FINANCIAL TRANSPARENCY COALITION

Who Makes the Rules on Illicit Financial Flows?

Six Financial Institutions You've Never Heard of...

POLICY BRIEF

It is prevailing wisdom that a country's head of state, minister of finance, or other elected officials would be the ones setting the rules of its financial system. Taxation, finance and monetary systems are cited as the quintessential "sovereign" issues, where a state exercises full control. But this is not always the case. While national-level leaders certainly play a role, there are dozens of global institutions setting standards and writing rules. Elected officials may have little to no say in these standards, but they are often obliged to follow them. These decision-making bodies wield significant influence over the international financial system, but most people have never even heard of them.

Beyond a few familiar names—the Organization for Economic Cooperation and Development (OECD), the Group of 20 (G-20), and the International Monetary Fund—there is an extended web of organizations designing how the financial system works. Most of these institutions are only known to a small group of technical experts. Rather than being truly global, the membership of these bodies is often selective and leaves much of the world on the outside looking in.

Although these groups often meet in Europe and North America, the decisions they make can have an impact far beyond those borders. That's because the global standards agreed to often become codified into national laws in many countries that had no voice in the standard-setting process. These standards and rules have a huge influence on how the financial sector operates, and whether financial industry professionals support or impede efforts for greater financial transparency.

Secrecy is central to hiding suspect financial activities from public scrutiny. Common sense financial transparency measures could help take away tools that enable billions in illicit

> "Speaking at an international financial summit in September 2006, the Minister of Economics and Planning recounted how his country had come to adopt the standard package of AML regulations. The Minister was told that Malawi needed an AML policy. When the Minister asked if the package could be adapted for local conditions he was told no, because then Malawi would not meet international standards in this area. The Minister was further informed that a failure to meet international AML standards would make it harder for individuals and firms in Malawi to transact with the outside world relative to its neighbors, and thus less likely to attract foreign investment. The Minister concluded: "We did as we were told."
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> *Source: Sharman, J. C. 2008. "Power and Discourse in Policy Diffusion: Anti–money Laundering in Developing States." International Studies Quarterly 52 (3): 635–56*

Header Image: United Nations General Assembly Hall, New York, NY, Basil D Soufi (2011), Used under Creative Commons license 3.0 cash to flow out of developing countries each year. Knowing who these global financial institutions are, and what they do, is vital to ensuring that the rules of finance benefit everyone, not just those who are currently at the decision making table.

In this brief, we outline six of the most important, yet often overlooked, institutions. We highlight what they do, who they are, and who gets left out of the process.

Financial Action Task Force (FATF)

The Financial Action Task Force was created in 1987 by the G7 group of nations, with an aim to cut down on the use of the international financial system for money laundering and terrorist financing. The group has produced a set of 40 recommendations[1], which include transparency issues, such as a call for limited transparency of beneficial ownership information[2]. While FATF doesn't set national-level legislation, its ability to place jurisdictions on its list of Non-Cooperative Countries and Territories[3] gives the body the final word in the financial sector and financial political arena, as FATF blacklisting can make it nearly impossible for a country gain access to world markets, receive loans, or entice new investment.

Although FATF deals with some tax-related initiatives, the majority of its work revolves around anti-money laundering and counter-terrorist financing through the lens of security. However, in 2012 FATF revised its standards to include tax crimes as a "predicate offense" to money laundering, indicating a willingness to make the link between tax evasion and money laundering.[4] Despite FATF's global reach, the vast majority of the organization's permanent members are advanced economies: only 8 of FATF's 36 permanent members are from the Global South.

Bank of International Settlements (BIS)

Established in 1930, and headquartered in Basel, Switzerland, the Bank of International Settlements was created by a mix of government central banks and private U.S. financial institutions[5] with the original mandate of facilitating payment of reparations Germany owed after World War I. BIS has now evolved into a multifunctional player in the financial arena, and also operates on the private market as an asset manager and lender. With its freedom to operate on the private market, BIS generates profits to finance its other activities, and has an annual budget of roughly € 270 million.

Referred to as a "bank for central banks"[6], the BIS collects enormous amounts of data on how much money is held offshore. If released[7], this data would shed a critical light[8] on the stability of the global financial system, as well as information on where and how money is moving around the world.

