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Compliance Convergence in FATF Rulemaking: The Conflict Between Agency Capture and Soft Law

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*The workings of the intergovernmental bodies that developed and implemented these rules are largely shielded from public scrutiny; the “international community” has accepted the rules uncritically while failing to subject the bodies that created them to meaningful scrutiny or democratic control.*¹

I. INTRODUCTION

Large-scale financial systems are vulnerable to external stressors that threaten their stability.² These stressors include money laundering³ and terrorist financing,⁴ each capable of causing long-term systemic risks to the global financial system.⁵ This was seen following the September 11, 2001 attacks and during the global financial crisis of 2008.⁶ In both instances, agencies and supranational bodies responded with more expansive regulatory strategies.⁷

1. See BEN HAYES, COUNTER-TERRORISM, ‘POLICY LAUNDERING’ AND THE FATF: LEGALISING SURVEILLANCE, REGULATING CIVIL SOCIETY 11 (Mar. 2012), available at <http://www.statewatch.org/analyses/no-171-fafp-report.pdf> (“[A] lack of democratic control, oversight and accountability of the FATF has allowed for regulations that circumvent concerns about human rights, proportionality and effectiveness.”).
2. GARRY J. SCHINASI, SAFEGUARDING FINANCIAL STABILITY: THEORY AND PRACTICE 8 (2005) (“[T]he financial system has become more complex in terms of the intricacy of financial instruments, the diversity of activities, and the concomitant mobility of risks.”); see also KERN ALEXANDER ET AL., GLOBAL GOVERNANCE OF FINANCIAL SYSTEMS: THE INTERNATIONAL REGULATION OF SYSTEMIC RISK 23–33 (2006).
3. “Money laundering” generally refers to the transactional activities in which illicit or illegitimate origins of proceeds (money or wealth) are disguised in order to prevent a criminal investigation or prosecution. See *Financial Crisis Window for Mafia Money Laundering*, CALGARY HERALD (Feb. 10, 2009), <http://www2.canada.com/calgaryherald/news/calgarybusiness/story.html?id=ef2bfcd6-c4eb-4f3f-8e47-23c74905f026> (Antonio Maria Costa, Executive Director of the United Nations Office on Drugs and Crime (UNODC), warned that “mafia groups have been channeling funds into banks desperate to survive the global credit crisis”); *UN Crime Chief Says Drug Money Flowed into Banks*, REUTERS (Jan. 25, 2009), available at <http://www.reuters.com/article/2009/01/25/financial-un-drugs-idUSLP65079620090125> (observing that during the financial crisis of 2008 “liquidity was the banking system’s main problem and hence liquid capital became an important factor,” and evidence suggests that some banks benefitted from “interbank loans . . . funded by money that originated from drug trade and other illegal activities” (internal quotation marks omitted)). Steve Scherer & Vernon Silver, *Mafia Cash Increases Grip on Sinking Italy Defying Berlusconi*, BLOOMBERG (May 26, 2009, 6:01 PM), <http://www.bloomberg.com/apps/news?sid=aHtly5QjUYzo&pid=newsarchive> (Italy’s President, Giorgio Napolitano, observed: “There’s a risk that Mafia organizations can profit from the current crisis by buying control of struggling businesses, infiltrating all regions of the country”).
4. “Terrorist financing” refers to the financial support, in any form, of terrorism or of those who facilitate, encourage, plan, or engage in terrorist acts. PAUL ALLAN SCHOTT, REFERENCE GUIDE TO MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM, at I-1 (2d ed. 2006).
5. See generally FIN. ACTION TASK FORCE, GLOBAL MONEY LAUNDERING & TERRORIST FINANCING THREAT ASSESSMENT (July 2010), available at https://www.imolin.org/pdf/imolin/Global_Threat_assessment.pdf.
6. HAYES, *supra* note 1, at 7 (“[S]hortly after the ‘9/11’ terrorist attacks, FATF issued eight Special Recommendations on combating the financing of terrorism . . .”).
7. See KEVIN DAVIS, REGULATORY REFORM POST THE GLOBAL FINANCIAL CRISIS: AN OVERVIEW 2 (2011), available at http://www.apec.org.au/docs/11_CON_GFC/Regulatory%20Reform%20Post%20GFC-%20Overview%20Paper.pdf (observing the harmonizing of global regulatory response post-financial crisis).

The actions of the Financial Action Task Force (FATF) have been no exception. As the leading standard-setter against money laundering and terrorist financing,⁸ the FATF has issued forty Recommendations designed to regulate the global anti-money laundering (AML) regime and combat the financing of terrorism (CFT).⁹ Backed by interpretive guidance and periodic updates, the FATF Recommendations form the backbone of the global AML/CFT regime.¹⁰ Yet, some of the other FATF-Style Regional Bodies (FSRBs) and various jurisdictions suffer from the confusion surrounding the FATF's objectives.¹¹ Such confusion has often been reflected in the international community's reluctance to accept some of the Recommendations.¹²

Despite shaping global AML/CFT frameworks, FATF rulemaking has been criticized predominantly on two grounds. First, the FATF's lack of binding power has been criticized for conferring a spurious legitimacy as a hard law mechanism

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8. See *FATF Steps Up the Fight Against Money Laundering and Terrorist Financing*, FIN. ACTION TASK FORCE (Feb. 16, 2012), <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfstepsupthefightagainstmoneylaunderingandterroristfinancing.html> [hereinafter *FATF Steps Up the Fight*].
 9. FIN. ACTION TASK FORCE, FATF 40 RECOMMENDATIONS 2 (Oct. 2003) [hereinafter FATF 40], available at <http://www.fatf-gafi.org/media/fatf/documents/FATF%20Standards%20-%2040%20Recommendations%20rc.pdf> (“The revised Forty Recommendations now apply not only to money laundering but also to terrorist financing, and when combined with the Eight Special Recommendations on Terrorist Financing provide an enhanced, comprehensive and consistent framework of measures for combating money laundering and terrorist financing.”). With respect to “anti-money laundering,” I refer to the expansive process instrumentalities and the system of laws and regulations that currently exist to prevent, punish, and deter activities related to money laundering. With respect to “combating the financing of terrorism,” I refer to the broader agenda and activities designed to identify, prevent, and prosecute activities related to obtaining and utilizing funds, proceeds, or any financial means towards terrorist activities.
 10. See generally FIN. ACTION TASK FORCE, THE FATF RECOMMENDATIONS (Feb. 2012) [hereinafter 2012 RECOMMENDATIONS], available at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.
 11. HAYES, *supra* note 1, at 30 (“The U.S. Council on Foundations, together with more than 70 foundations, charities, advocacy organizations, non-profit associations and legal advisers, has strongly opposed these measures . . . calling the Guidelines ‘counterproductive’ insofar as ‘they impose excessively burdensome and impractical barriers to global relationships and grantmaking.’ The Council contends that the ‘guidelines create confusion about legal requirements . . .’”); see Giancarlo Del Bufalo, President of the Fin. Action Task Force, Address at MONEYVAL Plenary Meeting (Dec. 13, 2011), available at <http://www.fatf-gafi.org/pages/moneyvalsroleintheglobalamlcftnetwork.html> (“The FATF has been considering ways to further reinforce the global [anti-money laundering and combating the financing of terrorism (AML/CFT)] network throughout this year. In October [2011], we agreed on a new set of high level principles and objectives for both the FATF and [FATF-Style Regional Bodies (FSRBs)]/associate members, which now replace the confusing criteria and obligations that previously applied.”).
 12. See *The Global Regime for Transnational Crime*, COUNCIL ON FOREIGN REL. (June 25, 2013), <http://www.cfr.org/transnational-crime/global-regime-transnational-crime/p28656> (“[R]egional initiatives modeled on FATF have . . . been widely hailed as successful. However, more broadly, regional efforts have been weak.”); see also WILLIAM C. GILMORE, DIRTY MONEY: THE EVOLUTION OF INTERNATIONAL MEASURES TO COUNTER MONEY LAUNDERING AND THE FINANCING OF TERRORISM 137–38 (3d ed. 2004) (“Concerns over partial non-compliance by other FATF members have been frequently expressed.”).

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and, thus, should be characterized as a soft regulatory framework.¹³ Second, some have questioned the FATF's intrusive guidelines.¹⁴ Recognizing that the minority's conceptualization of the FATF's regulatory norms are intrusively imposed upon the majority of jurisdictions, this article examines the anatomy of the discontent in greater detail in an attempt to chart a pathway for adopting future FATF guidelines within an organically developed ecosystem. By evaluating the FATF's scope and agenda, this article intends to place the regime within a proper setting while exploring the fundamental tension between the FATF's regulatory scope and its participatory process.

