European Economic and Social Committee

ECO/147
Money laundering

Brussels, 11 May 2005

OPINION

of the

European Economic and Social Committee

on a

Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering, including terrorist financing

COM(2004) 448 final

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On 21 October 2004, the European Council decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

> *Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering, including terrorist financing*
> COM(2004) 448 final.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 15 April 2005. The rapporteur was Mr Simpson.

At its 417th plenary session on 11 and 12 May 2005 (meeting of 11 May 2005), the Economic and Social Committee adopted the following opinion by 107 votes in favour and one abstention.

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1. Summary

1.1 This draft directive will be the third in connection with the prevention of money laundering, following the first in 1991 (91/308/EEC) and the second in 2001 (2001/97/EC).

1.2 The key drivers for this draft directive are:

1) the inclusion of a specific reference to terrorist financing, although this was agreed by Member States under the previous directive to be include within the concept of serious offences, and
2) to take account of the revised Forty Recommendations of the Financial Action Task Force on Money Laundering (FATF)[1] published in June 2003.

2. General comments

2.1 The key groups affected by obligations that would be imposed under the draft directive are:

a) businesses in those sectors required to comply with the provisions of the directive ("the regulated sector");

[1] The FATF is an inter-governmental body which sets standards, and develops and promotes policies to combat money laundering and terrorist financing. Website: www.fatf-gafi.org

b) users of services provided by the regulated sector (i.e. their customers and clients);

c) persons making reports of knowledge or suspicion of money laundering;

d) law enforcement agencies and the Financial Intelligence Units ("FIUs") who receive and use the intelligence contained in money-laundering reports; and

e) elements of the criminal community - those committing "serious crimes" (defined in Article 3 (7) of the draft directive) where those crimes result in proceeds, or involve handling funds, relating to criminal activity.

2.2 The draft directive is intended to replace the existing directives, which will be repealed.

2.3 The key changes, compared with the first and second directives, are:

i. The inclusion of specific reference to terrorist financing and further detail as regards "serious offences".
ii. Increased coverage regarding trust and company service providers and high value dealers in goods and services.
iii. Considerable expansion of details concerning customer due diligence and verification of identity, including beneficial ownership.
iv. Provision regarding protection of employees making money-laundering reports.
v. A prohibition against informing a client that a report has been made.
vi. A requirement to apply EU standards in branches and subsidiaries outside the EU.

2.4 The draft directive allows for further convergence with countries where the recommendations of the Financial Action Task Force on Money Laundering (FATF) of the Organisation for Economic Cooperation and Development (OECD) have been, or will be, applied.

2.5 The consolidation in the new directive of the requirements of the first and second directives is also an aide to clarity.

2.6 However, the third directive follows very closely on the heels of the second directive, which itself had greatly expanded the scope of anti-money laundering provisions, and the range of sectors affected. There has only been a short period to evaluate the impact of the 2001 Directive, and the Committee notes that, as yet, there has been no comprehensive study has been made of the effectiveness of the existing regime, or its proportionality, including whether Member States' government investment is in balance with that made by the regulated sector.

2.7 The EESC welcomes measures that will make money laundering and terrorist financing more difficult. In support of the EU-wide application of preventative measures, the EESC recognises that money launderers will attempt to exploit weaknesses in the monitoring

systems and that the money will be moved to the weakest points in the supervisory system. For this reason, Member States need to establish rigorous standards across the European Union and encourage their establishment in other countries.

2.8 This opinion comments in more detail on specific aspects of the draft directive.

3. Comments on specific areas of key change

3.1 *Terrorism and serious crimes*

3.1.1 The ESC endorses the inclusion of terrorist financing within the draft directive.

3.1.2 As regards the definition of serious crimes and money laundering, further clarification would help those affected to have a better comprehension of the precise intentions of the directive and, accordingly, help to ensure consistent and effective implementation of the law.

