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COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for 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

and

Proposal for a Regulation of the European Parliament and of the Council on information accompanying transfers of funds

{ COM(2013) 44 final }

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INTRODUCTION – THE NEED TO UPDATE THE EXISTING ANTI-MONEY LAUNDERING AND TERRORIST FINANCING FRAMEWORK

The EU has in place a developed framework to combat money laundering and terrorist financing. Over the years the rules have evolved and the scope has expanded, with each change aimed at closing down additional possible avenues that criminal and terrorists might exploit.

However the system is continually confronted with reminders that no framework, however robust, is immune from money laundering. The recent admission of money laundering by HSBC is just the latest example of what can happen when vigilance is lifted and controls are not sufficient. Increasingly heavy fines imposed by regulators in such circumstances are both confirmation of the international resolve to ensure enforcement of the rules, and a warning to other stakeholders of the potential consequences of any failings in their systems.

Regulators and policy makers must not become complacent to the risks. Criminals are continually searching out new vulnerabilities they can exploit. The amount of criminal proceeds seeking to enter the financial system and to conceal their illicit origins is truly staggering. A recent study by the United Nations has estimated that the amount of funds available for money laundering annually is somewhere in the region of \$1.6 trillion, equivalent to 2.7% of global GDP. However they also estimated that less than 1% of laundered funds are intercepted by law enforcement, and actual seizures amount to less than 0.2%.

For these reasons, work has been underway to update and strengthen the existing international standards. The Financial Action Task Force (FATF) published a new set of revised standards in February 2012, and will begin the process of evaluating the conformity of national jurisdictions at the end of 2013. The new standards will enable national authorities to take more effective action against money laundering and terrorist financing at all levels – from the identification of bank customers opening an account through to investigation, prosecution and forfeiture of assets. They will also better address the laundering of the proceeds of corruption and tax crimes and strengthen the requirements for higher risk situations and allow countries to take a more targeted risk-based approach.

In parallel to this process, the European Commission has also been undertaking its own review of the EU framework, and published a report on the application of the Third Anti-Money Laundering Directive ("Third AMLD")¹ in April.

The implications of this work are that the EU framework will need to evolve and adjust to changes which should see an increased focus placed on the effectiveness of regimes to counter money laundering and terrorist financing, greater clarity and consistency of the rules across Member States, and a broadened scope designed to address new threats and vulnerabilities.

¹ Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

1. PROBLEM DEFINITION

The problems of Money Laundering and Terrorist Financing – who is affected, and how.

There is a general consensus globally and across political spectrums that immense damage can result if financial systems are insufficiently protected from criminal or terrorist abuse. In particular, systems which fail to prevent money laundering and terrorist financing expose themselves to:

- Societal risk, stemming from the feedback of criminal and terrorist funds into criminal and terrorist activities;
- Negative economic impacts, arising from disruptions to international capital flows, reduced investment and lower economic growth;
- Financial market instability, resulting from reluctance of other financial intermediaries to engage in business, loss of reputation, drop in confidence and prudential risks.

A broad range of stakeholders is affected by money laundering and terrorist financing in different ways:

- Those **obliged entities** that are expected to keep the system safe by applying checks and controls, who face consequences should their systems be found to be inadequate;
- **Public authorities** who need to enforce the rules and protect the system from criminal or terrorist abuse;
- **Customers** of obliged entities, who need to bear the burden of increased controls and potentially reduced access to certain services;
- The **business community**, which bears the burden of controls and restrictions, but which benefits from a sound and secure financial system;
- **Perpetrators** of money laundering and terrorist financing, who continually seek to exploit – and must be prevented from exploiting – any weaknesses in the system;
- **Citizens and Society** within the EU, who must be protected against terrorist acts, or the damage caused by increased criminality fed off the proceeds of crime, or loss of welfare resulting from tax evasion, damage to market integrity or trust;
- **Society and governments** in third countries if the EU system is used in order to channel illicit proceeds resulting from corruption and criminality in those countries.

The EU Preventative system

The EU has in place a framework designed to keep the financial system safe from money laundering ("ML") and terrorist financing ("TF"). The framework is based, to a large extent, on the international standards adopted by the FATF of which the European Commission is a founder member. The EU framework has rules in place that require financial institutions and other obliged entities and persons to take measures to prevent them being used for the purposes of ML and TF.

