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Change of paradigm in fighting money laundering

A global anti-crime system in operation

(The new European Union directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing)

"Money laundering and terrorist financing are international problems and the effort to combat them should be global."
(Directive 2005/60/EC of the European Parliament and the European Commission)

After years of preparation the Parliament of the European Union adopted the new directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (hereinafter referred to as the directive) relatively quickly, on 26 October 2005, which replaced the first and the second 'anti money laundering directives' bringing back the relevant legislation of the EU to the forefront. The member states are required to adjust their legislation by 15 December 2007 the latest.

One might ask whether it is not an exaggeration to speak about a global system of instruments in connection with the regulation of such a special field. In this essay I would like to highlight changes that have contributed to this instrument, which initially served as a tool in the prevention of drug-trafficking, to become a global instrument in anti-crime efforts.

GENERAL CHARACTERISTICS

The international legislation fighting money laundering is specific in a number of ways.

- The system of global regulation is based on a group of experts, whose authority is unquestionable, operating on a club like basis (which means that it is an exclusive organisation with strict admission rules where admission is to be consented by the members), established in 1989 as an ad hoc working committee, the form of which is still retained. This organisation is authorised to create rules, monitor and assess compliance and sanction non-compliant behaviour.
- The legal and other rules related to money laundering – unlike elsewhere in the world – require uniform procedures from a uniform group of those obliged based on uniform principles with uniform content using uniform concepts. Being an element of the system of rules, the international cooperation, the uniform regulation in these countries and the institutions based on these form a global system.
- A stable mechanism serves as a basis of the constant development and functioning of such uniform regulations on a global level.
- The basic principle of the operation of this system is the procedure initiated based on the

principle of the emergence of a suspicion. In the first place the key role players – who become quasi law enforcement entities – are financial institutions, lawyers, traders etc., often referred (unofficially) to as the 'guardians of the gates'.

■ Due to its success to date the system has been charged with the prevention of financing terrorism as a global commitment in addition to their existing tasks, and assigned a significant role in the fight against global corruption (by a new rule on the control of the so-called politically exposed persons, i.e. political elite in the world).

ESTABLISHMENT OF THE INSTITUTIONAL BASIS FOR COMMON STANDARDS

The FATF Group

In 1989, the leaders of the G7 countries decided to set up a task force for a defined period of time to lay down the principles for the elimination of money laundering practices witnessed in the financial sector. Presumably it did not occur to any of the founders at that time that they launched one of the most influential international organisations in the world. Indeed, the abbreviated name of the Financial Action Task Force (FATF) soon became a 'trademark'. Its success may be due to the fact that the experts worded their forty recommendations in a simple and easily understandable form in line with everyday practical moral standards. The documents known as the Forty Recommendations not only became an international standard, its title became a symbol, too. The number of the new recommendations adopted in 2003 is 40 again with various new parts categorised under subtitles, supposedly in order to keep the original title, which became so familiar. Since its establishment, the assignment of FATF has been renewed a number of times, and it seems that this will continue in the future.

After 11 September 2001, in addition to the Forty Recommendations, the Eight Special Recommendations on Terrorist Financing were adopted. (Further nine were added, that's why these are addressed as the 40+9 Recommendations).

As a result of the fairly restrictive admission policy of the FATF, which is still operating on a club-like basis, and its evaluation system based on mutual evaluations carried out regularly, it became necessary to set up regional, FATF-type organisations for non-FATF member countries. (Hungary, for example, is a member of Moneyval, a FATF-type organisation established in the framework of the European Council.) The region is made up of European countries other than the EU-15. These organisations are engaged in the monitoring of compliance with the FATF recommendations; however, they have no right to prepare recommendations. There is a pyramid-like hierarchy evolving, with FATF on the top authorised to create rules, monitor adherence and sanction shortcomings and regional organisations at the base, which follow up and evaluate the compliance with the rules in accordance with the methodology of the FATF.

The new 40+9 Recommendations published in June 2003 is different from the former ones essentially in that the short, easy to understand, but necessarily simplified rules were replaced by new regulations that make often quite different options possible, thus taking into account the mechanisms of the economy and financial transactions. In addition it was the service provider's responsibility to determine to which extent the stipulated measures were to be applied based on an assessment of risks. Practice will reveal whether the system may remain uniform when those liable take advantage of these options. These FATF recommendations are addressed primarily to the member states and legislative organisations and the content of these recommendations should

be transposed in the national laws. Each EU member state transposes the recommendations in its national legislation. The EU member states – and thus Hungary – are directly subject to the adoption of the Forty Recommendations effective since June 2003. However, most member states will consider the Forty Recommendations filtered through the new EU directive as a basis of their national legal acts to be created by 15 December 2007.

In order to establish and prevent a single internal market the EU believes that Community level regulation should be adopted which contains the minimum requirements and is uniform as far as the key issues are concerned. In the EU the free movement of goods in the internal market and the free provision of financial services in all EU member states require the management of the resulting risks specifically.