3.1.3 It is important to bring clarity to the level of knowledge of criminal law that is actually required of persons working in the regulated sector, the great majority of whom have little or no expertise in this area. Article 3 (7) of the draft directive contains a detailed definition of "serious crimes" but we recommend that this definition is qualified to make clear that, in determining whether to make a money-laundering report, a person in the regulated sector is only required to apply the knowledge and skill concerning criminal law that a person carrying out that function would be expected to have. To do otherwise would put a disproportionate burden on the regulated sector (both in terms of training their staff and controlling their actions) with all the risks of increased costs, and undue disruption for customers and clients, related to it. It could also bring unnecessary risks to persons working in the regulated sector.

3.1.4 "Serious crime" (defined to include "at least" the activities listed in Article 3 (7)) appears to be framed as a minimum standard. Implementation to date of the existing directives shows that Member States have taken different approaches resulting in regimes either encompassing all crimes, or alternatively encompassing only serious crimes.

3.1.5 Consideration should be given to limiting Member States' choice in this regard to promote an even application of the anti-money laundering regulation and accordingly, provide a level playing field for the regulated sector across the EU. If Member States wish to apply the draft directive on a wider basis, the ESC recommends that consideration is given to a regime where reporting is compulsory only in respect of serious crimes (the minimum standard), but with a facility to make voluntary reports, afforded the same protection by law as the compulsory reports, in respect of other crimes.

3.1.6 An "all crimes" compulsory regime, particularly where linked to an extra territorial requirement for reporting, risks diverting valuable private sector and law enforcement resources to no good effect. The need for the UK "limited intelligence value" reporting

system, designed in an attempt to minimise effort, by both the regulated sector and law enforcement authorities in dealing with matters of no or very little value to law enforcement (and those matters already reported to the relevant authority), illustrates well some of the pitfalls of a compulsory “all crimes” regime.

3.1.7 The Committee considers that the fixed monetary *de minimis* limit laid down in Article 6 (b) (EUR 15,000) is reasonable, given that this limit can be reached through one or several transactions that appear to be interlinked in some way.

3.1.8 A further worthwhile clarification, to promote consistency, would be to make explicit that the definition of money laundering, from Article 1.1(c) of the second directive (repeated in Article 1.2(c) of the draft directive), includes the possession of the proceeds of a criminal’s own crime, without any further transaction having been necessary.

3.1.9 Article 2.1(3)b sets out five categories of transaction conducted by independent legal professionals to which the Directive would apply. The Committee recommend the addition of a sixth category: (vi) tax advice.

3.2 ***Trust and company service providers and dealers in high value transactions***

3.2.1 Article 3 (9) defines “trust and company service providers” and Article 2.1(3)(f) defines "high value dealers". The clarification in the definitions is welcomed and particularly the inclusion of “services” within Article 2.1(3)(f). Money laundering can be carried out by the manipulation of large transactions for services in cash, just as it can be carried out by the manipulation of large transactions for goods in cash.

3.3 ***Customer due diligence and verification of identity, including beneficial ownership***

3.3.1 The Articles concerning these subjects must be clear, and capable of being applied on a risk-based system. Dealing with these aspects of the money laundering regulation is a major contributor to the cost of compliance, and also has a direct impact on customers and clients.

3.3.2 ***Definition of beneficial owner***

3.3.2.1 Article 3 (8) refers to a beneficial owner as being a natural person who ultimately, directly or indirectly, owns or controls 10% or more of the shares or the voting rights of a legal person or the property of a foundation, a trust or a similar legal arrangement or who otherwise exercises comparable influence, for instance over management. The Committee considers this to be too low a threshold, when taken together with Article 7.1 (b), and the reference to risk-based measures in Article 7.2.

3.3.2.2 The draft directive should refer to the principles regarding requirements for identification and impose a requirement on Member States to provide guidance, either directly or by allowing

representative professional bodies to produce it, on a risk-based system of identification allowing varying levels of identification of beneficial owners depending on circumstances.

3.3.2.3 Whilst we can understand the motivation for stringent requirements, in practice their universal application without regard to risk tends to penalise legitimate customers and clients through additional cost, effort and potential loss of commercial confidentiality as regards transactions planned to be undertaken, whilst having little or no effect on illegal activities.