To evaluate these criticisms, we must recognize a set of considerations at the outset. The FATF owes its existence to the need to supervise an AML/CFT regime.¹⁵ Conceptualizing the interaction between the FATF AML/CFT regime and the underlying jurisdictions provides us with a window into the FATF's regulatory scope. Next, understanding the participatory dynamics of the FATF guidelines helps us identify the benchmarks with which to evaluate the effectiveness of a jurisdiction,¹⁶ which aids in evaluating the FATF's assessment-effectiveness paradigm by recognizing global compliance as a function of the FATF's efforts. In this context, benchmarks are provided by FATF guidelines via a set of expected outcomes. Institutional effectiveness is measured and evaluated based on each jurisdiction's ability to produce compliance outcomes on par with such designated outcomes.¹⁷

This article assesses the effectiveness of the FATF in establishing global convergence among AML/CFT compliance regimes. Part II explores the history of the FATF's processes and instrumentalities to understand its rulemaking nuances. Part III discusses compliance convergence as the goal of FATF rulemaking, which leads into a discussion of how the negative externalities of agency capture, hegemonic

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13. See Dieter Kerwer & Rainer Hülse, *How International Organizations Rule the World: The Case of the Financial Action Task Force on Money Laundering*, 2 J. INT'L ORG. STUD. 50 (2011), available at http://journal-iostudies.org/sites/journal-iostudies.org/files/JIOS201121final_5.pdf.
 14. See generally *How the FATF Is Used to Justify Laws That Harm Civil Society, Freedom of Association and Expression*, CHARITY & SEC. NETWORK (May 16, 2013), http://www.charityandsecurity.org/analysis/Restrictive_Laws_How_FATF_Used_to_Justify_Laws_That_Harm_Civil_Society; see also GILMORE, *supra* note 12, at 133–53.
 15. FIN. ACTION TASK FORCE, FINANCIAL ACTION TASK FORCE ANNUAL REPORT 6 (2009) [hereinafter FATF ANNUAL REPORT], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/2008%202009%20ENG.pdf>.
 16. In its role as the standard-setter for the AML/CFT regime, the FATF employs a participatory process that should be both inclusive and democratic, the absence of which would make the objective of rulemaking for all jurisdictions a suspect initiative on account of a mismatch between process transparency and stated objectives.
 17. See FIN. ACTION TASK FORCE, *METHODOLOGY: FOR ASSESSING TECHNICAL COMPLIANCE WITH THE FATF RECOMMENDATIONS AND THE EFFECTIVENESS OF AML/CFT SYSTEMS* 14–21 (Feb. 2013) [hereinafter *METHODOLOGY*], available at <http://www.fatf-gafi.org/media/fatf/documents/methodology/fatf%20methodology%2022%20feb%202013.pdf>; see also Saby Ghoshray, Regulatory Risk & Compliance Advisor, WorldCompliance, President, Inst. of Interdisciplinary Studies, Remarks at the New York Law School Symposium: Combating Threats to the International Financial System: The Financial Action Task Force (Apr. 25, 2014), available at <https://www.youtube.com/watch?v=4F8TpKweET8>.

subservience, and democratic deficit impact the FATF's soft law. Recognizing the FATF regulatory norms' success as soft law, Part IV examines the source of the FATF's soft law rulemaking. Despite the facial veneer of soft law, at its core the FATF imparts hard law onto jurisdictions. Observing how the soft norm of the FATF has a hardening impact on jurisdictions, this article explores the dynamics that provide vitality to FATF laws. Finally, I conclude by noting that the two competing concepts—rulemaking deficiency due to a lack of transparency and soft law efficiency arising out of internal order—are complementing forces in evaluating FATF laws.

II. FATF: BACKGROUND, RULEMAKING, AND SOFT LAW

A. FATF Background

Judging the FATF's dichotomy between soft law and hard law requires an understanding of the FATF and its role in the global sphere. However, it is first instructive to briefly introduce this dichotomy's general contour.¹⁸ Soft law is a set of regulatory guidelines borne out of negotiations among actors bound by a common agenda or a unified objective.¹⁹ Lacking a binding power of enactment, and without a precise prescriptive mechanism, soft law finds its force within the promissory confines of commitments made by negotiating parties. Unlike soft law, 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.²⁰ Hard law draws its force from its authoritative nature while guiding entities under its jurisdiction through prescriptive implementation guidelines.²¹

The FATF was established in 1989 to effectively combat money laundering worldwide.²² The FATF currently has thirty-six members: thirty-four jurisdictions, and two regional bodies—the European Commission and Gulf Co-operation Council.²³ As

18. See discussion *infra* Part IV.A.

19. See Volker Hüls, *Soft Law, Hard Compliance: Somalia's Informal Funds Transfer Systems in the International Legal Order* 18 (Sept. 2004) (M.A. dissertation), available at <http://www.lawanddevelopment.org/docs/hardcompliance.pdf>; Dinah Shelton, *Normative Hierarchy in International Law*, 100 AM. J. INT'L L. 291, 319 (2006).

20. See Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance*, 94 MINN. L. REV. 706, 707–18 (2010).

21. *Id.* at 717–18.

22. *History of the FATF*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/pages/aboutus/historyofthefatf/> (last visited Apr. 10, 2015) [hereinafter *History of the FATF*]; see also Andrew de Lotbinière McDougall, *International Arbitration and Money Laundering*, 20 AM. U. INT'L L. REV. 1021, 1029 (2005).

23. The thirty-four current FATF member jurisdictions are: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; Finland; France; Germany; Greece; Hong Kong, China; Iceland; India; Ireland; Italy; Japan; the Kingdom of the Netherlands (including the Netherlands, the Netherlands Antilles and Aruba); Luxembourg; Mexico; New Zealand; Norway; Portugal; Republic of Korea; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States. *FATF Members and Observers*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/pages/aboutus/membersandobservers/> (last visited Apr. 10, 2015). The Republic of Korea became a member in 2009, and India became a member in 2010. See also *Korea*, FIN.

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a matter of vigilance, the FATF responds to emerging threats within the global financial system by expanding and modifying existing guidelines. For example, in the wake of the September 11, 2001 attacks, the FATF significantly expanded its regulatory directives on terrorist financing.²⁴ Similarly, after the 2008 financial crisis, the FATF broadened its regulatory plenary power to immunize the global financial system from vulnerabilities.²⁵

The FATF regulates and supervises the global AML/CFT regime by publishing expected norms and assessing a jurisdiction's AML/CFT enforcement.²⁶ Its periodic assessments evaluate the quality and effectiveness of a jurisdiction's AML/CFT framework and provides guidance on fixing deficiencies.²⁷ Thus, as the chief standard-setter in the global fight against money laundering and terrorism financing, one of the FATF's main functions is to evaluate member jurisdiction's domestic regulatory framework and publish a list of Non-Cooperative Countries or Territories.²⁸ Listed in descending order of the severity of AML/CFT deficiencies within the so-called "blacklist," the FATF has identified two categories: (1) jurisdictions for which the FATF calls for applying countermeasures based on significant strategic deficiencies; and (2) jurisdictions with AML/CFT deficiencies that have not been addressed or have not committed to an action plan.²⁹ The FATF

ACTION TASK FORCE, <http://www.fatf-gafi.org/countries/j-m/korea/> (last visited Apr. 10, 2015); *India*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/countries/d-i/india/> (last visited Apr. 10, 2015). In addition, the FATF has admitted six other members since 2000. See FATF ANNUAL REPORT, *supra* note 15, at 26. The Gulf Co-operation Council (GCC) is a full Member of the FATF, but the individual member countries of the GCC, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates are not. See *Co-operation Council for the Arab States of the Gulf (GCC)*, FIN. ACTION TASK FORCE, <http://www.fatf-gfi.org/pages/co-operationcouncilfortheArabStatesoftheGulfGCC.html> (last visited Apr. 10, 2015).

24. FATF ANNUAL REPORT, *supra* note 15, at 6; see also *FATF Steps Up the Fight*, *supra* note 8.

25. See JAMES K. JACKSON, *THE FINANCIAL ACTION TASK FORCE: AN OVERVIEW 1-2* (Nov. 28, 2012), available at <https://www.fas.org/sgp/crs/misc/RS21904.pdf>.

26. See *METHODOLOGY*, *supra* note 17.

27. *Id.* at 8. A FATF Mutual Evaluation takes approximately one year and involves an on-site visit by the assessment team consisting of several assessors from other member jurisdictions, headed by a representative of the FATF Secretariat. This team drafts a Mutual Evaluation Report that is discussed, frequently amended, and ultimately agreed on by the FATF Plenary. See FIN. ACTION TASK FORCE, *THIRD ROUND OF AML/CFT MUTUAL EVALUATIONS: PROCESS AND PROCEDURES 3-8* (Oct. 2009), available at <http://www.fatf-gafi.org/media/fatf/documents/process%20and%20procedures.pdf>; see also FIN. ACTION TASK FORCE, *METHODOLOGY FOR ASSESSING COMPLIANCE WITH THE FATF 40 RECOMMENDATIONS AND THE FATF 9 SPECIAL RECOMMENDATIONS 1-10* [hereinafter *METHODOLOGY FOR ASSESSING COMPLIANCE*], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/methodology.pdf> (last updated Feb. 2009) (providing an overview, background, interpretation, and guidance on the methodology).

28. *FATF Steps Up the Fight*, *supra* note 8.