Cooperation of FATF and other international organisations

Jointly, the International Monetary Fund and the World Bank (IMF/WB) have long been keeping guard over the balance of the world's international finances. In this framework 'country reports' are prepared on a regular basis on the state of a given country's financial system (Financial Sector Assessment Program: FSAP). Recognising the significance of the fight against money laundering as far as a given country's financial state is concerned, adopting the FATF recommendations and their assessment aspects, a uniform IMF/WB assessment methodology was elaborated as part of the FSAP, which is compatible with the methodologies of FATF and FATF type organisations. The cooperation of these organisations is well illustrated by Hungary's country report of last year. In this framework the third round of the Moneyval assessment of the member states' measures against money laundering and terrorist financing ('mutual assessment') was carried out by the experts of the IMF/WB commissioned by and with the participation of Moneyval. The results discussed and partly revised by the general meeting of Moneyval was integrated (without any modification) in the FSAP report of the IMF/WB due in the same year.

The Basel Committee on Banking Supervision, which provides a forum for authorities supervising central banks and financial institutions, has created standards for various aspects of bank security. This is how it became a creator of a number of recommendations on measures against issues endangering the renown of banks, such as money laundering. FATF considers these highly important and so it refers to them directly in its new Forty Recommendations. Furthermore, it stipulates their application in other financial service areas, wherever possible. It means that the two regulatory systems, formed taking different aspects into consideration, are connected. The connection was made in the intersection of the protection of financial institutions, their customers, owners and the financial markets and the protection against criminal activities, serving both purposes. The international bodies of other financial services (insurance, securities trading etc.) have also prepared their own recommendations on the fight against money laundering in line with the Forty Recommendations. This is how the hierarchic system of compatible recommendations has been established.

THE EVOLUTION OF THE BASIC ELEMENTS OF THE SYSTEM

Extension of the definition of money laundering

The fight against money laundering evolved from measures against drug-trafficking. For a relatively lengthy period money laundering

meant cleaning dirty money obtained through drug-trafficking especially as international agreements covered only this field. However, with the emergence of FATF and the issuance of the Forty Recommendations the international background facilitated the extension of the definition of money laundering to financial and other instruments obtained from other criminal acts, too. For a while money laundering was defined as the concealment of instruments derived from serious criminal acts. The 'all crimes approach', as a final solution covers all criminal acts where the origin of the instrument is concealed. The new EU directive has actually introduced this latter principle. It also means that money laundering activities are globally on the rise partly as an increasing number of criminal acts are included in the definition of money laundering. A very important achievement is that those under obligation should report suspicions of money laundering acts. Should any other criminal acts be behind the suspicious proceeds or transaction, they all may be considered as reportable transactions. It means, however, that regulations against money laundering have turned into an instrument against all crimes instead of an instrument against a single crime.

Extension of the reporting obligation

Initially, when the primary objective was to prevent laundering money obtained from the sale of drugs, the relevant regulations referred only to institutions capable of entering money into bank accounts, i.e. financial institutions.

The most important elements of the regulations are well known. Their short summary is as follows:

- it is obligatory to record and keep the customers' data;
- suspicious transactions should be reported to an authority set up for this very purpose and the transaction should be stopped, if it is possible and suitable;
- money laundering is a crime, which may be punished even by detention for years;
- the reporting entity is not responsible for the customer's loss arising in connection of such reporting.

However, as the money laundering techniques are becoming more refined, and anti-money laundering measures are in place in financial institutions, criminals try to make their proceeds legal through newer and newer transactions. Recognising this, the obligatory application of anti-money laundering measures was extended in 2000 in the European Union, years before the similar steps taken by FATF. From this date this covers various professions other than financial services such as lawyers, car dealers, jewellers or real estate agents. Consequently, the following step in the procedure was that for all purchases exceeding a relatively high limit (which is currently 15 thousand euros) the anti-money laundering rules apply to all traders within the territory of the EU with special regard to recording the customer's data and reporting suspicious transactions.

This means that the obligation related to anti-money laundering (and terrorist financing) regulations, which originally applied only to banks, now potentially affects all traders. Therefore the number of those who should understand the various rules is measured in millions. They are also required to prepare internal regulations, train their staff on a regular basis, set up records, check black lists etc. The implementation and compliance should always be controlled (or validated) by an authority (which could be a professional local government). Such extension is a great burden not only on those under obligation but also on the public administration, chambers and other similar self-governing bodies. (There is no ready solution for these tasks in any EU member states.)

Such development incurs a number of problems for the investigating authorities, too. Due to the continuous and significant rise in the number of those obliged the number of reports has multiplied. For the law enforcement agencies the system offers a great advantage in that from now on not only the financial service providers, but also a significant portion of the non-financial service providers are treated as the "guardians of the gates".

In case law enforcement is carried out thoroughly, a further extension of the group of those obliged could have a great impact, i.e. when the anti-money laundering regulations are extended to all natural and legal persons who and which – due to their positions – act on behalf of the actual owner concealing the owner's identity. (I will go into details later, when listing the new instruments, however let me point out that the core of the system's development in the field of anti-corruption measures is already present in this regulation.)

