

The Internationalization Of Anti-Money Laundering and The Compliance Of States

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Abstract

Money laundering has a cross-border character and multifaceted nature of criminal activities. In responding to it, trend in anti-money laundering strategy has moved from a domestic to an international level. This trend was marked by the establishment of international legal instruments which were manifested into the internationalization in preventing and controlling this type of crime. At the same time, international standards as well as global regulations have also emerged into global administrative laws and institutions. The question is how far those countries that are involved in the formulation of the international standards have complied with their obligations? This article takes an analytical approach towards the internationalization of anti-money laundering and some of the key issues surrounding the compliance of states. This research was done by using a normative legal approach, sources of data used in this study are primary and secondary legal resources. This research has concluded the internationalization is one of dynamic aspects of anti-money laundering in responding the global character of money laundering practices. Through this feature, anti-money laundering has manifested into 'international standards' which involve binding and non-binding rules

Key words : Internationalization, compliance, anti-money laundering

Abstrak

Pencucian uang memiliki sifat lintas batas dan multi aspek dari kejahatan. Untuk menanggapi hal tersebut, tren dalam strategi anti pencucian uang telah berpindah dari tingkat domestik ke tingkat internasional. Tren ini ditandai dengan ditetapkannya instrumen hukum internasional yang dimanifestasikan ke dalam internasionalisasi dalam mencegah dan mengendalikan jenis kejahatan ini. Pada saat yang bersamaan, standar internasional maupun peraturan global juga telah tumbuh menjadi hukum dan lembaga administratif global. Pertanyaannya adalah seberapa jauh negara-negara yang terlibat dalam perumusan standar internasional tersebut telah mematuhi kewajiban mereka. Artikel ini menggunakan pendekatan analitis terhadap internasionalisasi anti pencucian uang dan beberapa permasalahan pokok sekitar kepatuhan negara-negara tersebut. Penelitian ini dilakukan dengan menggunakan pendekatan hukum normatif. Sumber data yang digunakan dalam kajian ini adalah sumber-sumber hukum primer dan sekunder. Penelitian ini menyimpulkan bahwa internasionalisasi merupakan satu dari aspek-aspek dinamis anti pencucian uang dalam menanggapi karakter global dari praktek-praktek pencucian uang. Melalui fitur ini, anti pencucian uang telah bermanifestasi menjadi standar internasional yang meliputi peraturan-peraturan yang mengikat dan yang tidak mengikat.

Kata kunci: Internasionalisasi, kepatuhan, anti pencucian uang

Introduction

Trends in money-laundering activities have been moving from conventional to more sophisticated methods. The development of these trends might be split into four categories based on its type, scope, perpetrator, and modus operandi. The first category is marked by the extension of predicate offences underlying the crimes of money laundering - from drug-related crimes to all serious crimes. The development of the second category concerns the movement of money launderers, from individuals that are operationally restricted in one jurisdiction to internationally organized criminals that operate on a global scale. The third category is developed by the movement of perpetrators from 'blue-collar criminals' such as drugs-traffickers, arms smugglers, and human traffickers, to 'white-collar criminals' which involves lawyers, accountants, notaries and other legal professions. The final category concerns the development of modus operandi, which is shifting from real crimes to the cyberspace crimes.

The emergence of new techniques for the laundering technique as described above has been responded by anti-money laundering in preventing and countering this type of crime. In connection with this reality, it can be said that there is a relationship between money-laundering practices and the level of anti-money laundering. On the one hand, money laundering practices have been significantly increasing following the development of technology. On the other hand, anti-money laundering has been adjusted with technological development as well as the increase of the laundering techniques. The more sophisticated laundering practices, the more sophisticated anti-money laundering. As well, the more sophisticated and completed anti-money laundering are, the more new techniques of laundering methods. One of the dynamic aspects of the anti-money laundering in responding the development of money laundering practices is the internationalization of this regime.

Problems Statement

The internationalization of anti-money laundering is aimed at raising the issue of money laundering to an international level in order to response the global character of this crime. The interdependence and interrelationship among countries in preventing and combating money laundering are necessary in this regard. This means that it indicates the need for states to cooperate with each other. One critical

aspect of the internationalization of anti-money laundering is the setting of norms and international standards¹ in preventing and countering money laundering practices. The question is how far those countries that are involved in the formulation of the international standards have complied with their obligations?

Aim of Research

This study elaborates on the internationalization of anti-money laundering and how the compliance of states in this matters. The key idea developed shows the internationalization of anti-money laundering is a response to the cross-border character of money laundering criminality. This study sketches out the concept of internationalization (section VA), analyzes the internationalization of anti-money laundering (section VB), and examines the compliance of States with anti-money laundering with details States compliance with the binding and non-binding rules (section VC). This study ends with conclusion (section VI).

