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THE TRANSPARENCY OF LEGAL ENTITIES AND ON MEASURES TO ENHANCE TRANSPARENCY IN THE BANKING/FINANCIAL SECTOR IN THE CONTEXT OF ACTION TO COMBAT MONEY LAUNDERING

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Introduction

1. Conclusion number 58 of the Tampere Special European Council in October 1999 invited the European Commission "to draw up a report identifying provisions in national banking, financial and corporate legislation which obstruct international co-operation".

2. Following a note tabled by the Commission for the joint Finance/Justice and Home Affairs Ministerial meeting in October 2000, the Council called on the Commission "to submit to it a report examining in particular the possibility of establishing minimum transparency criteria for various types of legal entities (such as trusts, trust funds and foundations), for the purpose of identifying the beneficial owners more easily".

3. To facilitate this work, the Commission commissioned a study from the Transcrime Institute of the University of Trento in Italy. The title of the study is "Transparency and Money Laundering: A study of the regulation and its implementation, in the EU Member States, that obstruct anti-money laundering international co-operation (banking/financial and corporate/company regulative fields)". The Final Report of that study is attached as an Annex to this document.

Scope of the study

4. The aim of the Study is to highlight in EU Member States the regulation and/or its implementation that – in the banking/financial and corporate/company fields – constitute obstacles to anti-money laundering co-operation. The research was carried out using primary and secondary sources. Data was collected from relevant experts in the Member States on the basis of a questionnaire, which sought to identify, for each Member State, obstacles arising directly from the existing legislation/regulations; or from the way in which such legislation/regulation had been implemented. In addition, the study also sought information on the extent to which, in the banking/financial sector, self-regulation (or the lack of) played a part in creating obstacles to effective anti-money laundering co-operation. As the study shows, there are significant differences between Member States in the use that is made of regulation and self-regulation as effective and appropriate tools. [For an explanation of the terms "regulation", "implementation", "self-regulation" and others, please see Chapter 4 of the Transcrime study.]

5. In line with the Tampere Council conclusions, the research looked at both the banking/financial regulative field and at the corporate/company regulative field. For the banking/financial regulative field, the study covers the analysis of the regulation and of its implementation as regards "banks and other non-bank financial institutions" as defined in Article 1 of the Council Directive 91/308/EEC of 10 June 1991 and as clarified in Article 1 of the Proposal for a European parliament and Council Directive amending Council Directive 91/308/EEC of 10 June 1991 of 19 February 2001. For the corporate/company regulative field, the study covers "legal and non-legal structures", which are defined as an "organization with an economic or patrimonial vocation". (See pages 20 & 21 of study).

6. Details of the methodology used in the study are set out in the Transcrime report itself. The research is based on a number of assumptions. The most important of these is that **"the less regulation in the banking/financial and in the company/corporate regulative fields there is, and the lower its implementation, the greater the obstacles for law enforcement, judicial and financial authorities in dealing with money laundering cases at the national level."** (page 25). The study does not, therefore, attempt to provide any sort of statistical analysis of the extent to which particular structures have/have not been found to be involved directly in money-laundering activities within the Member States. It is not based on evidence gathered directly from money-laundering prosecutions – information that appears not readily available in most Member States - but, rather, on the views of the relevant law-enforcement, financial, judicial and academic experts in each of the Member States.

7. It should also be noted that the study was based on a further assumption: namely that **"the higher the obstacles to investigation of money laundering cases at the national level are, the higher the obstacles to anti-money laundering international co-operation "** (page 25). In other words, an assumption that the obstacles to co-operation at the international level are a function of the obstacles to investigation of money laundering at the national level.

<u>Outcome of the study</u>

8. On the basis of the available data, the study concludes that, for the **banking/financial regulative field**, "the greatest obstacles to anti-money laundering international co-operation seem to be found in the lack of regulation", rather than in a lack of implementation where regulations do exist. Of the four thematic areas identified in the study, those where obstacles in the regulation to international co-operation show the highest dimension were **"International payments systems"** and **"Identification and record-keeping rules"**.

9. For the **corporate/company regulative field**, the analysis looked at a number of different categories of corporate structure throughout the EU and identified three groups where the risks of misuse for money laundering purposes appeared high. These three groups were the following:

(i) public and private limited companies;

(ii) the trust; and

(iii) the société de droit civil and other legal and non-legal structures.

10. For the first of these, **public and private limited companies**, the study shows that the greatest obstacles to effective anti-money laundering international co-operation lie in the thematic area of **"Identification of the beneficial owner"**. The main obstacle appears to be the lack of regulation requiring that full information on the beneficial owner of a public or private limited company be supplied, especially in those cases where a legal entity is itself registered as a shareholder or director of a company. The existence of nominee shareholders and directors in some jurisdictions was also identified as a potential problem in this context.

