EU Legal Armory to Combat Financial Crimes

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Abstract

An investment in any financial or commercial sector with dirty money generated by the commission of any form of financial crimes such as bribery, corruption, tax evasion or fraud, organized crimes may potentially distort the investment climate in any country, region, etc. There are several legal measures adopted at the global, regional and national level to combat money laundering associated with such crimes.

The aim of this paper is to examine how the European Union (EU) is fighting financial crimes within its single market. It has a sophisticated and modern legal armory at its disposal to eliminate or at least minimize the risks to the investment climate resulting from the movement of dirty money. The overall objective of this EU initiative is not only to protect the sanctity and stability of its dynamic single market but also to generate and enhance confidence among investors and market operators that their investments are safe and secure from any form of corrupt or illegal practices. Having this overall objective in the background, this paper will critically examine the effectiveness of the relevant EU legal instruments and to further identify the provisions, which may have a universal application.

Keywords: commercial sector, financial crimes, dirty money, organized crimes, investment climate.

General Introduction

The European Union (EU) born soon after the devastating second world war in 1958 as a peace project have now developed to be one of the worlds leading economies. It is currently the second largest economy in the world after the United States with a consumer base of approximately 440 million. The EU according to its constitution is a market-oriented economy which bring together twenty-seven economies within its fold.

At the heart of the European economy is its single market launched in 1993. The object of the single market comprising of four economic freedoms, namely goods, persons, services and capital is they should flow freely without any legal or technical impediments between the Member States of the EU. Since the EU single market cannot operate in isolation from the global economy and finance, it also extends its benefits to countries outside the Union, known in the EU legal jargon as third countries, subject to the policy of reciprocity.

A major challenge confronting the single market is the risk of being exploited for illegal purposes such as corruption and money laundering. The EU have adopted various counter measures to combat financial crimes largely influenced and modelled on some international legal instruments such as the Financial Action Task Force (FATF).

The aim of this paper is to focus on the progress made by the EU to combat financial crimes. The topic of research covers three major components of financial crimes, corruption, money laundering and terrorist financing. The economic and financial benefits of closer integration of the European Single Market can only be fully realized if the EU adopt corresponding measures to prevent and combat financial crimes both within and beyond its terriroty. The EU has thus deployed a sophisticated and modern legal armory to combat corruption and money laundering.

The methodology adopted to develop the research paper may be summed up as historical-legal method and comparative-legal method. The paper will thus critically examine the evolving nature and the effectiveness of the EU legal weapons modernized and adopted at different times to protect the single market from financial crimes emanating from within and outside its territorial limits. The extent to which other relevant international legal instruments such as the Financial Action Task Force contributed to refine the EU anti money laundering legal armoury will be explored.

International legal instruments to combat money laundering

The relevance of the international legal instruments to counter financial crimes such as money laundering within the EU could be viewed from different perspectives. Money laundering involves complex covert activities well-orchestrated by a number of groups and individuals based in different EU Member States. The process of money laundering involves different stages in executing this crime[(1)]. One of the stages may involve even a country outside the EU. The money generated by a criminal act in a third country can also find its way into the EU for laundering purposes.

Article 63 Treaty on Functioning of the European Union (TFEU), provides for the liberalisation of the free movement of capital between the EU Member States. Unlike the other economic freedoms, free movement of capital is also liberalized towards third countries[(2)]. This liberal legal environment also provided greater opportunities for the free movement of dirty money between the EU and third countries.

The risk of money laundering between the EU and third countries give rise to jurisdictional issues, as the EU law does not have extra-territorial application to counter this situation. In order to deal with the problem of jurisdiction, the best option the EU had is to adopt its own laws and make references to various international legal instruments dealing with money laundering[(3)].

The EUs first money-laundering directive (first AML) makes specific reference to certain international legal instruments on money laundering[(4)]. It declares that money laundering should be tackled within the framework of international cooperation among judicial and law enforcement authorities. When the first AML was adopted in 1993, the EU had no competence in criminal law. Due to lack of competence, the first AML refers to various international legal instruments as means to claim legality and legitimacy, such as the Vienna

(1) There are three stages involved in the process of money laundering, known as the placement. layering and integration process, also known as the wash, dry and spin process.
(2) Joined Cases C-163, 165 and 250/94, Sanz de Lera and Others. EU: C: 1995:451. See also Sideek Mohamed, “Legal and Judicial Developments in the Field of Capital Movements”, (1996) 7 European Business Law Review 273-279.
(3) This is abundantly evident in a Statement attached to the Directive 91/308 by the representatives of the Governments of the Member States meeting within the Council which declares as follows: Member States signed the 1988 UN Vienna Convention against illicit traffic in narcotic drugs and psychotropic substances; Member States have already signed the 1990 Council of Europe Convention on laundering, tracing, seizure and confiscation of proceeds of crime; description of money laundering contained in Article 1 of Directive 91/308/EEC derives its wording from the relevant provisions of the aforementioned Conventions.
(4) Recitals 4-9 of the Money Laundering Directive 91/308/EEC.

Convention[5] and the Strasbourg Convention[6]. All the Member States of the EU have ratified these international legal instruments.

The first AML further declares that the Community action should take particular account of the recommendations adopted by the Financial Action Task Force (FATF) on money laundering[7]. The original directives adopted on money laundering refers to the FATF as a means to supplement for the lack of EU competence in the field of criminal law. Even after assuming competence in criminal law, the EU continues to make specific reference to the FATF in its AML legal instruments[8].

Financial Action Task Force

The FATF[9] was established in July 1989 by a group of seven developed countries belonging to the Organisation for Economic Cooperation and Development (OECD) and the European Commission[10]. It is an inter-governmental body currently composed of 39 countries including two international organisations[11]. The membership includes all twenty-seven Member States of the EU and the European Commission. Even the Gulf Cooperation Council (GCC) in which Kuwait is a prominent member, is a member of the FATF[12]. There are also nine FATF-style regional bodies[13]. There is no organizational hierarchy

(5) Vienna Convention against illicit trafficking in narcotic drugs and psycho tropic substances was ratified on 19 December 1988.
(6) Council of Europe Convention on laundering, search, seizure and confiscation of the proceeds from crime was ratified on 8 November 1990.
(7) Recital 6 of the first AML declares as follows: “Whereas any measures adopted by the Community in this field should be consistent with other action undertaken in other international fora; whereas in this respect any Community action should take particular account of the recommendations adopted by the financial action task force on money laundering, set up in July 1989 by the Paris summit of the seven most developed countries”.
(8) See for example Recital 4 of the Directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing adopted in 2015. It is significant to note that Lisbon Treaty 2009 had already conferred specific competence in the field of criminal law to the EU.
(9) FATF (2012-2019), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF, Paris, France, www.fatf-gafi.org/recommendations.html
(10) The EU was the first regional organization to adopt the FATF Recommendations.
(11) The members of the FATF are Argentina, Australia, Brazil, Canada, Hong Kong, China, Iceland, Japan, Mexico, New Zealand, Norway, Singapore, Switzerland, Turkey, USA and all fifteen EU Member States.
(12) Although the Gulf Cooperation Council is a full Member of the FATF, the individual Member countries of the GCC (of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) are not.
(13) Asia/Pacific Group on Money Laundering (APG), Caribbean Financial Action Task Force (CFATF), Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), Eurasian Group (EAG), Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), Financial Action Task Force of Latin America (GAFILAT), Inter Governmental Action Group against Money Laundering in West Africa (GIABA), Middle East

between FATF and the FATF-style regional bodies[14].

FATF is a common platform to devise ways and means to combat global money laundering[15]. In February 1990 the FATF issued the first well-known Forty Recommendations, which set out detailed guidelines to facilitate the fight against money laundering. It was regularly revised and updated in 1996, 2003 and 2012 to keep pace with the trends and developments in this branch of financial crime. The last update of the Recommendations was in June 2019. Since they are only recommendation, they belong to the soft law regime and therefore have no binding force on its signatories.

An important task assigned to the FATF is to protect the global financial systems from being exploited for money laundering purposes. The Recommendations cover a mixture of substantive and procedural criminal rules requiring its member countries to adopt in their national legal system. It ranges from customer identification, customer due diligence, bank secrecy, record keeping to legal and administrative cooperation to combat money laundering. They are directed not only to financial institutions but also to several other professions, casinos, dealers in art, antiquities and precious metals, etc.

After the 9/11 terrorist attack in New York and some other US cities in 2001, the tasks assigned to the FATF was expanded to include terrorist financing. In order to facilitate the fight against terrorist financing, the FATF adopted a Special Recommendation on Terrorist Financing, which came into force on 31st October 2001[16]. The aim of the new rules is to strengthen the powers of the governments to freeze assets, impose greater reporting requirements of suspect transactions and blacklist the countries that fail to cooperate in identifying and combatting terrorist financing.

The war on terror was included in the FATF agenda as the findings of the terror attack exposed the link between terrorist financing and money laundering. The Special Recommendation impose various obligations to combat terrorist financing and if they fail to comply, such countries are liable to financial sanctions including exclusion of their banks from international markets.

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and North Africa Financial Action Task Force (MENAFATF), Task Force on Money Laundering in Central Africa (GABAC).

(14) FATF (2012), High-Level Principles for the relationship between the FATF and the FATF-style regional bodies, updated February 2019, FATF, Paris, France,

(15) There are also similar financial action task forces in the Caribbean and Asia, which also seek to foster closer cooperation with countries outside the regions.

(16) In October 2001, the FATF issued the original eight Special Recommendations on Terrorism Financing. Special Recommendation VIII" (SR VIII) specifically targeted non-profit organizations.

It is significant that FATF rules already require financial institutions to report suspect transactions. A major departure from the previous compliance requirement is that the new regime on terrorist financing makes it a mandatory requirement on the member countries to inform the market regulators even if they have reasonable grounds to suspect that funds may be channelled to finance terrorism.

There are reservations expressed to the linking of terrorism in the global war on money laundering. Some scholars view the combination of money laundering and terrorist financing in the same legal instrument may prove to be counter-productive. The Special Recommendations were adopted too swiftly in response to the 9/11 terror attack without sufficient reflection on the merits of combining the two quite distinct and less linked crimes.

These measures were adopted with some degree of emotionality and insufficient discussion and consultation among the stake-holders such as the law enforcement officers, financial operators, regulatory authorities, etc. There is thus a risk the combined legal regime may prove to be an ineffective tool to combat both the sophisticated financial crime and politically or otherwise inspired inhuman terror-related crimes[(17)].

The source of the funds for the purposes of money laundering and terrorist financing are not the same. The source of dirty money flowing into the laundering industry is a by-product of the commission of a financial crime. In that sense money laundering is not the primary but secondary crime. There should be a previous criminal act to acquire the dirty money, which in turn is used by various means and avenues to hide its illegal origin from law enforcement agencies.

On the other hand, the source of money used for terrorist financing may be from innocent benefactors or fundraisers. It may be a rich philanthropist or even a little school-going kid who could innocently contribute for a simple humanitarian charity which may be misused and channelled to finance terror as disclosed by the investigations into the 9/11 terrorist attack[(18)].