Research Methods

By using a normative legal approach, sources of data used in this study are primary² and secondary³ legal resources. Primary legal resources involve conventions, agreements, and regulations. Secondary legal resources include textbooks, journal articles, periodicals, and working papers. This study reviews extensive literatures and databases of the legal and regulatory framework. To analyze the focus of the problem, it examines the internationalization of anti-money laundering regime and the compliance states with the regime.

¹ 'Standard' is generally understood to be a 'guide for behavior and for judging behavior'. Standards may be established by authority or gradually evolve by custom or consensus. See Herbert V. Morais, "Globalization and Sovereignty: The Quest for International Standards; Global Governance vs. Sovereignty". *Kansas Law Review*, Vol.50, 2002. See also Kenneth W Abbott & Duncan Snidal. *International 'Standards' and International Governance*. *J. Eur. Pub. Pol'y*, Vol.8, 2001, p. 345.

² Primary legal resources consist of the authoritative records of the law made by law-making authorities. See Enid Campbell, E.J. Glasson, Ann Lahore, *Legal research: Materials and Methods*, 2nd Edition (Sydney: Law Company Book Limited, 1979), p. 1. See also J. Mayron Jacobstein, Roy M. Mersky, and Donald J. Dunn, *Fundamentals of Legal Research*, Sixth Edition (New York: the Foundation Press INC, 1994), p. 10. See also Suzanne E. Rowe, "Legal research, Legal Writing, and Legal Analysis", 29 *Stetson L. Review*, 1999-2000, p. 1197-8.

³ Secondary legal resources comprise all the publications that pertain to law but which are not themselves authoritative records of legal rules. See Enid Campbell, *Ibid*; See also J. Mayron Jacobstein, Roy M. Mersky, and Donald J. Dunn, *Ibid*.

Discussion

The Concept of Internationalization

'Internationalization'⁴ has often been understood synonymously with other existing concepts such as 'globalization'⁵ and 'international standards'.⁶ Internationalization occurs when public or private conducts their cooperative activities beyond national borders. In the context of money laundering, 'internationalization' refers to the effort to raise the issue of money laundering into an international level. The significance for the internationalization of the anti-money laundering is to response the transnational character of money laundering practices. An essential reason for expanding the issue of money laundering to an international level is because this type of crime creates transnational threats in nature and multidimensional problems in practice.⁷ The former is the case because the crime is committed across the boundaries of multiple jurisdictions. In the process of money laundering, criminals move their illicit funds through several accounts and/or financial institutions worldwide to distance the funds from their illegal sources. Multi-dimensional problems are those where the crime of money laundering is dynamic in which the money can flow to various financial institutions in a domestic area as well as abroad.

A central objective in managing the control of money laundering internationally is to make the same vision, mission, and strategy among countries. Another objective

⁴The prefix 'inter' of 'internationalization' comes from a Latin word which originally means 'between, mutual'. See Futao Huang, *Internationalization of Higher Education: Discussion about Its Definitions*, see <http://www.gcn-osaka.jp/project/finalreport/1/1-2e.pdf>.

⁵'Globalization' refers to a set of process leading to the integration of economic, cultural, political, and social systems across geographical boundaries. In more concrete, 'globalization' is described as continuous increase of cross-border financial, economic, and social activities. Or it refers to the process of growing interdependency among events, people, and governments around the world. See <http://www.hswebdepot.org/imstool/GEMI.nsf/WEBDocs/Glossary?> See also Wolfgang H. Reinike and Jan Martin Witte, "Challenges to International legal System; Interdependency, Globalization, and Sovereignty: The Role of Non-binding International Legal Accords", in Dinah Shelton (Ed), *Commitment and Compliance: The Role of Non-binding Norm in the International Legal System*, Oxford University Press, New York, 2000, p.75; Herbert V. Morais, "Globalization and Sovereignty: The Quest for International Standards: Global Governance vs. Sovereignty", 50 *Kansas Law Review*, 2002, p. 781; Kenneth W. Abbott & Duncan Snidal, "International 'Standards' and International Governance", 8 *J. Eur. Pub. Pol'y*, 2001, p. 345. The similar meaning and using interchangeable between 'globalization' and 'internationalization' also proposed by Heba Shams. See Heba Shams, *Legal Globalization: Money Laundering Law and Other Cases*, International Financial Law Series, 2004, p. 10, 62, 63, 64, 65, 100.