BIS is made up of five separate committees, including the Basel Committee on Banking Supervision, which will be discussed in the following section. As of 2015, BIS had 60

1 FATF (2012), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, updated October 2016, FATF, Paris, France, www.fatf-gafi.org/recommendations.html

2 FATF recommends countries should make beneficial ownership information available to law enforcement in a timely manner. However, it does not recommend public disclosure of beneficial ownership information, nor mandate all information should be kept in a central register.

3 "About the Non-Cooperative Countries and Territories (NCCT) Initiative." More - Financial Action Task Force (FATF). N.p., n.d. Web. 10 Sept. 2016..

4 Improving Co-operation Between Tax and Anti-Money Laundering Authorities. OECD, 2015. Web.

5 Central banks of Belgium, France, Germany, Italy, Japan, United Kingdom, and J.P. Morgan & Company, First National Bank of New York and First National Bank of Chicago.

6 "About the BIS - overview." About the BIS - overview. N.p., 01 Jan. 2005. Web. 24 Oct. 2016.

7 McNair, By: David. "HSBC Scandal: why tax havens are fuelling global poverty and how you can help stop it." ONE. 05 Oct. 2016. Web. 21 Feb. 2017.

8 Zucman, Gabriel. "The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?" The Quarterly Journal of Economics (2013): 1321-364. Web.

members, yet only 21 came from the Global South.[9] The African continent and Latin America and the Caribbean were especially underrepresented, with just two and six members, respectively[10].

Basel Committee on Banking Supervision (BCBS)

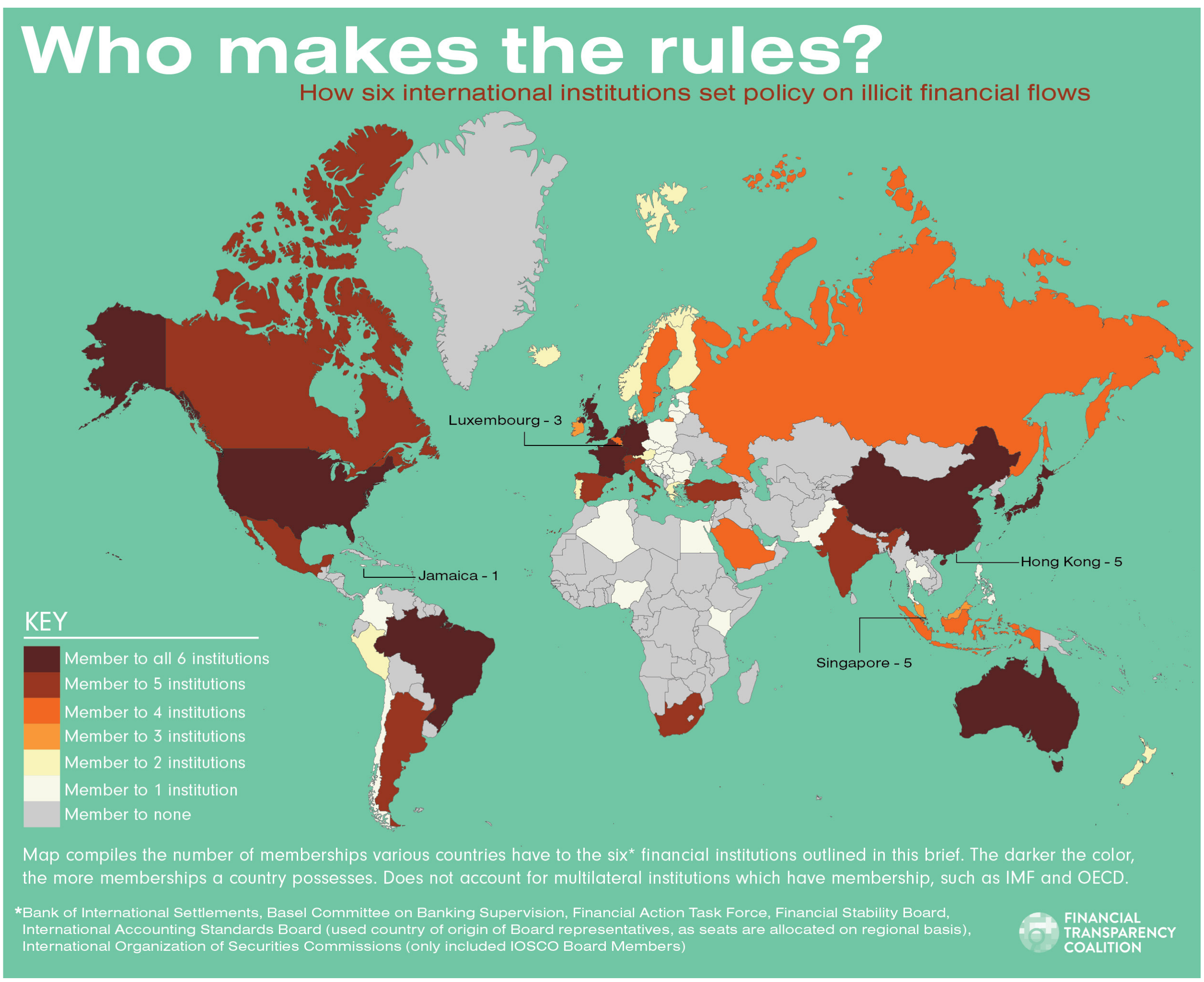
Much of Basel Committee's regulatory guidelines assess banking risks and bank capital requirements. BCBS is quite active, holding member meetings four times each year, and puts forth banking supervision principles intended to improve financial stability.