Even the motive for the commission of these crimes are quite different. The primary interest of those who engage in money laundering is pure self-

(17) The reservations of including both these crimes in one legal instrument is acknowledged in Recital 22 of Directive 2005/60/EC (third AML) declares: “It should be recognized that the risk of money laundering and terrorist financing is not the same in every case.”

(18) The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States (Authorized Edition) Paperback, 17 July 2004.

aggrandisement and personal greed. On the other hand, the motive for terrorist financing are more related to the promotion of extreme political or religious ideologies.

The Special Recommendations of the FATF may impose an additional burden on the financial institutions to assist law enforcement agencies to combat money laundering and terrorist financing. The financial institutions have to monitor both the origin and the destination of the flow of money, which may be used to finance terrorism.

Over the years the financial industry has adopted credible control mechanisms to spot dirty money coming into its system. They are however not sufficiently prepared nor have the necessary competence to detect or prevent the movement of legitimate money passing through their system for terrorist purposes.

In addition, there are other issues that may arise if the financial institutions were to police how its customers spend even small amounts of their money. The Special Recommendations emphasises on subjective judgments how money will eventually be spent and that would raise issues on civil liberties. The FATF special rules requires banks to report on their customers who may have not committed any offence whatsoever.

In order to avoid being labelled as failing in their duty to report, banks may prefer to be over-cautious and report at the slightest hint of any trivial suspicion to the authorities. This could result in huge increase in suspicious transactions report, which the law enforcement agencies would be unable to deal with, particularly in view of the already existing lack of resources both in terms of funding and skilled personnel to combat money laundering.

It is also harder to detect terrorist financing than the commission of money laundering. There is a wide difference in the amount of money raised for example by the sale of drugs and the money channelled to finance terrorism. According to the FATF statistics published in 1996, the total amount of money laundered worldwide annually was in the region of around $1.5 trillion. The figure includes the illegal funds from the sale of drugs, which is estimated to be around $500 billion, roughly equivalent to the value of the total output of an economy the size of Spain.

The volume of money passing through terrorist organisations involves only a very small fraction of the dirty money generated in the laundering industry. It could be in the range of less than a few million dollars, which would be much

easier to hide[19]. The bankers and regulators do not have the ability or the means to detect small sums involved in terrorist activity[20].

The FATF special rules provides for blacklisting of countries that fall short in their efforts to deal with terrorist financing. This rule could raise both political and diplomatic issues in its enforcement. The 2001 FATF report reveals several countries, some of which are the so-called allies of the West that have to be blacklisted[21]. The same report declares that almost two-thirds of the FATF members failed to comply fully with its anti-money laundering recommendations.

Since the FATF Recommendations are soft laws, they are not legally binding on the member countries. The FATF can only require its member countries to implement them at national level[22]. If the member countries do not comply with any of the Recommendations, the FATF may adopt a number of graduated sanctions which are purely of non-pecuniary nature. It may initially send a written warning, name and shame in a public declaration[23] or as a last resort suspend or expel from the organization[24].

EU competence in criminal law

At the initial stages of the construction of the common market as the single market was known before 1993, there was no threat of criminal abuse of the four economic freedoms. The common makret was subject to only minimum liberalization. There was thus no need for the EU to have competence to combat cross-border crimes as the Member States had the legal means to deal with such crimes domestically.

The Single European Act 1985 which for the first time amended the founding Treaty of Rome 1958 expedited the process of cross-border market integration.

(19) The 9/11 terror investigations revealed that the amount involved for the terror attacks in New York and Washington was less than half a million dollars.

(20) Some senior executives of the Societe Generale of France were arrested on 15th January 2002 on suspicion of laundering money between France and Israel by way of defrauding insurance companies claimed in defence that annually several millions of cheques of different values pass through their bank system, which is practically impossible for them to keep track of all of them.

(21) The list of 19 non-co-operative jurisdictions contains the usual Caribbean and Pacific tax havens as well as Israel, Hungary, Russia and Egypt.

(22) Kern Alexander, Rahul Dhumale, John Eatwell, Global Governance of Financial Systems: The International Regulation of Systematic Risks, Oxford University Press, 2006

(23) For example, in 1996, when Turkey failed to comply with the FATF Recommendations, the latter issued a press release advising financial institutions to scrutinize transactions with persons and businesses in Turkey.

(24) In 2001 when Austria failed to change its banking secrecy laws, the FATF threatened to suspend it from the OECD.

It imposed 1 January 1993 as a deadline to launch the single market. This led to the adoption of several legislation to complete the single market project(25). The rapid integration of the single market correspondingly widened the opportunities for cross border financial crimes.

The EU acquired limited competence after the Maastricht Treaty 1993 to adopt laws to combat cross-border financial crimes. It created a complex three-pillar structure with one of the pillars known as the Justice and Home Affairs. Within this pillar the EU gained some competence in the field of criminal law. The rule making in this pillar was however subject to unanimity voting in the Council. The European Parliament, an EU co-legislator and only representative body, had no role except to be consulted by the Council before adopting any laws in the field of criminal justice.

A major breakthrough in the field of criminal law emerged with the coming into force of the Lisbon Treaty in 2009. It abolished the complex pillar structure and created a new Title known as Area of Freedom, Security and Justice(26). The Lisbon Treaty removed the unanimity voting system in the field of criminal law. A host of new competences was conferred on the EU in the field of asylum, immigration, judicial cooperation in criminal matters and police cooperation.

Corruption in the European Union

An Overview

Coronavirus disease (COVID-19) believed to have originated in a Chinese city, Wuhan in December 2019 and spread rapidly across the entire country. Soon thereafter, it spread globally leaving no place immune from this infectious disease. This highly infectious disease did not spare any country and its victims range from heads of state, ministers to garbage collectors and ordinary people on the street. It is the same with the deadly virus of inhuman corruption. It is a global infectious financial disease which respects no physical barriers infecting across the globe, sparing neither the super rich nor the poorest of the poor.

The origin of corruption is as old as human history(27). It is defined as the abuse of entrusted power for private gain(28). Generally corruption is closely

(25) There were 282 laws passed between 1985 and 1992 with the aim of launching the single market on 1 January 1993. (European Commission, MEMO/10/528 Brussels, 27 October 2010).

(26) Title V, Articles 67-89 TFEU: Area of freedom, security and justice.

(27) The First Dynasty (3100–2700 BC) of ancient Egypt noted corruption in its judiciary.

(28) Transparency International is an international non-governmental organization based in Germany whose purpose is to take action to combat global corruption.

associated with bribery. It often arises when bribery had to be paid to influence the actions of a public official one way or the other[29]. It is a financial crime that exists in both public and private sector. The beneficiaries of corruption are also not one sided. The bribe-taker will be illegally remunerated while the bribe-giver may secure an undue advantage such as a public contract by-passing its legitimate competitors.

Corruption exists in all forms of governance: democratic or communist; capitalist or socialist economies. In such countries, a close nexus can be detected between politics and corruption. The general assumption is that once public power is delegated to politicians, it is held by them on trust. The abuse and breach of such trust for personal gains tantamount to corruption.

This contagious disease has different symptoms such as bribery, nepotism, influence peddling between the public and the private sectors, etc. It is a dangerous enemy for the good health and proper and smooth functioning of any economy. The effects of corruption on the economy are manifold. Corrupt practices in businesses can result in lowering of the economic growth, slow down foreign direct investments due to the erosion of trust, create uncertainty leading to turbulence in the financial market, etc.

The immediate loss caused by corruption may be calculated in pecuniary terms running into several billions of euros. According to some official statistics, the turnover of international bribery exceeds US$1.5 trillion annually which accounts for about 2% of global gross domestic product[30].

The financial sector is singled out as being directly or indirectly contributing to the growth and sustenance of corruption. Some segments of the financial industry are accused of actively or passively facilitating the laundering of dirty money generated by corrupt activities using its complex network. The financial sector seems to be the easiest and convenient route for corrupt officials to hide and launder the stolen dirty money. This allegation quite often has been confirmed even within the EU. It had adopted several laws requiring the banks to do a range of checks to detect the proceeds of financial crimes but in practice, as highlighted below, some failed to uphold them.

The cost of corruption for the EU is quite enormous and gigantic. It cost the EU taxpayers billions of euros annually. According to a report published by

(29) For example, according to Transparency International, Indonesia's former president Suharto have stolen more than $15 billion of national wealth; the Philippines' Ferdinand Marcos, Mobutu Sese Seko of Zaire may have robbed more than $5 billion each.

(30) IMF Staff Discussion Note, Corruption: Costs and mitigating strategies. May 2016. SDN/16/05

the European Commission in 2017, the annual cost of corruption exceeds €120 billion. The enormity of this figure can be highlighted by comparing it with the EUs annual budget for the same year, which was €175.9 billion. Even a more disturbing finding was highlighted in a report prepared by the European Parliament. According to this report, corruption cost the Union €904 billion when indirect effects such as loss in tax revenues and decrease in foreign investment across the Union are included(31).

The level of corruption among the Member States of the EU varies widely. Transparency International, a non-governmental organization was established in 1993 to keep track of bribery and corruption across the globe(32). Its main task is to prepare a list of countries and highlight their level of exposure to corruption. In its 2017 report, the Transparency International singled out Denmark, Finland and Sweden as the least corrupt within the EU whereas at the bottom placed Bulgaria, Hungary and Romania, respectively.

The Member State of the EU whether they are less corrupt or more corrupt are all put in the same basket of clean and rotten eggs within the integrated single market. Since their economies and financial market are closely integrated, they have to prosper or perish together as evidenced by the 2011 Greek debt crisis(33).

Even before the Lisbon Treaty came into force in 2009, there had been some degree of EU intervention to deal with corruption within the Union. Article 29 of the EC Treaty specifically provides for prevention and combating corruption as one of the means to achieve the EU objective to create an area of freedom, security and justice.

Some laws were passed to deal with corruption even targeting the EU institutions and agencies, which themselves were found to be infected with this contagion disease. The corporate sector was also not immune from corruption. Hence the EU had to intervene to adopt legal measures to contain the threat in both vital segments of the single market.

The Lisbon Treaty which introduced major changes in the area of freedom, security and justice specifically recognizes corruption as one of the financial

(31) "The cost of corruption across the EU," The Greens/EFA Group in the European Parliament, 7 December 2018.
(32) Transparency International founded in 1993 is an international non-governmental organization based in Berlin, Germany. Its current membership is about 176 countries.
(33) Sideek M Seyad, "A legal analysis of the ECB's OMT program to combat the debt crisis" (2015) 30 Journal of International Banking and Regulation 349-358.

crimes[34]. It provides for the adoption of minimum rules on the definition of criminal offences and sanctions such as corruption[35].

Legal framework to combat corruption by EU and national officials

The EU is a huge bureaucracy employing several thousands of people in its seven institutions[36] and several other agencies and bodies[37]. In order to carry out its tasks and functions the EU has a large budget to which all Member States contribute based on the size of their economies and population. In its budget for the financial year the EU had allocated a sum of € billion in commitments[38] and €billion in payment credits.