The Problem Drivers

As the risks posed to the financial system by those involved in money laundering or terrorist financing constantly evolve, the framework for its prevention needs to be robust, flexible and up-to-date. The Commission services have identified three main areas where the current framework is in need of modification:

1. **The existing rules are inconsistent with recently revised international AML/CFT standards.** - Mutual Evaluations of Member States (by the Financial Action Task Force or Moneyval) have revealed certain inconsistencies between the Third AMLD and the FATF Recommendations. In addition, the FATF has made several extensions to the existing Recommendations which would render parts of the existing framework out-of-date. For example, the Third AMLD requirements on simplified customer due diligence have been criticised in mutual evaluation reports as being out of step with the FATF Recommendations. The FATF has also extended the scope of its Recommendations to include a larger category of politically exposed persons. Not being in compliance with the international standards has reputational impact for Member States and the European Union as a whole.
2. **The existing EU rules are differently interpreted across Member States.** - The Commission's review process has revealed several areas where the existing rules are differently interpreted. Examples include the requirement to identify the beneficial owner of a legal entity and the consistency of statistical data. This poses risks to the Internal Market and creates compliance difficulties for business operating across borders.
3. **There are inadequacies and loopholes associated with the current EU rules.**- Given the evolution of ML and TF risks, it is important that the EU framework is able to respond in a robust but flexible way. The Commission's review process has revealed concerns about the scope of the current Directive in respect of gambling services and traders in high value goods, where the rules are perceived as not being sufficiently robust. Strengthening the rules will be a step towards addressing these risks, and will place EU legislation ahead of the international standards.

The baseline scenario

The ever-changing nature of the threats posed by ML and TF require a response which is proportionate to the threats posed. If no action were to be taken, the following consequences would result:

1. The EU framework would not be in line with international standards. Given the risk that Member States would receive poor mutual evaluation reports, Member States might be tempted to adapt their own frameworks, resulting in fragmentation and a lack of convergence;
2. The uncertainties due to different application of the rules at national level would persist and would undermine the Internal Market;
3. Failing to better target resources at the risks of ML and TF would leave the EU vulnerable to emerging threats.

2. ANALYSIS OF SUBSIDIARITY

Flows of dirty money and terrorist financing can damage the stability and reputation of the financial sector and threaten the internal market. However, any measures adopted solely at

Member State level could have adverse effects on the EU Single Market and result in a fragmented response. EU action is justified in order to address the overall threat of money laundering and terrorist financing and to maintain a level playing field across the EU.

3. OBJECTIVES OF EU INITIATIVE

The overarching objective for the revision of the AML framework is to protect the financial system and the single market from abuse by criminals seeking to launder illicit proceeds, or from terrorists seeking to fund terrorist activities or groups. The Commission has identified four general objectives, namely strengthening the Internal Market by reducing complexity across borders, safeguarding the interests of society from criminality and terrorist acts, safeguarding the economic prosperity of the European Union by ensuring an efficient business environment and contributing to financial stability by protecting the soundness, proper functioning and integrity of the financial system. These are backed up by specific policy objectives linked to improving the effectiveness of AML/CFT regimes and maintaining the EU financial system's reputation. Operational objectives linked to the problem drivers complete the framework in which the various options for changing the legislation were considered.

4. POLICY OPTIONS

In terms of policy options, the Impact Assessment assesses a variety of measures/dimensions aimed at fulfilling the three operational policy objectives:

1. With respect to **ensuring consistency with the international standards**, different options are considered with respect to:
 - The inclusion of tax crimes into the EU framework;
 - The introduction of a risk-based approach;
 - The approach regarding equivalence/non-equivalence of third countries' AML regimes;
 - The introduction of risk-based supervision;
 - The introduction of new requirements for domestic PEPs/PEPs working in international organisations;
 - The best way to improve availability of beneficial ownership information;
 - The adjustment of the Fund Transfers Regulation to the new international standards (inclusion of beneficiary information, exemptions from scope).
2. With respect to **ensuring consistency between national rules and where appropriate flexibility in their implementation through the strengthening and clarification of current requirements**, different options are considered with respect to:

- Improved collection and reporting of statistical data;
- Clarifying how the 25% threshold for the identification of the beneficial owner is meant to apply;
- Introducing new rules to clarify that branches and subsidiaries situated in other Member States than the head office apply host state rules and reinforcing cooperation arrangements between home and host supervisors;
- Strengthening administrative sanctions.