⁶'Standard' is understood to be a 'guide for behavior and for judging behavior'. 'International standards' is intended to connote some universally, or at least generally accepted, canons of behavior for states, corporations and individuals in the conduct of business and financial affairs. See Herbert V. Morais (2002), *Ibid*. See also Kenneth W. Abbott & Duncan Snidal (2001), *Ibid*, p. 345.

⁷Heba Shams (2004), *Supra* note 3, p. 23.

is to facilitate international cooperation in preventing and combating this type of crime. For instance, if one country considers money laundering as a crime but another country does not, it is not easy to hold cooperation. The same condition also applies where the two countries do not have the same predicate offence(s) underlying the crime of money laundering. As such, countries that carry out cooperation, such as extradition or mutual legal assistance, have to meet the principle of *dual criminality* in which the offence is a crime in both requesting and requested countries. Despite these differences, bringing anti-money laundering under international control is an essential one.

The Internationalization of Anti-Money Laundering

The internationalization of anti-money laundering has been marked by the establishment of the United Nations Vienna Convention⁸ and the Basle Committee on Banking Regulations⁹. The former refers to the internationalization of the penal aspect of money laundering, while the latter addresses to the internationalization of the principle of financial regulations against the use of the financial sectors for money laundering purposes. In broadest sense, Gilmore describes these two international instruments as “a twin tract solution of the problem of money laundering; on the one hand it calls for the strengthening of the criminal law since it is widely acknowledged that the principle burden must be carried out by invoking penal means; and on the other hand, it is generally accepted that the financial system can and must play an effective preventative role”.¹⁰ It is not the exaggeration, therefore, that these instruments regarded as one of the most significant factor in the considerable development of anti-money laundering regime internationally.

Citing Baldwin and Munro, Gilmore describes that the UN Vienna Convention established a basis for placing international controls and setting the standard for international efforts on money laundering.¹¹ As the internationalization of the penal aspect of money laundering, the Vienna Convention obliged each participating state to criminalize the laundering of drugs proceeds. This convention has a binding authority to which each state party is bound. Even though its scope is limited to the drugs-related

⁸The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988.

⁹Statement of Principles for the Prevention of Criminal Use of Banking Systems for the Purpose of Money Laundering, 1988.

¹⁰William C. Gilmore, 1983, “Money Laundering: The International Aspect”, in David Hume Institute, *Money Laundering*, Hume Papers on Public Policy, Vol.1, No.2, Edinburg University Press, p. 2.

¹¹*Ibid.*, p. 3-5.

crimes as predicate offences for money laundering, the convention plays a significant role in raising the issue of money laundering to an international level. Subsequently, the convention has served as the basis for intergovernmental initiatives (such as the G7 Financial Action Task Force) and other international agreements (such as the Strasbourg Convention, the Palermo Convention, and the EU Directive). In addition, the convention also laid a foundation to promote cooperation in relation to the confiscation, extradition, and mutual legal assistance. As such, it is a sensible if Morgan points out that the Vienna Convention is 'a uniform international effort' in combating money laundering criminality.¹²

The scope of the Vienna Convention is to oblige parties to criminalize and confiscate drug trafficking and money laundering as well as to provide international cooperation in all aspects of investigation, prosecution, and judicial proceedings, including extradition and mutual legal assistance.¹³ Article 3(1)(a) regulates the criminalization of illicit drugs and psychotropic substances. This article obliges each party to establish as criminal offences under its domestic law a comprehensive list of activities involved in drugs-trafficking. This includes production, manufacture, cultivation, possession or purchase of any narcotic drugs or psychotropic substances. This article also includes manufacture, transportation, or distribution of any equipment, materials or substances, knowing that they are to be used to manufacture illicit drugs. In addition, this article also required each party to criminalize the organization, management, or financing of the drug offences enumerated in the convention.

The criminalization of money-laundering is mentioned in article 3(1)(b). In this article, the term 'money-laundering' is defined in three ways: first of all, the conversion or transfer of property, knowing that such property is derived from [drugs] offence for the purpose of concealing or disguising the illicit origin of the property or of assisting any other person who is involved in the commission of [a drugs] offence to evade the legal consequences of his actions; secondly, the concealment or disguise of the true nature, source, location, disposition, movement or ownership of property, knowing that such property is derived from [a drugs] offence and from an act of participation of such offence; and thirdly, the acquisition, possession or use of property, knowing at the time of receipt, that such property was derived from [a drugs] offence.

¹²Matthew Morgan, "Money Laundering: The American Law and its Global Influence", L. & Bus. Rev. Am. 24, 1995, p. 7.

¹³ In this convention, the two essential components of the strategy to combat drug trafficking are the criminalization of money-laundering and the confiscation of criminal proceeds.