3.3.2.4 The Committee recommends that the minimum requirement to identify ownership or control should be 25% either by an individual or by a group acting as a "concert party".

3.3.3 ***Politically exposed persons***

3.3.3.1 The Committee considers that the proposed definition of politically exposed persons, as in Article 3 (10), is unnecessarily wide ranging and should be amended to introduce the phrase *"who are not citizens of the EU"* after the phrase *"natural persons"*. PEPs within the European Union (though not necessarily immune to the temptations of corruption) are subject to assured democratic controls which make the enhanced due diligence requirements envisaged in Article 11.1 unnecessary.

3.3.4 ***Customer due diligence and identification***

3.3.4.1 "Customer due diligence" is an area of the draft directive where more precise definition of terms is required to bring clarity. Terms such as "due diligence", "scrutiny" and "verification" may be open to varying interpretations across different parts of the regulated sector, and across different Member States, and accordingly they should be defined more precisely to enable a common understanding.

3.3.4.2 As in relation to identification, the Committee recommends that the draft directive should require Member States to provide for clear risk-based guidance within their own territories.

3.3.4.3 Article 6 (c) requires the application of customer due diligence procedures when there is a suspicion of money laundering, regardless of any derogation, exemption or threshold. This may not be practicable, as performing such procedures when prompted by suspicion might put the suspected party or parties on notice. The stipulations in Article 6 (c) should be qualified to indicate that such procedures should be performed only to the extent possible without alerting the suspected parties.

3.3.4.4 In respect of the simplified customer due diligence procedures as specified in Article 10.3 (c), the Committee recommends modifying the latter part as follows, by adding the words in italics: "a pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages *and/or from employers* ...".

3.3.4.4.1 Article 11.2 proposes to prohibit credit institutions from entering into a relationship with a correspondent bank which permits its accounts to be used by shell banks. It may not always be easy for a credit institution to discover when a correspondent bank does so. It should be clear that institutions will only be expected to take reasonable precautions in relation to their respondent banks, to assess the latter's policy in relation to shell banks.

3.3.4.5 In Article 11.1 (a), the reference to documentary evidence does not need to be qualified by the word "additional" which could be deleted.

3.3.4.6 Article 12 permits reliance on third parties for the performance of customer due diligence procedures but indicates that the ultimate responsibility for such procedures remains with the institutions or persons covered by the proposed Directive. The Committee recommends removal of the latter part of Article 12, related to *"the ultimate responsibility shall remain with the institution or person covered by this Directive which relies on the third party"* and its replacement by the principle included in recital (20) on page 11 of the proposed Directive (avoiding duplication of work by relying on customer-identification procedures performed by third parties that are regulated). Unless reliance is permitted, once reasonable measures have been undertaken to establish the *bona fidae* nature of the third party, this provision will not avoid duplication of work.

3.3.4.7 Article 13.2 seeking the reporting of suspicions might usefully be extended to add an extra sentence: *"The Commission should investigate such referrals and inform Member States of the conclusions reached."*

3.3.4.8 To remove doubts about the compatibility of the provisions of Article 14 with the privacy regulations in certain Member States, the term "immediate" should be removed from Article 14 and the third party must be permitted to seek consent from the persons whose information is being disclosed. The word "immediately" might be replaced by "promptly".

3.4 ***Prohibition on informing***

3.4.1 The Committee recommends a more closely defined meaning of "prohibition" as regards the first part of Article 25. It is required in some Member States that regulated sector personnel report to certain regulators or parts of the judiciary as well as the FIU [Financial intelligence unit], and also in practice the fight against money laundering may be facilitated by careful exchanges of information between parties not complicit in the money laundering. To allow for these positive forms of disclosure, we recommend altering the Article to make explicit the fact that disclosure is prohibited only where this may tip off a suspect, or prejudice a money laundering investigation.

3.5 ***Fair competition in overseas businesses***

3.5.1 In recital (23) on page 11, as well as in Article 27, it is suggested that Community standards should be applied in third countries where Community credit and financial institutions have branches and majority owned subsidiaries and where legislation in the area of money laundering and terrorist financing is found to be deficient.

