

Introduction to the Course: Materials for Class on Monday March 18, 2024

In Spring 2024 I am teaching this course as a compressed 2 credit course. Normally I teach the material through a three credit course that runs for an entire semester. The change means that I am making some adjustments in how I manage the course.

A course on international finance could mean a number of different things. It could focus on the law relating to international financial institutions (The IMF, World Bank, Regional Development banks such as the Inter-American development Bank), on the activities of financial firms that operate across borders and efforts to harmonize financial regulation, on issues arising out of particular international financial transactions (such as choice of jurisdiction and choice of law issues, sovereign debt), on the use of rules relating to finance to exert political control (sanctions measures, corruption), and on competition between different jurisdictions and financial centers (including issues relating to financial innovation). Money moves easily across borders, but regulation is linked to territory. This can create opportunities for firms to take advantage of differences in regulation in different jurisdictions (regulatory arbitrage) and also involves questions for policy-makers about how to define the territorial limits of their rules, including whether the rules have extraterritorial application.

For the first class of the semester I want to think about the IMF and, in particular, how the IMF works to influence policies relating to money. We're going to look at a recent paper on the IMF's work on money laundering and the control of the financing of terrorism (AML/CFT): [International Monetary Fund, 2023 Review of The Fund's Anti-Money Laundering and Combating The Financing of Terrorism Strategy \(December 5, 2023\)](#).

AML/CFT standards have been developed by the Financial Action Task Force (FATF),² which was set up in 1989 by the G7 countries to deal with money laundering,³ originally seen as

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² See <https://www.fatf-gafi.org/en/home.html>. The FATF standards are known as the FATF Recommendations. FATF recently released amendments to deal with asset recovery (including requirements for confiscation and provisional freeze and seize measures in the domestic context and measures to improve international cooperation on asset recovery) and protecting non-profits from abuse from terrorist financing.

³ <https://www.fatf-gafi.org/en/the-fatf/history-of-the-fatf.html>. The G7 is “an informal bloc of industrialized democracies—the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom (UK)—that meets annually to discuss issues such as global economic governance, international security, and energy policy. Proponents say the forum’s small and relatively homogenous membership promotes collective decision-making, but critics note that it often lacks follow-through and excludes important emerging powers.” See <https://www.cfr.org/backgrounder/what-does-g7-do>.

a way of addressing the “drug problem.” The G7 Declaration stated:

The drug problem has reached devastating proportions. We stress the urgent need for decisive action, both on a national and an international basis. We urge all countries, especially those where drug production, trading and consumption are large, to join our efforts to counter drug production, to reduce demand, and to carry forward the fight against drug trafficking itself and the laundering of its proceeds.... Accordingly, we resolve to take the following measures within relevant fora... Convene a financial action task force from Summit participants and other countries interested in these problems. Its mandate is to assess the results of cooperation already undertaken in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance.⁴

Over time the recommendations FATF issues have evolved to address new issues and techniques. For example, FATF has recently focused on virtual assets,⁵ and non-profits.⁶

In 1944, the 44 countries participating in the Bretton Woods Conference agreed on a framework to achieve peace and prosperity through economic co-operation, and to avoid another depression.⁷ The agreement led to the founding of the World Bank and the International Monetary Fund (IMF), and the IMF Articles of Agreement were signed in 1945.⁸ The purposes of the IMF set out in Art. I include the promotion of international monetary co-operation, assisting in the establishment of a multilateral system of payments and the elimination of foreign exchange restrictions, and making funds available temporarily to members. Member States are required under Art. IV to have policies to foster orderly economic growth with reasonable price stability,

⁴ G7, Economic Declaration (Jul. 16, 1989). The Declaration also identified insider trading as an issue of concern, requiring international co-operation (“ Financial activities are being increasingly carried out with new techniques on a worldwide basis. As regards insider trading, which could hamper the credibility of financial markets, regulations vary greatly among our countries. These regulations have been recently, or are in the process of being, strengthened. International cooperation should be pursued and enhanced.”)

⁵ FATF, Targeted Update on Implementation of the Fatf Standards on Virtual Assets and Virtual Asset Service Providers (Jun. 2023).

⁶ FATF, Best Practices: Combating the Terrorist Financing Abuse of Non-Profit Organisations (2023).

⁷ See, e.g., <https://www.worldbank.org/en/archive/history/exhibits/Bretton-Woods-and-the-Birth-of-the-World-Bank>.