Almost half of the funds in commitments was allocated to boost the European economy, employment and competitiveness. Among other groups, European farmers too benefit from the EU budget. About 80 per cent of EU expenditure is manged by the Member States.

After the onslaught of COVID-19, in order to counter its devastating impact on the economies of many Member States, in addition to the regular budgetary allocation, the EU have created corona funds running into billions of euros.

Since the budgetary allocation and distribution of EU funds involves both the EU and national public officials, there had been also several cases of corruption at both ends. In post-Covid 19, there are already several cases of alleged misappropriation of such funds both at the national and Union level. The dividing line between unlawful retention of EU funds at the Union and national level is hard to draw.

It is the national authorities who are responsible for preventing and detecting fraud in the use of EU cohesion funds. It is the responsibility of the national authorities to ensure that EU funds are allocated in accordance with prescribed procedures such as public procurement proceedings with due respect to the principle of transaprency and non discrimination. At the EU level, there are various mechanisms put in place to prevent the abuse of public power for a private gain but the scope of the paper and space consideration exlude an exhaustive exposition[39].

(34) Article 83 TFEU.
(35) Article 83(1) TFEU.
(36) Article 13 TEU.
(37) There are about 46,000 people employed across all EU institutions, agencies including about 33,000 civil servants. There are about forty EU agencies established across all the Member States of the EU.
(38) This is the money that can be agreed in contracts in a given year.
(39) Eulalia Rubio, "Balancing Urgency with Control: How to prevent fraud in the use of the EU Recovery Funds without delaying their implementation", Economics and Finance, Policy paper No 262, April 2021.

A well-known case that involved the allegation of corruption was the Santer Commission, which was in office between 1995-1999(40). This Commission gained popularity as it oversaw the introduction of the euro, the single currency in 1999. On the other hand, it also acquired notoriety as the first Commission in the history of the EU to resign *end masse*, owing to allegations of corruption.

In order to prevent and combat corruption within its own institutions and agencies, the EU adopted a Convention before the Lisbon Treaty came into force(41). The first legal instrument that addressed bribery and corruption was the adoption of a Protocol to the Convention in 1996. The Protocol imposes an obligation on the Member States to criminalize both passive and active bribery in their national law(42).

The scope of the Protocol covers not only direct participation but even instigating corruption. The aim of the Protocol is to fight corruption involving EU and national officials. The scope of the Protocol is however limited to the damage caused to the financial interests of the Union. If any such improper act had no effect on the financial interests of the Union, then the Member States are not under obligation to criminalize it. This narrow scope of the Protocol reflects the limitations to the EU competence in the field of criminal law. Due to this inherent legal limitation, the objective of the Convention was limited to strengthen judicial cooperation between the EU countries to combat corruption.

The Protocol impose various obligations on the Member States. They are required to set up their own jurisdiction over offences in accordance with the Protocol. The offence must be committed in whole or in part within the territory of the relevant Member State. The offender should be one of its nationals or its officials. The corrupt act must be committed against a national official or a member of the EU institution who is also one of its nationals. The offender should be an official working for an EU institution, agency or body and has its headquarters in the relevant Member State.

If an offence concern at least two Member States, they are required to

(40) It was a corruption scandal that involved the Commissioner for Research and Development, abusing power to hire her private dentist as an adviser on HIV/Aids.

(41) Council Act of 26 May 1997 drawing up, on the basis of Article K.3 (2) (c) of the Treaty on European Union, the Convention on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union ('the Convention against corruption involving officials') was signed on 26 May 1997 and entered into force on 28 September 2005. (1997) OJ C 195.

(42) Reindl-Krauskopf, Anti-corruption measures from a European and Austrian perspective, New Zealand Yearbook of International Law (2017)

cooperate in the investigation and prosecution of the alleged corrupt act. The Protocol requires all Member States to comply with the principle that no legal action can be carried out twice for the same offence, known as the *non bis in idem* principle. In the event of a dispute arising between the Member States over the interpretation or application of the Convention, it must be referred to the Council for its resolution. If the Council fails to find a solution within 6 months, one of the parties to the dispute may refer the matter to the European Court of Justice (ECJ), which has jurisdiction in such disputes.

Corruption in the EU private sector

After the adoption of some legal measures to protect the EU budget from fraud and corruption, the next task of the EU was to protect its single market from international corruption. There is a risk that corporations may bribe EU and national officials to illegally obtain some business advantages involving the EU budget. The bribe-givers may acquire a competitive advantage over other bidders who do not resort to bribery as a means for example to secure a lucrative contract.

The twin evils, corruption and bribery could potentially undermine the proper functioning of the single market. Any cross-border transaction tainted with corporate bribery can distort and undermine competition within the single market. The promotion and maintenance of free and fair competition is an important and integral part of the EU policy[(43)].

This policy has its roots almost from the very inception of the single market but has not kept pace with the developments in the corporate world. The European Commission is empowered to impose sanctions on firms for competition-related violations. On the other hand, it had only limited or no means to act against market distortions caused by firms that resort to bribery to secure businesses in the EU.

The EU have thus adopted some legal measures to protect the single market from distortions caused by transnational economic crimes. The aim of these measures is to protect the internal market but they are not sufficiently corruption-specific. The OECD[(44)] and the US regimes[(45)] have clear and

(43) Articles 101-106 TFEU.

(44) See for example the OECD 1997 Convention on Combating Bribery of Foreign Public Officials in International Business Transactions the 2009 Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials.

(45) In the US, corporate crimes such as money laundering and international bribery are investigated and prosecuted on an unprecedented scale. According to Moody's, for example European banks such as ING, Deutsche Bank and BNP Paribas were fines over $ 16 billion from 2012 to 2018 in connection with money laundering and trade sanction breaches.

specific regulations against international corruption and bribery in order to protect market competition from corrupt businesses.

The EU model looks at the problem largely from the perspective of criminal liability on the part of government officials. This approach has thus created problem of uniform enforcement across the Union as this function is within the exclusive competence of the Member States.

There are some Member States such as France and the UK before Brexit that had adopted laws similar to the US model. They have delegated competence to prosecutors to negotiate out of court settlements with corporations in cases involving bribery and corruption(46). If they cooperate with the prosecutors, the corporations may avoid criminal conviction and receive even lower penalties.

This method of dispute resolution is increasing within the Union as evidenced by some high-profile corruption cases involving multinational companies based in the EU such as *Standard Bank*(47), *Telia Company*(48) and *Societe Generale*(49). These companies while acknowledging their guilt entered into global foreign bribery settlements.

A recent case in which the UK prosecutor followed the US model to negotiate out of court resolution involved the *Airbus Aviation Company*. This company had used a network of secret agents to pay large-scale bribes to officials in seven countries to secure contracts. The UK Serious Fraud Office which is given the task with investigation and prosecution of fraud and corruption launched the probe into corrupt practices of this company. The French and US authorities were later involved in the same investigation as the alleged corrupt activities had even violated the French anti-corruption laws and breached certain US export rules.

Interestingly it was the Airbus Company that itself reported the inaccuracies in its disclosures to the UKs export credit agency about the use of intermediaries which ignited the investigation. The Airbus Company decided to co-operate with anti-corruption authorities with the aim of securing a lenient punishment

(46) "Corporate bribery-EU needs to step up to the plate", European Court of Auditors, ECA Journal, Issue 2/2019.

(47) In Standard Bank (Tanzania) 2015 involving bribery, the bank agreed to pay a fine of $16.8 million.

(48) In Telia Company (Uzbekistan) 2017, involving a bribery scandal, the company reached a coordinated resolution with the relevant UD and Dutch authorities totalling $965 million in criminal and regulatory penalties.

(49) In Societe Generale (Libya) 2018, the bank reached a paralelle resolution with the French prosecutors and agreed to pay $ 585 million as criminal penalty.

by entering into a so-called Deferred Prosecution Agreement (DPA)[(50)].

A corporate plea deal was thus reached by Airbus to end the bribery and corruption probe[(51)]. The courts in the UK, France and US approved the DPA after the Airbus admitted using intermediaries to pay bribes to secure aircraft contracts. It agreed to pay a sum of €3.6 billion in fines after reaching a plea bargain with prosecutors in the UK, France and US over alleged bribery and corruption.

The Airbus case is a good example how this fast track procedure could be a powerful weapon in the hands of the anti-corruption authorities. It facilitates the imposition of huge fines in a quick and effective way to hit multinational companies where it financially hurts while avoiding the long, complex and highly uncertain process of judicial trials. This case also highlights the importance of international cooperation in tackling corruption having a cross-border dimension.

Corruption whether in the public or private sector has a negative impact on competition in the EU single market. The EU have thus adopted a law to combat corruption in the private sector to ensure the harmonious development of the single market. An important law passed in this context was a Council Framework Decision adopted under the third pillar of the Maastricht Treaty[(52)]. This law imposes an obligation on the Member States to criminalize two types of conduct. Similar to the anti-corruption law directed against the EU and national officials, it covers both passive and active corruption in the private sector.

The scope of the anti-corruption law targeting the private sector is quite similar to the Convention dealing with the EU and national officials. The difference is that the anti-corruption targeting the private sector is wider in scope. It targets not only private persons but also includes the liability of legal persons for both active and passive corruption committed for their benefit. Legal persons such

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(50) A Deferred Prosecution Agreement is an agreement reached between a prosecutor and an organization which could be prosecuted, under the supervision of a judge. The agreement allows a prosecution to be suspended for a defined period provided the organization meets certain specified conditions (https://www.sfo.gov.uk)

(51) On 31 January 2020, international enforcement authorities in the United States, the United Kingdom, and France simultaneously approved Deferred Prosecution Agreements with multinational aerospace giant Airbus S.E. (Airbus). In addition to the financial penalties, the three-year DPAs impose France's anti-corruption agency as a monitor on Airbus and require ongoing compliance reforms at the company.

(52) Council Framework Decision 2003/568/JHA on combating corruption in the private sector (2003) OJ L 192.

as business entities, non-governmental organizations or public organization are all covered by this law. It applies to business activities covering both profit and non-profit making entities. The list of offences covered is also broad covering even instigation, aiding and abetting of corrupt activities.

Since the relevant law was adopted before the Lisbon Treaty came into force, it only provides for punishment of its breach which should be effective, proportionate and dissuasive. It prescribes different forms of non-pecuniary sanction such as exclusion from entitlement to public benefits, disqualification from the practice of commercial activities, placing under judicial supervision, judicial winding up order, etc.

EU anti-money laundering directives (AML)

The launching of the single market in 1993 marks the beginning of the initial intervention of the EU in developing common rules to combat money laundering. A preventive intervention became a necessity as the EU single market led to the adoption of several legislative measures to dismantle the barriers to the free movement of capital and the establishment of a unified financial market. The liberalisation and integration initiatives also posed serious risk of abuse of the financial market such as money laundering.