29. The FATF lists these jurisdictions under "Non-Cooperative Countries and Territories." See *FATF Public Statement*, FIN. ACTION TASK FORCE (June 27, 2014), <http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/public-statement-june-2014.html>; see also FIN. CRIMES ENFORCEMENT NETWORK, *ADVISORY ON THE FATF-IDENTIFIED JURISDICTIONS WITH AML/CFT*

periodically updates these lists based on specific criteria for remedying previously identified deficiencies while meeting prescribed FATF standards.³⁰

The first category—requiring countermeasures—is the more severe category and member jurisdictions work with the FATF to fill compliance gaps. Removal from the blacklist requires a jurisdiction to show significant progress in remedying its deficiencies.³¹ For example, removal could happen when a jurisdiction shows a strong political commitment to work with the FATF and the relevant regional bodies, such as the Asia/Pacific Group, or when progress is shown in addressing their most significant strategic AML/CFT deficiencies.³² For example, the FATF removed Bolivia, Brunei Darussalam, the Philippines, Sri Lanka, Ghana, Venezuela, Trinidad and Tobago, and Thailand from regular monitoring.³³

The FATF provides specific guidelines to assist jurisdictions in its ongoing compliance program. Listed below are some examples of FATF Recommendations to establish an adequate and sufficient AML/CFT framework:

- (a) Enhanced scrutiny to guard against money laundering, and robust procedures for identification, capture, and report of suspicious transactions;
- (b) Enhanced due diligence to identify all foreign correspondent banks and to obtain information relevant to assets used in establishing accounts;
- (c) Following all applicable steps to mitigate money laundering risks associated with a foreign bank's correspondent accounts, including capturing all relevant information relevant to the identity of those foreign banks; and
- (d) Enhanced due diligence for correspondent accounts for which shares are not publically traded, such that the identity of each owner of the foreign bank and the nature and extent of such owner's ownership interests can be ascertained.³⁴

By providing granulated guidelines on prescribed behavior for banks and financial institutions, the FATF brings uniformity across global AML/CFT regimes.³⁵ Departures from these guidelines by banks and financial institutions would make participating jurisdictions noncompliant with FATF norms, which requires a

DEFICIENCIES (Sept. 17, 2013), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-A006.pdf.

30. *See High-Risk and Non-cooperative Jurisdictions*, FIN. ACTION TASK FORCE (Oct. 2014), <http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/>.

31. *Id.*

32. *Id.*

33. *Outcomes of the FATF Plenary, Oslo, 19–21 June 2013*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/documents/documents/plenary-outcomes-june-2013.html> (last updated July 5, 2013).

34. *See generally* FATF 40, *supra* note 9.

35. *See* FIN. ACTION TASK FORCE, GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING: HIGH LEVEL PRINCIPLES AND PROCEDURES 1–4 (June 2007), *available at* <http://www.fatf-gafi.org/media/fatf/documents/reports/high%20level%20principles%20and%20procedures.pdf>.

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jurisdiction to provide its institutions with an adequate supervisory framework.³⁶ A corporate entity's failure to conform to these guidelines may be seen as an inherent regulatory weakness within the supervisory jurisdiction.

B. Dissecting the Process Instrumentalities of FATF Rulemaking

The FATF provides soft regulatory oversight on member jurisdictions. Delineating a few specifics on the source and context of FATF rulemaking will help understand its relevance. First, the FATF manages the global AML/CFT regime through a comprehensive panoply of Recommendations related to prescribed conduct.³⁷ Second, as a supranational body, the FATF resides within the Organisation for Economic Co-operation and Development (OECD).³⁸ Since the FATF differs from similar international organizations in not having an internal constitution or constituent charter,³⁹ its Recommendations are not binding on its member jurisdictions.⁴⁰ Without legally binding authority and direct supervisory enforcement ability, the FATF guidelines are thus soft regulations or soft international law.⁴¹ However, the FATF attempts to complement its lack of binding power by frequently issuing specific guidelines of prudent behavior and by periodically publishing its members' assessment results.⁴² Moreover, working relationships with established supranational bodies, the expansive coverage of proscribed conduct, and pervasiveness of its Recommendations have allowed the FATF to exert sufficient authority as a legitimate supervisory body capable of setting international standards.⁴³

The FATF mandate for AML/CFT gains its vitality through its linkages with the powerful International Monetary Fund (IMF), the United Nations Security Council

36. *High-Risk and Non-cooperative Jurisdictions*, *supra* note 30.

37. See HAYES, *supra* note 1, at 16–19.

38. JACKSON, *supra* note 25, at 1.

39. James T. Gathii, *The Financial Action Task Force and Global Administrative Law*, J. PROF. LAW., 2010, at 198 (“[The FATF] is unlike typical international organizations that have a constituent charter. While it cannot therefore issue legally binding rules, its mandate to combat money laundering is tied to several very powerful international financial institutions like the International Monetary Fund (“IMF”) and the UN Security Council, and it has the backing of powerful governments like the United States, and international organizations like the European Union.”).

40. *Id.*

41. Navin Beekarry, *The International Anti-Money Laundering and Combating the Financing of Terrorism Regulatory Strategy: A Critical Analysis of Compliance Determinants in International Law*, 31 NW. J. INT'L L. & BUS. 137, 155–66 (2010) (discussing the soft law nature of the AML/CFT international regulatory framework).

42. See discussion *infra* Part IV.A.

43. See discussion *infra* Part IV.B–C (examining how the pervasiveness of the FATF Recommendations and their internal structuring have allowed for efficient coverage of proscribed conduct, thereby allowing the FATF to exert effective supervisory pressure on the global AML/CFT framework); see also Gathii, *supra* note 39, at 198, 200–01 (observing how the FATF utilizes its close relationship with the IMF to promote its Recommendations as global mandates for all jurisdictions to follow).

(UNSC), and sponsorship by powerful Western governments.⁴⁴ Further contributing to the FATF's normative authority is its working relationship with the United Nations Counter-Terrorism Committee and endorsement of its Recommendations by the Sanctions Committee of the UNSC.⁴⁵ Global endorsement of various Recommendations through specific UNSC resolutions have the dual effect of significantly contributing to the enhancement of the FATF's status as a supervisory regulatory body, transcending its Recommendations from mere prescriptions on desired conduct to legitimate legal norms.⁴⁶ However, despite sponsorship by the powerful G7 and close linkages with the IMF and the United Nations, the FATF's lack of hard-law-making ability has led critics to question the FATF's global effectiveness.⁴⁷

However, the FATF process instrumentalities attain the institutional rigor of hard law in four ways. First, when enhanced with a multitude of Interpretive Notes, the FATF Recommendations become a comprehensive governance framework for member jurisdictions.⁴⁸ Second, when engaged in an ongoing evaluative and feedback-orientated assessment process with its member jurisdictions, the FATF's governance becomes precise and its Recommendations become directive principles guided by narrow action-oriented prescriptions.⁴⁹ Third, some member jurisdictions recognize the benefit of the FATF's close surveillance of potential destabilizing triggers on the global financial system,⁵⁰ while placing reliance on the FATF's updated guidance to

44. Gathii, *supra* note 39.

45. UNITED NATIONS, BRIEFING TO THE UNITED NATIONS SECURITY COUNCIL COMMITTEE, NEW YORK (Oct. 26, 2009) [hereinafter UNITED NATIONS BRIEFING], available at http://www.un.org/en/sc/ctc/docs/statements/2009_10_26_fatf_brief.pdf (“[The FATF] place[s] great importance on the relationship with the United Nations, in particular with your Committee (CTC) and its Executive Directorate (CTED), as well as with the 1267 Committee, the 1540 Committee and the Vienna based UNODC.”).

46. See, e.g., S.C. Res. 1617, ¶ 7, U.N. Doc. S/RES/1617 (July 29, 2005), available at http://eurasiangroup.org/files/documents/oon_eng/1617_20_2005_20eng.pdf (“[The Security Council] [s]trongly urges all Member States to implement the comprehensive, international standards embodied in the [FATF’s] Forty Recommendations on Money Laundering and the FATF Nine Special Recommendations on Terrorist Financing[.]”); see also Kenneth S. Blazejewski, *The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Transgovernmental Networks*, 22 TEMP. INT’L & COMP. L.J. 1, 38–42 (2008) (discussing the impact of such endorsements on countries’ ability to comply). Here, I draw attention to the FATF’s working relationship with globally recognizable supranational bodies, influencing global jurisdictions in conformance with the FATF Recommendations.

47. See GLOBAL WITNESS, HOW FATF CAN MEASURE AND PROMOTE AN EFFECTIVE ANTI-MONEY LAUNDERING SYSTEM 2 (June 2012), available at <https://www.globalwitness.org/sites/default/files/library/How%20FATF%20can%20measure%20and%20promote%20an%20effective%20anti-money%20laundering%20system.pdf> (criticizing the existing approach to measuring and ensuring effectiveness as neither systematic nor fully integrated in the evaluation process).

