary objectives of the bloc of countries. Consequently, the FATF’s strive may come at the expense of the socio-economic and political peculiarities of these countries (cash-based, remittances, etc.) which not only hinders their unique development but may result in a regulatory paradox.

More so, the compliance drives which are expected to be effective in all countries, are seen to have different outcomes across ACs/EEs. More precisely, chapter three argues that law is crucial when designed properly, and most importantly, when backed with confidence. Confidence in financial stability, institutions, governmental and political systems, and enforcement structures. The extent to which these factors are instituted within ACs/EEs to ensure implementation and compliance is however questionable. This serves as an indication that ACs/EEs would be incapable of effectively transplanting or complying with the FATF standards. These pre-condition feed into the compliance drivers which are categorised as legal and non-legal factors which can be internal or external to a country. It is against these ‘drivers’ that the compliance probability of ACs/EEs is examined.

In chapter five, the compliance drivers enumerated in chapter three are examined within the context of Africa’s socio-economic and political history. The current positioning of ACs in the global economy is also considered in determining how the compliance drivers actually define ACs compliance with the FATF’s standards. In examining compliance as a function of legal factors, the impact of democracy and rule of law, enforcement and law mirroring society are considered. On rule of law and democracy,

findings indicate a positive correlation between these indexes and compliance with AML/CFT recommendations. Signifying that the more advanced a country's rule of law or democracy indexes are, the higher their compliance levels. ACs have low indexes on both indicators, one possible explanation for their low compliance levels. Irrespective of these shortcomings, ACs face enforcement actions (sanctions) for non-compliance. Most ACs sanctioned have reacted by projecting formal compliance in their engagements with IFIs/FATF so as to evade future sanctions. Such formal or sham compliance have seen laws in ACs mirror the FATF standards, some of which are antithetical to the ACs agenda on financial inclusion.

Legal compliance drivers are backed by non-legal drivers, such as reputation, political will, domestic conditions, resources and capacity deficit. The extent to which reputation can drive compliance in ACs is however limited, as most AC's shamed for non-compliance resort to formal compliance. More so, politically will which may be internally or externally generated can be hindered by factors such as corruption. Statistical findings by this thesis indicate that higher corruption in ACs occasions lower compliance levels. These countries also lack the necessary resources and capacity to check against illicit transactions.

Also crucial are the external compliance drivers of ownership and legitimacy. The belated associate membership of the ACs within FSRBs has tinted their perception of the FATF's legitimacy. This is particularly due to the perceived absence of input and ownership in standards and processes of the FATF, especially on issues that concern them, a situation that leads to coerced or formal compliance, which is nevertheless apathetically low. Their low compliance is indicative of two things. Firstly, that although ACs are keen on integration and integrity within the global economy, their aspirations are hindered by culture and capacity. Secondly, the shortcomings of ACs indicate that subjecting these countries to the same standards, methodology and sanctions as other developed countries would be to ignore their heritage and socio-economic challenges whilst facilitating legitimacy issues. It would be setting these countries up to fail or permitting them to engage strategically with IFIs/FATF given their low integration with the global economy.

Chapter six examines the impact of the compliance drivers enumerated in chapter three within the socio-economic and political positioning of the BRICS. It starts by appraising the impact of legal factors as compliance drivers. On rule of law and democracy, it finds that, contrary to the situation in ACs where these are key drivers, it is not the case with all the BRICS. Statistically, there is a negative correlation between the rule of law and democracy on one hand and compliance with the AML/CFT standards on the other hand. Meaning that these indices do not necessarily drive compliance. Conversely, these factors may indeed have some impact on compliance – but the actual compliance levels would be shrouded in secrecy. This can be attributed to the law mirroring international standards – a situation which has led to the wholesale application of non-contextualised policies. For instance, the FATF’s attempts at curtailing ML through remittances mirrors the requirements for curtailing ML through FIs, a process which is at best fallible. These situations can, however, be remedied by enforcement actions which have an impact on EEs, as these countries, keen on retaining their position within the international economy – respond positively to enforcement actions.

