AT A GLANCE

Requested by the ECON committee

Study in Focus

European Parliament

Improving anti-money laundering policy

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The original full study[1] assesses four key measures to improve anti-money laundering (AML) policy and legislation: (i) identification of high-risk countries through blacklisting; (ii) reduction in money laundering through letterbox or shell companies, (iii) harmonisation of EU AML policies through regulations; and (iv) strengthening the European executive, e.g. through a European public prosecutor, a European Financial Intelligence Unit (FIU), a European supervisor, or a European police also in the light of Covid-19.

Background

Identifying **high-risk jurisdictions** for money laundering is key to enable obliged entities to carry out appropriate customer due diligence and identify when enhanced checks are needed. Various different rankings and blacklists co-exist, whilst differences stem from variable ways to define high-risk but also from political issues. Likewise, defining and distinguishing harmless **shell** from harmful **letterbox companies** is difficult, since big companies can use shell companies with substance, but in practice they would still be *empty*. So far, AML policy in the EU was mainly done through directives, which have to be transposed/implemented by the Member States, some of which were delayed up to three years in doing so. Though the Fourth AML Directive had less delays, they were still substantial. Contrary to directives, regulations are the same for all Member States and all national law related to them has to be adjusted. A new Union body in charge of conducting criminal investigations and prosecutions for crimes against the EU budget is the **European Public Prosecutor's Office** (EPPO). Operational in 2020, the EPPO will strengthen the Union's capacity to protect taxpayers' money. Its agenda is quite small however, and other bodies could be necessary to fight money laundering. The coronacrisis will not only mean tremendous changes to business and the economy, but also to the way criminals behave, to the types of crime they commit and to the way, they will use the crisis for money laundering purposes.

Key findings

This study compiles diverse **rankings** through which high-risk countries can be identified. These include the list of the Financial Action Task Force (FATF), the EU list of non-cooperative countries for money laundering in 2019 and the EU list of non-cooperative countries for tax purposes in 2020, the Basel Money Laundering Indicator (BAMLI), Financial Secrecy Index (FSI), and several lists from academics. Qua volume, the largest money laundering risks come from wealthy countries with good financial infrastructure, and not from poor countries. Europe must, therefore, also look at its own high-risk jurisdictions.

Blacklists suffer from the *emptying blacklist paradox* if there are economic sanctions applied to the countries on the list. Governments will find creative ways to get off the blacklist by fulfilling standards on paper or using diplomacy to get removed from the list. The blacklists are diplomatically biased as well: e.g. the inclusion of Saudi Arabia, a major trading parter of some European countries, on the EU's dirty money list in 2019, sparked heavy debate and the list was rejected by 27 out of 28 Member States. Therefore, the wide use of blacklists should be reflected upon. It is a powerful instrument, but risks compliance on paper rather than true compliance. They may have counter-effects as well: thorugh these lists money launderers discover attractive places for their practices.

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The study suggests the use of white lists for countries with best practices, incentivising true compliance. Nevertheless, high-risk countries have to be identified, but this should be left to financially and diplomatically independent NGOs. The methodology, aims and outcome should be transparent, publicly available and regularly updated.

Shell companies are a phenomenon that is by design difficult to observe and none of the existing indicators to measure them are very reliable by themselves. However, comparing previous research on this topic, a pattern emerges of EU Member States with an unusually large number of foreign-owned firms and asymmetric or over proportionately large Foreign Direct Investment (FDI) stocks. For those jurisdictions, shell companies are more likely to be or become problematic. The most promising way forward seems to improve and harmonise **ownership registers**, since letterbox or shell companies cannot be measured directly as there are many ways of circumventing substance rules. The study suggests that both **legal** and **beneficial** ownership registers of companies should be easily available and regularly updated, including that of trusts, foundations and partnerships. Data verification is crucial for the effectiveness of the registries. Background data on the owners, employees, the company structure, its presence online and in social media or financial transactions could allow for *pattern finding* and *red flagging*. An encompassing legal analysis of EU Member States (and other countries') measures to fight letterbox companies could be done using data of the International Bureau of Fiscal Documentation, which is time consuming, but, once established, it can easily be updated.

Since criminals may profit from variety between legal systems and existing loopholes, **more harmonisation** within EU Member States is **needed** regarding information exchange, cooperation possibilities, fines, definition of predicate offences of money laundering, prosecution and conviction of launderers. The study suggests that regulations should be used when harmonisation needs to be reached fast as well as when setting up new EU bodies. While they are better for harmonisation than directives, risks that regulations bring are longer delays, compliance only in the books and resistance. There is a tradeoff between harmonised policy through regulation and the flexibility needed for anti-money laundering policy to be effective through directives.

The study finds that the model chosen for the EPPO to act like a *chameleon* adapting to diverse national laws and procedures, is cost effective. Since the latest scandals, voices for a **European supervisor** have become stronger. A direct model, where an autonomous European Supervisory Board has its own competencies and sanction possibilities, seems faster and more efficient than an indirect model in which the European supervisor only supervises national supervisors. Supervision should concern all financial institutions (as opposed to only high-risk institutions), while non-financial institutions should be excluded, since they are too diverse. There have also been calls for a European Financial Intelligence Unit, but the study finds this more complicated and less urgent. Good cooperation among national FIUs seems sufficient. Likewise, a European police seems too far from reality.

In the light of the coronacrisis, the study confirms the need for a European Intelligence Center in order to trace new types of cross-border transactions. Criminals will use loopholes between shifts in financial assets and might use the crisis as an opportunity to bring illicit money back in the real economy. The Intelligence Center could analyse these shifts in transactions as well as update the AML Tool comparing tax and money laundering laws in Member States and cross-check entries in beneficial ownership registers.

[1] https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648789/IPOL_STU(2020)648789_EN.pdf

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