

Council of Bars and Law Societies of Europe (CCBE)
Efficiency in anti-money laundering regulation
The path to combating the laundering of proceeds of crime effectively
July 2020

Table of Contents

Introduction.....	2
Effectiveness and efficiency of AML regulation	2
<i>Timing of regulatory measures</i>	5
<i>The risk-based approach</i>	5
<i>The subsidiarity principle and self-regulation</i>	7
<i>Focus on predicate offences</i>	8
Recommendations.....	9

Introduction

Anti-money laundering (AML) efforts have been high on the European Union's agenda for the last 30 years, with already four updates and revisions of the initial Directive from 1991.

Nevertheless the substantive AML efforts and legislative measures adopted at EU level, the EU institutions and Member States have recently indicated on several occasions that they are not satisfied with the current AML regime due to perceived significant loopholes and divergences within national AML frameworks. Moreover, the recent stark examples of financial institutions' failures in the fight against money laundering have prompted actions at EU level which aim at improving and further strengthening the EU AML rules and supervision.

The most recent initiative in this direction is the *"Communication from the Commission on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing"*¹, issued on 7 May 2020. With this document, the European Commission (EC) outlined its plans for a more harmonized set of AML rules to be announced in 2021, as well as different options for strengthening AML supervision at EU level. Although the EC has not explicitly stated whether the Action Plan will lead to an AML Regulation, it has indicated that this decision will be *"[...] subject to a thorough analysis to ensure that [it] reaches as high a level of harmonization as possible"*.²

Taking stock of these developments, in this paper, the CCBE aims to address the effectiveness and efficiency of AML regulation at EU level and explores, from the legal profession's perspective, some potential issues that could arise from the adoption of a new regulatory regime in this area.

The paper further aims to highlight the benefits of the risk-based approach to AML and why a change of focus on certain predicate offences has the potential to result in more effective and efficient prevention of money laundering.

Effectiveness and efficiency of AML regulation

According to existing research, a policy is considered legally effective when the norms are implemented and followed. Thus, legal effectiveness is achieved when a rule is in force and functions. To achieve effectiveness, legal norms also need to be meaningful and should contribute to specific policy goals.³ In the context of AML, the key policy goals are:

- the prevention of money laundering and terrorist financing and crime in general – by developing systems that hinder potential launderers and financiers of terrorism from actually laundering money or funding terrorism – and
- the reduction of money laundering, terrorist financing or crime in general.⁴

¹ C(2020) 2800 final

² European Commission (2020): *Questions and Answers – Commission steps up fight against money laundering and terrorist financing*. [Online] Accessible at https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_821

³ Project 'ECOLEF' (2013): *"The Economic and Legal Effectiveness of Anti- Money Laundering and Combating Terrorist Financing Policy"*. Final Report, Utrecht University (NL), pp.59-60

⁴ *Ibid.*

At the same time efficiency in policy and regulation is about making the best use of resources to achieve best outcomes with less input/costs.

The literature focusing on the economics of AML/CFT regulation shows that it aims to justify resources (tax money) spent on AML policies and guide lawmakers so that they can formulate appropriate responses to money laundering and terrorist financing, pursuing both effectiveness and efficiency of AML regulation and enforcement.⁵

The current AML regime across the European Union is based predominantly on the AML directives. The EU directives require member states to achieve a certain result but leave them a degree of discretion to select the means for achieving the intended results. EU member states are required to transpose EU directives into national law in order to achieve their prescribed objectives,⁶ thus resulting in heterogeneous approaches to the implementation of directives among member states. At the same time, this does not necessarily mean that an entirely heterogeneous outcome is achieved within each member state following transposition.

The AML rules at EU level have not only incorporated the best international standard for AML (the Financial Action Task Force Forty Recommendations)⁷, they have enshrined these Recommendations as a common EU basis and, the EU AML rules have gone even further. Recent developments in the EU AML legislation (including the Fifth AML Directive⁸) have aimed to further strengthen the EU anti-money laundering and countering the financing of terrorism framework.