3. With respect to ensuring that the rules are risk-focused and adjusted to new emerging threats, different options are considered with respect to:

- Broadening the scope of the Directive beyond casinos to cover the gambling sector;
- Clarifying the interaction between AML/CFT and data protection requirements;
- Addressing vulnerabilities in the high value goods sector;
- Strengthening FIU powers and cooperation.

5. ASSESSMENT OF IMPACTS

It is not possible to provide an accurate quantitative estimate of the **benefits** of having in place up-to-date, internationally compliant rules which are coherent across the Internal Market. However the World Bank describes the benefits as follows: "*..an effective framework for anti-money laundering (AML) and combating the financing of terrorism (CFT) have important benefits, both domestically and internationally, for a country. These benefits include lower levels of crime and corruption, enhanced stability of financial institutions and markets, positive impacts on economic development and reputation in the world community, enhanced risk management techniques for the country's financial institutions, and increased market integrity.*"²

The adaptation of the framework to stricter international standards, coupled with the additional changes which are proposed as a result of the Commission's own review process are expected to represent a substantial strengthening of the overall framework. The envisaged changes should mean that:

- a broader scope will address additional areas of risk,
- cross-border compliance should be strengthened,
- greater coherence between national rules achieved,
- greater effectiveness should result from more targeted and risk-sensitive rules.

² Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism Second Edition and Supplement on Special Recommendation IX, The World Bank/IMF, 2006.

In terms of **cost impacts**, the impact assessment acknowledges that the implications will be very different according to the situation of various stakeholders. The most significant cost factors associated with AML compliance are those connected with initial one-off costs associated with the introduction of new systems, training, consultancy, etc. On the basis of a previous Commission study³, it is already clear that how high those costs are likely to be will very much depend on the type of strategy adopted to ensure compliance (e.g. focus on automated, as opposed to manual processes). It will also depend on the degree of AML/CFT risk associated with the nature of each business. It is not expected that existing obliged entities will be unduly impacted by the envisaged changes, as they have already made systems investments which should be relatively easily adapted without the need for heavy new investments. The same cannot however be concluded with respect to entities which were hitherto outside the scope of the AML framework but which will need in future to apply AML/CFT rules. This is notably the case for the gambling sector, where in a number of Member States only "traditional" casinos are currently within the scope of national rules⁴. Where existing measures are extended (for example, in the case of Politically Exposed Persons) additional resources will be needed to make the necessary checks. Supervisors will also face greater burdens due to the broadened scope.

Giving greater prominence to the risk-based approach will have implications for governments (who will have to organise risk assessments), competent authorities and obliged persons and entities. However, these costs should be balanced by more targeted and effective measures aimed at dealing with the risks of money laundering and terrorist financing, which will mean that time and resources are not spent on technical compliance which might not be targeting actual risks. Customers are unlikely to be directly affected by the changes, although there will be changes in the level of information they are required to give (for example if they are politically exposed persons, or if they are the customer of one of the newly scoped entities).

In terms of **other impacts**, the impact assessment gives detailed consideration to how the envisaged measures would affect:

- Stakeholders – both those falling under the scope of the existing framework, and other stakeholders affected by the changed rules.
- Fundamental rights, where it is particularly important to ensure an appropriate balance between effectiveness of AML/CFT measures and the respect to data protection and privacy.
- SME's, where a distinction is drawn between the impacts on SME's which fall under the scope of the AML/CFT framework, and the impacts on SME's in general.
- The environment – where no significant impacts are foreseen.
- The international dimension, where in particular the current approach towards recognition of third country equivalence needs to be adapted to the risk-based approach, which should consequently mean that in future geographical location will be just one factor in a broader assessment of ML/TF risks.

6. COMPARISON OF OPTIONS

In terms of policy choices, the Impact Assessment concludes that a consistent EU approach to implement international standards would be appropriate, while introducing additional

³ Europe Economics: Study on the Cost of Compliance with Selected FSAP Measures, 5 January 2009.

⁴ This is further explored in Annex V.

elements of harmonisation to improve coherence across the Internal Market with sufficient flexibility to allow Member States to respond to new and emerging threats.

