TRANSPARENCY INTERNATIONAL
the global coalition against corruption

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Increasing compliance to counter corruption:
Transparency International Submission to DG Internal Market and Services on the review of the Third Anti-Money Laundering Directive

Transparency International (TI) is the leading organisation in the fight against corruption, representing a global movement of more than 90 National Chapters committed to a world free from corruption and misappropriation.

Money Laundering represents an obstacle to the European Union's objective of a sustainable and stable economy by distorting markets and legitimising the illegal. Allowing dirty money to enter European financial centres makes the EU complicit in contributing to corruption overseas and decreases the legitimacy of its role as a global governance setter, as enshrined in its external policy objectives.

Enforcement of the current anti-money laundering standards has in many cases been found to be poor.[1] The Commission itself noted similar in its roadmap for the review of the Third Anti-Money Laundering (AML) Directive, identifying a number of areas where practical improvements need to be made[2]. Transparency International strongly suggests that in order for the Directive to become an effective framework for tackling the proceeds of corruption, tax evasion, terrorist financing, and organised crime, the European Commission strengthen its AML Directive so as to require stronger compliance across Member States. This is inline with Commissioner Barnier's comments on the recently-revised FATF recommendations, which pave the way for a stronger fight against money laundering and terrorist financing at the EU-level[3]. As the Commission's review of the AML Directive is explicitly tied to the recently-revised FATF standards, Transparency International calls on the Commission to follow the lead taken by FATF and implement, *inter alia,* effective measures for identifying beneficial ownership information, and tightened requirements for politically exposed persons.

Risk-Based Approach (RBA) and Diligence

Whilst basic client identification is already a requirement of the Directive, the Commission should ensure that it is an absolute requirement to identify ultimate beneficial owner(s), regardless of risk. Institutions should be required to carry out the same level of diligence for customers resident domestically as well as overseas. The Commission needs to give greater guidance for RBA requirements. This could include a list of EU-wide accepted identity documents to facilitate risk-based identification. Such a list would greatly facilitate assessing risk in cross-border transactions.

Harmonisation

The Commission noted in its roadmap[4] that the existing Directive is based on minimum harmonisation, which leaves room for Member States to adapt solutions to their specific market needs. Stronger coordination of rules at the EU level would eliminate independent actions by Member States. As differing sets of legislation within the EU lead to dirty money flowing to jurisdictions with weaker regulations and compliance costs, maximum harmonisation on as many articles of the Directive as possible would result in stronger compliance across the EU.

Compliance

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[1] Reports by Transparency International UK, Global Witness, UK FSA, and Deloitte, have all found compliance with existing money laundering regulations to be weak.

[2] http://ec.europa.eu/governance/impact/planned_ia/docs/2012_markt_001_third_anti-money_laundering_directive_en.pdf

[3] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/113&format=HTML&aged=0&language=EN&guiLanguage=en

[4] See footnote 2

Whilst legal privilege should be respected in explicitly criminal matters, legal advice should not remain subject to obligations of professional secrecy when a lawyer is acting as a financial agent. All covered institutions, including legal counsel, should be obligated to report suspicions of money laundering or terrorist financing to competent national authorities. Notions of client confidentiality are not justifiable reason to prevent delivery of this information.

In light of the variations in capacity and resources that exist between Member States, the Commission should make available tools and resources to aid and promote compliance. Art. 37 of the AML Directive requires Member States to ensure competent authorities effectively monitor compliance with the Directive. TI suggests Member States be required to carry out regular regulatory reviews of covered financial institutions in their jurisdiction to actively assess rates of compliance.

Art. 39 of the AML Directive requires effective, proportionate and dissuasive penalties for any infringements of the national provisions adopted pursuant to the Directive. TI suggests that such infringement be further clarified to deter non-compliance. Appropriate fines for non-compliance, criminal convictions of individuals, as well as naming and shaming, could all be used as means to strengthen enforcement.

Beneficial Ownership

Information about who has ultimate control and ownership of a company is vital if the European Union is to effectively fight financial crime and corruption. Therefore in all circumstances information relating to the ultimate owner of a company, trust, or legal structure must be known before any risk-based assessment can be carried out. If for any reason a bank cannot determine the beneficial owner, it should not enter into a business relationship with the client. Moreover, if the structure of ownership is unusually or especially complex or suspicious without apparent reason, enhanced due diligence procedures should be used.

Whilst the current Directive lacks provisions for gathering beneficial ownership information, national authorities have an important role to play in collecting this information in a reliable and up to date format. The EU's 2010 Internal Security Strategy called on the Commission to "enhance the transparency of legal persons and legal arrangements" in the context of the FATF discussions and the process of revising the AMLD[5].

It should therefore be mandatory for Member States to hold a register of information about the ultimate owner of companies and trusts within their jurisdiction. This information should be shared with competent investigative and judicial authorities both domestically and internationally, taking into account legitimate individual and privacy rights. To identify what constitutes the ultimate owner of a company, banks should use their discretion and carry out diligence procedures accordingly, as the current 25% threshold to identify the beneficial owner can be easily circumvented. The 25 % threshold misrepresents the nature of beneficial ownership, as reducing understanding to a simple percentage of ownership provides money launderers with a guide on how to avoid AML checks. At the same time, a complete removal of a threshold for beneficial ownership is unrealistic as it creates an unmanageable burden for covered institutions. TI recommends therefore that the threshold be lowered to, for example, 10 percent. This is in line with the US Foreign Account Tax Compliance Act (FACTA), the requirements of which many EU banks will be required to follow as of 2013. Whilst a lower threshold could still be circumvented comparably easily, it will nevertheless require a greater level of diligence by covered institutions.