The financial market compared to other segments of the economy are much more fluid and dynamic. Due to these peculiar features of the financial market, the EU had to regularly update and amend the financial laws including those dealing with money laundering. During the period 1993-2015 the AML was subject to five amendments. The last amendment came into force in January 2020 and a further amendment would become inevitable in the light of recent explosion of a series of scandals associated with some large banks allegedly involved in aiding and abetting money laundering.

An examination of the second to fifth AML disclose that these legal instruments mainly enlarges both *ratione materiae* and *ratione personae* covered by the first AML. There are several provisions in the fifth AML legal framework which are inherited from its original form since the first AML was adopted in 1993. It is therefore useful to briefly highlight the relevant legal provisions in the preceding directives. The essential and significant features of the fifth AML will be critically examined to evaluate the extent to which they could be further strengthened.

Original rules on EU anti-money laundering (AML)

In the early 1990s the Member States of the EU themselves did not have any

separate laws to deal with money laundering. It was not treated as a specific offence in any of the Member States. In some Member States the proceeds of money raised by committing a crime and invested to hide its origin was covered in their penal code. Even in such Member States money laundering was not recognised as a separate and distinct offence.

It is in this background we have to look at the origin of the EU law on money laundering. The first EU intervention was a simplistic and minimalist approach when it adopted the first money-laundering directive in 1993 (first AML)[(53)]. It laid down only the minimum rules necessary to combat money laundering[(54)]. The reason for adopting such a minimalist approach is due to the emergence of various sensitive issues raised by the Member States.

The desire to preserve their banking secrecy laws and the objection towards EU institutions encroachment into their traditionally exclusive competence in the field of criminal law are some of the factors that militated against the adoption of a comprehensive piece of legislation to combat money laundering.

There are a series of five generations of EU legal instruments that deal with money laundering. The first two generations of AML are replaced by the third generation of AML. The current fifth AML amends the fourth AML and the latter repealed the third AML effective from 26 June 2017. Even before the fifth AML came not force on 10 January 2020 there had been discussions for its amendment perhaps by adopting a sixth AML.

The first AML

Due to lack of competence for the EU in the field of criminal law, the first AML did not provide a definition of money laundering nor did it prescribe a common harmonised sanction system. Due to this legal handicap, the most the EU could do was to prohibit, not criminalise money laundering[(55)]. However, a non-binding Statement was added to the first AML urging the Member States to criminalize money laundering.

The first AML applies primarily to banks and other financial institutions[(56)].

(53) Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering (first AML). Article 16 of the first AML declares that Member States shall bring into force the laws, regulations and administrative decisions necessary to comply with this Directive before 1 January 1993 at the latest.

(54) See Sideek M Seyad, «Public Policy Limits Capital Movements in the European Common Market», (1995) 6 European Business Law Review 262-269.

(55) Article 2 of the first AML declares Member States shall ensure that money laundering is prohibited.

(56) Article 1 refers to the First Banking Directive 77/780/EEC, Second Banking Directive 89/646/EEC and Second Life Insurance Directive 79/267/EEC as amended by 90/619/EEC.

The main thrust of the directive is to penalise the proceeds of the criminal conduct. It covers a broad range of activities such as attempting, aiding, abetting or counselling the transfer or obtaining the ownership or use of objects that were realised by criminal activities with the aim of concealing their illegal background. The rules covering the target groups and nature of offence associated with money laundering are inherited in the current fifth AML legal framework.

The nature of obligations set out in the first AML are still retained in the fifth AML. It imposes an obligation on the financial institutions to adopt and maintain proper identification and record keeping procedures. If the monetary transaction exceeds ECU 15,000 (the reference to ECU was replaced as euro by the second AML) or value is less but creates reasonable suspicions about the nature of the transaction, the bank has a duty to clearly identify the client.

They are required to maintain copies or references of identification documents for a minimum period of five years after a specific transaction and after the termination of their relationship with their customer, to maintain the information for a similar length of time. The requirement of identification will be triggered when entering into business relations such as opening a bank account or offering safe custody facilities.

The financial institutions are obliged to introduce a credible system of reporting procedure to the competent authorities. This positive duty to supply information comes into conflict with the banks duty of confidentiality owed to its customer. If the reporting subsequently turns out to be incorrect but done in good faith, the credit institution is immune from both criminal or civil liability. The financial institutions are required to provide special education for employees to learn to recognise activities relating to money laundering. As far as sanction for the breach of first AML is concerned, it is for the Member States to determine the appropriate penalties.

All Member States except Austria implemented the first AML in full(57). Some Member States went even beyond the requirements of the directive in a number of areas, e.g. lower thresholds and wider coverage of financial and non-financial professions. Since the first AML had its legal basis in the Treaty of Rome, the EU institutions had no competence to compel the Member States to amend their criminal legislation. It only required the Member States to combat the laundering of the proceeds of drugs trafficking.

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(57) Austria was threatened with having its FATF membership suspended unless action was taken to eliminate anonymous passbooks; legislation was proposed and adopted by the national legislature, which caused the FATF to lift the threat of suspension.

Second AML

The background to the first amendment of the AML was the unprecedented 9/11 terror attack in New York and Washington in 2011[58]. Prior to this tragic event there had been disagreements between the EU co-legislators, the Council of Ministers and the European Parliament on the amendment of the first AML. The terror attack and the follow up aggressive Bush-doctrine on terror left no choice for the co-legislators but to set aside their differences and agree to adopt the second AML. It is significant to highlight that the terror attack happened on 9/11/2001 and the second AML was adopted the following month on 4/12/2001. The second AML was also the first amendment adopted after the Maastricht Treaty came into force in 1993.

Several changes were introduced by the second AML. Its scope of application was extended and the existing rules were strengthened to keep pace with the changes taking place in the EU financial market. The second AML widened the scope of application of the preceding directive. It extends the scope of application to embrace not only drugs trafficking but broadly covers organised crime[59].

The scope of the directive was extended to include money obtained by fraud or corruption relating to the EU budget[60]. The narrow definition of financial institutions was expanded to cover investment firms, collective investment undertakings, currency exchange offices, remittance offices, etc[61].

Another novelty is that the amending directive extend its coverage to non-financial activities and professions as vulnerable avenues for money laundering. The rules on client identification, record keeping and reporting was extended to a wide range of professions[62]. This legal obligation was extended to external accountants, auditors, real estate agents, casinos and fund transporting companies[63]. In relation to casinos, its customers shall be identified if they

(58) Directive 2001/97/EC amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering,(2001) OJ L 344. Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering - Commission DeclarationDirective 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering - Commission Declaration

(59) Article 1(E) of the second AML.

(60) Article 1 (E) of the second AML.This was in response to several allegations of fraud, corruption and mismanagement of the EU finances.

(61) Article 1 of the second AML.

(62) Article 2a of the second AML.

(63) As far as casinos are concerned, Article 3a provides that identification shall be required of all customers

purchase or sell gambling chips with a value of €1,000 or more. Even dealers in high value goods such as precious stones or metals exceeding €15,000 in value are covered by this directive.

It was the legal profession which delayed the adoption of the second AML as it was against its inclusion as a reportable entity. Their objection was based on the premise that it will compromise their duty of confidentiality in the professional relationship with their clients. A compromise was thus reached whereby the legal profession was included in the second AML subject to certain safeguards and exceptions. Their obligations would apply only in respect of specific financial and company law activities where the risk of money laundering is high. They were exempt from identification or reporting requirement if they are representing the same client in any formal legal proceedings.

If any legal advice is sought directly or indirectly for the purpose of facilitating money laundering, it will obviously not benefit from any exception on the duty to report. When the lawyers assist or represent their clients in respect of buying and selling of real property or business entities, handling of client money, securities, opening or managing bank, savings or securities accounts, creation, operation or management of companies, trusts they should fully comply with the provisions of the second AML[64].

Another compromise reached was the second AML leaves it to each Member State to designate an entity to which the lawyers should communicate any suspicions of money laundering. The Member States for this purpose can nominate the anti-money laundering authorities or the bar associations or equivalent professional body[65]. It is for the Member State to decide on the form of cooperation between the bar association and anti-money laundering authorities.

Third AML

The inclusion of terrorist financing as an additional offence to money laundering is a distinct feature in the third AML that came into force in 2005[66]. As highlighted in the context of the FATF, there are mixed academic views expressed on the

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of purchasing or exchanging gambling chips with a value of €1000 or more. This is in contrast with the general rule which has set €15 000 as the lowest threshold for identification and reporting.

(64) Article 2a of the amending directive.

(65) Recital 17 and 20 of the second AML.

(66) Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (Text with EEA relevance, (2005) OJ L 309. This directive expressly repeals the first and second AML, respectively. 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)

combination of these serious crimes in the same legal instrument. Terrorism is no doubt an international curse, but it had been in existence for centuries across the globe. In modern times it caught the eyes of the international community only when it struck in the US soil.

The patchwork done to the third AML would be inadequate to deal with this heinous crime of terror. The extension of the third AML to combat terrorism should not result in weakening its primary war on money laundering. After the 9/11 terrror attack, the EU was exposed to several rounds of terror attacks but the third AML failed to prevent the terror attacks committed in London, Madrid and Stockholm.

The third AML also extend its reportable entities to trusts and company service providers and the applicable rules was further refined by the fifth AML. Another distinct feature in the third AML is that it implicitly extends its coverage even to third countries. Any EU-based credit or financial institution providing services outside the Union by way of a branch or a subsidiary is required should fully comply with this directive[(67)].

The third AML also makes specific reference and the need for closer cooperation between the national Financial Intelligence Units[(68)]. Besides, the concept of customer due diligence is given a broad meaning, setting out guidelines different context in which it should be applied in a simplified and enhanced manner.

Fourth AML

The Lisbon Treaty gives competence to the EU to create and define new financial crimes and prescribe appropriate sanctions. Article 83 TFEU gives competence to the EU to create a variety of crimes by ordinary legislative procedure, opposite to the complex and difficult unanimity voting known as special legislative procedure. Some serious financial crimes such as terrorist financing and money laundering are explicitly covered by the Lisbon Treaty.

The fourth AML was adopted in 2015, six years after the Lisbon Treaty came into force[(69)]. It repealed the third AML but inherits all the legal provisions as

(67) Article 31 of Directive 2005/60/EC, the third AML.

(68) Article 38 of Directive 2005/60/EC, the third AML.

(69) Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, (2015) OJ L 141. Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Text with EEA relevance) It is significant to note the legal basis of this directive is based on the traditional catch-all single market

highlighted above[70]. It introduced far-reaching changes in relation to customer due diligence, imposed an obligation on the Member States to create and maintain a central register of the beneficial owners of legal entities and further widened the scope of obliged entities.

It also provided a clear and precise definition of politically exposed persons for the purposes of money laundering, which is discussed in more detail under the fifth AML. An important change introduced by the fourth AML is that it lowered the cash payment threshold which are prescribed both in the FATF Recommendations and the preceding AML directives from €15,000 to €10,000.