Flowing from enforcement is the non-legal driver – reputation. Evidence shows that EEs are keen to protect their reputation to ensure continued business with the West. This is strengthened by the resources at their disposal, coupled with their fortified technical capacity. Whilst this signals ingrained political will which can propel compliance, like ACs, such ‘will’ may be undermined by corruption. This is backed by statistics which indicate that where corruption is high, there is low compliance. However, as opposed to ACs, globalisation and integration drives compliance in EEs, especially those like China that have established physical businesses in developed countries. This is, however, the concern that their procedures may only follow the host countries AML/CFT policies on paper.

Crucially important is the external drive of ownership and legitimacy. Unlike ACs who are associate members of the FATF, the BRICS have gained membership, hence

possibly augmenting their perception of the FATF as legitimate. Whilst the BRICS and developing world viewed this as a means to gain increased representation within the FATF, the agenda of the West was to ensure that the financial movement to the Global South is not replete with illicit transactions. The power-play involved in negotiations between these ‘North-South strategically important countries’ was predicated on the assumption that representation would be a catalyst for improved compliance with AML/CFT recommendations. Conversely, the BRICS coerced and belated membership has created a very unbalanced membership between EEs and the developed countries. Against this background, this chapter argues that membership does not necessarily guarantee comparable representation or legitimacy; neither does it guarantee the overtly improved compliance of BRICS countries. It presents a contrary argument that ‘representation’ taints the socio-economic complexities inherent in these countries and their ability to comply. Worse still, it conceals the asymmetries occasioned by variances in the strength of legal structures reinforced by political and economic differences between members of the FATF. For membership to equate to legitimacy, there must be existent changes along existing political and economic global structures, arguing that this would ensure improved adherence to FATF recommendations.

The third set of questions are focused on the factors that exacerbate information asymmetry between IFIs/FATF and ACs/EEs. Additionally, it examines whether agency slack arises from countries acting in their self-interests to hinder information sharing. These questions are addressed in chapter four which uncovers the relationship between the collective principals and countries. This synergy examined through the agency theory unveils the power dynamics between developed countries, the institutions they create and lead and ACs/EEs. It reveals that the AML/CFT standards reflect the priorities and interests of the global north and is sublimated with covenants of agency capture which can hinder the unique development of ACs. Analysing the interaction between agent states and the CPs, it argues that two factors are crucial for understanding information asymmetry between these actors on ML/TF issues; the level of a country’s integration with the global financial system and its perceived compliance levels. It finds that the incentive for information sharing is highest when a country is ‘highly integrated’ with perceived high compliance levels. In opposite situation, the

countries would usually engage strategically with the principal in order to evade observatory tools or sanctions.

Furthermore, in acknowledgement of the flow of money within countries, the interaction between 'highly integrated' and 'mid-integrated' countries are examined. The chapter illustrates that these set of countries share information only when it is in their self-interest, particularly when there is a continuous financial business that is of systematic importance to both parties. It, however, argues that even when low-integrated countries are willing to exchange viable information, they may be limited by capacity challenges. Where however information asymmetry continually thrives, the CPs are privy to tools to rein in the agent-states. The tools utilized are dependent on the circumstances in question and the application of the inappropriate tool may indeed lead to under-regulation, as the tool would at best be inadequate.

The fourth question on whether the risk-based approach sufficiently takes into consideration the peculiarities of countries and facilitate increased legitimacy of the FATF? Chapter seven addresses this. It argues that whilst the RBA recently adopted by the FATF was aimed at resolving AML/CFT compliance differentials by taking into consideration the peculiarities of countries, its flawed conceptualisation has hindered its ability to achieve this aim. Rather, this has aggravated the agency slack between IFIs/FATF and ACs/EEs particularly due to the difficulty in implementing the RBA which is outcome focused. Consequently, the argument advanced is that a UBA would be more suited to addressing the current agency slack as it shifts the focus to the process of decision making as opposed to the outcome. Moreover, it can better incorporate the priorities of ACs/EEs. This would aid in resolving the legitimacy crisis which also requires a remodelling at the FATF level to mirror the IADI.