Like many of the other institutions outlined here, these principles have no legal force, and are considered soft law. But soft law is often translated into actual law at the national-level, as BCBS standards are rarely subject to domestic legislative scrutiny. The BCBS has issued three sets of principles and regulations: Basel I in 1988, Basel II in 2004, and the recent Basel III, which will go into effect in 2019. The B20 expressed concerns that the Basel III reforms were "about what Europe and the US need to do" and would be damaging for developing countries.[11]

9 *Africa, Asia, and Latin American and the Caribbean*

10 *BIS members from Africa include Algeria and South Africa; Colombia, Chile, Brazil, Peru, Argentina and Mexico make up BIS' Latin American membership. See http://www.bis.org/about/member_cb.htm*

11 *Masters, Brooke. "Basel III will 'damage developing countries'." Financial Times [London] 14 June 2012: n. pag. Financial Times . Web.*



Financial Stability Board (FSB)

The Financial Stability Board (FSB), whose membership consists of central bankers and financial regulators from the G20 countries and five financial centers[12], was given the mandate to develop and coordinate global financial regulation in the aftermath of the 2008 financial crisis. The FSB is the global agenda-setter on issues of financial stability, information exchange among authorities, and promotion of new financial standards and recommendations. Its recommendations cover a broad range of issues, from bank resolution regimes to financial disclosure practices and even the monitoring of cross-border financial flows. FSB recommendations have far reaching impact, and developing countries (non-FSB members) are often first implementers.[13]

International standard-setters like the IMF, OECD, IASB and BCBS are also members of the FSB Plenary. In fact, every institution outlined in this brief, with the exception of FATF, are permanent members of FSB[14]. To strengthen outreach and adoption of reforms, the FSB has six Regional Consultative Groups (RCGs) that meet regularly with non-members. However, RCG members do not have a voice in the Plenary – which is the FSB's sole decision-making body. The FSB is an independent association under Swiss law, but is hosted at the Bank of International Settlements in Basel, Switzerland and receives the entirety of its roughly € 10 million budget from the BIS, and its budget is approved by the FSB Plenary, where the RCGs have no vote. The current hosting relationship with the BIS is scheduled to be reviewed in 2017.

