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**Anti-Money Laundering Measures:  
from the International Perspective to their  
Application in Italy and UK**

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*To my imaginary friends*



## **List of abbreviations**

AML	anti-money laundering
CDD	customer due diligence
DD	due diligence
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
GdF	Guardia di Finanza
KYC	know your customer
L.D.	Legislative Decree
NATWEST	National Westminster Plc
POCA 2002	Proceeds of Crime Act 2002
SARs	Suspicious Activity Reports
SOCA	Serious Organised Crime Agency



## INTRODUCTION

Money laundering has been an increasingly sensitive issue within the international community and the European Union in the last twenty years. Started as a concern for the considerable amount of money, and thus power, in the hands of drug traffickers, the awareness has exponentially increased with the advent of new type of financial instruments and with the extreme globalisation and deregulation of financial markets. Today the main legal instrument at the international level is a soft-law set of provisions, namely the FATF Recommendations. These requirements triggered the creation of a set of other hard law regulations above, which the Third European Directive Against Money Laundering is at the present time, the strongest regional instrument in Europe. This main international and regional legal instruments disciplining AML practices will be investigated and particular attention will be put in the understanding of customer due diligence concept and requirements. The implementation of such legal provisions in the domestic law of United Kingdom and Italy will then be analysed. Due to the vastness of money laundering regulations, in order to take a comparative approach towards regulation and implementation mechanisms, the examination will focus on CDD and related practices. The choice of limiting the analysis to these applications was done considering the greater importance that the risk-based approach is achieving. In particular, the Proposal for a Fourth European Anti-Money Laundering Directive enhances the trend towards a greater investment with responsibilities of relevant persons. The risk-based approach is highly inter-related with that of responsibility, thus understanding the current interpretation of risk-based CDD measures shall better contribute to the realisation of prevalent shortcomings and potential improvements.





## Table of Contents

<b>List of abbreviations .....</b>	<b>3</b>
<b>INTRODUCTION .....</b>	<b>5</b>
<b>Table of Contents .....</b>	<b>7</b>
<b>CHAPTER 1 - MONEY LAUNDERING AND ITS INTERNATIONAL REGULATION .....</b>	<b>9</b>
<b>1.1 What is money laundering? .....</b>	<b>9</b>
1.1.1 The process of money laundering .....	12
1.1.2 Why to criminalise and combat money laundering? .....	18
<b>1.2 Legal Responses to Money Laundering.....</b>	<b>21</b>
1.2.1 Historical overview .....	21
1.2.2 General Trends: from a ruled-based to a risk-based approach.....	22
1.2.3 A mix of hard and soft law .....	26
1.2.4 International legal responses: hard law .....	27
1.2.5 International legal responses: soft law. ....	32
1.2.6 European Legal Response .....	34
<b>CHAPTER 2 – CUSTOMER DUE DILIGENCE PRACTICES IN THE INTERNATIONAL AND EUROPEAN LEGAL FRAMEWORK.....</b>	<b>41</b>
<b>2.1 The Customer Due Diligence concept.....</b>	<b>41</b>
2.1.1 CDD in the International Legal Framework – hard law.....	43
2.1.2 CDD in the International Legal Framework – soft law .....	44
2.1.3 CDD in the European Legal Framework.....	48
2.1.4 To sum up, how it is CDD today at the international and European level .....	51
2.1.5 Simplified CDD.....	52
2.1.6 Enhanced CDD.....	55
2.1.7 CDD in the proposal for the fourth directive .....	57
<b>2.2 The issue of the beneficial owner identification .....</b>	<b>59</b>
<b>CHAPTER 3 - National implementation of international and European standards in UK and Italy .....</b>	<b>63</b>

<b>1. Domestic implementation of international and European AML regulation .....</b>	<b>63</b>
<b>3.2. Money laundering and AML regulations in UK.....</b>	<b>65</b>
3.2.1 Money laundering numbers and trends in UK.....	65
3.2.2 AML Regulations in UK.....	67
<b>3.3 AML regulatory approach in Italy.....</b>	<b>71</b>
3.3.1 Money laundering in Italy .....	71
3.3.2 AML Regulations in Italy.....	74
<b>CHAPTER 4 - Customer due diligence in UK and Italy.....</b>	<b>83</b>
<b>4.1 Customer due diligence approach in UK.....</b>	<b>83</b>
4.1.1 Relevant Persons .....	85
4.1.2 Simplified CDD.....	87
4.1.3 Enhanced CDD .....	88
4.1.4 Consequences for non-compliance with the Regulations.....	91
4.1.5 CDD case law in UK.....	92
<b>4.2 Customer due diligence approach in Italy.....</b>	<b>98</b>
4.2.1 Relevant persons .....	102
4.2.3 Simplified due diligence .....	103
4.2.4 Enhanced due diligence .....	104
4.2.5 Reporting suspicious operations.....	104
4.2.6 Consequences for non-compliance with the Regulations.....	105
4.2.7 Italian Case Law .....	107
4.2.8 Datas .....	110
<b>3. AML Regulation and CDD in UK and in Italy in comparison.....</b>	<b>114</b>
3.1 The Mental Element.....	115
3.2 On-going monitoring.....	117
3.3 General regulatory system.....	119
3.4 Disclosure and report mechanisms .....	120
<b>FINAL CONSIDERATIONS.....</b>	<b>125</b>
<b>Reference List.....</b>	<b>128</b>