In the mean time, the Basle Committee, which deals with the regulation of the financial system, is not a binding arrangement. The Committee issued guidelines which members are encouraged to apply. It introduced a general rule to encourage ethical standards of professional conducts among banks and other financial institutions to put in place effective procedure to ensure the following matter: 'that all persons conducting business with their institutions are properly identified; that transactions that do not appear legitimate are discourage; and that cooperation with law enforcement agencies is achieved'.¹⁴

In the context of the internationalization of money laundering law, the Basle Committee has a role in preventing banks and other financial institutions globally from being used as a channel for money laundering. The 'know your customer' principle is a monumental issue of the Basel Committee that is very relevant in detecting and preventing money-laundering effectively. The implementation of this principle was developed by the Financial Action Task Force (FATF) and other legal instruments. Two main features of the Basle Committee approach to the problem of money laundering are 'Statement of Principles for the prevention of criminal use of banking systems for the purpose of money-laundering'¹⁵ and 'Minimum standards for the supervision of international banking groups to emphasize the need for more consolidated supervision'¹⁶.

The Statement of Principles is the first international agreement introduced the term of 'money laundering' in international level. The Statement is intended to prevent financial institutions from associating with criminal activity, and, thus, to maintain the integrity of the banking system.¹⁷ The Statement contains ethical standards of professional conducts among banks and other financial institutions which encourage them to adopt policies and practices consistent with the Statement. What should be done by the financial institutions is conducting the identity of their customers and close any accounts if there is a suspicion that the banking system has been used for money laundering purposes. Furthermore, financial institutions should keep records of transactions and provided training for their staff in order to assist these goals.

¹⁴See Preamble, 6th recital.

¹⁵It is issued on December 1988; hereinafter the Statement of Principles.

¹⁶It is issued in 1992; hereinafter the Minimum Standards

¹⁷Statement of Principles for the Prevention of Criminal Use of Banking Systems for the Purpose of Money Laundering, Preamble 3.

The Minimum Standards, meanwhile, was formed in responding the rapid growth of international banking activities. The purpose of these is to ensure that all banks conducting international financial activities are properly supervised by a single authority.¹⁸ The single authority has all the information necessary to exercise that supervision effectively. The Minimum Standards set forth guidelines that provide a host country's banking regulators with the right to obtain information from international banks. Under the standards, if the host country determines that an international bank fails to meet the standards, then the host country's regulator may impose sanctions.¹⁹

Anti-Money laundering and the Compliance of State

Defining Compliance

In reviewing the literature, there are various theoretical definitions and multiple meanings of 'compliance'. In a broader context, the term 'compliance' literally means 'the act of complying with a wish, request, or demand; obedience to a request, command, etc'²⁰; or 'the willingness to do what you have been asked to do'.²¹ In relation to state behavior, compliance refers to a 'state of being consistent with international standards or agreements'.²² Compliance can also be described as 'a situation where a state is abiding by its obligations under an agreement'.²³ This means that compliance is concerned with 'factual matching of state behavior and international norms'.²⁴ Compliance can also be defined as 'a state of conformity or identity between an actor's behavior and specified rule',²⁵ or 'whether countries in fact adhere to the provision of what they accord and to the implementation measures that they have instituted'.²⁶

Whichever definition is formulated, compliance comprises three basic elements: 'actor', 'behavior', and 'norm'. 'Actor' refers to the states or non-state entities that

¹⁸ Basle Committee Report on Minimum Standards for the Supervision of International Banking Groups and their Cross-border Establishment, Reprinted in International Economic Law Documents, I.E.L. II-1 (1992).

¹⁹ *Ibid.*

²⁰ The Oxford Encyclopedic English Dictionary, Oxford University Press, 1991, p. 299.

²¹ Collins Cobuild English Language Dictionary, London & Glasgow, 1987, p. 284.

²² Cheryl E. Wasserman, "An Overview of Compliance and Enforcement in the United States: Philosophy, Strategies and Management Tools", See <http://www.inece.org/1stvol1/wasserman.htm>.

²³ Trevor Findlay, "WMD Verification & Compliance: The State of Play, A Study for Foreign Affairs Canada", London, 2004, p. 2.

²⁴ Dinah Shelton, ed, 2000, *Commitment and Compliance: The Role of Non-Binding Norms in International Legal System*, Oxford University Press, New York, p. 5.

²⁵ Benedick Kingsbury, "The Concept of Compliance as a Function of Competing of International law", Michigan Journal International Law, Vol.19, 1998, p. 345.

²⁶ Jacobson, HK and Brown Weiss, E, "Compliance with International Environmental Accord", 1 Global Governance, 1995, p. 119.

conclude international agreements and then implement and enforce them in their actual behavior.²⁷ 'Behavior' refers to the action of the actor undertaken to conform to the international obligation in question on the domestic level.²⁸ 'Norm' refers to the standard or specification to which the actor has to comply.²⁹ The question to be asked is when does compliance take place?