Despite the current robust set of EU AML Rules, the European Commission, together with the European Parliament and the Council, are of the opinion that the framework needs to be improved and that major divergences in the way it is implemented and enforced should be addressed.⁹ Some of the measures outlined by the EC include proposals to achieve better implementation of existing rules, a more detailed and harmonised rulebook, improved and consistent supervision, including a potential delegation of specific supervisory tasks to an EU body.

The CCBE would like to focus specifically on the proposals related to the establishment of a harmonised AML rulebook and an EU supervisory body and how they will impact the effectiveness and efficiency of the AML framework.

The European Commission has argued that the EU AML/CFT legislation needs to become more detailed, more precise and less subject to diverging implementations/transposition by member states. In order to achieve this goal, the EC has suggested that certain provisions of the AML Directives should become directly applicable by transforming them into a Regulation.

⁵ Borlini, L. and Montanaro, F. (2017): *“The Evolution of the EU Law Against Criminal Finance: The ‘Hardening’ of FATF Standards within the EU”*. Georgetown Journal of International Law, Vol.48, 2017, p.1018 [Online] Accessible at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3010099

⁶ European Commission *Types of EU Law*. [Online] Accessible at https://ec.europa.eu/info/law/law-making-process/types-eu-law_en

⁷ FATF (2012): *“The FATF Recommendations”* [Online] Accessible at <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>

⁸ Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (Text with EEA relevance), OJ L 156, 19.6.2018

⁹ Communication from the Commission on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing, C(2020) 2800 final, 7.05.2020, p.2

The CCBE has identified potential difficulties with the proposed approach and doubted to what extent the adoption of an AML Regulation would address the perceived loopholes, lead to better harmonization and improve the efficiency of the current framework.

Firstly, EU directives provide for more flexibility than EU regulations. According to Borlini and Montanaro (2017)¹⁰, such flexibility, as provided for instance in the FATF Recommendations¹¹, is very important in the area of AML where national laws and their enforcement must constantly develop to keep pace with emerging money laundering risks and typologies. Furthermore, flexibility is needed in terms of transposition approach so as to take account for the fact that AML applies across so many divergent business sectors which are already regulated in a variety of manners by different regulators with regard to the business activity they engage. For example, AML applies across many business sectors to designated bodies/obliged entities which include not only some legal services provided by the legal profession identified as being vulnerable to money laundering but also financial service providers, gambling providers, accountants, estate agents, dealers in high value goods etc.

Secondly, under Article 288 of the Treaty on the Functioning of the EU (TFEU), EU regulations apply directly and uniformly to all EU member states with an immediate effect after they enter into force. Regulations are binding in their entirety on all EU countries and should not be transposed into national law¹². However, regulations often might allow Member States to enact national implementing measures aimed at facilitating their effective application. The implementing measures can be either related to the establishment of an institutional framework in charge of the application of the Regulation or to introduce procedural rules necessary for the implementation of the Regulation.¹³ Due to such provisions which are obligatory for member states,¹⁴ regulations might potentially lead to incomplete harmonization of rules in EU member states and achieve no more than what is already achieved by the Directive-led approach

Another efficiency issue which might arise from the adoption of an AML Regulation is related to the different legal systems within the European Union belonging to the common and civil law. The adoption and implementation of an AML Regulation might cause conflicts with national rules not least because of differences in legal tradition, terminology, principles and styles of legal discourse of these legal systems.¹⁵ Accordingly, the current Directive-led approach may reduce the potential for conflict between an EU AML Regulation and a feature of common-law which could be respected and accommodated when transposing an EU AML Directive.

¹⁰ See *supra* note 4, p.1011

¹¹ See *supra* note 6

¹² EUR-Lex *Sources of European Union law* [Online] Accessible at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3A14534>

¹³ Somssich, R. (2015): "*Cohabitation of EU Regulations and National Laws in the Field of Conflict of Laws*", ELTE Law Journal [Online] Accessible at <https://eltelawjournal.hu/cohabitation-eu-regulations-national-laws-field-conflict-laws/>

¹⁴ Capeta, T. (2010): "*Harmonisation of National Legislation with the Acquis Communautaire*". Report, European Commission for Democracy Through Law (Venice Commission). Accessible at [https://www.venice.coe.int/webforms/documents/?pdf=CDL-UDT\(2010\)017-e](https://www.venice.coe.int/webforms/documents/?pdf=CDL-UDT(2010)017-e)