In terms of detailed policy choices, the Impact Assessment considers, a number of specific policy areas matching the identified problem drivers as follows:

1. **The existing rules are inconsistent with recently revised international AML/CFT standards:** the need to comply with international standards needs to be met with a response that recognises the specificities of the single market. With this in mind, the Impact Assessment concludes that that there should be changes to the current framework to reflect the following:

- Tax crimes – are to be added as a predicate offence;
- National risk assessments – are to be required, with the option for elements of supra-national assessments.
- Simplified and Enhanced Customer Due Diligence rules - are to be revised in order to comply with the international standards;
- Third country equivalence – will be reviewed to focus on "non-equivalent" third countries.
- A risk-sensitive approach to supervision – is to be given specific recognition, with the option for guidance to be provided on a sectoral basis;
- Politically Exposed Persons – the Directive will propose an extension of the categories of individuals who are included in scope.
- Beneficial ownership information – will be made available to competent authorities and obliged entities.
- Electronic Fund Transfers – Regulation 1781/2006 will be amended to cover the recent changes to the FATF standard and to take into account the Commission's review process.

2. **The existing EU rules are differently interpreted across Member States:** the different approaches adopted by Member States to the existing EU legislation highlight the need for a greater level of harmonisation in the framework. However, full harmonisation would not necessarily be the most pertinent solution to deal with the risks of ML and TF in the EU. Given the need for a degree of flexibility to deal with the emerging risks, the conclusion of the Impact Assessment is that the Directive should propose the following changes:

- Statistical data – improvements are needed to the way statistical data is collected across the EU;
- The definition of "beneficial owner" – will be clarified.
- Home and host supervisory responsibilities – will be clarified;
- The availability of administrative sanctions – will be harmonised to a certain extent.

3. **The existing rules do not adequately address the new Money Laundering and Terrorist Financing risks:** The need for a robust but flexible response to new and emerging threats points towards introducing more risk-based measures but without a prescriptive level of detail. The Impact Assessment concludes that the following amendments to the legislation are appropriate:

- Gambling - the scope of the Directive should be expanded to cover all types of gambling;
- Data protection rules – should be clarified to enable the proper application of AML/CFT rules;
- Traders in goods – the threshold for inclusion in scope and customer due diligence requirements will be reduced to €7,500;
- Cooperation between Financial Intelligence Units – will be strengthened in the Directive.

7. MONITORING AND EVALUATION

The Commission is the guardian of the Treaty and will therefore need to monitor how Member States have implemented the changes to the Third AMLD and the FTR. Where appropriate and on request, the Commission services will offer assistance to Member States, throughout the implementation period, for the implementation of the legislative changes in the form of transposition workshops with all the Member States or bilateral meetings. Wherever necessary, the Commission will follow the procedure set out in Article 258 of the Treaty in case any Member State fails to respect its duties concerning the implementation and application of Community Law.

The Commission will work with the joint Committee of the European Supervisory Authorities on AML (AMLC), which in particular produces reports on the implementation of the third AML Directive in some specific areas in order to monitor the application of the new legislative framework. The Committee on the Prevention of Money Laundering and Terrorist Financing (CPMLTF), could also serve as a forum for sharing information on application issues. The Commission services may also use the findings of studies carried out by stakeholders or Member States as well as any feedback from meetings with private stakeholders. Consideration will also be given to commissioning an external study as appropriate.

Monitoring of the application of the AML Directive will also take place indirectly through the mutual evaluation processes of the FATF (15 EU Member States are members of this body) as well as Moneyval (the other 12 Member States are members of this body). This peer review process is an essential and rigorous process to ensure that Member States comply, both in law and in practice, with FATF international standards, from which most of the requirements of the AML Directive are derived. Evaluations take place around every 5-7 years for each country and can be complemented by follow-up reports, usually every 2 years (or more frequently if the deficiencies identified require it).

CONCLUSION

The Commission considers that the preferred options described and analysed in this Impact Assessment are proportionate to the objectives. By ensuring a tailored and flexible approach, Member States should not be constrained from adopting measures and taking actions as necessary to counter important threats they may confront at national level. The inclusion of processes at EU level to ensure greater coordination and the development of supranational approaches, together with further harmonisation in specific areas should ensure that EU

objectives are also met. Although ensuring an effective AML/CFT system entails considerable costs for obliged entities, the Commission considers that the (much harder to quantify) benefits associated with preventing money laundering and terrorist financing will continue to outweigh the costs, including the new costs arising from the changes to the framework.