11. In addition to the identification of the beneficial owner, the study also highlighted the issue of **"Incorporation"** as one that presented obstacles to effective anti-money laundering co-operation. The study highlighted the fact that the "lack of regulation in this area makes it more difficult to acquire information of physical persons party to the creation of legal structures and increases the possibility that they might be used for criminal purposes" (page 125)

12. For the second category examined, namely **trusts**, the study noted that "the analysis of regulation covering trusts has shown it as being characterised by great opacity and absence of all those provisions relevant for anti-money laundering international co-operation" (page 125). The study also noted that the regulation of trusts and the confidentiality which characterizes their constitution make it difficult to acquire relevant information on the persons setting it up and on the way in which the trust find is managed. Accordingly, the study concludes that "this opacity creates obstacles to anti-money laundering international co-operation" (page 125).

13. The third group analyzed included **société de droit civil** and other legal and non-legal structures. The study concluded that many of these structures were not, strictly speaking, "entities" and that "The real problem here is not of regulation but more of investigation" (page 126). The study nonetheless recognises the possible use of such structures for money laundering purposes (especially where the physical person who owns the structure acts on behalf of, or in association with, the real owner who operates behind the scenes). However, it concludes that "it does not seem necessary to propose further action in order to increase the level of regulation". It is not entirely clear how the authors of the report reached this conclusion and the issue is clearly one which merits further examination.

<u>Recommendations</u>

14. In the light of its findings, the study makes four specific recommendations in relation to the banking/ non-banking financial institutions and four recommendations in relation to the corporate/company regulative field. The recommendations together with the possible measures to implement them identified by the study are reproduced below. It must be stressed that these recommendations and measures are the views of the authors of the study and do not represent proposals from the Commission. Clearly, it will be necessary for the Commission itself to consider in more detail the substance of these before determining what concrete initiatives might be taken

Banking/Non-banking Financial Institutions

Recommendation 1

Action might be taken to extend anti-money laundering regulations to institutions transacting international payments, so as to make them subject to the same identification and reporting requirements as the institutions and persons already covered by anti-money laundering regulation.

Implementation of the Recommendation

The European Commission should assess and introduce the most effective instruments (e.g. Directive or other binding instrument) within the European Union to ensure transparency in international payment systems. Recipient banks and non-bank financial institutions in the EU Member States should introduce measures ensuring ineffectiveness of bank secrecy by requiring full details of the persons ordering and receiving international payments. If the institution from which the payment originates fails to supply this information, it should be sanctioned. Accordingly, the EU institution should not proceed with the international payment. If the transaction is nonetheless performed in the EU jurisdiction, a penalty should be imposed on that EU institution. To facilitate implementation of this provision, a "negative list" of banks and other financial institutions forbidden to operate within the EU could be set up, in order to exclude non-co-operative institutions from the international circuits.

Recommendation 2

Action might be taken to improve customer identification and record-keeping rules, and to harmonise it across the EU Member States.

Implementation of the recommendation

The European Commission should assess and introduce the most effective instruments (e.g. Directive or other binding instrument), within the European Community by requiring that the following elements, which regard customer identification and record-keeping rules, are incorporated into the EU Member States' national anti-money laundering legislation:

- legal provisions requiring that in banks offering private banking services, all new clients and new accounts are approved by at least one person besides the private banking manager;

- legal provisions prohibiting the opening of special types of customer accounts or the setting up of a business relationship, where the identity of the customer is known only to senior management in the institution;

- legal provisions requiring that documents related to customer identification be regularly updated;

- legal provisions requiring institutions and persons subject to anti-money laundering

regulations to verify the identification and other checks made by their counterparts in

the EU and non-EU Member States;

- legal provisions requiring elaboration of a customer acceptance policy;

- legal provisions requiring specific customer identification in cases where accounts are

opened through introductions or referrals;

- legal provisions requiring automatic registration of transactions above a given threshold.

Recommendation 3

Action might be taken to encourage the supervisors of the institutions operating in the banking and non-bank financial sectors to enact self-regulation instruments in the form of guidelines.

Implementation of the Recommendation

The European Commission should assess and introduce the most effective instruments (e.g. Directive or other binding instrument) within the Community to encourage institutions supervising banks and other non-bank financial institutions to enact common anti-money laundering guidelines.

Recommendation 4

Action might be taken to assess the feasibility of creating a methodology for the measurement of the impact of the Directive 91/308 on the EU Member States' regulation and on its implementation, and of empowering a suitable institution with the task of making periodic impact evaluations.

Implementation of the recommendation

The European Commission should identify relevant impact indicators of the Directive on EU Member States regulation and on its implementation in matters of anti-money laundering, and assess the achievement of these targets periodically.

Corporate/Company Regulative Field.

Recommendation 1

Action might be taken to increase transparency in the corporate/company regulative field, in particular by improving and harmonising the rules on the identification of the real beneficial owner of public and private limited companies, across the EU Member States.

Implementation of the Recommendation

The European Commission should assess and introduce the most effective instruments within the European Community to ensure that rules on the identification of the real beneficial owner in particular of a public or private limited company, are incorporated into the EU Member States' national company law, with special attention to the following:

- where a legal structure is a shareholder, legal provisions requiring that complete

information is supplied, so as to identify the real beneficial owner;

- legal provisions prohibiting the issuance of bearer shares;

- legal provisions prohibiting nominee directors;

- legal provisions prohibiting nominee shareholders;

- legal provisions requiring the disclosure of the identity of the real beneficial

owner of a company to the authorities.