¹⁵ Taylor, S. (2011): "*The European Union and National Legal Languages: an Awkward Partnership?*". *Revue française de linguistique appliquée* 2011/1 (Vol. XVI) [Online] Accessible at <https://www.cairn.info/revue-francaise-de-linguistique-appliquee-2011-1-page-105.htm>

Specific issues relating to effectiveness and efficiency

Timing of regulatory measures

Typically, EU regulations consist of comprehensive and complete regulatory measures, meaning that they make all necessary regulatory choices and allocate rights and obligations to particular groups or institutions.¹⁶

The detailed and highly technical nature of regulations require a great amount of care and time for their formulation. Because of these characteristics, one of the arguments against an AML Regulation is that the adoption process would cause policy and procedural delays in the introduction of a new AML regime at EU level. It may be ambitious to believe that existing Directives can simply be converted to a Regulation because the Directives have never had to take account of differing regulatory choices, differing allocation of duties and rights, differing sectors as well as different regulatory regimes for each sector within each member state. It has already been observed that the political process for reaching consensus and adopting the anti-money laundering directives took a very long time. There have also been huge delays with the implementation of the AML Directives¹⁷ and it is not necessarily the case that a Regulation would result in delay if ultimately what is enacted is not practical, legal or feasible within a sector in a member state.

In addition, the time spent by member states interpreting Directives and transposing them in practical and workable ways for industry may be passed instead to industry itself which will result in even less harmonisation than the current Directive-led approach.

Last but not least, because regulations are directly applicable and binding in their entirety, this might necessitate significant adjustments in member states' laws which could potentially result in further delays and inefficiency of the anti-money laundering regulation.

Accordingly, the Regulation-led approach may not be the panacea it is currently hoped it will be. There is the risk too of 'throwing the baby out with the bathwater' by departing from the tried and trusted Directive-led system which might be better served by evidence-based reform to realise the EU's objectives in enhancing AML.

The risk-based approach

The risk-based approach (RBA) in AML represents part of a more general trend and shift in regulation away from prescriptive and compliance-based approaches¹⁸ with the aim being to *"address the problems inherent in prescriptive regulatory approaches: over-regulation leading to excessive compliance costs, inflexibility and consequent poor regulatory performance, and a focus on legalism rather than regulatory effectiveness"*.¹⁹

¹⁶ See *supra* note 12, p.7

¹⁷ European Parliament (2020): *"Improving Anti-Money Laundering Policy, Blacklisting, measures against letterbox companies, AML regulations and a European executive"*. Study requested by ECON Committee, p.49

¹⁸ Ross, S. and Hannan (2007): *"Australia's New Anti-Money Laundering Strategy"*, Current Issues in Criminal Justice, Vol.19, N.2, November 2007, p.142 "Paolo Baffi" Centre on Central Banking and Financial Regulation "Paolo Baffi" Centre Research Paper Series No. 2012-125

¹⁹ Ross, S. and Hannan, M. (2007): *"Money laundering regulation and risk-based decision-making"*, Journal of Money Laundering Control, Vol. 10, Issue 1, p. 107

The history and evolution of the EU's AML policy has demonstrated that the rule-based approach – that is a set of top-down and rigid rules not taking into consideration the divergent nature and risk characteristics of regulated entities – is not very effective in the prevention of money laundering.

In contrast, the RBA implies that the components of the AML system as a type of regulation, compliance and control should be developed by considering the risks that they are aimed to address.²⁰

According to the FATF,²¹ the goal of a risk-based AML regulation is to adjust measures to the risk, meaning that the highest money laundering risk should receive the maximum resource allocation in order to strengthen regulatory results.

Moreover, the FATF²² have defined the RBA as meaning that “countries, competent authorities, and banks identify, assess, and understand the money laundering and terrorist financing risk to which they are exposed, and take the appropriate mitigation measures in accordance with the level of risk. This flexibility allows for a more efficient use of resources, as banks, countries and competent authorities can decide on the most effective way to mitigate the money laundering/terrorist financing risks they have identified. It enables them to focus their resources and take enhanced measures in situations where the risks are higher, apply simplified measures where the risks are lower and exempt low risk activities. The implementation of the risk-based approach will avoid the consequences of inappropriate de-risking behaviour.”