12 *Hong Kong, Netherlands, Singapore, Spain and Switzerland, see http://www.fsb.org/about/fsb-members.*

13 *Financial Stability Issues in Emerging Market and Developing Economies. International Monetary Fund. 2 Nov. 2011. Web.*

14 *"Financial Stability Board Members List." Financial Stability Board, Web.*

International Accounting Standards Board (IASB)

The International Accounting Standards Board is a global accounting standard-setter, and is funded by a group called the International Financial Reporting Standards Foundation (IFRS). Based in London, the aim of the IASB has evolved from setting basic accounting standards to developing global norms on financial reporting. IASB standards impact corporate financial disclosure and even financial regulation. Many regions, including Latin America and the Caribbean, have welcomed international standards set by the IASB, but there is little regional analysis or national debate on the merits.[15] In its more recent work, the IASB has introduced more subjectivity in how firms determine what to report and how they report it.

The IASB is unique among global financial standard-setters. Despite its role as gatekeeper in global accounting standards, it is not a public institution. The IASB is hosted at the IFRS Foundation, a private non-for-profit corporation (incorporated in Delaware) that is governed by a board of individuals. No board members represent governments, and of the 14 IASB board seats, just one is allocated to Africa and one to Latin America. IASB has a budget of roughly €30 million, made up of voluntary contributions from various private firms and government agencies (Ministries of Finance, Central Banks, etc.). The largest contributions come from international accounting firms, with the "big four"[16] contributing significantly more than any government. This funding model

15 *See Atu, Oghogho Gina et al. "Challenges of the Implementation of IFRS in Less Developed and Developing Countries," Igbinedion University Journal of Accounting (Vol. 1 February, 2016). See also "Practical Implementation of International Financial Reporting Standards: Lessons learned (Country Case Studies on IFRS)," UNCTAD (2008). See also Irvine, Helen J. and Natalie Lucas. "The Rationale and Impact of the Adoption of International Financial Reporting Standards: The Case of the United Arab Emirates," Faculty of Commerce - Papers, University of Wollongong (2006), p2-3.*

16 *The "big four" refers to the international accounting firms of Deloitte, Ernst & Young, KPMG and PwC.*

has been scrutinized for potential conflicts of interest, as special considerations for major contributors could impact the outcomes of the standard-setting process.

International Organization of Securities Commissions (IOSCO)

The IOSCO is the international body that convenes global securities regulators and is recognized as the global standard setter for the securities sector (i.e. investments such as stocks, bonds, options, collateralized securities, derivatives, etc.). IOSCO currently has 124 members, responsible for regulating more than 95 percent of the world's securities markets. The stated aim of IOSCO is to protect investors, instill fairness and transparency in the markets, and to reduce systemic risk. All publicly traded companies are affected by the reporting and disclosure standards set by securities regulators.

IOSCO enjoys global legitimacy through the endorsement of its mandate and standards by the G20 and the Financial Stability Board, which it works with intensively on the global regulatory reform agenda. IOSCO standards form the basis for the evaluation of the securities sector for the Financial Sector Assessment Programs (FSAPs) of the IMF and the World Bank. This global standard-setter is based in Madrid, Spain and is governed by a board of 34 national regulators. While regulators in the Global South account for 75 percent of IOSCO membership, current Southern membership on the IOSCO board is only 44 percent (most of which are G20 countries).

So why do these institutions matter?