Spatial extension of the application of the Forty Recommendations

It ensues from the characteristics of the FATF group that initially, its members took on the obligation to introduce the anti-money laundering measures themselves. Soon however, the OECD, which, apart from its own tasks, performs secretarial tasks for the FATF, included the implementation of the Forty Recommendations among the conditions of OECD membership. Among other things, the recommendations state that *it is* necessary to consider breaking off relations with countries and institutions that have inappropriate anti-money laundering regulations. The next step taken in this direction was the FATF action called *blacklisting*, within the framework of which the FATF selected the countries whose legislation they did not deem appropriate – and made their names public. This practically obliged each country in the world to have legislation that complied with the Forty Recommendations, unless it wished to intentionally risk breaking off its settlement, and (through that) economic relations with other countries.

Blacklisting proved extremely successful: the states in the list made every possible effort to be taken off the list, and the others also enhanced their efforts to further improve their legislation. The totally public nature of the repeatedly held mutual assessments, and their results' being made public supplemented the effect of blacklisting – partly even taking its place. Today, in the third round of mutual assessments, it is not the existence of the legislation that is scrutinised any more – as, essentially, it can already be taken for granted in every country, but the observation of the actual regulations. Today, regulations already require both the authorities and those obliged to comply to implement them. One effective tool of a quick survey of the implementation will be the obligatory collection and publication of statistical data on reporting, investigations, judicial proceedings, verdicts, and seized assets.

Geographically, the circle of corporations obliged to comply that follow appropriate procedures has further expanded. The reason is that now a company registered in any Member State is obliged to observe the anti-money laundering and terrorist financing regulations and procedures of its parent country in all its branches in countries outside the EU, and even in its subsidiaries. Should that prove impossible in a given country, immediate reporting is obligatory.

Establishing comprehensive customer monitoring

It has long been one of the cornerstones of the prudential regulations concerning financial institutions to require circumspect customer

management and appropriate monitoring. Thus, the "Know Your Customer!" rule has quickly become one of the tools in the fight against money laundering.

However, the new legislation reformulated the unchanged provision, now as a comprehensive requirement. When establishing a business relationship, the service provider is obliged to become familiar with the purpose of the customer's business activity, the origin of the assets serving to achieve it, and, in the case of companies, the identity of beneficial owners. On establishing that relationship, the service provider shall conduct ongoing monitoring to find out whether the transactions between the customers and their business partners correspond to the originally established customer profile. Therefore, it is necessary to monitor all the customers and all their transactions during the whole course of the business relationship, and it is also necessary to assess whether a transaction that can be deemed suspicious on any account has been made – continuously, within a realistically set interval.

Extension of the indictability of the activities relating to money laundering

In Hungary today, the law differentiates between two types of money laundering, i.e. between the intentional and negligent commission of the offence. According to the definition of the new EU Directive, if the suspicion of either money laundering or terrorist financing arises, it is being committed intentionally that decides whether it is possible to consider it a criminal offence. In this respect, the Directive is milder than the current domestic legislation. However, in another section, the EU Directive imposes the requirement that it be possible for those having leading positions within legal persons to be held liable on the basis of their function at the company – depending on the decision of the given country, but at least in the framework of a surveillance procedure, even if they have had no part in the money laundering itself at all, but

- one of their employees has committed the infringement for the benefit of the given institution, or
- they have failed to conduct the controlling activity which is their task, thus making the commission of the infringement possible.

However, essentially, these latter facts – limited to leaders – correspond to the concept of responsibility for negligent commission, while they also fit into the new legislative trend which intends to establish the greater personal legal responsibility of leaders of legal persons.

It promises to be a new provision of great practical impact that legal persons shall be indictable – with effective, proportionate and dissuasive penalties -, at least within a surveillance procedure. (It is true that the possibility of legal persons' being held criminally liable had been part of the legal system of the EU, and since our accession, that of Hungary as well.)

However, according to the definition, hiding funds and other assets derived from crimes committed by themselves – expressively termed as "self-laundering" –, disguising their origin, etc. are considered to be money laundering, in spite of the fact that several legal experts in Hungary regard this as double punishment. (Influenced by previous notions originating from the EU, this concept was incorporated into the Hungarian legislation years ago.)

In summary, the new legislation exerts direct pressure on senior management, and creates owners' interest in the compliance with the provisions at the same time.

Extension of the monitoring and reporting obligations

The world-wide institutional system established to prevent money laundering has numer-

ous features that also enable it to cut off terrorist funds.

- Primarily, the peculiar feature that reporting is obligatory even if only based on mere suspicion. This makes very early initiation of inspection and detection possible.
- The thoroughly outlined legal background – the chain from reporting obligation, through prohibition to inform the customer, to exemption from responsibility for incidentally caused damage – can be immediately applied essentially unchanged; so it is not necessary to take years to newly develop an international system.
- Technologically, it is essential that the automated monitoring programs, embedded in the computerised settlement and clearing systems, developed for anti-money laundering systems, which also recognise transaction types, together with the elaborate and well-proven reporting systems, which are operated by all those obliged to comply, can be rendered suitable to quickly select transactions and persons of different types, and to inform the authorities of them – promptly and with relatively few additions.