3.5.2 The Committee has a concern that such an application may render Community credit and financial institutions branches and majority-owned subsidiaries unable to operate effectively and competitively in countries where money-laundering laws are not of a standard comparable to those in the EU. Therefore, the application of EU or comparable standards should be encouraged but an absolute requirement for application overseas may be premature. It would be preferable, in these situations, for institutions to inform the competent authorities in other countries, with a view to assistance being provided to them to improve their controls in relation to money laundering and terrorist finance.

3.5.3 It would be more appropriate for the EU to reinforce the application of good and relevant globally recognised standards by replacing the references to the application of EU requirements with the application of the FATF 40 recommendations. This would remove any implications that the EU is trying to enforce its requirements with extra-territorial effect, where there are global standards with broadly equivalent effectiveness.

3.6 ***Employee protection***

3.6.1 The Committee applauds the inclusion in Article 24 of this protection and urge the Commission to extend this further to include a reference to judicial processes and the role of police authorities in providing protection. Clarity over protection of the confidentiality of the source of the money-laundering report is critical to the smooth and complete operation of the reporting systems. Not only employees, but their employee organisations should be covered by Article 24 which should also specifically refer to the obligation of Member States to keep the identity of reporters confidential to the fullest extent permitted by Member State criminal and civil law. The Directive should specifically provide that the identity of reporters should be kept strictly confidential, unless they have given consent to its disclosure, or it is essential for a fair judicial process in criminal proceedings.

3.6.2 Article 24 should be amended to ensure that the protection provisions extend to sole practitioners and small businesses.

3.7 **Other comments**

3.7.1 ***Sectoral application of the proposed Directive***

3.7.1.1 Unless otherwise defined, all the systems' requirements included in the draft directive are applicable to all institutions and persons as defined in Article 2. As the regulated sector is now diverse, consideration needs to be given to the situation of institutions or professions whose activities are only partly covered by the draft directive as they need clarification as to how they are to apply the provisions to relevant parts, and not other parts, of their business.

3.7.1.2 It is unclear why Article 2 restricts the applicability of the draft directive to notaries and other independent legal professionals only when carrying out certain activities, while other liberal professions, with equivalently high standards of ethical and competence standards enforced on their membership, have all their services included. The Committee understands that there are certain activities reserved to notaries and other legal professionals in some Member States (usually linked to their role as advocates in formal legal proceedings), and that within those areas legal professionals can be validly distinguished from the members of other liberal professions, and thus that an argument exists for their exclusion from the scope of the Directive. However, the Committee believes that they should be included within the scope of the Directive wherever the activities in which they are engaged are not reserved to legal professionals, and the services would be included within the scope of the Directive if carried out by any other appropriately regulated professional firm.

3.7.2 ***Reporting obligations***

3.7.2.1 Article 17 requires that the institutions and persons covered by the draft directive **examine with special attention** any activity which is likely to be related to money laundering.

3.7.2.2 This requirement could result in the performance of substantial additional procedures by the institutions and persons covered by the draft directive and also raise the risk of a subject being "tipped off" by the conduct of special procedures.

3.7.2.3 The Committee believes that it should not be the task of the regulated sector to perform **investigations** in the sense apparently meant in Article 17, but to be alert to the need to form suspicions on the basis of **information** which came to them during the normal course of business and to report on such information for investigation by law-enforcement authorities.

3.7.3 ***Member States' option for stricter provisions***

3.7.3.1 Article 4 allows Member States to adopt or retain in force stricter provisions than those contained in the draft directive.

3.7.3.2 Material differences in the toughness of provisions from one Member State to another may harm the principle of the single market, result in a disruption of fair competition, and may encourage criminals to migrate their money-laundering activities to less stringent Member States.

3.7.3.3 The Committee recommends that the provision allowing local variation is limited to those areas where such variation (if it is to be imposed by Member States on a compulsory rather than voluntary basis) is necessary to reflect specific local conditions.

3.7.4 ***Comments on specific paragraphs***

3.7.4.1 The Committee welcomes the responsibility placed on Member States to provide feedback (Article 31.3) and recommends that this is specifically made the responsibility of the FIU. Feedback is useful as it promotes better and more effective future compliance in applying the legislation.