Therefore, risk-based regulation transfers responsibility from regulatory institutions to regulated entities that have the expert knowledge, experience and tools to develop and implement effective regulatory strategies.²³ As a result, the RBA has contributed to a more flexible AML regulation but at the same time has intensified the responsibilities of designated bodies.²⁴

Since the adoption of the Third AML Directive,²⁵ and more specifically following the revision of the FATF Recommendations in 2012, there has been a significant shift towards and an increased emphasis on the risk-based approach to anti-money laundering in the EU.²⁶ As a result, risk, risk assessment and risk management have all become important elements of the EU AML framework.

Moreover, the flexibility of the RBA has become a central tenet of AML policy. Money launderers will always seek out the gaps and the current Directive-led approach empowers countries, competent

²⁰ See *supra* note 4, p.1040

²¹ FATF (2007): “*FATF Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing - High Level Principles and Procedures*” Accessible at <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatfguidanceontherisk-basedapproachtocombatingmoneylaunderingandterroristfinancing-highlevelprinciplesandprocedures.html>

²² FATF (2014): “*Risk-Based Approach for the Banking Sector*” Accessible at <https://www.fatf-gafi.org/documents/documents/risk-based-approach-banking-sector.html>

²³ Pieth, M. and Aiolfi, G. (2003): “*Anti-Money Laundering: Levelling the Playing Field*”, the Basel Institute on Governance Working Paper Series, ISSN: 2624-9650, p.15 [Online] Accessible at <https://www.baselgovernance.org/publications/working-paper-1-anti-money-laundering-levelling-playing-field>

²⁴ See *supra* note 4, p.1040

²⁵ Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (Text with EEA relevance) *OJ L 309, 25.11.2005*

²⁶ Koster, H. (2020): “*Towards better implementation of the European Union's anti-money laundering and countering the financing of terrorism framework*”. *Journal of Money Laundering Control*, Vol.23, N.2,2020, p.380

authorities and designated bodies to adopt this RBA in order to be alert, nimble and agile in their response to the particular risks to which they are vulnerable.

Accordingly, an EU Regulation to prevent money laundering may never be able to achieve harmonisation to any greater degree than a Directive because, in order to be successful in achieving the risk-based approach, AML must itself be agile.

While a Regulation-led approach may be successful for increasing data protection compliance or other regulation objectives in other areas and while it may enhance technical AML compliance, there is the risk it may fundamentally weaken the actual prevention of money laundering by over-emphasising compliance with rules rather than compliance with the more bespoke RBA. Therefore, the current Directive-led approach is inherently more suited to money laundering prevention because it is a more efficient mechanism with which to implement the risk-based approach while coincidentally and effectively preventing money laundering.

The CCBE further considers that the European Commission proposals for the adoption of an AML Regulation represent a shift away from the risk-based approach. Consequently, a Regulation-led harmonised approach will remove the agile ability of countries and designated bodies to respond to ‘on-the-ground’ vulnerabilities and risks particular to individual industries, member states and localities.

The principle of proportionality and self-regulation

The CCBE is of the opinion that any proposals and considerations relating to the adoption of a new EU AML regime need to be in line with the principle of proportionality, as set out in Article 5 of the Treaty on European Union.²⁷ In this regard, we refer to the CCBE paper on *“Proportionality in anti-money laundering regulation: Balancing the fight against laundering proceeds of crime with protective rights of the citizen”* (see annex).

By following this fundamental principle, embedded also in the European Commission’s ‘Better Regulation’ Guidance,²⁸ any action in the area of AML should be at the appropriate level of governance, proportionate and not going beyond what is strictly needed.

The CCBE also believes that no AML measure should interfere with the independence of the legal profession which is necessitated by the rule of law. The independence of the legal profession is an essential aspect of the rule of law. Self-regulation is a necessary and natural requirement for this independence. It addresses the collective independence of the members of the legal profession and is nothing less than a structural defence of the independence every individual lawyer.