Oran Young in his book *Compliance and Public Authority* pointed out that 'compliance occurs when the actual behavior of a given subject conforms to prescribed behavior, and non-compliance or violation occurs when actual behavior significantly differs from prescribed behavior'.³⁰ In the meantime, Shihata distinguished two categories of compliance, namely, formal compliance and substantive compliance.³¹ According to him, formal compliance occurs when states enter into an international agreement, while substantive compliance takes place when a state adopts the international agreements and implements them in its domestic legal system.

Assessing States Compliance with Anti-Money Laundering States Compliance with the Binding Rules

Compliance concerns both state and non-state entities. With regard to the state, compliance refers to a state's adherence to international obligations. If any state ratifies an international agreement, as a consequence, it should comply with the obligations accorded in the agreement. Whether a state complies with its obligations, it can be checked by observing it after ratification. Two actions that the state should take after ratifying an agreement are, firstly, harmonizing its domestic laws by drawing up new ones or amending the existing ones in order to make them consistent with the international agreements, and secondly, implementing and enforcing those instruments in its domestic legal system. However, it is not always the case; some states comply with their obligation, but others do not.

State compliance exists on an international as well as a domestic level. On the international level, state compliance might be measured by identifying to what extent

²⁷In a greater concept, actors not only refer to the states, but also to the firms and individuals.

²⁸In this context, theories of compliance are useful for understanding compliance related behaviour and the reason behind the behaviour.

²⁹Norms in this context could be referred to the international and domestic compliance. The first is about the behaviour of state; about how and why they comply with norms. The second is focused on the behaviour of firms and individuals.

³⁰Oran Young, 1979, *Compliance and Public Authority: A Theory with international Application*, John Hopkins, University Press, p. 2-3.

³¹Ibrahim F.I. Shihata, "Implementation, Enforcement, and Compliance with International Environmental Agreements – Practical Suggestions in Light of the World Bank's Experience", the *Georgetown International Environmental Law Review*, Vol. 9, 1996, p. 37.

any state participates in concluding international agreements, and to which level it complies by internalizing these agreements into its domestic legal system. On the domestic level, state compliance might be measured by asking the question, to which level does a state take the implementation and enforcement of its international obligations?

With regard to anti-money laundering, state compliance might be measured by assessing the legal instruments that govern this regime. From a general point of view, there are two kinds of legal instruments regulating the regime of anti-money laundering, namely, binding and non-binding rules. The former refers to the international treaty obligations concluded by countries, while the latter refers to the various recommendations, codes of conducts, guidance, and regulatory principles issued by international or intergovernmental organizations. Binding rules in the anti-money laundering were drawn up during the United Nations Drug Convention of 1988, the Strasbourg Convention of 1990, the Palermo Convention of 2000, the Financing of Terrorism Convention of 2001, and the Convention against Corruption of 2003. Non-binding rules were set up by the Basel Committee on Banking Regulation and the Financial Action Task Force on Money Laundering.

The binding rules of the anti-money laundering regime consist of preventive and repressive measures. The preventive measures aim to prohibit the occurrence of specified crime underlying the crime of money laundering such as drugs-related crime, organized crime, and corruption; or to prohibit the laundering of the proceeds of the crime itself. The underlying crime of money laundering generates illicit funds that are necessary to be whitewashed. The implementation and enforcement issues of binding rules are crucial elements in controlling and fighting money laundering criminality. However, the binding rules are not easy to enforce because of a lack of coercive enforcement mechanisms in this regard. In implementing and enforcing the binding rules, much depends on the consciousness of member States. Sometimes sanctions can be imposed on the States that do not comply with the convention, such as military, economic, membership or unilateral sanctions. However, the application of those sanctions is costly and, in the end, it will raise the question of legitimacy.

The implementation of the UN Drug Convention in controlling and fighting drug trafficking is one example which shows how difficult it is to implement and enforce the binding rules. More than 167 countries ratified the Convention.³² However, the

³²Rodrigo Yepes-Enrique and Lisa Tabassi, Eds, Treaty Enforcement and International Cooperation in Criminal

compliance of states concerning its implementation is still highly questionable. Some states are reluctant or simply unwilling to comply with the convention's obligations even though they have criminalized drug trafficking and money laundering in their domestic legal systems. Several countries were also found to be failing to comply with the duties imposed by the convention. The consequence of non-compliance by several countries will affect the efficacy of the convention. As a matter of fact, there is a significant positive correlation between the compliance of States and the level of success of the prosecution and conviction of money laundering criminality. These facts show us that the binding rules of the anti-money laundering are still on the level of what Shihata³³ called 'formal compliance', and has not reached the level of 'substantive compliance'.

