

MONEY LAUNDERING AND ANTI TERRORIST FINANCING MEASURES

Summary: Besides the Financial Action Task Force (FATF), an increasing number of authorities at international and European level contribute to the world-wide effort against money laundering and terrorist financing. As a result, the banking industry is facing a number of new obligations and an increase in costs of implementation. At EU level, a proposal for a third Anti-Money Laundering Directive has been published by the Commission on 30 June 2004. The proposed Directive contains aspects of concern for the financial services industry for which, for reasons of efficiency, the fight against money laundering should be focused on the most serious forms of crimes. Resources - public and private alike – should be allocated to the fight against money laundering on a proportionate basis, i.e. in relation to concrete risks faced by banks.

1. Introduction

The first international reaction against money laundering dates back in 1990 when the Financial Action Task Force (FATF)¹ adopted its 40 Recommendations. The 40 Recommendations were quickly followed at EU level by the first anti-money laundering directive on 10 June 1991. The scope of the first directive was limited to the proceeds of drug related offences² and covered exclusively the financial sector. After the terrorist attacks of 9.11, the FATF adopted 8 Special Recommendations on Terrorist Financing, one of them imposing originator information requirements that would have to accompany the payment order.

At EU level, the second anti-money laundering directive was adopted on 4 December 2001. It extended the scope from drug related offences to all serious offences³ and to sectors other than the financial sector, such as accountants, notaries and lawyers under some conditions.

On 30 June 2004, the Commission published its proposal for a third anti-money laundering directive, even though the second directive has not yet been implemented in all Member States⁴. This third directive aims at transposing the revised FATF 40 Recommendations of June 2003⁵. The Council achieved a general approach on the proposal at the ECOFIN meeting of 7 December 2004. The proposal lies now before the European Parliament (Rapporteur: MEP Mr Nassauer, Committee LIBE). The proposal includes terrorist financing in its scope.

Besides, the FATF, which has become the leading standard setting body on the fight against money laundering and terrorist financing, other international organizations such as the UN, the IMF and World Bank⁶ and the Basel Committee on Banking Supervision⁷ have been more recently involved. In addition, the Wolfsberg Group, a group of large international banks, has published some standards on specific fields of activities such as private banking and correspondent banking.

Finally, one should note that terrorist financing is also combated through the EU regime of financial sanctions. Several EU Financial Sanctions (Embargo) Regulations impose on banks to freeze the assets of suspicious terrorists/terrorist organizations.

¹ The FATF was established by the G7 summit in 1989. Currently, its Members are the 15 (old) EU Member States, the EU Commission, Iceland, Norway, Switzerland, Russia, the US, Canada, Mexico, Argentina, Brazil, Japan, Hong Kong, Singapore, Turkey, South Africa, the Gulf Cooperation Council, Australia, New Zealand.

² Although Member States had the possibility to extend the scope of the directive to other offences.

³ Although the definition of “serious offence” still allowed some margin for manoeuvre to Member States, which were not in favor of the “all crimes approach”.

⁴ Several Member States including France, Sweden and Greece have not yet fully transposed the directive.

⁵ The 40 Recommendations were revised for a first time in 1996.

⁶ The IMF and World Bank conduct together with the FATF a money laundering assessment programme.

⁷ The Basel Committee on Banking Supervision has published recommendations on Customer Due Diligence for Banks and Consolidated KYC Risk Management.

2. The third Money Laundering Directive

The Commission had the obligation, pursuant to the second anti-money laundering directive, to revise the definition of “serious offence” in order to align it with the one of the Joint Action of 3 December 1998, which includes a wide range of offences including basic (as opposed to organized) tax offences. It also took the opportunity to transpose in the draft directive the revised FATF 40 Recommendations of June 2003.

The main aspects of the general approach as agreed by the Council in December 2004 which are of interest concern to the financial services industry relate to:

a. The risk-based approach

Long advocated by the banking industry, the risk-based approach was explicitly acknowledged in the revised FATF 40 Recommendations of June 2003 and was incorporated into the draft third money laundering directive. The risk-based approach is an important concept, focusing on account opening and know-your-customer procedures, which should permit financial institutions to tailor the anti-money laundering requirements to their own business activities and specificities, therefore allowing a more focused and efficient fight against money laundering. A risk-based approach, however, should not apply to suspicious activity reporting where such instances should be reported regardless of the perceived level of an individual or entity determined by an institution.