⁸ For the Articles of Agreement see <https://www.imf.org/external/pubs/ft/aa/index.htm>.

and seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions, and the IMF engages in surveillance (bilateral and multilateral)⁹ to ensure that Member States comply with their obligations. The original fixed exchange rate system, pegged to gold, came to an end in 1973 when major currencies began to float against each other. The IMF now has 190 members.¹⁰

The IMF's work involves surveillance of its members, lending, and capacity development (technical assistance and training).¹¹ Its funds derive from Members' contributions (known as quotas), and from borrowing. Wealthier countries contribute more funds and have, as a result, greater voting power than less wealthy countries, although the IMF has adjusted its quota and governance system in order to enhance "the Fund's legitimacy and effectiveness as an impartial guardian of global economic stability."¹²

The IMF's reviews of its members include Reports on the Observance of Standards and Codes, which assess the extent to which the member States's laws conform to international standards, including standards of financial regulation. These reports are a component of the joint World Bank/IMF Financial Sector Assessment Program (FSAP) which was established in 1999

⁹ With respect to multilateral surveillance the IMF publishes regular reports, including the World Economic Outlook and Global Financial Stability Report.

¹⁰ <https://www.imf.org/en/About>. The United Nations has 193 Member States: <https://www.un.org/en/about-us>.

¹¹ The IMF's Independent Evaluation Office has concluded that the IMF's capacity development work is effective but also noted that improvements were possible. IEO, The IMF and Capacity Development, Evaluation Report 2022 at 3 ("Prioritization and the strategic framework for CD could be enhanced further. Strategic CD priorities in terms of country groups and topics are not clearly grounded in an integrated Fund-wide strategy covering surveillance, lending, and CD activities; such a strategy would make it easier to understand how the amount and allocation of CD resources—and synergies of CD with other Fund activities—are intended to support the achievement of the Fund's broader strategic goals. It would be desirable to develop clearer guidance, endorsed by the Board, on how staff should balance considerations of recipient need, recipient preferences, likelihood of success, and evenhandedness across the Fund's membership in allocating CD resources. Prioritization should also be more clearly grounded in regular assessments of the relative effectiveness and impact of different CD topics and delivery modalities in different circumstances, and clearer analysis of recipients' track records with past CD and commitment to current CD. Strategic CD reviews every five years have effectively set the agenda for enhancing Fund CD but have largely focused on internal management of CD. Key strategic questions—such as the role and relative importance of CD in different country contexts, the overall scale of CD relative to surveillance and lending, the appropriate funding model for CD, and how the CD delivery model should evolve—merit focused attention in the context of the Fund's broader institutional strategy and objectives. The upcoming CD strategy review provides an opportunity to reflect on these strategic issues, as well as follow up on this evaluation's recommendations.")

¹² IMF, IMF Quota and Governance Reform—Elements of an Agreement (Oct. 31, 2010).

to "reduce the likelihood and severity of financial sector crises."¹³ After the Global Financial Crisis the IMF decided to improve its financial surveillance to address new challenges created by the increased complexity and interconnectedness of financial systems and national economies.¹⁴ Compliance with internationally agreed standards and codes is also relevant to the IMF's assessment of its lending. IMF lending is based on certain conditions (this is known as conditionality) and the conditions can include structural conditions, which may relate to the need to make improvements in financial regulation and supervision.¹⁵

In class on March 18 we will discuss the IMF AML/CFT document. The document is an example of the IMF's focus on standards and codes, in particular the standards developed by the Financial Action Task Force (FATF). The plan is to develop some understanding of how the IMF sees and characterizes its role with respect to the development of the law in IMF member states, and also to think about why we are concerned to regulate money-laundering as a component of financial regulation (i.e. not just as a means to control organized criminal activity), and the idea of harmonization of legal rules.

As to legal harmonization—making rules in different jurisdictions the same, or similar—it can be achieved in various ways. Countries sometimes agree on binding rules established in treaties,¹⁶ or they may implement standards agreed by international organizations that are not formally binding,¹⁷ or they may transplant legal rules from another jurisdiction.¹⁸ In these two latter situations, although the adoption of new rules may not be required as a matter of law, it may be encouraged more or less forcefully by the actions of international organizations,¹⁹ other states, or trade organizations lobbying for rules they want to promote.²⁰

¹³ See World Bank, Financial Sector Assessment Program (FSAP) at <https://www.worldbank.org/en/programs/financial-sector-assessment-program>.

¹⁴ See, e.g., IMF, The IMF's Financial Surveillance Strategy (Aug. 28, 2012) at <http://www.imf.org/external/np/pp/eng/2012/082812.pdf>.

¹⁵ See, e.g., IMF, 2018 Review of Program Design and Conditionality (May 2019) at p. 39.

¹⁶ See, e.g., Inter-American Convention Against Corruption (1996).

¹⁷ Where countries amend their domestic rules to reflect the work of the FATF in developing thinking about AML/CFT rules, this is an example of implementation of formally non-binding standards.

¹⁸ See, e.g., Alan Watson., LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW (1974).

¹⁹ See, e.g., The IMF document we are focusing on this week.