48. ALEXANDER ET AL., *supra* note 2, at 150 (“[The] FATF’s compliance review process and designation of non-cooperative countries, which carries the threat of sanctions, has created a limited international legal regime that has the potential to be transformed into a more comprehensive international legal framework for the control of financial crime.”).

49. See 2012 RECOMMENDATIONS, *supra* note 10, at 7–9.

50. GILMORE, *supra* note 12, at 99, 135, 239–40 (discussing the FATF’s peer-review process, which is designed to encourage members to implement the FATF Recommendations).

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modify and enhance their domestic AML/CFT framework.⁵¹ Fourth, the FATF categorizes jurisdictions by measuring their proscribed actions with prescribed benchmarks and periodically publicizes blacklists of noncompliant jurisdictions,⁵² which forces member jurisdictions to adapt to the FATF guidelines due to peer pressure and the fear of losing global connectivity.⁵³ In essence, a noncompliant jurisdiction acquiesces into compliance by compulsion, hardening the trajectory of soft regulatory norms. Thus, the dynamics of social connectivity and peer relationships have allowed the FATF to develop a predictable trajectory of expected behavior.⁵⁴ This in turn has enabled the FATF Recommendations' soft prescriptions to attain the scope and characteristic of hard law within global finance.

The FATF's mandate-driven enforcement paradigm empowers the FATF to formulate legal, financial, and law enforcement policies.⁵⁵ Substantively, this allows the FATF to evaluate the effectiveness of members' AML/CFT regimes. Procedurally however, the FATF injects the right balance between providing stability to the system by introducing Recommendations, while allowing flexibility to these standards by accommodating specific jurisdictional nuances through an expansive array of guidelines.⁵⁶ In seeking compliance convergence, FATF mechanisms provide a window

51. *Id.*

52. Kerwer & Hülse, *supra* note 13, at 55–61.

53. Note the exogenous imposition of fear-shaping, forced conformance on countries in adopting FATF standards. See, e.g., Bing Baltazar C. Brillo, *The Politics of the Anti-Money Laundering Act of the Philippines: An Assessment of the Republic Act 9160 and 9194*, 6 ASIAN SOC. SCI. 109–25 (2010) (observing the FATF's influence in the internal policymaking process of the Philippines). This fear of losing company within the comity of nations is borne out of the peer-review mechanism underlying the FATF's Mutual Evaluation of a country's conformance with prescribed standards. See HAYES, *supra* note 1, at 9, 17–18 (noting how the peer-review process forces conformance with the FATF Recommendations).

54. Hüls, *supra* note 19, at 19 (“Peer pressure is the main driving force, and, to a certain extent, market incentives, as compliance with FATF guidelines arguably makes a country more attractive for legitimate foreign direct investment.” (footnote omitted)).

55. The FATF's central activity is assessing its members' compliance with the AML/CFT Recommendations via the mutual evaluation process. See *Operational Issues—Financial Investigations Guidance*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/documents/guidance/operationalissues-financialinvestigationsguidance.html> (last updated Oct. 5, 2012); see also *METHODOLOGY FOR ASSESSING COMPLIANCE*, *supra* note 27; FIN. ACTION TASK FORCE, *AML/CFT EVALUATIONS AND ASSESSMENTS: HANDBOOK FOR COUNTRIES AND ASSESSORS 4–10* (Apr. 2009) [hereinafter *FATF HANDBOOK*], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/Handbook%20for%20assessors.pdf>. FATF Recommendations are implemented in a timely and effective manner by the FSRB network by means of a peer-review process. In the event that countries or jurisdictions are not members, they are encouraged to join the regional body applicable to them. The FATF's third round of Mutual Evaluations utilizes the common assessment methodology and is geared towards determining the compliance level of countries, as assessed by their fidelity to the 40+9 Recommendations. The FATF's follow-up procedures involve encouraging and facilitating members' adherence to the Recommendations by addressing and closing compliance gaps that have been identified through the mutual evaluation process. *Id.*

56. See 2012 RECOMMENDATIONS, *supra* note 10, at 8 (“The risk-based approach allows countries, within the framework of the FATF requirements, to adopt a more flexible set of measures, in order to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way.”).

into how soft regulatory norms can attain the institutional rigor of hard law. However, imbibing the spirit of hard law within the parameters of soft regulations should not necessarily be recognized as a standard-setter. Whether or not the FATF is a true standard-setter in the global AML/CFT regime is a conceptual paradox for more than one reason—an area I shall explore next.

III. COMPLIANCE CONVERGENCE THROUGH AGENCY CAPTURE, PATRIMONY, AND DEMOCRATIC DEFICIT

Hard laws' definitiveness is difficult to apply when jurisdictions show a wide range of compliance differentials. Unlike hard law, soft law is naturally conducive to producing varying degrees of compliance across target entities.⁵⁷ Here, I define "compliance differential" as the measured degree of separation between the two states of a jurisdiction under two scenarios—the "optimal standard" scenario and the "in-progress" scenario. An optimal standard exists when a jurisdiction's regulatory framework can be considered compliant with the supervisory regime's prescribed benchmarks. The in-progress scenario exists when a target jurisdiction is recognized as deficient based on such prescription and is working to achieve compliance. In this case, the compliance differential is measured as the quantum of compliance offset that a target jurisdiction exhibits in comparison to the optimal compliance threshold. For example, a jurisdiction identified as severely noncompliant would have to exhibit a higher compliance differential than a jurisdiction measured as reasonably compliant. Thus, without the binding power of a hard norm, the natural inertia would tend to produce a wider range of compliance differentials among the targeted jurisdictions. Therefore, the goal of a regulatory regime is to reduce such compliance differential by achieving compliance convergence.

Compliance convergence is a matured global state, under a particular supervisory regime, where the dispersion of compliance differential among the targeted entities is low. Thus, in order to be an effective standard-setter, a regulatory regime should respond well to diverging jurisdictional nuances, while also minimizing compliance differences among jurisdictions. Thus, to be effective as a standard-setter for global AML/CFT norms, the FATF's interpretive guidance must exhibit compliance maturity for representing divergent aspirations of all jurisdictions. To fulfill its role as the global supervisor for combating money laundering and terrorist financing, the FATF must be able to accommodate domestic uniqueness across jurisdictions, while achieving compliance convergence. The success of the FATF's soft law must be reviewed against a reality check of laws that imply objectives of compliance convergence.

With negative externalities of agency capture, hegemonic subservience, and democratic deficit as a guide, I now embark on an analysis of the FATF's soft law success in the global AML/CFT framework.

57. See Beekarry, *supra* note 41, at 147 (discussing soft law's normative structure to achieve international cooperation and world order).

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A. The FATF's Agency Capture: A Legacy of Its Origin

The FATF's standard-setting process has been criticized for becoming a proxy for fulfilling the aspirational needs of a few developed countries.⁵⁸ Although the FATF was created to deal with the global need to fight against money laundering, the agency's original policymaking objective might have been sublimated with covenants of agency capture.⁵⁹ Originally founded at the initiative of the G7 countries, the FATF's aspiration was to be the global standard-setter for all jurisdictions.⁶⁰ Implicit in its rulemaking is, therefore, the aspiration of all economies to be given their due evaluation for effective incorporation of their unique nuances within the Recommendations. The reality of the FATF's standard formulation, however, reflects the priorities and interests of Western market economies—most notably its founding members.⁶¹ Thus, criticism of the FATF rulemaking process being hijacked by powerful minorities cannot be rejected outright.⁶² Within a coercive imposition of the Recommendations, there are more complex dynamics of the market economy's dominion and control over planned or participatory economies.⁶³ By working in tandem with a handful of developed countries, FATF rulemaking may have stymied some developing countries' unique development objectives—a predictable consequence of agency capture.⁶⁴ The Recommendations embody views of close-knit players in global finance⁶⁵ who have failed to recognize the divergent nuances of jurisdictions in developing and underdeveloped countries. Yet, these minority players expect such jurisdictions to ramp up their domestic laws in the image of the developed world.⁶⁶

To develop a comprehensive regulatory regime for diverging jurisdictions, without adequate input from a representative sample, is a sign that the FATF process instrumentalities may have been subjugated under the weight of a powerful G7 agenda of dominion and control over the global financial order. Jolted by the September 11 attacks, and spooked by the systemic course correction of 2008, the FATF objectives have become a proxy for a handful of Western market economies,

58. See generally José Alvarez, *Hegemonic International Law Revisited*, 97 AM. J. INT'L L. 873 (2003).

59. See Gathii, *supra* note 39, at 201 (noting how international organizations' lawmaking, like the FATF's, raises the specter of agency capture by special interest groups and governments).

60. UNITED NATIONS BRIEFING, *supra* note 45.

61. Gathii, *supra* note 39, at 201 ("In the case of the FATF, the overwhelming presence of Western market oriented economies among its 35 members, as well as the exclusion of all but one African country among this core membership, means that the promulgation of the FATF's agenda primarily, if not exclusively, reflects the priorities and interests of these countries.")

62. *Id.*

63. See Saby Ghoshray, *3(D) View of India's Patent Law: Social Justice Aspiration Meets Property Rights in Novartis v. Union of India & Others*, 13 J. MARSHALL REV. INTELL. PROP. L. 719 (2014) (discussing how the colonialist agenda still runs deep in the veins of international lawmaking).