The UN, the EU and certain governments publish the names and other known data of the persons for whom or which no service whatsoever shall be provided owing to their participation in terrorist activities, whose availing of any funds or assets shall be hindered, and whose funds and other assets shall be frozen in different international lists. The EU publishes its own lists and the relating freezing measures in the form of regulations having direct effect in all Member States, while requiring the use of other lists necessitates issuing domestic legislation. (In Hungary, that requires legislative authorisation considering that it constitutes limitation of a fundamental right. However, Act No LXXXIII of 2001 empowers the government to publish its own limiting and prohibitive lists – for a limited period of time.)

Regulation (EC) No 2580/2001 – as an exceptional measure, corresponding to a particularly significant problem –, proceeding in a manner that to a certain extent evokes ancient Roman proscriptio, i.e. exclusion from all protection under law, obliges everybody (i.e. natural and legal persons as well as organisations) to freeze all movable and immovable properties of the persons and organisations in the list, which is essentially the equivalent of seizure of property in the everyday sense. The authorities in the Member States have had three tasks. One was to create adequate internal legislation. Pursuant that, those who do not implement what is required by the regulation are adequately punished, and reporting the freezing to the national authority designated for this purpose (usually the ministry of finance) is made mandatory. The second step: the national authority shall also immediately inform the EU Commission of the freezing. The third task: for reasons of equity, or to provide their owners a way to make a living, the designated national authority may again give access to the frozen assets to their owners in justified cases. In a rather one-sided fashion, the legislation deriving from this regulation rendered it the task of private individuals and enterprises to deprive terrorists of their assets – based on their own assessment and decisions, relying on the names and possible other identification data in the list –, without even mentioning the procedural tasks of law enforcement bodies. By comparison, the significance of the new Directive is that now the full and well-proven set of instruments of protection against money laundering may and shall also be applied as soon as the suspicion of terrorist financing arises. Practically, it means that if e.g. a person whose name seems familiar to service providers from the list appears among their customers, providers are not left to their own resources during the procedure because, on their informing the police, the whole well-proven mechanism is supposed to be set in motion.

However, the Directive did not take the opportunity to connect the instruments serving the same purpose: it does not refer to the still obligatory monitoring and use of the terrorist lists pursuant Regulation (EC) No 2580/2001. The reason for this presumably lies in the rigid legal separation of the tools belonging to the three different pillars of the EU. Thus the seemingly logical step, i.e. the EU anti-terrorism Directive's requiring the automatic application of the appropriate provisions against the persons in the EU terrorist list failed to be taken. (The Directive on the specific details of the implementation of Directive 2005/60/EC is expected to contain at least one reference to the still obligatory application of Regulation (EC) No 2580/2001 and its amendments.)

According to the present definition, terrorist financing – similarly to money laundering – is only considered a criminal offence if committed intentionally. Concerning specific cases, this will obviously render the taking of evidence more difficult. Consequently, the efficiency of the legislation will crucially depend on the judicial practice to be established in the course of handling such cases.

NEW (FUTURE) INSTRUMENTS OF THE DIRECTIVE

Risk-based approach

The so-called risk-based approach has long been used in several fields of process control – such as the supervision of financial institutions. Briefly, it means concentrating limited resources on the areas and institutions constituting the largest potential danger and damage. At several points, the new Directive empowers the Member States and certain institutions obliged to comply to introduce provisions or internal procedures milder than recommended, or even ignore the application of the given rule altogether if it is found permissible in the course of risk assessment. However, this permissive rule implies – not in the domain of state decisions, but in that of corporate decisions – that if something goes wrong, then it is the company that shall prove before the supervisory body: the measures applied have corresponded to the extent of the risk. By comparison to the previous system, the simple but rigid system that required identical procedures against everything and everybody ceases to function. The professional skills and experience of those obliged to comply may have a part in the choice of necessary procedures, which, on the other hand, has its price: the persons authorised to make decisions will have to assume the responsibility of their choice and the risk involved.

This constitutes a huge risk for the management of individual institutions: naturally, the application of simplified procedures may be advantageous for profit maximising, however, in such cases the possibility that their supervisory body will not approve of their procedures in retrospect and they will have to bear the personal consequences described above will lurk above them continuously. This makes it probable that many of them will endeavour to make the supervisory body approve of deeming the given type of situation one of low risk in advance. However, this would hardly be in harmony with the aim of the Directive: the risk of the application of the risk-based approach is to be taken by the accountable managers of service providers, which is to force them to examine all still bearable risks regularly, on a case by case basis.

Simplified and enhanced customer monitoring, prohibitions

It is perhaps in this field that the Directive presents really ample opportunity to the Member States to outline country-specific vari-

ations of the legislation, taking domestic characteristics into consideration. After describing the different steps of customer monitoring, the Directive describes cases and situations when enhanced or simplified procedures shall or may be applied, as opposed to the default procedures, in two chapters. In the majority of the cases encompassed in the Directive, the Member States can decide to introduce the milder procedures themselves; however, they are obliged to introduce the considerably tightened procedures.

Some simplified procedures grant actual, total exemption from customer management provisions. (The Directive, probably unintentionally, does not differentiate between identification procedures and transaction monitoring, and when authorising simplified procedures, basically, it remits both. However, the Implementing Directive will in all probability establish that filtering transactions shall constitute a fundamental obligation, not to be neglected under any circumstances.)

