EUROPEAN COMMISSION
Internal Market DG

FINANCIAL MARKETS

Brussels,
MARKT/G4/RJ/MFS/AP D(2004)

NOTE FOR THE ATTENTION OF MR. SCHAUB, DIRECTOR GENERAL

Subject: **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 (ML) and terrorist financing (TF)**

Interinstitutional file: 2004/0137(COD)

Peparation of Coreper of 17/18 November 2004

1. BACKGROUND

1.1. A new (3rd) directive on money laundering: priority area

The fight against ML and TF is a priority area for the Commission and the Member States.

The proposed Directive will be the third directive in the field of ML. It will repeal the existing directive of 1991, as modified in 2001. The Commission proposal was adopted by the College on 30 June 2004 (COM(2004)448).

1.2. Objective

The main reason for introducing the proposal has been the June 2003 revision of the global Standard of the Financial Action Task Force on ML and TF (FATF), of which the 15 old Member States and the Commission are member. We committed ourselves to incorporate these (world) standards into our legislation. The proposal is generally in line with the revised FATF Standards.

Moreover, the proposal fills in the invitation of the Council in the Second Directive on ML to bring the definition of serious crimes into line with the definition of serious crimes of the relevant Justice and Home Affairs (JHA) Council framework decision.

1.3. The rules of the proposed directive

The main elements of the proposal are the following.

1) The proposal prohibits ML and TF.
2) The proposal is applicable to the financial sector and different categories of persons (i.e. lawyers and other legal professions, and potentially all providers of goods). To safeguard the financial sector from disruptive effects, entities subject to the Directive need:
    a) to identify respectively verify their customer and its ultimate beneficial owner and monitor the customer, while taking into account a risk based approach;
    b) to report suspicions on ML and TF to a Financial Intelligence Unit (FIU); and
    c) to take supporting measures, such as: record keeping, training of personnel and the establishment of internal policies and procedures;
3) Supervision on the compliance with the requirements is organised by the proposal;
4) If requirements are not met, sanctions need to be applied;
5) For the first time, a Comitology procedure is included. Several important provisions will be completed by implementing measures (even if, formally, this is not a "Lamfalussy" measure).

2. DISCUSSION IN COUNCIL WORKING GROUPS

2.1. Procedural information

Discussions at Working Group level started on 13 July 2004 and concluded on 25 October 2004, after 7 intensive meetings. A meeting at Financial Attachés level took place on 8 November 2004.

Progress towards a draft acceptable to the almost all Member States has been remarkable. It is worth noting that Member States accepted to work on this file although the Commission was only able to officially send the draft 3rd directive (with all linguistic versions) to the Council mid October 2004.

After the meeting at Attachés level, the Dutch presidency decided to submit the proposed directive to the COREPER meeting of 17/18 November.

2.2. Mains points of amendment

The current text of the presidency largely follows the Commission proposal and is certainly compatible with FATF standards.

The definition of ML has not been changed compared to the existing Directive on ML. TF is now defined as an autonomous offence.

There is agreement on the scope of the entities that are subject to the Directive with the exception of the legal and natural persons trading in goods in an amount of EUR 15000,- or more in cash (see section 2.3.1). It is worth noting that the proposal does not modify the way lawyers and independent legal professions are covered, although France in an isolated position has suggested deleting lawyers and other independent legal professions

On the definitions, the Council has mainly changed the definition of the beneficial owner. A last point of discussion in this respect is the height of the threshold when a beneficial owner controls or owns a corporate entity, foundation, trust or similar arrangement (see section 2.3.2).

On the procedures to identify and verify the customer and its beneficial owner, the amendments are mostly of a clarifying nature. On politically exposed persons (PEP's), the Council has followed the substance of the Commission's definition. However, it has specified that normal procedures of scrutiny need to be followed with regard to domestic PEP's and enhanced measures of scrutiny need to be taken with regard to non-domestic PEP's.

On reporting of possible infringements to competent authorities, the amendments are also of a clarifying nature. However, agreement still needs to be reached on the disclosure of information that has been transmitted to the Financial Intelligence Unit (FIU) outside a group or network. (see section 2.3.3).

On the supporting measures and supervision the amendments have been of a clarifying nature. It is worth noting that a legal base for funding FIU.NET has been added, the network of FIUs. This Article will likely allow the Commission to sponsor the development of a CESR-type cooperation in this field in the future, if wished.

With regard to the penalties, Member States insisted on their competence (third pillar). The text has been changed accordingly.

Although the UK is still sulking, it is the impression that the comitology procedure is now accepted by everybody. Two Lamfalussy-style recitals have been added as well, leading to a kind of Lamfalussy comitology procedure. It follows from these recitals that entities subject to the Directive will be consulted on implementing measures. Member States not only agree to the proposed comitology, but they also recognise its indispensability by imposing a deadline (6 months following entry into force of the Directive) on the Commission for adopting some of the implementing measures.

2.3. Three main points still under discussion

It follows from the discussions that no real contentious elements remain, although isolated Member States still maintain some reservations (mostly scrutiny reservations pending approval from capitals) or alternative proposals in some articles (no real change of substance). There remain, however, 3 issues which are still under discussion, i.e. large cash transactions, the definition of "beneficial owner" and the disclosure of suspicious transactions reports.