Recommendation 2

Action might be taken to increase transparency in the corporate/company regulative field, in particular by improving and harmonising the rules on transparency in the incorporation phase of public and private limited companies, across the EU Member States.

Implementation of the recommendation

The European Commission should assess and introduce the most effective instruments within the European Community to ensure that rules on the incorporation in particular of a public or private limited company, are incorporated into the EU Member States' national company law, with particular attention to the following:

- legal provisions requiring a minimum period for the incorporation, in order to

check on the information regarding the founders;

- legal provisions requiring background investigations on the founders of a

company;

- legal provisions prohibiting the incorporation of shelf companies;

- legal provisions requiring checks on the legal origin of the incorporation capital;

- legal provisions requiring a statutory authorisation to incorporate a company.

Recommendation 3

Action might be taken to increase transparency in the regulation of the creation and management of trusts.

Implementation of the recommendation

The European Commission should assess and introduce the most effective instruments within the Community to ensure that rules ensuring the transparency in the creation and the management of trusts, are incorporated into the legislative systems of the EU Member States, where they exist, with particular attention to the following:

- legal provisions requiring written constitution of the trust;

- legal provisions requiring registration of the trust deed in a public register;

- legal provisions requiring that the generalities of the settlor be included in a

public document;

- legal provisions requiring that the generalities of the beneficiary be included in a

public document;

- legal provisions prohibiting the settlor from being also the beneficiary of the

same trust;

- legal provisions prohibiting the beneficiary of a trust from being another trust;

- legal provisions requiring a public register of trustees;

- legal provisions requiring an authority to supervise the activity of trustees.

Recommendation 4

Action might be taken in order to assess the trade-off between the increased transparency in the corporate/company regulative field, which would improve antimoney laundering international co-operation, and the costs associated with the reduction of the efficiency and flexibility of the financial system.

Implementation of the recommendation

The European Commission may wish to take action in order to make a cost-benefit analysis of the rules which, if enacted and harmonised across the EU Member States, would increase transparency in the corporate/company regulative field, thus reducing obstacles to anti-money laundering international co-operation. The tradeoff between transparency and efficiency should be carefully analysed in corporate governance reforms across the European Member states. At the end of this Study it will be clear what Member States and the European Union want to pay in terms of efficiency in order to acquire more transparency or viceversa. Analysis in this perspective of present regulation is urgently needed to enable policy makers to make informed choices aware of the results they produce in terms of transparency and efficiency.

Conclusion

15. To the Commission's knowledge, this study marks a first attempt to look systematically at the financial and company/corporate structures within the European Union with a view to identifying the obstacles that such structures present to international anti-money laundering co-operation. It is important to recognise that the study is not a statistical analysis but an evaluation based on the experience of Member State national experts with expertise in the investigation of money-laundering activity.

16. It is also important to recognise that the study does not attempt to make an assessment of the important balance between greater transparency, on the one hand, and efficiency/economic costs on the other. Nonetheless, it has to be recognised that the one impacts on the other. Enhancing the regulatory aspects of the company/corporate system, for example, by requiring much more detailed investigation of the identity and financial standing of directors and of the true capital worth of a company would impose additional burdens on regulatory and supervisory authorities. A statutory requirement to record all information relating to the true beneficial owners of corporate vehicles and mechanisms to update and evaluate such information would also have resource consequences. Similarly, there would also, of course, be additional costs and time factors imposed on those wishing to undertake and set up businesses. These and other, more general, issues relating to the functioning of the financial and corporate systems in Member States will need to be addressed.

17. The study is also significant because it seeks to look not only at the impact of the regulatory regimes in each Member State but also at the extent to which self-regulation in the banking/financial sector helps or hinders anti-money laundering co-operation. The focus, both for the regulatory regimes and for such self-regulation aspects, is very much on the extent to which such regimes are transparent and clearly defined. The study evaluates the general level of effectiveness of self-regulation without looking at the precise methods used by supervisory authorities. Instead, the study seeks to draw some general conclusions about the overall effectiveness of the systems in place in the Member States.

18. It is clear from the work carried out for the study that each Member State has developed a different balance between the regulatory and self-regulatory approaches. Some have chosen to introduce comprehensive legislative provisions that render the need for a self-regulatory regime superfluous. Others may have little in the way of formal regulation but a wide-ranging self-regulatory arrangement. The study does not seek to draw specific inferences from the choice between either regulation or self-regulation. It does not seek to give greater weight to the regulatory regime over the self-regulatory one. Member States have developed different approaches in the light of different political, legal and fiscal traditions and practices.

19. Furthermore, it must also be stressed that the study does not aim to present any ranking of Member States' performance. The elements identified in the study as obstacles to

international co-operation are those which appear to be significant features across the EU as a whole. The various graphs and tables make that clear.

20. What the study does show, in broad terms, is that there remain within all Member States aspects of the banking/financial and the company/corporate regimes that might be susceptible for abuse by those seeking to launder money by virtue of their lack of transparency. The Commission is of the view that further work should now be put in hand to determine the best way to implement the recommendations set out in the report.

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