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Appendix 1

Questionnaire for thesis titled: Compliance with the Global AML/CFT Regulation: Parameters and Paradoxes of Regulation in African Countries and Emerging Economies.

Background

The purpose of this study is to understand, through a semi-structured interview, the relationship between the legal development of countries and their compliance levels to global AML/CTF standards. It examines this within the context of legitimacy in the global regulation of AML/CTF. This study is paramount and operationally relevant because this is a watershed moment for ML/TF in African Countries and Emerging Economies. This qualitative interview is designed to generate richer information across a range of issues within the AML/CTF spectrum.

Research Questions:¹³⁴

1. Does the current global AML/CTF recommendations and benchmarks adopted for assessing technical compliance allow West African Countries/Emerging Economies to be adjudged equitably in the compliance ratings?
2. Does the relationship between the International Standard Setter (FATF) and West African/Emerging Economies encourage improved compliance within these states?
3. What are the AML/CTF enforcement challenges within West African States and how can these be addressed?

Questionnaire

Instructions for Interviewees

¹³⁴ These research questions have been modified for interviewees ease of understanding. Refer to Chapter 1 for thesis research questions.

- I. Respond to designated questions only
 - Interviewee(s) from international/regional institutions – respond to section 1 and 2
 - Interviewee(s) from financial institutions – respond to section 1 and 3
- II. Please respond to all questions in your designated sections

Section 1. Legitimacy of institutions and its effect on Compliance in West African States and Emerging Economies

- a. Do you have any experience of working with emerging economies and African states?
- b. Do you see any difference in the way they comply?
- c. How do states interact with the FATF and does it differ from the way they interact with the IMF/WB?
- d. There is a large body of literature critiquing the legitimacy of the international AML/CTF regulatory framework, should international bodies improve their legitimacy? ¹³⁵
- e. If yes, how can the legitimacy of the FATF be improved?
- f. Can the IMF and World Bank push for improved legitimacy in soft law bodies?
- g. Would improved legitimacy within soft law bodies like the FATF translate to improved AML/CTF compliance?
- h. Does the risk-based approach recommendation ensure improved compliance ratings within African states/emerging economies?

Section 2. Legal development and other issues arising in compliance

- a) What factors hinder West African Countries and emerging economies from fully assimilating the FATF recommendations?

¹³⁵ Legitimacy here refers to membership, composition of board and decision making process within regulatory bodies and its interaction with/effect on developing countries

- b) To what extent does the current regulatory framework take into consideration the level of legal development within countries and its effect on their ability to comply?¹³⁶
- c) Does the ‘soft-law’ enforcement process by the FATF recognise the legal development of countries?
- d) Do you think that aspects of investigative, prosecutorial and judicial processes in these states hinder ML/TF prosecutions and sanctions?
Can you give example or instances?

Section 3. **Compliance Levels Across Jurisdictions**

- a.) Do you have any experience in compliance divisions of financial institutions within emerging economies and African states?
- b.) Within the institutions you’ve worked with, what are compliance levels to FATF recommendations (particularly on KYC, CDD, CTF recommendations and correspondent banking)
- c.) Do you consider such compliance levels adequate?
(particularly KYC, CDD and CTF recommendations and corresponding banking)
- d.) How do you assess the compliance level to these recommendations?
- e.) Are branches in WA/EE hindered in their ability to comply? If so, how?
- f.) Is the KYC requirement conflated with the middle class population given the inability of the lower class to meet the requirement to bank?
- g.) Do these financial institutions exchange financial intelligence with enforcement agencies in a timely manner?
- h.) Describe the relationship between compliance departments and other departments within financial institutions as regards to closing a financial deal.
- i.) How can compliance levels in financial institutions within these jurisdictions be improved?

¹³⁶ Legal development here refers to the strength of the legislative and judicial arm of governments – coupled with their enforcement and regulatory bodies.

Please note that the list of interviewees is kept private on request. They comprise of staff of the International Monetary Fund, regulatory institutions in Nigeria, financial institution in Kenya and the FATF styled regional body, West Africa (GIABA). Transcripts can be provided on request – in accordance with the General Data Protection Regulation (GDPR).