With regard to the second group of simplified procedures, the Directive renders possible the simplified execution of the required inspections in the case of transactions of small individual value relating to certain services provided on occasions, or to an insignificant extent.

A number of key institutions – e.g. credit institutions, insurers, investment funds, etc. – are under strict (official) state supervision as managers of other people's money, and so are players of the financial and capital markets to protect the operation of the market. As part of the state administration or as a state property (e.g. state-owned companies), several customers (e.g. municipalities) are under direct or indirect state supervision of some form. In view of this supervision, and also taking the differences in the nature of the supervision into account, the Directive requires and permits both obligatory and optional simplified procedures.

The Directive grants obligatory exemption from customer management provisions to credit institutions and financial institutions[1], which means that the legislation of a Member State cannot impose obligations on them in this respect.

As for the other institutions listed in the Directive and its Implementing Directive, the exemption is optional; consequently, national legislation may provide exemption, but not obligatorily.

Enhanced, or tightened customer monitoring shall always be required of those obliged to comply, by national legislation, if

- customer identification has been carried out without the physical presence of the customer,
- a correspondent banking relationship has been established with a credit institution of a non-EU country or a country to be deemed identically,
- they establish or maintain business relationships with customers classified as politically exposed persons, or
- they deal with products or transactions that favour anonymity.

Apart from financial organisations' exemption from the identification obligation, only two definitive prohibitions are found throughout the Directive: one prohibits establishing relationships with so-called shell banks, i.e. phantom banks registered somewhere without actual business presence, while the other prohibits establishing or maintaining relationships with unidentifiable customers. As far as the latter is concerned, it is worth noting that with regard to small-amount anonymous accounts, diminishing, but at a very slow pace after the campaigns aiming to identify the owners of savings both in Hungary and in certain other Member States, the Directive permitted maintaining these accounts as a separate rule, on condition that the owners might not use their deposits

in any manner prior to the registration of all their identification data (which condition had been taken over from the Hungarian Anti-Money Laundering Act).

Divulging the beneficial owner's identity

The previous EU Directive had already required that apart from the identity of the customer, service providers also know that of the natural person known as the beneficial owner, who – in contrast to the customer – was the ultimate owner or beneficiary of the given funds and other assets. A beneficial owner may only be a natural person. Theoretically, this means that independently of the number of legal persons (ltd's, plc's, foundations, etc.) through which someone's proprietary right is established, the service providers obliged to comply shall continue searching until they reach the living, flesh and blood human being. The customer's obligation to divulge the beneficial owner's identity and the service provider's obligation to trace the real owner serve the same purpose: to extend the effect of the Directive to the real owners. (Among those specifically referred to in the Directive, the terms "trust and company service provider" and "trustee" refer to professions whose names do not even have established Hungarian translations yet, and the legislation concerning them has solidified to an even smaller extent. At the same time, it is highly probable that the representative and trust activities relating to them are wide-spread in Hungary albeit without their being recognised as professions.) Consequently, demanding that the actual market players be identified reaches much further than the fight against money laundering and terrorism: in the long run it may serve as a basis to create general money and capital market transparency.

However, when the legislation was being drafted, it quickly became obvious that these ideas in their pure form could not be put into practice at present. The reasons include the following:

- there exist millions of small owners without any influence on the business activity of the company co-owned by them, thus it is unnecessary to identify them as beneficial owners;
- the owners of public limited companies may change several times or significantly even during one day, which, naturally, authorities have to trace for the transparency of market processes and in order to prevent fraud. Still, it is not necessarily expedient for the different service providers (e.g. their banks or investment consultants) to continuously register these temporary changes;
- the ultimate beneficiaries of the activities of foundations and charity associations are not (and cannot) be known in advance.

Also, it is impossible to put these ideas into practice in a perfect form because the large public registration systems established throughout the world over the centuries – such as company registers of company registrars, land registers, etc. – have not been developed to allow establishing the identity of beneficial owners; thus they are not suited to serve as background tools of an automated query system.

The above reasons have led to a significant shrinkage of the theoretically rather ambitious scheme to identify beneficial owners – partly out of rationality, partly out of necessity. However, the basic principle has remained unaltered, and will probably prevail in the long run.

The most important exceptions and simplifications concerning beneficial owners contained in the Directive are the following:

▫ It is not obligatory to apply most of the tools of customer monitoring in relation to

credit institutions and financial institutions registered in EU Member States or in certain third countries at all. Especially in the case of their own-account transactions, it is possible to waive the obligation of identification. (Naturally, this does not concern the dealings of intermediaries of customer transactions.)

- The Member States may waive the obligation of identification regarding owners of public companies, owners of amounts on lawyers' and notaries' clients' pooled accounts, and domestic authorities.
- In the case of limited companies, owners who own a minimum of 25 per cent of the shares, or have control over the managing of the company in any other way are to be regarded as beneficial owners. (This percentage was established through heated debates and may even be decreased in the long run.) Consequently, if there is not at least one person with such an ownership ratio, or an owner having similar influence on company decisions in any other manner (e.g. there are five co-owners with equal rights), the enterprise – at least with regard to anti-money laundering provisions – does not have a beneficial owner. According to the unofficial opinion of an EU expert, for this reason it is unnecessary to search any further to find one. This greatly eases the task of those obliged to comply, moreover, it creates a simple opportunity to evade the application of the provision (e.g. through a 24.9% ownership), and as such, it is likely to be utilised widely in the future.