²⁰ For example, the work of ISDA, the International Swaps and Derivatives Association to promote the adoption of close-out netting rules consistent with an ISDA model law. See, e.g., John Biggins & Colin Scott,

One limit on the effectiveness of legal harmonization, even where the rules are being harmonized through binding treaty provisions, is that the language in which the rules are drafted may leave scope for discretion in implementation. This is even more so in the case of international standards. However, the work of bodies like the FATF and IMF in assessing how different states have, and have not, implemented these international standards, does have an impact. The FATF identifies countries with serious weaknesses in their AML/CFT regimes in a list of high-risk jurisdictions, often referred to as a “black list” (currently The Democratic People’s Republic of Korea, Iran and Myanmar), and countries under increased monitoring, often referred to as a “grey list” including Croatia, Haiti, Jamaica, Nigeria, Gibraltar, Turkey and the UAE.²¹

Here are some notes and questions to think about to prepare for class:

Why does the IMF think that it needs to focus on AML/CFT issues?

What does the IMF mean by “financial integrity”?

Do you agree with the IMF’s assessment of the harms relating to financial integrity issues?

How are financial integrity and financial stability connected?

The IMF document suggests that it will “contribute to global policymaking by bringing the macro-criticality of financial integrity issues to the attention of the FATF (the global standard setter in this area) while proposing solutions that benefit the economies of Fund members, by

Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, the State and OTC Derivatives Market Reform, 13 *European Business Organization Law Review* 309, 327 (2012) (“ISDA and its members work with national governments to transpose so-called ‘safe harbours’ for OTC derivatives transactions and associated collateral. In short, safe harbours seek to absolve OTC derivatives contracts, and other types of financial instruments,¹²⁶ from the reach of gambling legislation and ‘automatic stays’ in insolvency, ensuring the enforceability of the Master Agreement in relation to the settlement of outstanding obligations (‘close-out netting’). The objective of safe harbours is to facilitate the smooth execution and settlement of OTC derivatives contracts, irrespective of whether the intention of the parties to the agreement is to hedge or speculate and irrespective of whether one of the parties to the agreement becomes insolvent.”)

²¹ <https://www.fatf-gafi.org/en/countries/black-and-grey-lists.html>. Cf. Mark T. Nance, *Re-thinking FATF: An Experimentalist Interpretation of the Financial Action Task Force*, 69 *Crime, Law and Social Change* 131-152, 142 (2018) (“There is a clear pattern within the blacklisting process, a process that many see as vital to FATF’s operation, whereby members alter it in light of perceptions about the challenges of implementation... .blacklists in FATF more generally have been applied only when the state or jurisdiction in question has stopped engaging the reform process.”)

continuing to conduct AML/CFT assessments, as well as participating in assessments led by others, by reviewing draft reports for quality and consistency, training assessors and countries' authorities, and providing CD in coordination with other providers." (at p. 7) These are ambitious goals.

How effective do you think the IMF's AML assessments are likely to be (remember the IMF has 190 member states)? The IMF has 2400 employees,²² but also employs a number of specialized experts on short-term assignments.²³ Note, on p 15: "Staff has been able to raise financial integrity policy issues in a more consistent manner in the context of the yearly or biennial AIV consultations—especially when compared to AML/CFT assessments that are undertaken on an eight to 10-year cycle under the current FATF Global Network assessment cycle."

On p. 8 the document refers to various sources of data the IMF will use in thinking about risks to financial integrity, including data on unusual cross-border financial flows.

The document compares and contrasts AML and CFT: the threats differ, the people who may be involved are different, and the consequences are different. Why, then, do you think that the FATF (and therefore the IMF) think about AML and CFT together?

The IMF's focus on financial integrity issues has become more significant as a component of surveillance since 2018 (see, e.g., p 13) for a number of reasons, including scandals, and difficulties for some countries in maintaining correspondent banking relationships (CBRs) because of financial institutions' risk assessments (derisking).

Note the references on page 14 to the expansion of issues in this area (e.g. beneficial ownership, crypto assets, citizenship by investment, proceeds of corruption, tax evasion, foreign direct investment).

IMF staff participate in the FATF assessment process (see, e.g., p 25-9). The FATF now focuses not just on the law on the books ("the assessment of the country's legal and regulatory framework against the FATF Recommendations" (p 25)) but also on the effectiveness of AML/CFT outcomes given the relevant risks. Responsibilities for these assessments are shared out: "Pursuant to a longstanding agreement and to ensure that there is no duplication of efforts,

²² <https://www.imf.org/en/About/corporate-responsibility-sheet>.

²³ <https://www.imf.org/en/About/Recruitment/working-at-the-imf/short-term-expert-assignments>.

the global assessment burden is divided between the FATF, FSRBs,²⁴ the IMF, and the World Bank. The Fund assesses some of its member countries' AML/CFT framework upon request³⁷ and focuses primarily on countries with systemically or regionally important financial sectors or high ML/TF risks." (P.25) The IMF says the emphasis on effectiveness makes assessments more complex and has resource implications.

²⁴ FATF-Style Regional Bodies. See <https://www.fatf-gafi.org/en/countries/global-network.html>.