Fifth Generation of AML

The Paris[71] and Brussels[72] terrorist attacks and the leaked revelation on the Panama Papers[73] raised doubts about the effectiveness of the fourth AML. The human and financial tragedy caused by these terror attacks was the background to the Commission initiative to address the inadequacies in the fourth AML[74]. The fifth AML which amends not repeal the preceding directive came into force on 9 July 2018 and imposed 10 January 2020 as the deadline for Member State to transpose into their respective national laws[75].

The fifth AML is relatively an extensive amendment of the previous legal

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legal provision, Article 114 TFEU, not the new competence in criminal law set out in Article 83(2) TFEU.Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Text with EEA relevance)

(70) Recital 63 of Directive 2015/849/EU declares: Given the very substantial amendments that would need to be made to Directive 2005/60/EC in light of this Directive, they should be merged and replaced for reasons of clarity and consistency".

(71) On 13 November 2015, there were a series of coordinated terrorist attacks in Paris, France that killed 130 innocent people and injuring more than 413 people. Investigations had revealed that one suspect in the atrocity sent seven Western Union wires totaling $552 and another sent a single wire for $226, which illustrates the nature of terrorist financing.

(72) On 22 March 2016, there were three coordinated suicide bombings in Brussels, Belgium killing over thirty people and injuring more than 300 people. Similar to Paris terror attack, even in the Brussels attack the terrorists had used prepaid cards to fund the attacks.

(73) The International Consortium of Investigative Journalists published the secret information kept by a Panamanian law firm of the financial secrets of global celebrities, oligarchs and criminals. The Panama law firm had worked closely with global banks including HSBC, UBS and Credit Suisse and law firms in the Netherlands, Mexico, the United States and Switzerland.**Swiss wealth**

(74) European Commission [https://ec.europa.eu/info/policies/justice-and-fundamental-rights/criminal-justice/anti-money-laundering-and-counter-terrorist-financing_en] 28-12-2019

(75) Directive 2018/843/EU amending Directive 2015/849/EU 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

instrument and done within a short span of three years of its existence. It follows the preceding models not only expanding its scope of application but also further strengthening the existing rules. A number of emerging issues that may potentially pose a threat to the well-being of the EUs financial market are also pro-actively addressed in the fifth AML.

A distinct feature in the fifth AML is that it provides for the establishment of registers of ultimate beneficial owners (UBO) of companies and other legal entities. It takes into consideration innovation in the market and thus extends its coverage to those uncovered service providers such as electronic wallet providers and virtual currency exchange service providers. The third AML implicitly extended its coverage to tax crimes[(76)], the fourth AML explicitly covered direct and indirect taxation[(77)] and the fifth AML extends even beyond professional tax advisors to any person who provide tax related services.

It also covers traders engaged in works of art provided the value of a transaction exceeds €10.000[(78)]. The second AML included estate agents as reportable entities[(79)], but the fifth AML applies more broadly even when they are acting as an intermediary in the letting of property provided the monthly rent exceeds €10,000. The use of prepaid cards is restricted and the fifht AML also mandate Member States to apply not simplified but enhanced due diligence measures to monitor suspicious transactions involving high-risk third countries even more strictly.

The fourth AML brought Politically Exposed Persons (PEP) within its purview and the fifth AML impose an obligation on the Member States to prepare and keep an up-to-date list of such persons. Another distinct feature in the fifth AML is the duty imposed on the Member States to establish a centralized national bank account registries or electronic data retrieval systems which would allow for identification of every natural or legal person.

Ultimate Beneficial Ownership

In the context of the EU law on financial services, the concept of beneficial ownership has its origin in the field of direct taxation. A brief reference to its background is useful to understand its significance in the light of the fifth AML.

The free movement of capital is one of the four fundamental freedoms

(76) Article 3(5)(f) of Directive 2005/60/EC defines serious crime, *inter alia*, as "all offences which are punishable by deprivation of liberty or a detention order for a maximum of more than one year or, as regards those States which have a minimum threshold for offences in their legal system, all offences punishable by deprivation of liberty or a detention order for a minimum of more than six months"

(77) Article 3(4)(f) of Directive 2015/849/EU.

(78) Article 1((1)(a) of Directive 2018/843/EU.

(79) Article 2(4) of Directive 2001/97/EC.

comprising the EU single market[80]. Apart from removing the barriers to the free flow of capital for cross-border investments, it also allowed natural and legal persons to open bank accounts in other Member States. Even after the Lisbon Treaty, the Member States continue to retain their competence in the field of direct taxation. Any law in the field of direct taxation must be adopted by special legislative procedure and according to this procedure every Member State retain the right of veto[81].

As the EU law liberalized the freedom to move the money and open a bank account in any other Member State, it also created a complex legal situation in the field of taxation. The Member States have the exclusive competence on the taxation of income from capital[82]. Due to this legal asymmetric between capital movements and taxation of capital income there had been a large outflow of capital from higher taxation countries to those with more liberal tax law.

In order to rectify the tax distortions produced by the free flow of capital, the EU adopted a directive on taxation of saving income[83]. As a transitional arrangement, the relevant EU tax allowed three Member States, Austria, Belgium and Luxembourg who are opposed to tax harmonization to introduce a system of withholding taxation. According to this transitional arrangement, income from savings account was subject to a progressive rate of taxation of 15% from July 2005 and to increase gradually reaching 35% effective from July 2011 onwards[84].

The other Member States of the EU were obliged to exchange information of the interest paid on capital income of the nationals of each other. The tax directive had a minimum coverage and originally applied only to the income from savings income of the beneficial owners who are natural persons and excluding legal persons.

(80) Sideek M Seyad, "Legal and Judicial Developments in the Field of Capital Movements" (1996) 7 European Business Law Review 273-279.

(81) Article 115 TFEU.

(82) Sideek M Seyad, "National tax laws reign supreme over capital freedom in the European Union" (1995) 2 European Financial Services Law 180-185.

(83) Council Directive 2015/2060 repealing Directive 2003/48 on taxation of savings income in the form of interest payments. Council Directive 2014/107 now repeals this law as regards mandatory automatic exchange of information in the field of taxation.Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxationCouncil Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation

(84) Directive 2015/2060 repealed Directive 2003/48/EC on taxation of savings income from 1 January 2016. All Member States are now subject to Directive 2014/107/EU amending Directive 2011/16/EU as regards exchange of information in the field of taxation.

Its scope of application was limited only to interest received from savings income and specifically excluded other forms of benefits of capital investment such as dividends, capital gains, etc.

Since the beneficial owners were defined in a narrow manner covering only natural persons, the EU tax law thereby provided a leeway to by-pass it. It was possible for a natural person to avoid the tax law by creating a legal entity such as a company. A company can open a bank account and since it is a legal person, it is not subject to the EU tax law. A natural person who created the company automatically became its shareholder.

The bank interest paid to legal entities such as companies was not subject to the tax law. A company pays out its profits to its shareholders not as interest income but as dividends and such payments are excluded from the tax law.

The loopholes associated with the concept of beneficial ownership in the tax law was to some extent addressed and rectified in the fifth AML. It lays down special rules targeting the UBO to mitigate risks of laundering dirty money. It recognizes the links between money laundering and tax evasion. It also seeks to improve transparency and availability of information of the UBOs.

There are various objectives in enhancing the concept of transparency in the fifth AML in relation to UBO. The public including the media and civil society should have sufficient access to information to have closer scrutiny of UBO. Such openness and accessibility to information may contribute to preserve and enhance the public trust in the EUs financial system. The recent bank scandals itself is sufficient proof of the erosion of trust the public have in the financial system largely due to its opaqueness.

The fourth AML was strengthened by the fifth AML in a variety of ways. An obligation is imposed on the Member States not only to prepare a list of UBO as required by fourth AML but the amending law requires it to be made publicly accessible. The obligation imposed on the Member States to create a list covers companies, other legal entities and even trusts.

The companies are under a legal obligation to prepare a list containing the names of UBOs. Such registers should be publicly accessible. In order to access this information, there is no requirement to show any legitimate interest in the company. The concept of the UBO is also given a wider meaning as a person who benefits from ownership of an asset such as a company or real estate or has the power to influence or vote on transaction decisions regarding the asset.

Apart from the companies the fifth AML also requires trusts to prepare and maintain a register of UBOs. Under the previous directive trusts were covered only if they generate tax consequences but the new directive dispenses with this requirement. It improves the scope of transparency of the trustees, and they are required to obtain and hold information of UBOs in a register.

Unlike the companies, the access to the register of trusts is available only to persons who can demonstrate a legitimate interest which should be defined by the Member States in their national laws such as the tax authorities, financial market supervisors, investigators and prosecutors of financial crimes. The trusts are accessible to various actors relevant to AML such as the financial intelligence units, banks and others who can demonstrate a legitimate interest. It is for the Member States to define and set out what constitutes legitimate interest[(85)].

The fifth AML impose an obligation on the Member States to set up a centralized national bank account registers or electronic data retrieval systems to identify the real holders of anonymous bank accounts, pass books or safe-deposit boxes. The aim of creating such a register is presumably to facilitate the detection of the movement of illicit funds between the Member States.

However, unlike UBO registers of companies, the list in the banking sector is not publicly available. It is only accessible to authorities such as those designated to combat money laundering, tax authorities, financial supervisory authorities, etc.

In exceptional circumstances, the Member States are authorized to deny access to a central register of UBOs to the public. There are different situations, which would justify this exclusion such as risk of a UBO being exposed to fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation. In these circumstances their names need not be publicized in the list.

Another distinct feature in the fifth AML is that it requires the national list of UBOs to be inter-connected at the EU level. This is to facilitate the exchange of information and enhance cooperation of UBOs between the Member States. The Member States are not prevented from providing even broader access to information in accordance with their national law. It leaves to the Member States to decide whether or not to require an online registration to get access to such information.

(85) Recital 42 of Directive 2018/849/EU, the fifth AML

Virtual currencies

Virtual currency is a type of unregulated digital currency that is available only in electronic form. It can be stored and transacted through designated software, mobile or computer applications or through digital wallets. The transactions in virtual currencies are done online through secure networks. It is considered to be a subset of the digital currency group. Within this group also includes cryptocurrencies, which exist within the blockchain network.

Cryptocurrencies are thus a part of the virtual currency group. It uses cryptography technology in order to keep the transactions secure and authentic. This technology also helps to manage and control the creation of new currency units. The cryptocurrencies are transacted over dedicated blockchain-based networks that are open to the public. It is possible for anyone to join and do transactions in cryptocurrencies.

Cryptocurrency is a fast-growing product in the global financial market. Unlike the traditional currencies, there is no public authority such as the central bank or an administrator to oversee the cryptocurrency transactions. The Users of cryptocurrency store them in a virtual account known as a digital wallet. The transactions in cryptocurrencies are purely private which makes it difficult to trace its Users. There is thus the risk of the cryptocurrency becoming the medium of payments to buy illegal drugs online or to engage in other illicit or immoral activities.

There is insufficient information on the extent to which cryptocurrency may pose a threat to the stability and security of the EU single market. There are however some reports published by various EU institutions which highlight the potential risks cryptocurrencies may pose as a vehicle to commit financial crimes such as money laundering, terrorist financing and tax evasion(86).