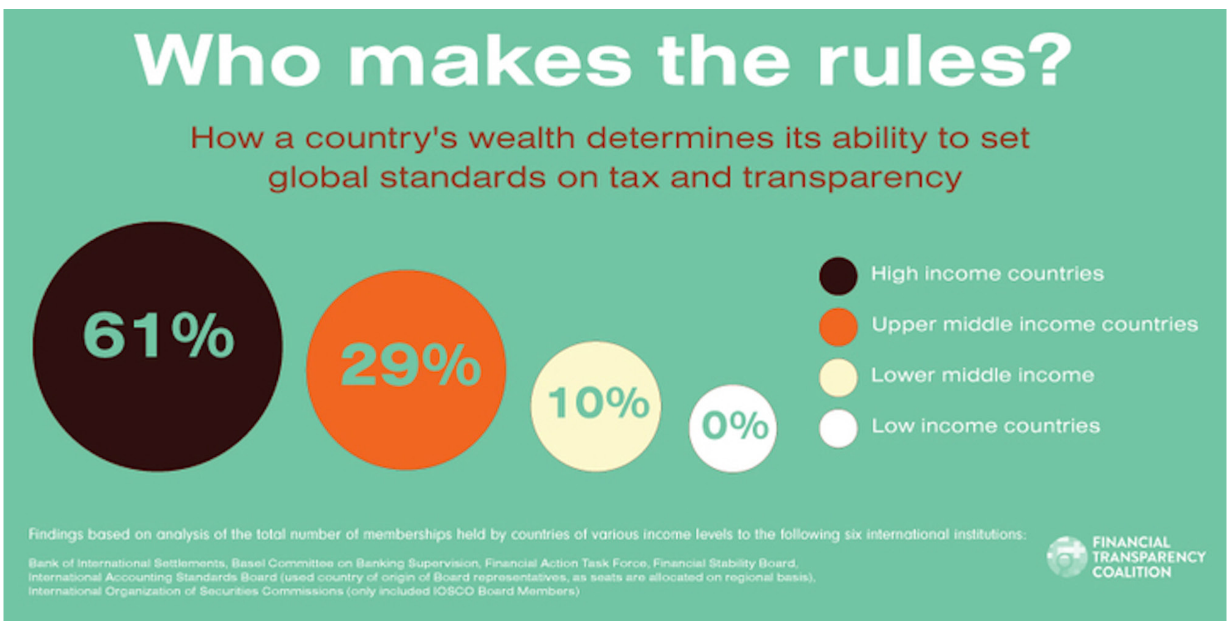
The G20, OECD and IMF may receive the lion's share of attention, scrutiny, and funding, but these lesser-known bodies are also central to the international institutional architecture. While we know they can significantly influence the 'rules of the game', there is simply not enough transparency or accountability on how they operate. While at first glance, these bodies can seem like a diverse group of institutions tackling different elements of illicit financial flows, in reality, they form a close web, and many are directly linked through funding agreements and reciprocal membership.

More importantly, these institutions may not be inclusive enough to address the global scale and nature of illicit financial flows. The membership of most is often small, and there are usually only a few seats at the table for developing countries. Even where middle-income countries from the Global South fill some membership slots, low-income countries are often left out altogether. Without a global perspective, inevitable questions arise about the legitimacy and effectiveness of new international standards: Will they only benefit wealthy countries writing them? Could they create new loopholes that allow the continued flow of illicit cash? Will "groupthink" or narrow views make it more difficult to fix illicit flows in the long run?

Ordinary citizens may have not heard of these bodies before, but they have an impact on the financial system at both the global and local levels. Despite being institutions of soft law, many of their non-binding norms and standards are generally being implemented without question at a national level (this is particularly the case for low-income countries trying to comply with global standards). Especially worrying is the automatic nature of this "global norm to local law" path. The first step to greater accountability is to better understand this global financial architecture that makes the rules for all of us. The next step will be to ask whether this patchwork system of clubs is sufficient to meet the challenge of tackling illicit financial flows and safeguarding global financial sustainability in a new era. When we start to examine who makes the rules on illicit financial flows, some measures emerge that could improve the healthy oversight of these institutions:

- **They should not labor in obscurity.** These institutions play a major role in dictating financial standards eventually adopted across the globe. Researchers, civil society, and journalists should pay closer attention to their activities, and to explaining the practical impact of these rules on regular people. Most importantly, the institutions should be transparent and inclusive of non-government stakeholders in their processes to ensure accountability.
- **Their decisions should be subject to healthy scrutiny.** We've seen a worrying trend where non-binding soft-law eventually morphs into national-level legislation with little or no pushback. More must be done to highlight standards while they are written, so that they are better suited for adoption by a diversity of governments.
- **Their membership needs to be globally representative.** These 'independent' institutions are often far more interconnected than they first seem. From reciprocal memberships to joint funding and hosting arrangements, many of the same actors make up the majority of decision makers. Their disproportionate membership from wealthy countries must be addressed to arrive at effective solutions to illicit flows that work globally, not just for a small group of rich nations.

This brief was adapted from a study commissioned by the FTC and completed by Katiuska King, economist and former Minister for the Coordination of Economic Policy of Ecuador.



The Financial Transparency Coalition is a global network of civil society, governments, and experts. We work to curtail illicit financial flows through the promotion of a transparent, accountable, and sustainable financial system that works for everyone.

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