In light of this important characteristic of the legal profession, any possible consideration for an EU AML supervisory body for the non-financial sector could not extend to the legal profession as it would be of significant concern for the rule of law. The underlying arguments against delegating EU-level AML supervisory powers for the legal profession are: first, self-regulation means freedom from state intervention; second, without free and independent self-regulation there can be no free and independent

²⁷ Consolidated version of the Treaty on European Union OJ C 202, 7.6.2016

²⁸ European Commission: Better regulation: guidelines and toolbox [Online] Accessible at https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en

legal profession; and last but not least, only strong self-regulation can guarantee a robust independence of the legal profession as part of the administration of justice²⁹.

The European Parliament's *Resolution on the legal professions and the general interest in the functioning of legal systems*³⁰ emphasizes "the importance of rules which are necessary to ensure the independence, competence, integrity and responsibility of members of the legal professions so as to guarantee the quality of their services, to the benefit of their clients and society in general, and in order to safeguard the public interest".

The potential risk to the rule of law posed by an EU-wide supervisor for AML with authority over the legal profession would be of serious concern to the CCBE as it would, by design, have the ability to interfere with the maintenance of the independence of the legal profession from State and, for the first time, multiple Member States as well as EU Institutions.

Focus on predicate offences

Anti-money laundering initiatives have the objective of preventing money laundering; that is the prevention of criminals being able to benefit from the profits of their crimes. Originally, AML was targeted towards organised crime and subsequently extended to the financing of terrorism.

However, over the years, AML has been re-orientated to also target the profits of non-organised crime including white collar crime. The fight now includes tax evasion and many minor crimes.

This broadening of the scope of the predicate offence for money laundering diminishes the resources with which organised crime and terrorism can be fought. In addition, while AML initiatives have become beneficial sources of intelligence for white collar crimes, the potential privacy encroachments may not be proportional to potential low-scale crime.

The current discretion reserved to member states to designate additional offences as criminal activities for the purposes of the AML directives has been always objected to by the CCBE because it goes far beyond the scope and purpose of the fight against money laundering.

Accordingly, the CCBE recommends reducing the scope of the predicate offence of money laundering to improve the efficiency of current AML initiatives in Directives.

²⁹ See judgement *Akzo Nobel Chemicals and Akcros v Commission*, C-550/07 P, para 42, where the European Court of Justice defined the role of lawyers as "collaborating in the administration of justice and as being required to provide, in full independence and in the overriding interests of that cause, such legal assistance as the client needs".

³⁰ European Parliament Resolution on the legal professions and the general interest in the functioning of legal systems, 23.03.2006, point 4. Accessible at <https://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2006-0108+0+DOC+XML+V0//EN>

CCBE Recommendations

Based on the above overview of effectiveness and efficiency of AML regulation and recent developments in the area of AML at the EU level, the CCBE has formulated the following recommendations:

- **Recommendation 1:** Any new legislative developments in the area of anti-money laundering at EU level should avoid overly prescriptive and detailed rules and instead embed and strengthen the application of the risk-based approach by also accommodating the huge diversity of regulated entities.
- **Recommendation 2:** In order to be effective and efficient, any new EU AML rules need to provide a certain degree of flexibility to designated bodies/obliged entities and enable them to adjust and respond adequately to constantly evolving money laundering risks and typologies.
- **Recommendation 3:** The principles of independence and self-regulation of the legal profession must remain intact, something which requires strict adherence to the current regulatory processes within each Member State aimed at preserving independence from State interference and maintaining the rule of law.
- **Recommendation 4:** The scope of the predicate offence of money laundering should be limited in order to improve the efficiency of current AML initiatives.
- **Recommendation 5:** Before embarking upon a complete overhaul of the existing approach to AML/CFT and proposing a Regulation, it is crucial for the EC to follow its “evaluate first” principle of Better Regulation and evaluate existing legislation. The EC needs to analyse whether all avenues for harmonization of the EU AML/CFT rules are exhausted and to what extent a new regulatory regime would effectively address the perceived issues and loopholes in the current framework to any greater extent.