States Compliance with Non-Binding Rules

The Basel Committee and the FATF Recommendations with their non-binding rules, on the other hand, play a significant role in preventing money laundering. The question is why, in the case of money laundering, non-binding or voluntary rules are more effective than the binding rules. The answers to this question are, firstly, that the powerful States are concerned about the phenomenon of money laundering and use an extraterritorial regulatory authority to give a sanction to the countries that do not comply. Secondly, the monitoring and controlling system of the FATF are very effective for both its member and non-member countries. The third reason is that countries that are unwilling or reluctant to cooperate in implementing the Forty Recommendations are coerced to do so. Finally, the non-binding rules are supported by some conventions as binding instruments.

Regarding the first reason, it is the strong and concentrated interest of most industrialized countries to detect and discourage money laundering activities. In this context, Weiss pointed out that 'the leader countries have significant roles in negotiating international agreements and promoting compliance'.³⁴ The effort of the leader countries in preventing money laundering was marked by the establishment of the FATF in 1989. In relation to the second reason, the monitoring and controlling

Matters, the Hague: TMC Asser Press, 2004, p. 609.

³³Formal compliance occurs when states enter into an international agreement. See Ibrahim F.I. Shihata (1996), *Supra* note 29.

³⁴Edith Brown Weiss, "Conclusion: Understanding Compliance with Soft Law" in Dinah Shelton (2000), *Commitment and Compliance*, *Supra* note 22, p. 549. Drezner noted that the members of the G7 have great powers in financial regulation. See Daniel W. Drezner, "Clubs, Neighborhoods and Universe: The Governance of Global Finance", University of Chicago, 2003, p. 5.

system implemented by the FATF supports countries in obeying the elements of the FATF Forty Recommendations. International mechanisms for monitoring, supervision, and evaluation are manifest in three types of enforcement mechanisms, namely, self-assessment, mutual evaluation and the NCCT (Non Cooperative Counties or Territories) initiative.³⁵ The third reason is concerned with sanctions for non-compliant States. The FATF provides various sanctions, such as termination of the FATF's membership, the application of recommendation 21, such as being included in a blacklist for non-member states published by the FATF, imprisonment for natural persons, and a fine for non-state entities. Finally, non-binding rules are very effective in upholding the anti-money laundering because they are supported by treaties and other sources of international law. The FATF Forty Recommendations, for example, are derived from several treaties with international ratification.

It is at this point where the reasons why States comply with the non-binding rules of anti-money laundering are explored. Questions will arise as to the compliance of non-member States even though the standards are non-binding or are voluntary rules, and the States concerned are not involved in the legislative-process of the standards. In the theoretical framework, by examining the case of anti-money laundering, Hulsse and Kerwer try to explain this question. They argued that two crucial factors motivating non-members to follow non-binding rules are legitimacy through expertise and third party power (coercion).³⁶ In other words, these two features are the major explanations for how these standards work.

The first feature is legitimacy through expertise. Hulssee and Kerwer pointed out that standards are defined as 'specialized or expert knowledge'. Borrowing from Jacobsson (2000), they noted that 'standards are expert knowledge stored in the form of rules'.³⁷ To put it differently, they cited from Hallstrom (2004) which explained that 'standard-setters incorporate expert knowledge by adopting organizational procedures that ensure that experts from various fields participate in the standard setting process.'³⁸ If it is implemented to anti-money laundering, four empirical exercises that prove that the FATF standards are legitimized by expertise are: the

³⁵ Self-assessment happens by means of the report of every member state regarding the implementation of the Forty Recommendations in its territory. Mutual evaluation concerns the evaluation of a team to the member countries regarding the implementation of these Recommendations in their domestic legal system. Finally, the NCCT initiative aims to assess the level of compliance of non-members in implementing the FATF Forty Recommendations.

³⁶ Rainer Hulsse and Dieter Kerwer "Global Standards in Action: Insights from Anti-Money Laundering Regulation". *Organization*, Vol. 14(5), 2007, p. 629.

³⁷ *Ibid*, p. 629.

³⁸ *Ibid*.

FATF plenary meeting, the FATF typology meeting, the mutual evaluation for members, and the NCCT initiative for non-members. FATF plenary meetings, held three times a year, are a forum for taking decisions and for processing the creation of rules, which are presented as being expert-grounded.³⁹ Similarly, FATF typology meetings, which are emphasized in academic literature, also consider it as being expert-grounded.⁴⁰ Mutual evaluation, an assessment of the implementation of the Forty Recommendations by the FATF members, is also claimed to be expert-grounded.⁴¹ Finally, the expertise base is also a signal to exercise non-members that have not met the FATF standards, categorizing them as non-cooperative countries and territories.