The Directive left open the question whether those obliged to comply should obtain customers' and beneficial owners' data from

- registers also available for the public,
- customers' statements, or
- other sources.

This latter instance suggests that utilising any data collection not expressly prohibited by law for this purpose will be acceptable in the future.

Fulfilling the reporting obligation

In the early 1990's, what anti-money laundering experts emphasised was the importance of the largest possible pressure to be put on the clerk who had direct contact with the customer in order to ensure the fulfilment of the reporting obligation. At that stage, the sole obligation of the company or enterprise concerned was not to hinder reporting, but rather help it by appointing the person responsible for it.

Today companies and employers are the general addressees and executors of the legislation to be prepared based on the recommendations – and more importantly, on the Directive. It is their duty to make sure that they both operate appropriate systems and have appropriate employees who conform to regulations. Reporting has also become the duty of companies primarily, as it is unambiguously stated: "shall require the institutions (…) covered by this Directive, and where applicable, their directors and employees, to cooperate fully by promptly furnishing (...) information".

Focussing on the company with regard to that obligation shows that the treatment of the topic as such – due partly to the modernisation of the professional procedures, and partly to the transformation of the objectives – has become industrialised. It has been recognised that there is a higher interest in putting the whole enterprise – especially its top management – in the service of detecting and preventing money laundering than in maximising the pressure on a few employees who have direct contact with customers. Besides, the large majority of suspicious transactions and persons are now singled out, and the information on them is automatically sent to analysers by the fully automated checking and recognising software embedded in the clearing processes. Thus, suspicion often arises in the minds of machines and not people. Traditionally, or legally speaking, in

such cases it is not even possible, or at least it is difficult to speak about the recogniser's suspicion…

Eventually, in the majority of cases, after the examination has been carried out in compliance with several internal rules, utilising a series of software, and involving further experts, reporting is done by an analyst whose official range of duties includes detecting money launderers and terrorists. It is easy to accept that functionally, this person in charge of reporting is rather different from clerks who expressed their suspicion based on their own personal impressions on each occasion, and on whom the system was once built. Accordingly, the Directive no longer deals with the clerk in charge of reporting at all. Moreover, regulations concerning the person within the company traditionally reporting to the financial intelligence unit (FIU), and the reporting route up to the person in charge are only indirectly tackled. The reason is that it is required that those obliged to comply (i.e. the companies) "promptly inform (...) the FIU, (...), where the institution or person covered by this Directive knows, suspects or has reasonable grounds to suspect that money laundering or terrorist financing is being or has been committed". The prohibition of filtering – retaining reports that have been prepared, or refusing to forward them – has also only been formulated concerning forwarders of reports in certain countries, e.g. public prosecutors, thus emphasising that it is now companies that are primarily responsible for fulfilling the reporting obligation.

Restrictions concerning the use of cash

Since the beginning of anti-money laundering activities, cash transactions have been considered the most suitable method for money laundering. For this reason, a separate system of regulations has been outlined to treat them and restrict them to the greatest possible extent.

Despite the example of setting an upper limit for (permitted) cash payments in a Member State, the EU has not introduced this very drastic, prohibitive solution (even though there is reference to it in the Directive). Instead, it is required that in the case of cash transactions in an amount over EUR 15,000, even retailers who would otherwise not be covered by this legislation apply the rules of customer monitoring and other anti-money laundering measures. The provision is expected to have a restrictive but by far not prohibitive effect on cash payments in almost the whole of Europe. The introduction of the provision will probably cause problems in daily business activities, primarily in the new member states, which rely on cash to a significantly larger extent than the EU-average. Still, it is important to emphasise that this may be the first all-EU legislation which openly disfavours – even if only indirectly – the use of the notes issued by the central banks of the Member States as legal tenders as official and permitted means of payment. In the future, the process thus initiated is expected to continue: further restrictions are expected to be introduced in order to further reduce flow of money that is impossible to monitor.

Introduction of regulations concerning PEP's

The introduction of the term "politically exposed person" (PEP), and the provisions relating to procedures concerning such persons is the element the most fully representing the universal law enforcement function in the new legislation. The theme originated from the habit of many 20th century dictators and their henchmen, who, anticipating a

possible downfall, placed a significant part of the huge fortune which they had obtained from individuals and the state budget unlawfully during their reign in foreign banks. Obviously, making these amounts appear to be the property of those unlawfully possessing them is one form of money laundering. Also, it has been experienced that certain amounts moved through foreign accounts have served to finance further serious crimes such as arms smuggling and terrorism. Assuming that it is the possession of high-ranking state, military, political, etc. posts that creates an opportunity to commit such crimes, the Directive required that all people entrusted with prominent public functions, as well as their immediate family members and colleagues be classified as politically exposed persons, and also as high risk persons. The Directive also refers to the threat to the reputation of enterprises that maintain business relations with such persons and participate in their illegal transactions – and thus, eventually the threat to the trust in the financial system, one of the cornerstones of the economic system. [Again, at this point, the provision of the EU-Directive, (also) serving to protect good reputation, shows connections and overlap between the requirements set down in the Basel Core Principles on bank security and the FATF Recommendations concerning the fight against money laundering, thus verifying the existence of the global connecting process of regulations of different objectives, which, however, concern identical processes.]