64. See Gathii, *supra* note 39, at 201.

65. See *id.*

66. See discussion *infra* Part III.B.

which is a regrettable outcome in the development of a soft regulatory framework within international law.

B. The FATF's Hegemonic Agenda: Witnessed Through the Minority's Patrimony

Has the history of the FATF evolution been shaped by a hegemonic agenda? As this article has established thus far, the neutrality surrounding the FATF rulemaking is not without controversy. Before answering this question, some observations are worth discussing. First, only a handful of Western countries have been involved in developing the majority of the Recommendations.⁶⁷ Second, the FATF is housed within the OECD,⁶⁸ which is cause for consternation among critics because, while dealing with an issue requiring global convergence, the United States and OECD countries have imposed their preference via a top-down process without necessarily adopting a participatory framework.⁶⁹ If we look at the contentious discussions in the World Trade Organization (WTO) forum, we find more often than not that the developing and less-developed countries have significant opportunities to participate in agenda formulation, but not necessarily to the satisfaction of the developed world.⁷⁰ This, however, has not been the case in any stage of FATF rulemaking—neither the agenda development nor guidance formulation.

In the absence of either an IMF or WTO type of umbrella to effectuate majority participation, the FATF seems to gravitate towards a minority imposition of a global agenda paradigm. This exposes the majority of jurisdictions to hegemonic subservience, which is not conducive to developing compliance convergence. Moreover, the FATF rulemaking process suffers from a lack of transparency.⁷¹ Recommendations are much more imposing on developing countries, and the resulting procedural inequality of the process is geared towards identifying compliance differential without a substantive attempt at generating compliance convergence.⁷² This is also because the public humiliation via a “naming and shaming” ritual⁷³ that accompanies the FATF’s

67. See *History of the FATF*, *supra* note 22. These countries include: the participating member countries of the 1989 G7 Summit (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States), the European Commission, and another eight European Union member states (Belgium, Luxembourg, Netherlands, Ireland, Denmark, Sweden, Portugal, and Spain).

68. JACKSON, *supra* note 25, at 1.

69. See Gathii, *supra* note 39, at 203; see generally Paul D. Paton, *Cooperation, Co-option or Coercion? The FATF Lawyer Guidance and Regulation of the Legal Profession*, J. PROF. LAW., 2010, at 165; Louise L. Hill, *The Financial Action Task Force Guidance for Legal Professionals: Missed Opportunities to Level the Playing Field*, J. PROF. LAW., 2010, at 151.

70. See Gathii, *supra* note 39, at 201–03.

71. *Id.* at 202–04.

72. *Id.*

73. Anne L. Clunan, *The Fight Against Terrorist Financing*, 121 POL. SCI. Q. 569, 576–77 (2006–2007) (observing that the FATF uses naming and shaming as the stick to force countries into compliance). “In 2000, the [FATF] began a campaign of ‘naming and shaming’ jurisdictions that did not cooperate in the global effort to combat money laundering” *Id.*

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publication of the list of noncompliant jurisdictions is more adversarial towards a global agenda of compliance convergence.

Thus, a hegemonic imposition of a select few developed countries on the majority of developing countries could be counterproductive to these targeted countries. Peer-review driven, the FATF mutual evaluation of a targeted jurisdiction often leads to the targeted states offering concessions to institutionalized sanctions against a top-down and expansive regulatory regime. In doing so, developing countries are forced into conformance⁷⁴ without the domestic ratification process.⁷⁵ At the same time, developed countries fail to incorporate an organic internal regulatory framework or a democratically evolved infrastructure that has considered internal values. Accordingly, the product is a hurried framework that is economically unstable.

Moreover, when guidelines manufactured by a select few are being imposed against the free will of a larger majority who may acquiesce to the imposed global order, the stability of the global system is unsustainable in the long term. Therefore, a hegemonic imposition is also contradictory to the broader objective of compliance convergence. A regulatory framework manufactured without cooperation and interaction among the participants cannot become an effective tool in preventing the wider dispersion of a compliance differential within the larger set of interconnected jurisdictions.

C. Democratic Deficit in FATF Rulemaking

When hegemonic subservience and agency capture shape FATF policymaking, its rulemaking suffers from democratic deficit,⁷⁶ and its consultation process lacks opacity.⁷⁷ This may not be desirable, but is legitimate under international law.⁷⁸ Despite flexible and purposeful guidelines,⁷⁹ the FATF development process lacks participation from outside jurisdictions.⁸⁰ As a result, the asymmetric negotiating power between developed countries and the developing and underdeveloped countries

74. See HAYES, *supra* note 1, at 9–13 (providing examples of how coercion and imposition by the FATF has several undesired consequences for many countries).

75. See Gathii, *supra* note 39, at 201 (observing how international organizations exert exogenous pressure upon targeted states forcing them into conformance without due process of domestic ratification).

76. See *id.* at 201–02.

77. *Id.* at 202.

78. See generally Kal Raustiala & Anne-Marie Slaughter, *International Law, International Relations and Compliance*, in HANDBOOK OF INTERNATIONAL RELATIONS 538, 553 (2d ed. 2002) (explaining aspects of international law in the context of “the complexity of the interaction between compliance and effectiveness”); see also Dinah Shelton, *Normative Hierarchy in International Law*, 100 AM. J. INT’L L. 291, 319 (2006).

79. 2012 RECOMMENDATIONS, *supra* note 10, at 6.

80. According to the FATF:

As of early September 2009, 129 jurisdictions have been assessed by the FATF, by an FSRB, by the IMF or by the World Bank. Of these jurisdictions, 30 have sufficiently implemented the United Nations Terrorist Financing Convention and the United Nations Security Council Resolutions 1237 and 1373.

99 jurisdictions have not.

continues to shape the FATF guidance formulation.⁸¹ If all current and future participating jurisdictions do not operate from an unbiased vantage point, achieving compliance convergence will remain a mirage. The reality for the majority of jurisdictions is that the FATF is a vehicle for shaping economic and social realities of developing countries in the image and aspiration of a handful of Western countries.⁸²

Available data on participation presents a telling reality of the FATF consultation process that is severely skewed.⁸³ A non-member can eventually obtain membership through meaningful participation in the FATF.⁸⁴ Certainly, this participation would allow for the voices of those currently unrepresented in the consultation process to be heard. However, active participation by jurisdictions outside of the developed world, such as countries not adhering to market economies, becomes extremely difficult within the current framework. A lack of effective participation by majority jurisdictions is ineffective for the FATF rulemaking process as individual nuances and norms of developing jurisdictions are not reflected in its standards.⁸⁵ The results are untenable for the majority jurisdictions in having a minority's manufactured global standard imposed upon them without having participated in its formulation.⁸⁶ In its current format, the FATF's Recommendations and interpretative guidance are insensitive to the concerns of countries whose global aspirations may be different from their economically advantageous counterparts.⁸⁷ Unfortunately, addressing such insensitivity

Similarly, of the 129 jurisdictions assessed, only 21 had effective systems in place to freeze terrorist assets, 108 jurisdictions had not.

The average compliance ratio for all IX Special Recommendations stands at 25 [percent], which is slightly higher than the compliance with the two recommendations I just mentioned that are based on United Nations instruments.

UNITED NATIONS BRIEFING, *supra* note 45.

81. FATF meetings are typically conducted in Europe, and the participants are typically members of European and American law societies. The countries exerting the most influence in policymaking continue to be the same core members that founded the FATF in 1989. *See* Kevin L. Shepherd, *Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transactional Lawyers*, 43 REAL PROP. TR. & EST. L.J. 607, 630 n.135 (2009) (noting that at most FATF meetings where Recommendations were being discussed, only a 2007 meeting in Bern had representatives from a sub-Saharan African country (Nigeria)).
82. Gathii, *supra* note 39, at 201.
83. *Id.*
84. *See Process and Criteria for Becoming a FATF Member*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/pages/aboutus/membersandobservers/membershipprocessandcriteria.html> (last visited Apr. 10, 2015).
85. *See* Gathii, *supra* note 39, at 201.
86. *See id.*; *see also* HAYES, *supra* note 1 (observing the democratic deficit in both FATF rulemaking and the mutual evaluation process, where a handful of countries set the agenda and shape the peer-review process based on rules, which the majority of the targeted jurisdictions are coerced into following without having any say in their formulation).
87. *See* Gathii, *supra* note 39, at 201 (noting that the FATF's agenda primarily reflects the interests of its Western market oriented members); *see also* Philip Alston, *The Myopia of the Handmaidens: International Lawyers and Globalization*, 8 EUR. J. INT'L L. 435, 439 (1997) (lamenting that the disconnect between a

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is outside the scope of the FATF process instrumentality due to the democratic deficit inherent in its process.⁸⁸