3.7.4.2 Article 19. 1 (b) requires that the institutions and persons covered by the proposed Directive to furnish the Financial Intelligence Unit with all necessary further information in accordance with applicable legislation. The Committee would like to point out that the law enforcement perception of *"all necessary further information"* might be very far reaching and indeed it may not be possible for the regulated sector to comply with such a requirement. We recommend the term *"all necessary"* is replaced with wording which allows the Member States to confirm with their regulated sectors the additional information that can be required to be provided, without becoming unnecessarily burdensome and safeguards to ensure that this is not exceeded by the FIU.

3.7.4.3 Article 20.2 should provide that suspicions formed in the course of providing legal advice (by notaries, independent legal advisers, auditors, external accountants or tax advisers) should be exempted from the suspicions reporting requirements. The current wording of this paragraph is more restrictive, suggesting that the exemption may only be limited to advice given when ascertaining the legal position of their client preceding legal proceedings. This would be an unjustifiable restriction on the human rights of clients to obtain legal advice in confidence.

3.7.4.4 The provision of Article 23 that disclosure in accordance with the draft directive shall not constitute a breach of any restriction on disclosure of information has omitted that such disclosure needs to be made "in good faith" to qualify for this protection. This was stipulated in the second directive. This qualification should be reinstated to emphasise that the regulated sector must be required to act responsibly and in good faith in order to benefit from the necessarily wide-ranging statutory protection. To specify otherwise risks distorting the balance of rights of persons and their access to justice.

4. Conclusions

4.1 Though the Committee support the twofold objective of ensuring the comprehensive application by the EU of global standards, as set out in the FATF 40 Recommendations, and the clear inclusion of terrorist financing, the Committee regrets that this 3rd Money Laundering Directive has been prepared before there has been an opportunity to fully evaluate the merits of the 2nd.Directive approved in 2001. Embarking on the preparation of a 3rd Directive, so soon after the second, and without a significant period for reflection to consider the lessons to be learnt from the application of the 2nd Directive may be somewhat precipitous.

4.1.1 To justify the preparation of a 3rd Directive at this time, it is essential that it is also used to improve upon the 2nd Directive and its implementation in further ways. In particular, we note, with approval, some provisions that have been included:

- to remove certain unduly burdensome aspects of the 2nd Directive, where requirements imposed are not reflected by equivalent benefits in terms of law enforcement and the fight against crime;
- to reduce inconsistencies in anti-money laundering requirements and practices both within the EU (in terms of both different Member States and different parts of the regulated sector or other sectors vulnerable to money laundering) and between it and third countries (this necessarily implies a reduction of Member State options under the Directive for their own discretionary variations); and
- to introduce clearer protections for the employees of reporting institutions

4.2 The suggestions made in this opinion are intended to improve the Directive in ways that would contribute to these complimentary but not inconsistent objectives. Any further changes introduced during the final stages of the negotiation of the Directive should bear these over-riding principles in mind.

4.3 In view of the short period from the coming into force of the 2nd Directive, in many Member States, a relatively generous period should be allowed, for the implementation of the 3rd Directive.

4.4 As experience is gained of the administration of the Directives to prevent money laundering and terrorist financing, the European Union will probably need to consider some links and policy synergies with other aspects of criminal behaviour and its deterrence. The Committee has noted suggestions for:

- comparison of the draft Directive with the work of the Council of Europe on criminal law;
- clarification of arrangements for the confiscation of criminal funds;
- more on helping 3rd Countries with problems of organised crime;

- specific vulnerable areas, such as cross border tax evasion

4.5 The Committee welcomes the further development of the rules to prevent money laundering and terrorist financing as a symbol of a European Union that is ensuring high standards of probity and conduct in public and private behaviour. The Directive is both a practical step in the management of financial affairs and also a means of strengthening the European Union.

Brussels, 11 May 2005.

The President of the European Economic and Social Committee	The Secretary-General of the European Economic and Social Committee
Anne-Marie Sigmund	Patrick Venturini