b. Politically exposed persons (PEPs)

In accordance with the revised FATF 40 Recommendations, the draft third money laundering directive imposes upon financial institutions stricter customer due diligence requirements for politically exposed persons (PEPs). Only national (domestic) politicians are excluded from the PEP definition. Some argue are that this exemption should be extended to intra-EU politicians which financial institutions have better knowledge of than for politicians from third (outside the EU) countries. This approach would be in line with the trend to consider the EU as a single jurisdiction (see the draft EC Regulation transposing FATF SRVII on wire transfers).

c. Beneficial owners

Identifying beneficial ownership is a fundamental part of anti-money laundering and know your customer due diligence, at least if the beneficial owner holds a significant interest in an account or investment vehicle. In accordance with the revised FATF 40 Recommendations, the draft third money laundering directive requires financial institutions to verify the identity of beneficial owners. While this is to be undertaken on a risk-sensitive basis, it is a very difficult obligation to comply with in countries where there is a no legal obligation to disclose beneficial ownership or where there are no fully reliable public registries providing such information. (shareholding of companies, etc...). It is important therefore to have sensible guidelines limiting the extent to which every investor in every fund needs to be identified and their identities verified, particularly where there is a chain of investments.

d. Feedback

Feedback from financial intelligence units (FIUs) to banks has always been deemed essential for banks, in particular as motivation and training of their staff is concerned. It is to be particularly welcomed that a case-by-case feedback was introduced in the third money laundering directive.

e. Comitology

The third money laundering directive introduces a comitology procedure by which implementation of several provisions of the directive would be entrusted to the Commission and national authorities at European level.⁸ It should be examined whether implementation of the directive should not be more confined at national level due to some degree of national specificity and flexibility needed for an efficient fight against money laundering.

⁸ For example, guidance on general criteria (but not a detailed code) would be helpful to firms in assessing the different levels of risk pursuant to a common standard.

3. Positioning of the financial industry in the fight against money laundering and terrorist financing

Financial institutions have invested a lot - both in human and financial resources- in the fight against money laundering. Since 9.11, there has been significant increase in rules against money laundering and terrorist financing, coming from an increasing number of authorities at all levels. Such a wide variety of rules and authorities involved in the fight against money laundering and terrorist financing sometimes creates confusion for banks.

Since the adoption of the first anti-money laundering directive in 1991, the fight against money laundering proved successful insofar as money launderers had to look for other channels to disguise the proceeds of their crimes, hence the extension of anti-money laundering requirements to other professions than the financial sector.

In order to guarantee the most efficient fight against money laundering, it is essential that the following principles be taken into account before the adoption of any new measure at any level:

- the principle of risk-based approach: any new measure must be based on concrete empirical risks.
- the principle of proportionality: the new intended measure must be proportional to the intended objective, i.e. the same objective cannot be achieved by less harmful means for the industry.
- the principle of cost-benefit: there must be a cost-benefit assessment of the new intended measure.
- the principle of no duplication: the same measure must not already exist.

In addition, the trend to harmonize anti-money laundering and terrorist financing measures should be pursued at international level. In this respect, there should be better co-ordination between the various authorities dealing with anti-money laundering and terrorist financing. Multilateralism rather than unilateralism (coming sometimes for instance from the US⁹) should be preferred.

Finally, in view of an increasing harmonization of anti-money laundering and terrorist financing standards internationally, mutual recognition of those standards should be granted as this would hugely facilitate cross-border business for financial institutions.

Is it successful?

It is difficult to assess the success or otherwise of the regulations imposed by the EU Money Laundering Directives in the fight against money laundering and terrorist financing, although it is admitted that money launderers may have to look for other ways to disguise the proceeds of their crime due to the strong involvement of the financial sector in the fight against money laundering particularly at the account opening and monitoring stage. It can be argued that many measures have a deterrent effect, yet this in itself is hard to measure. Equally, suspicious activity reports in themselves may be used to investigate and prosecute the underlying predicate offence rather than the money laundering offence itself. However, the costs of the requirement on industry to have effective procedures are high and the controls very large. While this is the case, it is difficult to measure the benefits (beyond successful deterrence) in real terms. Notwithstanding these difficulties, anti-money laundering/terrorist financing measures should be constantly tested against a cost/benefit analysis to measure their value for law enforcement and crime reduction purposes.

⁹ USA Patriot Act (example : the case of the Commercial Bank of Syria put under US embargo without consultation of other partners).

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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