Democratic deficit in agency rulemaking is borne out of the fundamentals of the underlying participatory dialectic and is manifested in the data regarding the lack of meaningful participation by majority jurisdictions.⁸⁹ This, in turn, impacts a jurisdiction's ability to close the compliance differential discussed earlier. Oftentimes, this lack of meaningful participation in the consultation process forecloses a jurisdiction's ability to benefit from the wider cooperation and information exchange of a regulatory framework. As jurisdictions fall within a wider spectrum on the global developmental trajectory, not being a part of the process makes it very difficult for a jurisdiction to internalize compliance differential issues. The FATF's effort to compel compliance with its Recommendations by singling out jurisdictions for nonconformance is an affront to a nation's sovereignty.⁹⁰

The FATF's tactic of publishing the blacklist or the list of Non-Cooperative Countries and Territories without having due imprimatur of international law could certainly be perceived as extraterritorial bullying.⁹¹ Affected jurisdictions may suddenly find themselves in a corner, realizing that they are compelled into conformity with rules for which they have no meaningful participatory linkage.⁹² Such lack of association and suddenness of conformance urgency makes internalization of compliance objectives a significant hurdle for the targeted jurisdictions to overcome.⁹³ On the contrary, being part of the process would allow a jurisdiction to eliminate the compliance differential. This is because it would be highly probable that its unique jurisdictional nuances would have been reasonably encapsulated with the promulgated Recommendation and guidance it had taken part in developing.⁹⁴

Lack of meaningful participation by a larger majority also allows the minority to develop a group-think mindset, which stymies the democratic consultative process.⁹⁵

developed country's focus on strengthening laws for the prevention of terrorism and combating money laundering may be inconsistent with a developing country's need to enhance basic infrastructure).

88. See generally HAYES, *supra* note 1, at 17–18 (noting the FATF's lack of democratic control, oversight, and accountability).

89. See Gathii, *supra* note 39, at 202 (“The authority of international institutions, and in particular international economic institutions like the World Bank and the International Monetary Fund (‘IMF’), raises fundamental questions, not simply from the point of view of the participation of non-western countries in standard formulation, but of the unequal and imbalanced power exercised by the wealthy countries that control the agenda of these institutions.”).

90. See Todd Doyle, *Cleaning Up Anti-Money Laundering Strategies: Current FATF Tactics Needlessly Violate International Law*, 24 Hous. J. INT'L L. 279, 281 (2002).

91. *Id.*

92. *See id.*

93. *See id.*

94. See generally Gathii, *supra* note 39.

95. When participation is restricted, deliberation is limited to a minority group, which results in the representation of fewer viewpoints. However, any rule made as a result of such consultation is applicable to all members. Therefore, the danger in precluding a larger minority from such discussions is that

The resulting situation can become a fertile ground for the supervisory agency to operate in a manner where minorities can effectively impose their agendas on the broader majority.⁹⁶ Democratic deficit in the FATF rulemaking process has allowed Western market economies to successfully impose their priorities, creating disadvantages for many jurisdictions, as previously highlighted.⁹⁷

Literature has identified how some of the FATF's fundamental assumptions and desired world views may have impacted the socio-political fabrics of the underdeveloped and developing countries.⁹⁸ Against a backdrop of increasing global interconnectedness and dependencies, a market economy's open-flow dynamics may not necessarily be optimum for all underdeveloped and developing countries.⁹⁹ However, the FATF's commitment to financial surveillance, financial reporting, and AML/CFT impose obligations on these countries to shape their domestic laws in the image of their Western counterparts.¹⁰⁰ Yet, these countries do not share the same socio-political realities of their Western counterparts and are often denied the opportunity to evolve within their jurisdictional uniqueness.¹⁰¹ Thus, the mismatch between domestic law's original aspiration and its coerced evolution can create system stress within such a jurisdiction. Such stress is often reflected in targeted countries facing difficulties and roadblocks in the general functioning of their economy.¹⁰²

Therefore, it is important to keep abreast of the FATF's evolution, especially looking through an evolving prism of negative externalities. When democratic deficit is at play, the FATF's encouragement to act on its recommended course of action may not always be consistent with domestic law's explicit guidance. Furthermore, while hegemonic subservience may have shaped the interpretive guidelines, the quandary between two conflicting regimes can provide a window through which to view a jurisdictions' compliance deficit. Yet, scoping out the potential for a more robust compliance convergence requires a two-step evaluation of these issues. First, is there a relationship between identified negative externalities and the success of the

restricting the discussion to a limited few allows the consultative process to suffer from narrow tunnel vision. See Robert Keohane et al., *Democracy-Enhancing Multilateralism*, 63 INT'L ORG. 1, 2-5 (2009).

96. See discussion *supra* Part III.B.

97. See Gathii, *supra* note 39, at 201.

98. See generally HAYES, *supra* note 1.

99. *Id.*

100. See Gathii, *supra* note 39, at 202, 205.

101. See generally DANIEL W. DREZNER, *ALL POLITICS IS GLOBAL: EXPLAINING INTERNATIONAL REGULATORY REGIMES* (2007) (observing that powerful states hijack the international regulatory process by setting a focal point around which other states are forced to voluntarily converge); Balakrishnan Rajagopal, *From Resistance to Renewal: The Third World, Social Movements, and the Expansion of International Institutions*, 41 HARV. INT'L L.J. 529 (2000).

102. See HAYES, *supra* note 1 (observing that the coercive nature of the FATF's policy influence is a matter of concern for developing countries to the extent that their domestic laws are subject to a shaping effect of the developed countries' laws).

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FATF's soft law? Second, are there other factors that have shaped the trajectory of the FATF's soft law? These questions are explored next.

IV. HARDENING OF THE FATF'S SOFT LAW

Despite the critical view of the FATF's extraterritorial imposition and its absence of international legal imprimatur, its regulatory norms have established a measure of universality. Examining the Recommendations' expansiveness, interconnectedness, and internal ordering, I seek to establish how its process instrumentalities exert exogenous pressure on targeted jurisdictions, while allowing the FATF to attain a quasi-hard-law status among the comity of nations. Structurally, the FATF has evolved around the dual consequences of hegemonic subservience eroding its participatory framework and the democratic deficit stymieing its compliance maturity.¹⁰³ Functionally, however, its regulatory framework has been one of the more efficient soft norms in international law.¹⁰⁴ Thus, democratic deficit in rulemaking has not jeopardized the FATF's ability to harden its soft norms.¹⁰⁵ Could it be that its soft regulatory nature is insulated from its patrimonial origin? Or, could it be that its internal ordering hardens its norm? An evaluation of its effectiveness would be best understood by dissecting its regulatory structure.

Central to FATF rulemaking is the spirit of public international law that comes alive via aggregating its constituent elements—its legal norms, relations, and functions. The Recommendations attain an institutional imprimatur by constraining state behavior by imposing rules that provide a hardening aspect to its soft law framework. Therefore, although fundamentally a product of a soft regulatory paradigm,¹⁰⁶ nuanced pathways help the FATF attain a quasi-hard-law status.¹⁰⁷ A series of questions follow: Is there an internal ordering system that lends itself efficiently towards approaching the hard law status? Does the practice of naming and shaming¹⁰⁸ noncompliant jurisdictions impose a hard law obligation? Does the categorization mechanism empower the FATF with an institutional imprimatur? Does switching to a risk-based approach introduce enhanced adaptability to achieve a more robust compliance convergence for law's hardening?

103. See Gathii, *supra* note 39, at 202–04.

104. See Laurel S. Terry, *An Introduction to the Financial Action Task Force and Its 2008 Lawyer Guidance*, J. PROF. LAW., 2010, at 6–9 (noting the effectiveness of the soft law nature of the FATF in bringing general compliance on AML/CFT for various targeted jurisdictions).

105. *Id.*; see also Gathii, *supra* note 39, at 198. Despite its non-binding rules, the FATF's mandate to combat money laundering and terrorist financing is supported by powerful international financial institutions, such as the IMF and the United Nations Security Council (UNSC). *Id.*

106. See discussion *supra* Part II.B.

107. See Hüls, *supra* note 19, at 10–13.

108. Clunan, *supra* note 73.

A. Evaluation of the FATF Compliance Assessment

The FATF's framework is an effective AML/CFT regime.¹⁰⁹ By acculturating various international law concepts, the FATF has been successful in developing a comprehensive AML/CFT framework.¹¹⁰ For instance, the soft regulatory approach has been effective in bringing regional and international regulatory bodies under a robust umbrella.¹¹¹ Here, law's hardening impact is manifested within its dual trajectory—one track monitors jurisdictional compliance against instituted benchmarks,¹¹² while the other track of periodic review identifies consistency or divergence with instituted norms.¹¹³ Jurisdictional categorization and public announcements are potent regulatory tools for addressing a range of compliance evaluations¹¹⁴—from being noncompliant to being fully compliant.¹¹⁵ As assessments are delegated to various international, regional, and supranational bodies, jurisdictions increasingly address their compliance deficits and embark on collaborations with the FATF to address their compliance differentials, which in turn hardens the regulatory norms.¹¹⁶ Furthermore, by providing jurisdictions with an inducement for being compliant,¹¹⁷ and in preventing noncompliant jurisdictions from further widening their compliance differentials through peer review,¹¹⁸ the FATF

109. Beekarry, *supra* note 41, at 140.

110. *Id.* at 169. As author Navin Beekarry noted:

The constantly evolving normative structure of the FATF system, which leads to greater institutionalization, has enhanced and provided more sustainability to its identity formation. Confronted with changing demands resulting from testing situations, it has regularly reconfigured its institutional setting (through regular reviews of its norms) and adapted itself into a more dynamic institutional framework enabling it to perform its functions and confirm its relevance as a permanent forum. This expansion of its role and functions to address [terrorist financing] issues on a global scale, providing a platform and process to identify jurisdictions that facilitate [terrorist financing] and strengthening cooperation networks, significantly reinforced the FATF setup and its compliance role.