# CHAPTER 1 - MONEY LAUNDERING AND ITS INTERNATIONAL REGULATION

## 1.1 What is money laundering?

Money laundering, the process of disguising the illegal origin of criminal proceeds, is a criminal phenomenon which has become increasingly serious and worrying in the past 30 years<sup>1</sup>. The opening up and internationalisation of capital markets, the growth in number and size of international financial operations and the fast development of information technology innovations, have contributed to the expansion of a phenomenon that, even if in reality it dates back in time, has raised awareness just in the last three decades<sup>2</sup>. The activity of concealing the criminal origin of money in order to inject it in the legal economy, traced back ancient times when first cash was the outcome of an illegal conduct<sup>3</sup>. The phenomenon became widely known with the practice of using laundrettes (cash intensive businesses) adopted by Al Capone in the 1930s; the term “money-laundering” derived from the word “laundrettes”<sup>4</sup>. Nevertheless, the problem became bigger in

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<sup>1</sup> B. Unger “Introduction” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham, Ed. Edward Elgar Publishing Limited, 2013, pp. 3-5; L. Dini “The Problem and its Diverse Dimensions” in *Responding to Money Laundering, International Perspectives*, Ed. by E. U. Savona, London: Routledge, 1997, p. 5.

<sup>2</sup> B. A. Simmons, “The international politics of harmonization: The case of capital market regulation.” in *International Organization*, 55(3): 589-620, p. 593.

<sup>3</sup> B. Unger “Money laundering regulations: from Al Capone to Al Qaeda” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, p. 21.

<sup>4</sup> Unger, “Money laundering regulations...”, op. cit. p. 23.

numbers, sophistication and seriousness relatively recently with the emergence and growth of big criminal organisations<sup>5</sup>. Organised criminal groups are able to move large amount of money coming from the proceeds of their illegal activities, which they need to re-invest in the legal economy. The change in the economic and financial sets-up, together with the fast technological development of the past three decades, have opened up a great deal of opportunities for both legal and illegal businesses<sup>6</sup>. The awareness of the phenomenon of past decades has been translated into a series of international, regional and national legal instruments to tackle, combat and prevent money laundering, which first started with its criminalisation in the late 1980s<sup>7</sup>. The offense is differently defined and established in several jurisdictions, both as a “legal concept” and as a “criminal offense”<sup>8</sup>. But the wording used in the Vienna Convention of 1988<sup>9</sup> can be used as a general and widely recognised definition. According to it, money laundering is

“... the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such a property is derived from an offence ...”<sup>10</sup>.

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<sup>5</sup> *Ibid.*

<sup>6</sup> Dini “The problem and its...”, op. cit., p. 6.

<sup>7</sup> W. C. Gilmore, *Dirty Money. The evolution of international measures to counter money laundering and the financing of terrorism*. Paris: Council of Europe Publishing, 2011.

<sup>8</sup> R. Booth, S. Farrel Qc, G. Bastable, N. Yeo, *Money Laundering Law and Regulations. A practical guide*, Oxford: OUP, 2011, p. 8.

<sup>9</sup> United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, on Dec. 20, 1988, U.N. Doc. E/CONF.82/15(1988)/28 ILM.493 (1989), (Vienna Convention).

<sup>10</sup> Vienna Convention, Art. 3; see chapter 2 for further considerations on the Vienna Convention.