The second feature is third party power or coercion. According to Sharman, a third party may refer to an international organization, ad hoc coalition of states, or to private entities.⁴² Even though the nature of the international standards is voluntary, members of the organization could coerce non-members to comply.⁴³ In the same vein, for political scientists, the reason that non-members to comply is because of force.⁴⁴ According to Hulsse and Kerwer, the FATF's rules are voluntary on paper, but compulsory in practice. The elaborated evidence that supports this statement is as follows: In 1999 FATF decided to evaluate non-members' anti-money laundering performance and, if necessary, take countermeasures against countries unwilling to cooperate. This more aggressive stance resulted in the publication of a black-list of Non-Cooperative Countries and Territories (NCCT) in 2000s. Should these countries fail to change their anti-money laundering policies, FATF threatened that it would encourage its members to apply sanctions against the NCCY countries (Winer 2002:45; Kern 2001:243). The sanction feared most by financial havens was that the U.S. denies access to its financial system. An coercion worked: when the black-list was first published, 15 countries were named and shamed, and 8 more were added later, but only 2 of them (Myanmar and Nigeria) remain on the list in June 2006.

³⁹The first annual report, for example, notes that "more than one hundred and thirty experts from various ministries, law enforcement authorities, and bank supervisory and regulatory agencies, met and worked together." See Annual Report 1989-1990, p. 3. See also Rainer Hulsse and Dieter Kerwer, *Ibid*, p. 631.

⁴⁰See FATF Annual Report 1998-1999, p. 6.

⁴¹See FATF Annual Report 1998-1999, p. 9.

⁴²J.C. Sharman, "The Global Anti-Money Laundering Regime and Developing Countries: Dammed if They Do, Dammed if They Don't?", Paper on Government and International Relations, University of Sydney, NSW, Australia, 2006, p. 9.

⁴³Daniel W. Drezner, "Who Rules? State Power and the Structure of Global Regulation", University of Chicago, 2002, p. 26, 28 and 32.

⁴⁴Rainer Hulsse and Dieter Kerwer, "How Standards Rule the World: The Case of Money Laundering", Paper, August, 2006, p. 14.

Apparently, the NCCT-practice has been successful in securing nonmembers' compliance with the-40 Recommendations (Drezner 2003:17-18). FATF itself finds that "overall, the NCCTs exercise has proved to be a very useful and very efficient tool to improve worldwide implementation of the FATF 40 Recommendations (FATF 2005). Non members, to put it in a paradox, are forced to comply voluntary. Anti-money laundering is considered a compulsory power story (e.g., Drezner 2003:17-18, Winer 2002:45, Kern 2001:243).⁴⁵

Non-member States that do not comply with the FATF standards risk being put on a 'blacklist' by the FATF. In addition, non-compliant States will face disinvestment pressures and limited access to international financial networks.⁴⁶ As a consequence, they have to pay significant costs for their economic activities,⁴⁷ such as the cost of transactions which compensate for the competitive advantage of the financial institutions located in the non-cooperative country or territory,⁴⁸ or the avoidance of penalties imposed by the regulators of non-compliance.⁴⁹ To legitimize its policy, the FATF collaborates with international organizations such as the IMF and the World Bank to create and implement global anti-money laundering to non-members. As an organization which has a universal membership, the IMF and the World Bank has a privileged position to pressure developing countries to create a domestic anti-money laundering regime. Here in this context, there is political pressure that leads countries to adopt the FATF Forty Recommendations.⁵⁰ However, if non-member states comply with those standards, they also have to face significant costs in having to implement those standards in their legal systems.⁵¹

⁴⁵Reiner Hulsse and Dieter Kerwer (2006), *Ibid*, p. 14.

⁴⁶Rainer Hulsse and Dieter Kerwer (2007), *Supra* note 36, p. 628.

⁴⁷Sharman noted, that "Shortly after Trinidad and Tobago included on the blacklist, the Bank of New York, Bank of America, Chase Manhattan, and HSBC all terminated their correspondent banking relations with Antiguan institutions. Those banks that continued to provide correspondent banking services raised their fees by 25 per cent, on the ground that they had to take extra precautions against illegal money. As consequence, the number of offshore banks from 72 at the end of 1998 to 18 in December 2000 and 15 in 2003, causing decline in government revenue and job losses". See J.C. Sharman (2006), *Supra* note 40, p. 11.

⁴⁸FATF Report 1991, p. 45.