2.2.1. Large cash payments (Article 2(1) (3) (f) in combination with Article 33(4))

The 2nd Directive covers as large cash payments dealers in precious stones, precious metals and works of art. Apart from the works of art this coverage is similar to the revised FATF Standards. The Commission proposal intended to extend the coverage to all persons trading goods and services receiving large cash payments (above €15000) . As a compromise the Dutch Presidency has narrowed the coverage down to large cash payments of traders in goods. Austria, Cyprus, Finland Hungary, Poland, Slovakia, Slovenia and Sweden (being not a blocking minority) prefer the text of the existing Directive. On the other hand, the Czech Republic, Estonia, Germany and Italy prefer the

Commission proposal. It is noted that the ML and TF process mostly start with vast amounts of cash. It is assumed that by including large cash transactions of at least traders in goods the transparency and traceability of large cash transactions will be enhanced.

Our position. The Presidency compromise is the limit that we can accept. To facilitate the agreement of the opponents, we can accept a recital where it will be clearly stated that supervision of this category of persons will be done on a risk sensitive basis. This is also contained in a specific provision on supervision (Article 33).

2.2.2. Beneficial owner (Article 3(8))

All Member States have agreed upon the general definition of beneficial owner (i.e. the person who is really in control of a legal entity). The proposed Directive makes this definition more concrete by specifying a percentage of shareholding which indicates such control. All Member States have reached an agreement on all but one aspect of the proposed definition in the Directive. The last point to resolve is the height of the threshold when a beneficial owner controls or owns a corporate entity, foundation, trust or similar arrangement. For company law reasons especially Germany and Austria insist on a percentage of 25% or more which seems to be acceptable for all Member States but Denmark, France, Poland, Spain and Slovenia (a blocking minority). The latter do not want to go further than 20%

Our position. Our proposal provided for a 10% threshold/ But accepting 20% or even 25% would already be a major improvement to the general definition contained in the FATF standards. Accordingly, both solutions are acceptable to us. Taking into account the sensitivity of this question for Germany (25%) and France (20%), we should be careful and accept whatever solution when we have the feeling that there is a global compromise.

2.2.3. Disclosure of suspicious transaction reports (STRs) (Article 25(3 and especially 3b)

Article 25(1) prohibits the disclosure of suspicious transaction reports (STRs) to the FIU to the customer or third persons and is not controversial. The idea behind paragraph 1 is that the more limited the circle of persons knowing that a STR has been filed is, the lower the change that the potential money launderer or terrorist financier will arouse suspicions with the client/beneficial owner. Moreover, confidentiality is also necessary because the STR does not implicate that the client is a money launderer or terrorist financer: that needs to be investigated and proven. Paragraph 1 does not prohibit in any way disclosing information, other than the STR on the client. When the institution or person subject to the Directive want to exchange information, data protection legislation needs of course to be respected.

It makes also logic and is therefore not controversial that competent authorities such as supervisors and law enforcement entities are excluded from the prohibition of paragraph 1; that is what paragraph 2 prescribes (i.e. disclosure of the existence of STRs may be made to them).

Paragraph 3 and 3a is a further extension of the possibilities of disclosing STRs to other relevant persons within a group of companies in the financial sector or a network of entities subject to the Directive. Although on the one hand, it weakens the limitations on disclosure, on the other hand it makes logic to share within a group that it is known, suspected or that there are reasonable grounds to suspect that money laundering or

terrorist financing is being or has been committed or attempted. If such information would not be shared conflicting situations could arise. Apart from the exact wording all Member States but Austria, Portugal, Slovakia and Slovenia accept this extension.

The further extension of the possibilities of disclosing information in paragraph 3b beyond the group or network in the case of the same customer and the same transaction is controversial. Austria, Italy, Luxembourg, Portugal, Slovakia, Slovenia and the UK insist on deleting this paragraph. The financial sector does not seem to be very enthusiastic either. This paragraph weakens the limitations on disclosure further, but foremost it is noted that paragraph 3(b) allows the exchange of STRs outside a group or network, while a STR does not automatically implicate that the customer or beneficial owner is a money launder or a terrorist financier (that needs still to be proven). On the other hand, Germany and France are very attached to this paragraph.

Our position. This provision is difficult: on the one hand, fighting against ML and TF implies exchanging information on possible dangerous persons; on the other hand, a risk of black listing based on non proven facts exists. France is really attached to this provision and this might be a price we have to pay to convince them to accept an increase of threshold for the definition of beneficial owner (see above, section 2.2.2). We could accept this trade if this is really necessary to make a deal, especially if its scope is narrowed down (as in the presidency proposal).

3. Discussion in Parliament

The first intention of the European Parliament (EP) was to allocate this file to the LIBE Committee, although it seems that the EMAC Committee is still claiming responsibility. Mr. Nassauer (PPE, DE) has been appointed *rapporteur* by the LIBE Committee. Work in the EP Committee(s) has not yet started, but Mr. Nassauer, upon request from the Dutch presidency, is willing to accelerate the work. It is assumed that Parliament will start after a political agreement has been reached in December. First indication shows a willingness to try to achieve a first reading.

4. Perspectives

An agreement is likely to be reached in COREPER on the content of the directive, despite some issues are still subject to discussions. It is however possible that the issue of Article 25 will need a new *attachés* meeting. For which case, the point would be subject to a new COREPER meeting on November 24. The aim of the Presidency is to get political orientations from the ECOFIN Council on 7 December 2004.

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