Furthermore, there is also no consensus globally or regionally whether cryptocurrency should be given the legal status as a medium of payment or as a store of value. Even within the EU, it is largely for preventive purposes the fifth AML brings cryptocurrency within its scope of application. There are different types of cryptocurrency in circulation(87). One of them, Bitcoin was the first and quite well-known in the market. It was only in the early part of 2020 the use of Bitcoin was legalized in the U.S., Japan, U.K., Canada and some other countries.

(86) Cryptocurrencies and blockchain: Legal context and implications for financial crimes, money laundering and tax evasion, European Parliament, Directorate General for Internal Policies, PE619.024-July 2018

(87) Some other known cryptocurrencies are Bitcoins, Ethereum, Ripple, EOS and Litecoin, respectively.

There are various potential benefits and corresponding costs in the use of the cryptocurrencies. One of the benefits using digital currencies is its cost effectiveness(88). The fees for its use are relatively lower compared to the traditional bank charges or other payment gateways(89). Unlike the traditional method of payments or credit transfers, there is no intermediary charging transaction fees for the use of cryptocurrency. The Users are not bound or directly affected by any changes in the exchange rates, interest rates or other transaction charges. These charges are of course the bread and butter of the traditional credit institutions!

Another advantage is that some virtual currencies are accepted as a means of payment by legal and natural persons. It can also be transferred, stored and traded electronically. Another argument weighing in favor of cryptocurrency is its anonymity. It may be viewed as an advantage if done legally as there is no need to disclose the personal identity information in a cryptocurrency transaction(90). It is possible to make payments with cryptocurrency for the purchase of goods and services online. Ccryptocurrency are less susceptible to counterfeiting compared to the traditional currencies.

There are also potential risks with the use of cryptocurrency. A strong argument against is the potential risk cryptocurrency may pose as a vehicle of tax avoidance, money laundering and terrorist financing. Due to its anonymity, cryptocurrency may become a new avenue to hide any wealth raised through questionable means.

There are some countries which has strict bank secrecy rules. Under pressure from the international community especially after the 2008 global financial crisis, the banks in such countries are prohibited from offering anonymous accounts. The risk is that such secret bank accounts may now be replaced by cryptocurrencies.

The issuing and withdrawing of the traditional currencies are done by the central banks but there is no such regulated mechanism to issue cryptocurrencies. The central banks are the monetary guardians of the respective currencies such as the ECB for the euro but there is no such public authority to protect

(88) Payments in Sweden 2019, Swedish Central Bank, official publication, 7 November 2019.

(89) Jonathan Chiu and Thorsten V. Koeppl, The Economics of Cryptocurrencies - Bitcoin and Beyond, Staff Working Paper/Document de travail du personnel 2019-40

(90) For example, in using credit cards such as Visa, MasterCard, these payment gateways operate on a pull basis where the merchant identifies the transaction and draws the amount of the sale from the card. On the other hand, cryptocurrency uses what is known as push model that will prompt the cryptocurrency holder to send exactly what they want to the seller without any other form of information.

and defend the cryptocurrency. The absence of such a designated authority can pose a threat in the event of any breakdown of payment system based on cryptocurrency.

The fifth AML extends its coverage to new service providers such as electronic wallet providers, virtual currency exchange service providers and providers engaged in exchange services between virtual currencies and fiat currencies such as coins and banknotes and electronic money that are legal tender. The aim of bringing these categories of service providers within the scope of AML is to end the anonymity associated with virtual currencies. Its main objective is to reduce the risk of its use for criminal purposes such as money laundering and terrorist financing. This objective is to be achieved by bringing virtual currency platforms within its scope of application. The fifth AML defines virtual currencies as follows:

"a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically"[91].

In terms of the fifth AML, custodian wallet providers and providers engaged in exchange services between virtual currencies and fiat currencies are to be considered as obliged entities. Since the fifth AML designates such platforms and service providers as an obliged entity, they will naturally fall within its scope of application.

They will thus be subject to monitoring for the purposes of money laundering like the traditional financial institutions. These new category of service providers should be registered with the relevant national authorities to provide their services. The prescribed platforms and service providers are required to perform customer due diligence and submit suspicious activity reports to the relevant authorities.

There are some safeguard measures introduced by the fifth AML to ensure that cryptocurrency platform do not directly or indirectly assist criminals to launder their dirty money. It authorizes the Financial Intelligence Units to obtain the addresses and identities of owners of virtual currency[92]. This legal requirement may to some extent rectify one of the major concerns with the anonymity surrounding the use of cryptocurrency.

(91) Article 1(2)(d) of Directive 2018/843.

(92) The financial intelligence units was initially covered by Article 21 of Directive 2005/60/EC, the third AML.

One of the shortcomings highlighted and associated with the use of cryptocurrency is the absence of an authority to regulate their activities. To some extent, this shortcoming is also rectified by the fifth AML as it provides for the regulation of providers of cryptocurrency exchanges and wallets. They should be registered with the competent authorities in their domestic locations, for example in Sweden with the *finansinspektionen*, financial supervisory authority, Germany, *BaFin,* etc.

The protective measures introduced by the fifth AML could potentially benefit and enhance the use of cryptocurrency as virtual currencies in the EU single market. The stigma attached to virtual currencies as faceless and as a potential medium of tax evasion and money laundering may be removed by the fifth AML as it requires cryptocurrency platforms to be transparent and accountable. These service providers based in the EU could thus be in a stronger position to compete with their counterparts for example in Asian countries, which have made legislative progress in integrating cryptocurrency with financial markets(93).

Prepaid Cards

The use of prepaid cards is quite popular in modern times. It has not only revolutionized the payment system but also make it accessible even to the socially and financially deprived groups in society. A person without a regular and sufficient source of income may find it difficult to open a bank account and create a payment account. This social problem to some extent has been addressed by the EU which created a new payment avenue known as Payment Institutions(94).

There are both advantages and disadvantages in using prepaid cards. An obvious advantage is it is more secure to use as a plastic card rather than carrying a bundle of physical bank notes. The prepaid card can be loaded with cash as and when its holder wishes to make payments and can also be easily reloaded. It is also secure especially with a prepaid debit card as it is possible to spend only what has been loaded. It is obviously more secure to hold a prepaid debit card than a credit card as holder of the latter can be exposed to the risk of easily getting into debts due to excessive spending coupled with an exorbitant rate of interest on credits.

(93) For example, in Japan, cryptocurrency exchange businesses are regulated by amending the Payment Services Act with effect from 2017.

(94) Sideek M Seyad, “A Critical Assessment of the Payment Services Directive” (2008) Journal of International Banking Law and Regulation 218-230.

Similar to a traditional debit card, the holder of the prepaid payment card can decide the value or the amount it should hold. There are some prepaid cards fixing an upper limit that can be loaded. Some other cards allow its holder even to transfer funds to a similar cardholder. They are often used as a medium of payment of small amounts. There is not much difference in holding prepaid card and having cash in a wallet or purse. The important difference is that in case the prepaid card is lost or stolen, the holder's losses will be limited only to the balance amount stored on the card.

There are also various risks associated with the use of prepaid cards. There are some cards that may involve several parties to execute any payments such as the issuer, acquirer, payment network, distributor and agents. Some of those parties may not be located in the same country which can enhance the risk of being used for terrorist financing.

The prepaid cards are also attractive to criminals as they are freely available and easy to purchase without disclosing the buyer's identity. It is not difficult to locate the retail outlets to buy the prepaid cards, can load the amount they wish to do so and still remain anonymous. In such transactions, it is not easy to apply the customer identification and verification measures for prepaid cards as done with other financial transactions.

There are prepaid cards that are linked to the accounts held at banks or companies providing money transfer or remittance services. Due to this link between the prepaid card and financial institutions, the FATF in 2013 published a non-binding public guidance for a risk-based approach on prepaid cards as well as mobile payments and internet-based payment services.

According to these guidelines, prepaid cards are to be treated the same way as bank accounts from an AML compliance standpoint. The FATF thus recommends the same level of due diligence in dealing with these payment cards. Since the EU law on AML closely follows the guidelines of the FATF, the sale and use of prepaid card was thus brought within its scope of application. The prepaid card service providers are now obliged to comply with the AML rules such as customer due diligence, record keeping and reporting of suspicious transactions.

The decision to further restrict the use of prepaid card in the fifth AML was due to a series of terror attacks across the Union. The follow-up terrorist investigations had revealed that in order to hide their identity, the terrorists have used prepaid cards to communicate with each other. They had moved small quantities of funds especially across the EU borders to facilitate terror attacks within the Union.

It was the fourth AML which originally brought the prepaid cards within its scope of application. Such payment instruments can only be used to purchase goods or services. It cannot be funded with anonymous electronic money. The fourth AML also set a limit to the amount that can be loaded into the prepaid card. It fixed an upper limit of anonymous loading of payment instruments with the aim of preventing or minimize the risk of financing terror attacks.

The Member States were given a derogation from the customer due diligence requirement if the payment instrument is not reloadable or has a monthly payment transaction below €250 and that can be used only in that Member State. It also allowed Member States to even increase the maximum amount to €500 for prepaid cards.

The fifth AML however reduced the limit set for monthly transaction on anonymous prepaid cards from €250 to €150. This lower limit also applies to the amount that can be stored or topped-up on the pre-paid cards. The service providers are required to carry out identity checks on customers if they are to use prepaid cards exceeding this amount. The cash withdrawal or anonymous remote or online transaction is now reduced to €50.

The fifth AML prohibits the use of prepaid cards issued outside the EU unless they were issued in a territory enforcing legislation equivalent to the EU's anti-money laundering standards. All obliged entities must review the way they handle prepaid card payments and put mechanisms in place to identify and even refuse transactions using cards from non-EU sources.

High-Risk third Countries

During the initial stages of the construction of the EU single market, it was operating largely within its territorial limits. Since the EU had to first remove the barriers to the free movement of goods and services between the Member States, opening of the single market to third countries was not its primary objective. Thus, the access to the single market during its formative stages was very limited to third countries goods and services. There was less risk for the single market to be exploited by criminals from outside the Union. Thus, the money laundering laws adopted initially focused purely on the single market with no reference whatsoever to trade relations with third countries.

With more trade liberalization within the EUs single market, it also became more liberal to the outside world. With the opening of the single market to third countries, the scope of application of the anti-money laundering laws was gradually extended to third countries.

The third AML applied for the first time to third countries but it had a very limited application. Its scope of application was extended to cover EU banks having operations in third countries through a secondary establishment such as a subsidiary or a branch. It was applied only if the host third country did not have anti-money laundering laws similar to the EU model. Even correspondent banks operating outside the EU was covered by this law(95).

The fourth AML mandated the Commission to develop policies towards specific third countries(96). Such policies do not apply automatically to all third countries but the Commission is required to identify them(97). There are guidelines which the Commission should follow to develop AML policies towards third countries. The aim of delegating the power of identification of high-risk countries to the Commission is to harmonize the control measures at the EU level.