However, the system, based on a deduction accepted as logical, will also have rather specific and unusual consequences. Declaring all world leaders to be high risk customers, and especially ones that require to be under close surveillance – at their banks, insurers, pension funds, and when purchasing cars, property, jewellery, etc. – will result in a sort of inverted "Big Brother is Watching You" situation. From now on, it is not the leader that will keep the ones led under constant surveillance, but – by service providers obliged to comply being inserted in the system – the relationship is becoming oddly reversed. We are witnesses to the unfolding of a global surveillance system mounted against the misuse of political power and state-level corruption, based on a thorough consideration of anti-money laundering principles, extending them to the utmost limits.

Therefore, in the PEP regulations, beside the double task to act against money-laundering and terrorist financing, we can recognise the introduction of a third use of the system, i.e. to act against corruption. (If we regard the obligatory tracing of the identity of beneficial owners as a separate task to be carried out even if there is no suspicion concerning either money laundering or terrorist financing, then together with the ones previously mentioned, we can distinguish four essential tasks of the system, out of which only two are openly declared.)

Deciding whom to classify as a PEP exceeded the possibilities of those outlining the Directive. The European Commission has been assigned the by no means simple task to define the term PEP within the framework of the decrees on the implementation with exactitude, seeking the opinions of the experts representing the Member States in the Committee to Prevent Money Laundering and Terrorist Financing. Outlining detailed rules, e.g. how long a former PEP can justly be regarded as a PEP, what the criteria of "outstandingly high rank" are, what "local state administration leader" means, what standards are to be used for the classification "of a large city", how wide "the circle of immediate colleagues" is to be extended, etc. has resulted in numerous debates and a heavy workload. All the basic principles and details are still far from being completely outlined.

With regard to the usual element of committing the crime in question, i.e. transporting something abroad, the task is further aggravated by the fact that each PEP is only to be treated as a PEP in the foreign Member States. Thus, it is not domestic but foreign PEP's that are to be recognised in each Member State. (However, the FATF has suggested that the PEP regulations be also extended to domestic PEP's, and some Member States will presumably take account of this recommendation.) This poses a practical obstacle – e.g. who outside Brazil can tell the name of, say, the governor of Mato Grosso State? –, which will obviously make consulting outside professional aids necessary.

However, the preparation and application of lists containing names and other data of PEP's had not halted to wait for the EU basic principles to be outlined. The reason is that the new FATF Forty Recommendations became effective in June 2003, while the already effective EU Directive only makes compliance with this provision (and the ones relating to it) obligatory in the Member States as of 2008. However, it is rather uncertain whether reference to the transitory period will provide full protection against any criticism to be expressed in the course of accreditations provided by the FATF or similar organisations.

There is also a list compiling industry, which has developed based on the very generally formulated FATF Recommendations. Its leading companies have already compiled lists containing hundreds of thousands of names and created the programs necessary to apply them for their clients. There already exist world-wide compilations on PEP's on sale, based on information deriving from the news, Who's Who-like publications, different authorities' search programs or blacklists, and perhaps their compilers' own research. However, as yet, their scope and data content does not necessarily correspond to the EU-criteria, which is being laid down in an autonomous manner.

As soon as such details as whether e.g. the EU wishes to classify mayors of large cities as well as the leaders of the Catalan Generalidad, the German Länder, etc. as PEP's have ultimately been decided, professional compilers of lists (also) working for the European market will probably comply quickly by developing a variation satisfying the European PEP regulations.

Within this process, naturally, it will also be essential to know to what extent and how the service providers obliged to comply will be held responsible for the mistakes and for the updating of the lists either compiled by themselves or purchased, rented, leased, etc. under national legislation. As yet, this question has not arisen; still, it is conceivable that a certain kind of regulation or supervision will have to be extended to compilers of lists themselves in the future.

A further question to be answered is what kind of provisions ought to be applied concerning small and medium sized enterprises, which account for the vast majority of those obliged to comply. The purchase of pricey lists and their regular maintenance would represent too big a burden for them, and, at the same time, it would not be expedient to require that of those enterprises due to the size, composition, etc. of their clienteles. It is mostly the copyrights and the business policies of the compilers of the lists that are expected to constitute the limitations of the development of the probably multifarious national legislation, as it is to be decided based on these whether e.g. it is possible to check if a new customer is a PEP over the phone, or whether several users may purchase a single PEP-database for common use, etc.

In the future, as a first step within the PEP procedure, service providers are expected to request all their customers to declare whether

or not they classify themselves as PEP's based on criteria provided for them.

Customer identification by agent

Acting on the Forty Recommendations, the new Directive has accepted the consequences of a globalised world economy and the development of telecommunications equipment: international investments have become large-scale without the vast majority of investors ever appearing in the country where they have purchased interests and, indispensably, financial and other services. For the legislation to require that these investors or other persons in similar circumstances – such as foreign royalty owners and heirs – be physically present at the service provider's office in the target country in order to identify themselves would indeed be incompatible with the actual functioning of the world economy. The Forty Recommendations – and the Directive presented based on them – have offered two routes towards the solution of the problem.