Id. (footnotes omitted)

111. *See id.* at 141–44.

112. *See* METHODOLOGY, *supra* note 17, at 11.

113. *See, e.g.*, FIN. ACTION TASK FORCE, NORWAY: MUTUAL EVALUATION REPORT (Dec. 2014), available at <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Norway-2014.pdf>.

114. *See High Risk and Non-cooperative Jurisdictions*, *supra* note 30.

115. Ratings are allocated according to four categories: Noncompliant (NC), Partially Compliant (PC), Largely Compliant (LC), Compliant (C). These categories are briefly defined as follows: NC: significant shortcomings, with a large majority of the essential criteria not being met; PC: some substantive action has been taken and is compliant with some of the essential criteria; LC: only minor shortcomings, with a large majority of the essential criteria being fully met; C: the Recommendation is fully observed with respect to all its essential criteria. *See* METHODOLOGY, *supra* note 17, at 6.

116. FATF HANDBOOK, *supra* note 55, at 1, 11.

117. *See* Blazejewski, *supra* note 46, at 16–18.

118. *Id.*; FIN. ACTION TASK FORCE, HIGH-LEVEL PRINCIPLES AND OBJECTIVES FOR FATF AND FATF-STYLE REGIONAL BODIES 7 (Oct. 2012), available at <http://www.fatf-gafi.org/media/fatf/documents/High-Level%20Principles%20and%20Objectives%20for%20FATF%20and%20FSRBs.pdf>.

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regulatory norms show an increasing sign of maturity. Yet, this brings an interesting definitional quandary to international law. For instance, is the FATF a hard law with soft law ambiguity, or is it a soft law with a hardening impact?

Hard law is a legally binding law, made precise and robust through regulations and adjudications.¹¹⁹ Soft law is distinct from hard law in that regulations are not binding and have no adjudicatory power. Soft law can be triggered when the precise dimensions of hard laws are relaxed.¹²⁰ Because components of hard law are able to combine in various different ways, soft law can be much more varied and can occupy a much larger spectrum by evolving (1) in varying degrees along each dimension, and (2) in different combinations across dimensions. Thus, soft law can be seen as either a derivative of hard law or a loose structural variant of hard law. It is within the nature of international arrangements and the spirit of international law's cooperative fundamentals that the FATF rules are predominantly soft law. For an international regulatory regime (such as the FATF) to be successful, it must rely on the fundamentals of dialectic, for which soft law is certainly a better conceptual arrangement.

To better understand the hardening of the FATF rules, an important delineation between hard law and soft law is noteworthy. Compared to soft law's shared origin and multiple coterminous trajectories, a typical hard law is realized through predominantly monolithic legal norms.¹²¹ Due to its shared origin, soft law may evolve via several monolithic variants with dichotomous outcomes.¹²² As the supervisory AML/CFT regime, the FATF imbibes within its broader framework many jurisdictional norms. However, instead of allowing these jurisdictions to unfurl along diverging regulatory contours, FATF rules force them to evolve along predictable contours. This is because, for the majority of jurisdictions, compliance convergence is sought by blacklisting and inducement.¹²³ By enabling delegation to regional bodies and encouraging a switch to a risk-based framework, the FATF attempts to induce jurisdictions to follow a normative structure.¹²⁴

Notwithstanding the structural nuances of its regulatory norms, FATF rules should be based on outcomes. Its supervisory position as a standard-setter in the

119. Kenneth W. Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421, 421 (2000).

120. *Id.* at 422–23.

121. W. Michael Reisman & Myres S. McDougal, *The Prescribing Function in World Constitutive Process: How International Law Is Made*, 6 YALE STUD. WORLD PUB. ORD. 249, 256–68 (1980).

122. See Filippo M. Zerilli, *The Rule of Soft Law: An Introduction*, 56 FOCAAL J. GLOBAL & HIST. ANTHROPOLOGY 3–18 (2010), available at <http://www.peacepalacelibrary.nl/ebooks/files/The%20rule%20of%20soft%20law%20An%20introduction%20Zerilli.pdf>.

123. See generally Cynthia Crawford Lichtenstein, *Hard Law v. Soft Law: Unnecessary Dichotomy?*, 35 INT'L LAW. 1433, 1438 (2001); Charles Lipson, *Why Are Some International Agreements Informal?*, 45 INT'L ORG. 495, 495–538 (1991).

124. See Beekarry, *supra* note 41, at 163 (“The FATF’s recent shift from the traditional rule[s]-based system to a more risk-based approach to [money laundering and terrorist financing] demonstrates further benefits of a flexible and adaptable AML/CFT normative system facilitating effective compliance guided by [money laundering and terrorist financing] risk assessments.” (footnotes omitted)).

AML/CFT regime is accepted by many jurisdictions partly due to the expansiveness and the internal ordering of its normative trajectory—an area elaborated on in more detail below. Most often, legal rules are successful not for having specific or precise provisions, but for their acceptance by constituents. A successful legal rule is not necessarily dependent on incorporating a specific component within a rule. Rather, a successful legal rule is measured and predicated on the rule's ability to accommodate a larger number of constituents. A specific component in a rule could influence its acceptance by constituents but, certainly, this is not a reason to tout a rule's success. The same applies to the FATF. For instance, as more jurisdictions adapt to the Recommendations, its soft law norm evolves in a trajectory akin to hard law.

B. Does the FATF Have Internal Ordering?

The current location of the FATF regime within the corpus of applicable international law tells the story of soft law's evolution. Its normative structure provides evidence in support of its hardening characteristics. Typically, a soft law is characterized by preference, in contrast to hard law, which imposes obligations. The FATF was conceptualized as a paradigmatic bulwark against money laundering in an era of escalating globalization. Without treaty obligations and legal specificity, the FATF creates enforceability via an interconnected set of Recommendations covering an array of proscribed behavior. The social isolation and reputational ignominy that results from being blacklisted incentivizes jurisdictions to conform to the Recommendations and guidelines. Thus, in achieving compliance success in shaping the policies and laws of many countries within an interconnected framework, the FATF requires a succinct, cohesive institutional structure. Manifested within the FATF standards is a developed internal ordering framework, which allows its soft law norms to exert pressure for global conformity through reputational and social pathways.

What creates ordering in the FATF rulemaking? Strong, normative frameworks and elegant sanction mechanisms, bound by adjudicatory power and characterized by successful legal systems. Despite a deficiency in adjudicatory power and a legally mandated sanction mechanism, the FATF draws its legal potency from its Recommendations and their accompanied guidance. Despite being dispersed across multiple legal norms and multidimensional international relations, the FATF gains institutional imprimatur via the history of its purpose,¹²⁵ precision of its implementation,¹²⁶ and cohesiveness of its ordering.¹²⁷ While internal ordering strengthened the FATF's scattered jurisdictions into a more cohesive legal unit, such

125. See *History of the FATF*, *supra* note 22.

126. See discussion *supra* Part IV.A.

127. With respect to “cohesive ordering,” I draw attention to precise ordering within the regulatory framework that lends itself well in following a predetermined course of law. The idea here is that, despite supervisory regulatory framework evolving along coterminous trajectory, the ordering imposes a strict evolution pattern.

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ordering has provided the FATF regulatory framework with a number of advantages typically not found in soft law.

First, internal ordering of the expansive corpus of Recommendations has provided heightened specificity to the various proscribed behaviors, which in turn transformed the FATF's soft law into an obligatory paradigm characteristic of hard law. Second, despite the traditional lack of institutional imprimatur of soft law, the FATF publication process of blacklisting countries introduced a unique dimension of coerced compulsion. Via the associative dynamics of conformance and reputational injury, the social nature of the FATF has transformed into a legal paradigm. The FATF process instrumentalities have allowed its preference-driven, soft regulatory norms to achieve the quasi-hard status of a mature compliance regime in which the scope and relevance of internal ordering is significant in evaluating the future trajectory of its Recommendations.

The FATF came into existence to prevent threats to the financial system.¹²⁸ Thus, despite criticism of the FATF's lack of binding authority and precision of hard formation, the FATF's soft regulatory structure has been quite effective in imposing both prescriptive and prohibitive obligations for its intended targets.¹²⁹ On the other hand, in spite of having democratic deficit and patrimonial origins, its normative structure has been reasonably successful as a legal mechanism.¹³⁰ A normative framework does not exist in a vacuum or evolve within a loose coupling of soft law. Rather, its solid institutional setup reveals its connection to an ordered entity.