The Commission should first and foremost be satisfied the identified third country would pose a significant threat to the Unions financial system due to the shortcomings in its anti-corruption laws(98). The fourth AML only set out a mechanism for the identification of a third country to protect the proper functioning of the single market. It was silent on the kind of measures EU should apply towards such third countries. This deficiency was to some extent rectified by the fifth AML. It broadens the scope of criteria that can be used by the Commission to make a scientific assessment of high-risk third countries.

A distinct feature in the fifth AML is that any EU-based company doing business with its customers in high-risk third countries are required to perform enhanced due diligence measures as opposed to simple due diligence(99). They

(95) Correspondent banks are authorized to provide services on behalf of another bank. A domestic bank can use correspondent banks to act as their agent abroad.

(96) Directive 2015/849, Section 3, Third country policy, Article 9.

(97) On 13 February 2019 the Commission's listed 23 countries as having strategic deficiencies in their anti-money laundering/ counter terrorist financing regimes. The Commission have taken into consideration three criteria before black listing these countries: the systemic impact on the integrity of the EU financial system; they are reviewed by the International Monetary Fund as international offshore financial centers; they have economic relevance and strong economic ties with the EU. For each country, the Commission had assessed the level of existing threat, the legal framework and controls put in place to prevent money laundering and terrorist financing risks and their effective implementation.

(98) When the fourth AML was applicable, the EU had identified 16 countries as 'high risk third countries'. They are Afghanistan, Bosnia and Herzegovina, Guyana, Iraq, Lao PDR, Syria, Uganda, Vanuatu, Yemen, Ethiopia, Sri Lanka, Trinidad and Tobago, Tunisia, Pakistan, Iran and Democratic People's Republic of Korea, respectively. Since the fifth AML has broadened the criteria for the European Commission in assessing high-risk third countries, it is likely this list will be expanded in future.

(99) On customer due diligence, see Chapter 11, Customer due diligence, Articles 10-29 of Directive fourth AML as amended by Article 1 (6-14) of the fifth AML

should specifically focus on addressing the deficiencies in such third countries legal instruments on money laundering and the potential risks they may pose.

The companies should be more vigilant if they are to enter into any complex transaction with a business partner in a third country. They are also required to exercise enhanced due diligence if it involves unusually large transactions or such transactions are conducted in an unusual pattern or does not have an apparent economic or lawful purpose.

When an EU-based company deals with individuals from a high-risk third country, they are obliged to collect and record the personal information of the foreign customer and the ultimate beneficial owner(100). It should not only collect and record the reason for the proposed transactions but also the origin of the third country individual's wealth. The companies exposed to trading with such high risk third countries are also required to report transaction details to its senior management. It is only after obtaining its approval, the company could establish or continue the business relationship.

The customer due diligence rules apply not only before establishing a business relationship. It is a continuing process. The EU-based company should continuously screen the third country customers to ensure that the business relationship is not being misused for money laundering or terrorist financing. Even if the threshold of a particular transaction is lower or negligible, the company should still apply the due diligence rules if there are any doubts about such transactions.

Politically Exposed Persons

It is not just the politicians who indulge in corrupt practices. More often than not, corrupt politicians do not directly indulge in corrupt practices such as accepting bribes from the public. It is often those closely connected who resort to such illegal activities either for their own benefit or on behalf of their political masters.

A new category known as politically exposed persons (PEPs) was first introduced in the fourth AML in widening the war on money laundering(101). An implementing Commission Directive provides a broad and extensive definition of what constitutes a PEP(102). It is defined as a natural person who

(100) For example, the Commission have identified certain individuals from Tunisia, Vanuatu, Ethiopia and some other countries who are deemed "high-risk". They will be subject to even greater due diligence check when using EU businesses.

(101) Articles 3(9-11) Directive 2015/849/ EU.

(102) Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC as regards the definition of politically exposed persons.

is or who has been entrusted with prominent public functions. It includes a long list of PEPs such as Heads of State, Heads of Government, Ministers and deputy or assistant ministers; Members of Parliament or of similar legislative bodies.

It also includes persons closely associated with political activities such as the members of the governing bodies of political parties. Even senior judicial officers such as the members of supreme courts and constitutional courts fall into the category of PEPs. The members of courts of auditors and the boards of central banks are also covered. Even diplomatic officers such as ambassadors, chargés d'affaires and security personnel such as high-ranking officers in the armed forces are subject to this law. The fourth AML also extend to members of the administrative, management or supervisory bodies of State-owned enterprises (SOE), directors, deputy directors and members of the board or equivalent function of an international organization.

What constitutes family members of PEPs is also very broadly defined. It includes their spouse, children and their spouses or even persons considered to be equivalent to a spouse of a PEP, the parents of a PEP, etc. The persons known to be close associates of PEPs includes natural persons who are known to have joint beneficial ownership of legal entities or legal arrangements or any other close business relations with a PEP; natural persons who have sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the de-facto benefit of a PEP.

The fifth AML continues the category of PEP even in a stricter form. It imposes an obligation on the Member States to create and publicly release a list of PEPs made up of those exposed to public functions. The list should include the name of the positions to be considered as politically exposed. The fifth AML does not require disclosing the name of the person who is occupying the position. The aim of this exclusion is to protect the personal identity of such persons. It is also not possible to give the name of a particular individual as such positions are not of a permanent nature. In democratic countries political leaders and public officials hold office for a definite period.

The obligation to prepare a list applies not only to the Member States but also extends to accredited international organizations such as the EU itself. The latter should release an EU-level version of the list. The aim of creating such lists is to make it easier for compliance officers to identify the PEPs. It is their duty to screen and monitor their activities and keep track of any changes to the risk profile.

Sanctions for breach of the AML

The EU did not have explicit competence to impose any sanctions for breach of EU law before the Lisbon Treaty came into force. Most of the legal instruments adopted especially in the financial sector had a provision, which declares that Member States shall secure compliance of the relevant law by prescribing a punishment, which is effective, proportionate and dissuasive.

After assuming competence in the field of criminal law, the EU adopted a separate law, the penal arm of AML, to impose sanctions for breach of money laundering laws.[103] The aim of this legal act is to provide a sanction mechanism to ensure the effective enforcement of the fifth AML.

The penal or punitive arm of the AML establishes minimum rules concerning the definition of criminal offences and sanctions. It covers a wide range of criminal activities such as organized crime, trafficking, counterfeiting, murder, robbery smuggling, extortion, etc. Apart from retaining the traditional approach requiring sanctions to be effective, proportionate and dissuasive criminal penalties, it goes further to explicitly prescribe imprisonment for natural persons of at least four years. Any professionals such as lawyers, notaries, auditors, estate agents, etc. will attract even higher punishment for breach of the fifth AML.

There is a separate sanction regime prescribed for legal persons violating the AML. The relevant EU criminal law prescribes a different form of punishment for legal persons who breach the fifth AML. The nature of sanctions takes the form of a fine, exclusion from access to public funding or judicial winding-up, to ban from practicing commercial activities, confiscation of proceeds of financial crimes, etc.

Effectiveness of the current AML regime

Even after the adoption of the fifth AML, there are still certain inherent shortcomings in the EUs legal arsenal to combat financial crimes. All five generations of AML are based on the principle of minimum harmonization. It is the same principle that forms the foundation of most of the laws passed in the field of EU financial law. This principle was a compromise between the Member States divided between adopting strict and flexible rules to regulate and supervise the financial market.

The directives based on minimum harmonization requires the Member

(103) Directive (EU) 2018/1673 on combating money laundering by criminal law, (2018) OJ L 284.

States to adopt the prescribed minimum rules entirely. The Member States are however free to set even higher standards in transposing them into their respective national laws[104].

The discretion given to the Member States to transpose the EU law even rigidly into domestic law contributed to the uneven application of the AML within the single market. This has resulted in some form of distortion in market integration. It enables the service providers to shop around for a Member State with less regulation to start their business[105].

The minimum harmonization principle in the AML directives did more damage than in the other sectors of the financial market[106]. The AML is not targeting the legitimate service providers but the criminals who exploit the single market for personal gains. Even the fifth AML based on minimum harmonisation does not prevent forum shopping by criminals for the weakest legal systems to carry out their money laundering operations. The money launderers are given an opportunity to shop around for a Member State, which has less restrictive rules on detection and lenient punishment for offences relating to money laundering.

The successive amendments to the AML confirm that the EU have kept pace with the constantly evolving nature of money laundering but rectifying and strengthening only its regulatory part. The EU however failed on the supervision and enforcement side of the war on money laundering. The divergent supervisory practices and different types of sanction prescribed in the national laws facilitated money launderers to escape or avoid the long arm of the criminal law. The effectiveness of the AML was thus unfortunately minimised and compromised.

Even after the EU gaining competence to prescribe a common sanction for certain financial crimes such as money laundering, the traditional practice that such sanctions shall be effective, proportionate and dissuasive is continued even in the fifth AML. The failure to provide any precise guidelines to ascertain what constitutes effective and proportionate led to the imposition of uneven sanctions in the Member States for the same offence. It is still the

(104) For example, Article 15 of first AML declares, "The Member States may adopt or retain in force stricter provisions in the field covered by this Directive to prevent money laundering.

(105) For example, Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms requires €5 million as initial capital to secure a license but Member States are free to set a higher capital requirement.

(106) Communication from the Commission strengthening the Union framework for prudential and anti-money laundering supervision for financial institutions.

Member States that have the competence to decide on the nature or quantum of the sanctions for breach of AML.

There are however some cases where the ECJ have intervened to determine whether the national sanctions prescribed for the breach of AML are in accordance with the principle of proportionality. In *Chmielewski*(107) the ECJ had to assess whether the quantum of sanction prescribed in the Hungarian law for breach of Council Regulation 1889/2005 on controls of cash entering or leaving the Community offends the principle of proportionality(108). On the facts of the case, the ECJ concluded that since there was no evidence the source of the non-declared money is connected to a specific crime, the punishment prescribed in the Hungarian law was not proportionate.

Another drawback in the EU legal framework on AML is its complex supervisory architecture. There are several supervisory authorities with different tasks within the single market. The nature of cooperation and the method of exchange of information between them are not satisfactory. There are three prominent European Supervisory Authorities, namely the European Banking Authority(109), the European Securities and Markets Authority(110) and the European Insurance and Occupational Pensions Authority(111) which have

(107) Chmielewski v Nemzeti Adó- és Vámhivatal Dél-alföldi Regionális Vám- és Pénzügyőri Főigazgatósága (Case C-255/14) EU: C: 2015:475; [2016] 1 C.M.L.R. 10.

(108) Regulation (EC) No 1889/2005 on controls of cash entering or leaving the Community [2005] OJ L 309/9.

(109) Regulation (EU) No 1093/2010 establishing a European Banking Authority (2010) Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC
Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC
OJ L 331.

(110) Regulation (EU) No 1095/2010 establishing a European Securities and Markets Authority (2010) Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC
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OJ L 331.