There should be a legal obligation for Member States to submit all information on beneficial ownership to the register held by the competent national authority. It would be helpful if Member States had to create (1), an obligation of the management of the registered companies to provide the identity of beneficial owner(s), including the names of shareholders, and further information beyond a certain threshold (for example a reduced threshold of 10%), and (2), a right of the registry to legally require this information.

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[5] The EU Internal Security Strategy in Action: Five steps towards a more secure Europe (COM(2010) 673), Objective 1, Action 1: http://ec.europa.eu/commission_20102014/malmstrom/archive/internal_security_strategy_in_action_en.pdf

Covered institutions should be allowed to rely on the available information, as held by the competent national authority, if they have no reason to believe that substantial management decisions are affected by shareholders which are below the given threshold. In addition, the management's obligation towards the registries as well the registries' right to ask for the relevant information must extend to the beneficial owners of shareholders; that is, not only the shareholder's name - be it a natural or a legal person - and other relevant information, but also the shareholders' beneficial owner(s).

Registers should include information regarding the management and ownership of a company. The registration data required to identify beneficial ownership information should be the same across all Member States. Registers should be easily accessible and the cost, if any, of accessing registration data should be minimal. When a company is registered in a country in which the company's owner is not resident, beneficial ownership information must still be collected. Whilst sharing information internationally is restricted by judicial assistance procedures, the Commission should ensure provisions to allow the sharing of beneficial ownership information between competent national authorities of Member States. The European Business Register, whilst currently only covering 23 Member States, makes it possible to obtain comparable, official company information from the countries connected to the network; this could be a good model for how EU-wide information sharing on beneficial ownership information might work.

The recent act[6] passed in France which obliges trustees, wherever situated, to register with the national authority the identity of beneficiaries of a trust could provide an example as to how a registration of trusts may work. The act obliges trustees to identify the beneficiaries of a trust whenever (1), one of them is resident in France, or (2), has an asset of the trust located in France. The Act applies to any trust, as defined in the Hague Convention on the mutual recognition of trusts of 1st July 1985. In such a situation, the trustee must file a declaration with the French tax authorities disclosing the identity of the constituent and all beneficiaries and stating the main provisions of the trust deed. The trustee must also, every subsequent year, file a statement indicating the value of the assets. If the trustee fails to do so, a fine at the rate of 3% of the value of the assets will be levied. The implementation regulations are not yet published, but the general comment is that the declarations will form part of a national registry.

To assess risk, Member States should create a single definition of "risk-based and adequate" measures. This definition could be delivered by Member States' Financial Service Authorities (FSAs). FSAs would have a better opportunity to evaluate the local situation (for example, access to company registration data) and together with institutions, set in place the risk-based and adequate measures for beneficial ownership identification. A clear mandate for such dialogue may offer the opportunity to improve relationships between FSAs and covered institutions.

Tax

The Commission should follow the lead of the recently revised FATF recommendations by explicitly identifying tax evasion in the designated category of predicate offences for money laundering.

Politically Exposed Persons

As the reports cited in footnote 1 indicate, many reporting institutions' due diligence procedures in relation to politically exposed persons (PEPs) are inadequate. Member States need to ensure better regulation of their financial institutions in order to detect PEPs and prevent corrupt politicians from laundering stolen assets in the EU.

The Directive should cover both domestic and foreign PEPs, consistent with Recommendation 12 of the newly-revised FATF standards, which states that financial institutions should be required to take reasonable measures to determine whether a customer or beneficial owner is a domestic PEP or a person who is or has been entrusted with a prominent function by an international organisation.

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[6] For more details see Act : loi 2011-900 du 29 juillet 2011 (art. 14)

As stated in Note 10 of the FATF Recommendations, financial institutions should be required to take enhanced measures to manage and mitigate risks when higher risks are identified.
Enhanced diligence should be automatic when a client is identified as a PEP. Financial institutions should also be required to apply enhanced due diligence measures to business relationships and transactions with natural and legal persons, and financial institutions, from countries identified as high-risk.

Member States can play a more active role in facilitating PEP identification, and should, for example, hold a centralised, up to date, and reliable list of PEPs, their immediate family members, and persons known to be close business associates. Frequent, automatic information sharing between national regulators should be in place to ensure clients are correctly identified as PEPs. Reporting institutions should be satisfied that a PEP is legally entitled under his or her domestic laws to establish a business relationship in an EU country and should know any limits of that business relationship.

Remuneration Policy

As banks are unwilling to turn down profitable business even if the source of funds cannot be clearly identified, the Commission should consider reforming remuneration structures to incentivise bank employees to turn away suspicious clients. The Commission has already established the principle that remuneration be tied to long-term performance in the Capital Requirements Directive[7] (COM(2011) 453) (see Art. 88.1). Currently bank employees are pressurised to accept clients to improve the bank's turn over; incentivising employees to turn away at-risk clients would eliminate this.

Transparency International is a non-governmental organisation that is promoting transparency in the EU decision-making process. This is why we assume that the results of your consultations with stakeholders (like TI's expert recommendations above) on the issue of money laundering will be dealt with in a transparent and open manner. We recommend that the contributions to consultations such as this one should be made public in the final communication or attached to the final communication in a "legislative footprint" (record of expert contributions).

We remain at your disposal for further discussion.

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[7] http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/20110720_directive_proposal_en.pdf