Is there an ordering advantage within the FATF? What is the origin of such ordering? The FATF, interconnected via loosely coupled sources, might look isolated and disjointed. Yet, its broader trajectory forms a corpus of an ordered regulatory landscape. As the central determinant of these norms and procedures, the FATF acts as the glue that has exhibited a superior binding ability with all associated stakeholders. Such stakeholders include the constituent members, targeted jurisdictions, and its associated supranational bodies, such as the IMF, United Nations, and various regional AML/CFT organizations. In order to achieve its compliance objectives, the FATF constantly communicates with stakeholders via dissemination of periodic review, Recommendations, and Mutual Evaluations through announcements and Plenaries. The FATF legalization norms originated from its central ordering, which contributed to the hardening of its soft law by shaping the AML/CFT laws of many jurisdictions via a global policy.¹³¹ However, the central ordering resulted from internalization of external threats from money laundering and terrorist financing. The external threat created an existential crisis, which helped with internalizing strong central ordering within the FATF regime. Despite jurisdictional divergences and structural flaws, this ordering has been responsible for the FATF's compliance maturity by hardening soft law.

128. See ALEXANDER ET AL., *supra* note 2, at 150.

129. Beekarry, *supra* note 41, at 156–57.

130. *Id.* at 155–66.

131. See discussion *supra* Part IV.A.

C. Assessing the FATF Recommendations

The FATF Recommendations provide both substantive guidelines and detailed procedures to fight against money laundering and terrorist financing. Substantively, these Recommendations have shaped regulatory practices across diverging jurisdictions.¹³² By providing a litany of proscribed conduct within the AML/CFT regime, the Recommendations apply to an array of behaviors and scenarios. Procedurally, the Recommendations have provided a threshold of prescribed behaviors for diverging jurisdictions.¹³³ Identifying threshold behaviors allows targeted jurisdictions to measure their regulatory practices and prescribed activities against a set of benchmarks. While the Recommendations identify specific rules-based obligations, they have sufficient flexibility within their legal foundation to provide adequate guidance for specific jurisdictional nuances.¹³⁴ Flexibility in the FATF guidance can be seen through linguistic structuring found in the Recommendations, as explained below.

Literature has identified the Recommendation's elegance in providing extensive guidance through linguistic structuring. By interjecting obligatory prescriptions, the Recommendations distinguish between mandatory and voluntary actions. Thus, by empowering FATF norms with precision, the definitiveness of hard law is introduced within its soft regulatory framework. For example, "should be required by law or regulation" and other such phrases indicating requirements would impose mandatory obligations to take definitive measures against a specific offense.¹³⁵ Failing to incorporate definitive measures could land the targeted jurisdiction on the blacklist. Incorporating obligatory terms in its rulemaking signifies the FATF's effort to provide precision and definitiveness. These normative characteristics supply further evidence of the existence of hard law within the FATF. On the other hand, the Recommendations contain linguistic cues, which suggest that the FATF intended the guidelines to be flexible and adaptable to handle various behaviors and conduct. For example, the expression "should consider" would not require a jurisdiction to incorporate hard actions—rather, it allows jurisdictions to depart from the FATF's prescribed behavior to deal with specific nuances of domestic law.¹³⁶

Thus, combining precise and clear language to impose mandatory behavior with flexible language in order to encourage jurisdictions to respond to domestic laws has made the FATF rules applicable to a wider spectrum of jurisdictions. The ability to deal with many jurisdictions, to satisfy stringent compliance needs, is a characteristic unique to the FATF. Thus, despite soft norms' expectation of unfulfilled ambiguity and deliberately incomplete language, the diverging Recommendations and

132. *See generally* Kerwer & Hülse, *supra* note 13.

133. *See* discussion *supra* Part IV.A.

134. *See* Beekarry, *supra* note 41, at 140–42.

135. *Id.* at 157.

136. *Id.*

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guidelines have empowered FATF jurisdictions with one of the hardest types of soft norms.¹³⁷

D. Soft Law's Transition Within the Paradigm Shift: Rules-Based to Risk-Based

In a recent paradigm shift, the FATF proposed to adopt a risk-based system for employing a rules-based framework.¹³⁸ This risk-based approach introduces additional flexibility into the system by allowing it to adapt to multiple jurisdictional characteristics.¹³⁹ Instead of encapsulating predictive offenses within a set of hard laws, an adaptable normative system allows effective compliance by allowing individual jurisdictions to craft individualized responses by adequately evaluating risk across prescribed offenses.¹⁴⁰ A case-based risk assessment allows for structuring a regulatory response, not based on pre-fixed rules but by evaluating individual risks and aligning responses which are consistent with a perceived threat. This flexible framework will mitigate against increased compliance differential. Responding to larger scenarios while addressing a broader spectrum of compliance needs would essentially help achieve a more robust compliance convergence. Within a strictly rules-based system, identifying an agency offense may not mitigate all risks, as some scenarios may fall outside the range of predetermined scenarios.¹⁴¹ On the other hand, a risk-based approach creates multiple responses and is sufficiently flexible to deal with evolving scenarios.¹⁴² Thus, under risk-based systems, soft law evolves into tangible and effective compliance processes.

Hardening of the FATF's soft regulatory structure is a dynamic process, emerging from multiple sub-processes. This provides vitality to the FATF laws, while the hegemony of the few is not conducive to achieving compliance convergence. Therefore, the two competing concepts—rulemaking deficiency due to lack of

137. See Ross S. Delston & Stephen C. Walls, *Reaching Beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing Outside the Financial Sector*, 41 CASE W. RES. J. INT'L L. 85, 92–97 (2009).

138. Risk-based approach refers to the framework that a country or entity utilizes to identify and assess its AML/CFT risks and applies commensurate measures to address those risks, as described in Recommendation 1. See FATF ANNUAL REPORT, *supra* note 15, at 21; 2012 RECOMMENDATIONS, *supra* note 10, at 11 (Recommendation 1).

139. 2012 RECOMMENDATIONS, *supra* note 10, at 8.

140. The advantage of the risk-based approach comes from the target entity's ability to efficiently allocate resources in proportion to the perceived risk. This results in efficient management and adequate allocation of resources by virtue of the flexibility in consolidating against enhanced risks. See HENNIE BESTER ET AL., IMPLEMENTING FATF STANDARDS IN DEVELOPING COUNTRIES AND FINANCIAL INCLUSION: FINDINGS AND GUIDELINES 1 (2008), available at http://cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf.

141. See *FATF Clarifies Risk-Based Approach: Case-by-Case, Not Wholesale De-risking*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/rba-and-de-risking.html> (last updated Oct. 28, 2014).

142. FIN. ACTION TASK FORCE, FATF GUIDANCE: ANTI-MONEY LAUNDERING AND TERRORIST FINANCING MEASURES AND FINANCIAL INCLUSION 5 (Feb. 2013), available at http://www.fatf-gafi.org/media/fatf/documents/reports/aml_cft_measures_and_financial_inclusion_2013.pdf.

transparency and soft law effectiveness arising out of internal order—are complementing forces in the evolution of FATF laws.

V. CONCLUSION

A critical analysis of the FATF's relevance requires an evaluation of its scope and effectiveness. The FATF's scope is conceptualized through the conflict between the law's role within a jurisdiction and the social processes affecting a jurisdiction. Its effectiveness is measured through the majority jurisdictions' hegemonic subservience and the regulatory process's democratic deficit. Stepping away from hard law's definitiveness, compliance convergence is evaluated through the tension between the effectiveness of soft law versus the level of transparency in the rulemaking process.

First, the FATF's soft law suffers from negative externalities of agency capture, hegemonic subservience, and democratic deficit—all of which impact its process integrity. Further, the Recommendations and interpretive guidelines do not represent the majority of jurisdictions, and its process does not incorporate jurisdictional nuances. Thus, the FATF's recommended course of action may not always be consistent with domestic law's trajectory and any measurement for compliance is deficient.

Second, without transparency and with minority patrimony, rulemaking is not optimal. Yet, the hardening of soft law allows the FATF to be effective as a global standard-setter. External threats create an existential situation, which internalizes strict ordering within the system. This ordering and nuanced rulemaking provides substantive imprimatur of hard law within the FATF regulatory norm.

Third, the FATF's relevance should be evaluated at the dual intersection of hard law's codification via soft law's flexibility and democratic deficit within the rulemaking process. Combating money laundering and terrorist financing requires cooperation, mutual learning, and overlapping of jurisdictions. When jurisdictions do not participate due to perceived ineffectiveness of the regulatory regime, systems lose value by moving away from compliance convergence, which impacts the framework's effectiveness. In contrast, enhanced participation provides feedback for system efficiency, which brings compliance convergence. Thus, compliance convergence is manifested in a regulatory framework's accumulated efficiency, which is the result of a continuous tradeoff between the value lost due to non-participation and the value gained through enhanced participation. It is through this prism of compliance convergence that we must view the FATF regime's overall success.