(111) Regulation (EU) No 1094/2010 establishing a European Insurance and Occupational Pensions Authority (2010) Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC

Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010

limited role to play in the application of the AML rules.

There is however no effective mechanism for coordination among them to apply the rules in a consistent, efficient and effective manner within the single market. Due to the absence or lack of effective cooperation between these authorities, the EU's financial system have become even more vulnerable to money laundering.

After the Banking Union was launched in 2012, the European Central Bank (ECB) was put in charge of issuing and withdrawing banking licenses within the euro-area. Even Member States outside the euro-area are allowed to join the Banking Union subject to the condition that they fully comply with the rules and decisions of the ECB. One of the tasks assigned to the ECB is to ensure banking stability within the Banking Union(112). The relevant regulation however left intact the competence of the Member States to combat money laundering.

The ECB as the lead supervisory authority of the banks within the Banking Union thus have no competence to conduct its own investigations on AML related matters. If there is any instability developing within the Banking Union due to any serious breaches of AML, the ECB will be deprived of a legal tool to deal with such an eventuality.

The fourth AML came into force in June 2017 and the fifth AML in January 2020. During the interim period there were a series of high-profile bank scandals involving serious breaches of the AML both within and outside the Banking Union. Some banks from Cyprus, Denmark, Estonia, Germany, Netherlands and Sweden(113) were implicated directly or indirectly in aiding and abetting money laundering.

The most serious and disturbing scandal that stands out in this tragic financial drama is what could be sarcastically termed as the infamous "*Troika Laundromat*" washing multi-billion euros of dirty money across the Baltic and Nordic regions and beyond with the godfather based in Denmark. The chief suspect in this drama is the *Danske Bank* that had turned a blind eye for about 9.5 million payments worth over €200 billion from certain high-risk

establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC OJ L 331.

(112) Sideek M Seyad, "The impact of the proposed Banking Union on the unity and integrity of the EU's single market" (2013) Journal of International Banking and Regulation 49-58.

(113) The Council of the European Union adopted a Money Laundering Action Plan in December 2018, which highlighted urgency to strengthen and improve the effectiveness of the EU's legal framework

customers to freely pass through its Estonian branch between 2007 and 2015.

There are also criminal investigations intiated against the Finland-based *Nordea* bank and the Sweden-based *Swedbank* as the main collaborators of the chief financial-hitman, the *Danske* bank. Even the well-known German-based *Deutsche Bank* had acted as a correspondent bank for the branch of the *Danske Bank* in Estonia. It was severely reprimanded by its German supervisor and instructed to do more to prevent money laundering and terrorist financing.

In addition to the *Danske Bank* scandal, there was even more scandals in some other EU Member States involving money laundering. The French bank, *Credit Agricole*, through its subsidiary *Indosuez* had carried out some suspicious transactions worth more than $470 billion sent in 1.3 million transfers from 230,000 firms. The Netherlands largest financial services provider, *ING GROEP* admitted that criminals had laundered money through its accounts and agreed to pay €775 million to settle the dispute.

The investigations into most of these scandals disclose that the banks failed to comply with certain core requirements in the EUs anti-money laundering legislation such as conducting risk assessments, customer due diligence and reporting suspicious transactions to their respective Financial Intelligence Units. These serious violations of the AML have brought into focus the inadequacies of the preventive measures prescribed in the EU money laundering legal framework. It has also exposed the shortcomings in the exchange of information system between the supervisory authorities of the Member States as almost all the said bank scandals had a cross-border dimension(114).

It is thus not only the criminals who take undue advantage of the loopholes in the AML. The financial market operators themselves have either failed or intentionally neglected to apply the customer due diligence principle in an effective manner(115). The investigations into these bank scandals have also exposed and cast doubts on certain national supervisors as inefficient and inept in preventing and detecting money laundering.

There had been some repeated failures by certain national supervisory authorities at spotting and countering money laundering. This has created

(114) Report from the Commission on the assessment of recent alleged money laundering cases involving EU credit institutions.

(115) For example, on 19 March 2020 the Swedish bank regulator, Financial Supervisory Authority, imposed a huge fine of SEK 4 billion, equivalent to $386 million on one of the big Swedish banks with heavy exposure to the Baltic region, Swedbank for serious deficiencies in its anti-money-laundering work. Swedbank acknowledged that it has had shortcomings in anti-money laundering work and disclosure.

doubts whether they are influenced directly or indirectly by supervised institutions or any vested interest groups. These scandalous non-compliance with the AML by some reputed banks and its inept supervisors has seriously undermined the citizen's trust in the EU financial system as a whole.

As a reaction to these money laundering scandals in different Member States, there is an initiative to amend or repeal the fifth AML. The initiative was taken not by the European Commission(116) but by a group of EU Member States(117). They published a joint paper proposing for a central, independent and autonomous AML supervisor for the entire EU. The joint paper makes another proposal, which is to terminate the principle of minimum harmonisation from the AML.

It would imply full harmonization of the AML leaving no space or discretion for the Member States in its transposition to their respective national laws. If this proposal is to be implemented, the EU have to change both the traditional Treaty basis and the nature of legal act invoked to make laws in the field of money laundering.

The Treaty basis even for the fifth AML is Article 114 TFEU. This is a classic single market legal basis to harmonise laws in policy areas where there is no specific Treaty basis to do so. It can be invoked only to approximate the laws where it becomes necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

Article 114 TFEU can also be invoked even to adopt a Regulation instead of the current practice of adopting directives to make laws in the field of money laundering(118). Even though Article 83 TFEU authorised the EU to adopt directives in the field of money laundering, it has so far not invoked this specific Treaty provision, which would have been more effective.

Since the directives had been traditionally invoked to facilitate the law making based on minimum harmonisation in the field of money laundering, it is suggested the EU should replace it with the directly applicable legal act, regulation. Any EU law based on a regulation would guarantee that the requirements set down in such a legal instrument would be the same in every Member State. This would remove the discretion Member States enjoy

(116) Article 65 of Directive 2018/843/EU, the fifth AML, requires the Commission to submit a report by 11 January 2022 with proposals for further reform of the AML

(117) The Ministers of Finance of France, Germany, Italy, Latvia, The Netherlands and Spain have published a joint position paper to amend the fifth AML.

(118) For example, Regulation 2015/847 on the information concerning fund transfers is based on Article 114 TFEU.

in adapting the EU's AML rules based on a directive to suit their national priorities.

There are multiple legal acts dealing directly or indirectly with money laundering and that should be merged into a single piece of legislation directly applicable in all Member States of the EU. This will give more clarity to the EU legal framework on AML and reverse the current system that allows Member States to adopt the AML rules to national prerogatives. It will put an end to the lenient application of the AML in some Member States but had wide spread implications across the single market.

In one of the publications in 2001 the author suggested the need for a centralized system of banking supervision in the EU banking market(119). The failure to heed such warning partially contributed to the worst effects of the global financial crisis, seven years later in 2008. It was the lack of cooperation between the national supervisory authorities that contributed to the meltdown of the entire EU financial market.

The devastating financial crisis was a wake-up call on the EU, which at least belatedly decided to establish a Pan-European banking regulator effective from 2013 as suggested in the relevant publication(120).

It is timely that even in the field of money laundering, the EU should follow the precedent it set in developing a centralized system of supervision within the Banking Union. The EU should urgently consider the establishment of an EU-Tsar to combat money laundering. The nature and complexities of financial crimes confronted by the EU in 2020 is not the same as it was at its inception in 1958 or when the single market was launched in 1993.

As the periodical amendments of AML confirm, the crimes associated with the financial market had never been static. The EU have to adapt with the changes in the dynamic financial market within which the laundering of dirty money is also thriving. The recent bank scandals should be viewed as an opportunity to persuade the reluctant Member States to agree to a more centralized method of combating financial crimes.

(119) Sideek M Seyad, "A Single Regulator for the EC Financial Market" (2001) 16 Journal of International Banking Law, 203-212.

(120) Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. (2013) OJ L 287.

Concluding remarks

The FATF is the only global standard-setting body to combat money laundering and terrorist financing. In the context of the EU, the FATF continues to have a profound impact to upgrade and modernise the money laundering legislation. Even though the FATF started operations only in 1989 with a small group of countries, due to its positive contribution to prevent and detect money laundering, its Recommendations have been universally recognised and adopted in several countries.

Corruption and terrorist financing did not pose a serious threat at the initial stages of the construction of the EU single market. Even though these are serious financial crimes, from a financial perspective the losses incurred to the EU are insignificant compared to the volume of dirty money laundered in its single market. The EU fight against corruption is also limited to its budget and it is the Member States who are responsible to deal with the losses arising from corrupt practices within their respective jurisdictions.

The scope of application of the fifth AML in terms of its coverage is quite comprehensive and sufficient to protect the single market. It covers almost all segments of the single market which may potentially pose a risk for money laundering and terrorist financing. The shortcoming in the current fifth AML lies not in its coverage of the target groups but the uneven manner in which it is being transposed into twenty-seven different jurisdictions with an equal number or more national supervisory authorities to oversee its application and enforcement.

It is suggested that EU should deviate from its traditional approach in the drafting of the laws to combat money laundering. Rather than amending or repealing the fifth AML and then replace it with a sixth AML, the EU should give a fresh start and equip itself with a refined legal weapon especially with a more unified command structure to combat money laundering and terrorist financing(121).

If the EU is to adopt a new warfare strategy against money laundering, it should move away from its traditional minimum harmonization and home country control approaches and replace it with a pan-European approach. The Member States should be deprived of their wide discretion in transposing the AML into their domestic legal system. The war on money laundering within the single market should be fought by creating a level playing field, thereby

(121) Sideek Seyad "A new legal order to combat financial crimes within the European Union" , (2020) Journal of International Banking Law and Regulation 351-362.

preventing the criminals to seek cover in a Member State with a weaker legal regime.

It is admirable that the EU even at least belatedly succeeded in centralizing the supervisory mechanism within the Banking Union with the ECB at its helm. Even this positive approach towards unified supervision of the eurozone banking and investment market failed to realize its full potential as the relevant regulation specifically exclude the ECB from having any specific role in combating money laundering.

As the recent money laundering scandals disclose, even certain reputed banks located within the Banking Union are implicated to varying degrees. All these scandals have exposed the lack of cooperation between the national authorities to prevent the cross-border flow of dirty money even within the Banking Union.

As such, an option for the EU is to consider conferring the competence to combat money laundering to a supranational body. One such potential candidate is the ECB and being the primary financial supervisory authority within the euro area, it is well positioned to protect and defend the EU financial market. It also has the full cooperation and assistance of the Europol with which the ECB has entered into a special agreement to protect the euro(122).

This approach to confer competence on the ECB will however create some legal obstacles as it has no competence to monitor or supervise the banks located outside the Banking Union. If the single market as a whole is to be evenly protected and shielded from money laundering, another option is to delegate such competence to an EU-wide agency such as the European Banking Authority which can exercise its jurisdiction across all twenty-seven Member States of the Union.

(122) Agreement between the European Police Office (Europol) and the European Central Bank (ECB) 2015/ C/ 123/01.

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