One: identification without the customer's being physically present. E.g. executing a contract through the internet demands increased diligence of providers: it is their task to verify the new customer's (or beneficial owner's) identity through the use of additional documents and by applying special identification techniques.

There is another possible solution, which is significantly more similar to identification in the physical presence of the customer than the previously mentioned method, and is mutually more advantageous for parties acting in good faith: involving a new, so-called third participant, called introducer in the terminology used in Anglo-Saxon countries, to carry out the identification on behalf of the service provider. The term was introduced by FATF's New Forty Recommendations in a manner that allows its members – representing different and sometimes mutually exclusive views on this topic – to follow their own ways. Essentially, legislators were entrusted to decide who or what might be an introducer in a given country or group of countries. Fitting the activity of introducers into the framework of a definable profession – and introducing it in one form or another throughout the world – apparently serves to somehow eliminate the contradiction that has emerged between the theoretical requirement of the type of "Know Your Customer!" and the actual functioning of the world economy.

The EU was driven by a similar intention when outlining its own detailed regulations, which allow for several options. Pursuant the main rule, a country may decide not to allow identification without the customer's being physically present at all. However, if it permits introducer's activities to be carried out by its residents and companies in any manner, then it will have to permit it to be carried out by introducers from all other Member States, belonging to the same categories.

Another general rule is that if the identification procedure applied by introducers satisfies their own Member State identification criteria, its result is to be accepted in another Member State even if different identification criteria are established there. It is apparent that both rules serve the consolidation of the internal market to the largest possible extent.

With regard to who is allowed to carry out identification for whom, the structure of the meticulously balanced regulatory system can be likened to a pyramid.

The top of the pyramid is constituted by credit institutions, insurers, investment firms, and (with the exception of currency exchange offices and money transmission or remittance offices) financial corporations. They are authorised to carry out customer identification on behalf of both each other and service providers

belonging to all the other categories. It is apparent that when granting them these rights, legislators were not influenced by size, but the following common characteristic of theirs: these financial organisations need to be licensed to start and maintain their activities in all Member States in any case, and for this reason they are under strict supervision of an equally high standard in each EU Member State, as it is legislatively declared. Still, it seems dubious whether e.g. a financial corporation with a few million Hungarian forint registered capital will always be able to carry out a customer identification procedure of a standard identical to that of a bank with a registered capital of several billion Hungarian Forints, or whether it will be able to have the result accepted as one of identical value to that of the latter's.

The second level of the pyramid is constituted by representatives of the two types of service providers excluded from the previous group, currency exchange offices and money transmission or remittance offices. These service providers may only carry out customer identification for each another.

Among the other financial service providers to be covered by the legislation serving to prevent money laundering and terrorist financing pursuant the Directive – e.g. auditors, external accountants, tax advisors, notaries, etc. – only real estate agencies, casinos and traders may not act as introducers, while the others may carry out such verification activities for all members of their own group. (However, the exclusion of notaries from among universal introducers will probably cause major problems as, traditionally, it is exactly the representatives of this profession who most often authenticate copies of identification documents throughout the world.)

In summary, it is apparent that the picture of a large-scale, world-wide identification system is starting to be outlined in which, – maybe in several possible combinations, but based on transparent rules – specific customer information may now flow among determined participants on a global scale. We are to witness data flow of an even larger scale if we also consider the new rule that makes it possible – in sharp contrast with the total prohibition earlier – to communicate suspicion concerning a given customer within a group of corporations, and, on certain conditions, often outside it as well.

Authorising the EU Commission to outline and modify certain details of regulations

It is widely known that EU Directives usually follow the international recommendations serving as their basis with great delay. The primary reason for this is the demand for and the practice of continuously comparing views, both rooted in the basic principles underlying the creation of the EU. Consequently, big changes cannot be expected in this area in the future, either. On recognising and admitting this, authorisations granted to the EU Commission have started to appear in the EU Directives more and more frequently. Pursuant these, the EU Commission is both granted the right to and is obliged to adjust the technical details of the given legislation to fit the circumstances changing with time, and to outline and – applying strict control mechanisms – revise the parts that are expected to change frequently within the period determined by the given legislation. Thus, among other things, Directive 2005/60/EC has instructed the EU Commission to compile and maintain a list of third (i.e. non-EU) countries which both have and execute legislation of a standard at least equal to that of the Directive to Prevent Money Laundering and Terrorist Financing, as the Directive allows a number of simplifications –

identical to those prevailing in the consolidated internal market of the EU – for the Member States concerning clearing, settlement, correspondent banking relationships and other important financial relationships maintained with the countries in this list. Consequently, the internal EU regulations concerning the European countries that constitute half of the FATF membership have already become or may become one measure of the international relations of the EU. This is expected to contribute to the further unification of the international criteria and requirements, and to their further development as a global system also influencing countries outside the European Union.

NOTE

[1] Identically to the usage of the Directive discussed here, the term *financial institution* is to be utilised as a broad term encompassing financial and investment corporations as well as insurers and insurance intermediaries.