⁴⁹Jackie Harvey, "Compliance and Reporting Issues Arising for Financial Institutions from Money Laundering Regulations: A Preliminary Cost and Benefit Study", *Journal of Money Laundering Control*, Vol.7, No.4, 2004, p. 336.

⁵⁰Mariano-Florentino Cuellar, "The Mismatch Between State Power and State Capacity in Transnational Law Enforcement", *22 Berkeley Journal of International Law*, 2004, p. 32.

⁵¹Sharman categorized three types of costs, namely, direct cost, indirect cost and opportunity cost. The implementation of AML regime impacts to the direct costs (the enforcing of the AML/CFT regulations to US and European financial firms have been estimated at over \$5 billion), indirect costs (it is harder for people to open bank accounts, transfer money across borders and set up charities), and opportunity costs (for example, when Africa and Caribbean government divert money from an anti-AIDS programme to meet FATF standards). See Sharman, *Supra* note 40, p. 5-8.

It is a dilemma for non-members, which are mainly developing countries, putting them in a difficult position to comply or not to an anti-money laundering: costs of compliance and risks of non-compliance.⁵² Borrowing from Sharman, the position of non-member states can be described as, 'dammed if they do, and dammed if they do not'.⁵³ In sum, Sharman concluded that 'coercion is obviously significant in the rapid growth of the AML regime worldwide even though its implementation is expensive and of dubious effectiveness'.⁵⁴ In light of the success of coercion on non-members, he noted that 'this confrontational tactic violated norms of international behavior and raised troubling issues of double standards between members and non-members'.⁵⁵ Those statements are based on the fact that the United States, Canada and Australia - members of the FATF - have often received very poor evaluations in terms of their compliance with the FATF Recommendations, but have never been included in the black list.⁵⁶ Citing from Blackman, Alldridge points out the fact that the United States has consistently been assessed as not meeting the FATF standards and even falling below the standards of some countries listed in the NCCT.⁵⁷ It is at this point that the coercion strategy to the non-member countries tends to be a political character.⁵⁸ It is now even said by some commentators that the evaluation process of member states such as mutual evaluation is a highly political character.⁵⁹

Conclusion

The internationalization is one of dynamic aspects of anti-money laundering in responding the global character of money laundering practices. Through this feature, anti-money laundering has manifested into 'international standards' which involve binding and non-binding rules. The binding rules were drawn up during the Vienna

⁵² Sharman, *Ibid.*

⁵³ *Ibid.*

⁵⁴ *Ibid.*, p. 5, 9. See also Eric Helleiner, "The Politics of Global Financial Reregulation: Lessons from the Fight against Money Laundering", Working Paper No. 15, Center for Economic Policy Analysis, New School for Social Research, 2000, p. 8.

⁵⁵ *Ibid.*, p. 13.

⁵⁶ *Ibid.*

⁵⁷ P. Alldridge, "Money Laundering and Globalization", *Journal of Law and Society*, Vol.35, No.4, 2008, p. 445.

⁵⁸ An example of this point is the first NCCT process that was imposed on Russia in June 2000. However, in a short time – within three years later – Russia became a full member of the FATF. Russia had a lack of banking supervision institutions, a missing FIU system, a reluctance to cooperate with other countries in the field of information exchange and legal assistance, and especially because the FATF members regarded the free market economy including the financial sector in Russia as not satisfyingly established. See Marie Wilke, "Emerging Network Structures in Global Governance: Inside the Anti-Money Laundering Regime, *Nordic Journal of International Law*, 2008, p. 514.

⁵⁹ *Ibid.*, p. 513.

Convention, the Strasbourg Convention, the Palermo Convention, the Financing of Terrorism Convention, and the Convention against Corruption. Non-binding rules, meanwhile, were set up by the Basel Committee on Banking Regulation and the Financial Action Task Force on Money Laundering. However, the compliance of states concerning its implementation is still highly questionable.

For the binding rules, particularly the Drug Convention, each country that ratify this agreement should comply with the obligations imposed on them. However, several countries were found to be failing, reluctant, or unwilling to comply with their duties. It is not an easy task to enforce the binding rules because there is no available power of enforcement and adjudication in this regard. The implementation and enforcement of the binding rules much depends on the consciousness of the member States. Even though there is available multilateral and unilateral sanctions, but the imposition of these sanctions raise the question of legitimacy.

For the non-binding rules, developed countries which members of the G7, have significant roles in negotiating international standards and promoting compliance. Non-member countries dominated by developing countries actually do not involved in the legislative-process of the standards. However, they also have to comply with these standards as developed countries have. Two crucial factors motivating non-members to follow non-binding rules are legitimacy through expertise and third party power (coercion).

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