Other definitions are very similar to the one offered by the Vienna Convention, sometimes offering a particular hint or perspective on a specific aspect of the criminal activity. One worth mentioning is the one expressed by the FATF's first version of the 40 Recommendations of 1990<sup>11</sup>, which will be analysed further. Acknowledging that "this process is of critical importance, as it enables the criminal to enjoy their profits without jeopardising their source."<sup>12</sup> The FATF 1990 definition of money laundering is based on that of the Vienna Convention, but expands it to all serious offences<sup>13</sup>. The ultimate goal of laundering money is in fact that of allowing criminals to fully and freely enjoy the proceeds of their illegal activities within the legal world<sup>14</sup>. Once the money has been laundered, it completely becomes a legitimate sort of wealth and it can both used as a source of immediate and available welfare for criminals or contribute to the financing of other criminal activities, not least to terrorism<sup>15</sup>. In any case, that money contributes to the increase of wealth, power and leverage of criminal organisations.

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<sup>11</sup> FATF *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*, 1990 (FATF 1990).

<sup>12</sup> From FATF webpage available at <http://www.fatf-gafi.org/pages/faq/moneylaundering/> Booth as accessed on 03/07/2014; Booth et al., op. cit., p. 8.

<sup>13</sup> FATF 1990, Rec. B(5)

<sup>14</sup> J. Ferwerda "The effects of money laundering" *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham, Ed. Edward Elgar Publishing Limited, 2013, p. 37.

<sup>15</sup> Ferwerda, op. cit., p. 38; FATF "Global Money Laundering & Terrorist Financing Threat Assessment. A view of how and why criminals and terrorists abuse finances, the effect of this abuse and the steps to mitigate these threats", Report FATF/OECD, 2010, (FATF Threat Assessment 2010), p. 7; L. de Koker, "Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion" *Journal of financial crime*, 2010, 13(1): 26-50, p. 36; T. Krieger and D. Meierrieks "Terrorism: causes, effects and the role of money laundering" in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, pp. 82-85.

### 1.1.1 The process of money laundering

The crime of money laundering is widely recognised as a specific process made up of three stages: so called placement, layering and integration<sup>16</sup>. The first phase, “placement” consists in injecting large amount of cash, coming from criminal activities, into the financial system<sup>17</sup>. There are several ways in which this can be done, the main ones employed are the physical distribution of large amounts of cash, which are then placed in financial institutions, other financial companies as exchange institute or “precious metal dealers”, in retailing, or abroad<sup>18</sup>; the so-called process of “smurfing”, which consists in splitting the proceedings into small bits is often used in this phase to avoid detection<sup>19</sup>. Moreover, at this stage, the collusion of financial institutions or other business such that ones mentioned before, may be an incentive<sup>20</sup>. Front companies may be used to justify the movement of large amounts of money, as well as real estate and other tangible assets may be bought with cash so to get rid of large amounts of coins<sup>21</sup>. Furthermore, large amount of money may be smuggled into other countries so to avoid possible detection in countries with stronger regulation<sup>22</sup>. At this stage, business, which make a high use of cash, may be used to buy assets and commodities, disguising the illegal source of money, getting rid of the large

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<sup>16</sup> Booth et al., op. cit., pp. 3-4; E. U. Savona and M. A. De Feo, “International Money Laundering Trends and Prevention/Control Policies” in *Responding to Money Laundering, International Perspectives*, Ed. by E. U. Savona, London: Routledge, 2004, pp. 22-30; Gilmore, *Dirty money*, op. cit., p. 32.

<sup>17</sup> Gilmore, *Dirty money*, at p. 34; Savona and De Feo, op. cit., p. 23.

<sup>18</sup> *Ibid.* p. 24

<sup>19</sup> *Ibid.*; This is one of the reasons why legislation has gone through a path of reducing the size of transactions to be considered at risk of laundering.

<sup>20</sup> Savona and De Feo, op. cit., p. 23.

<sup>21</sup> *Ibid.*, P. Campana “Eavesdropping on the Mob: the functional diversification of Mafia activities across territories” in *European Journal of Criminology* 2011 8:213-228, p. 220.

<sup>22</sup> Savona and De Feo, op. cit., p. 26; Campana, op. cit., p. 221; FATF Threat Assessment 2010, p. 9.

amount of cash<sup>23</sup>. These activities may include currency exchange offices, dealers of precious metals, casinos, real estates and movables, money order issuers such as travel checks, insurance companies<sup>24</sup>. Moreover, the complicity of attorneys or other such professionals, are used to deal with large amount of cash in their daily work, may be exploited<sup>25</sup>.

The second step goes with the name of “layering” and consists in concealing the illegal source of the wealth and in separating as much as possible the money from the actual beneficial owner<sup>26</sup>, by creating many different financial transactions<sup>27</sup>. At this phase, some of the methods used may be the producing of an actual false series of documents that disguise the original source of money; the conversion of money into monetary instruments available in bank institutions; tangible assets may be used to transform cash into non-cash wealth; moreover, electronic transactions has been widely used since the advent of e-banking mechanisms and offer a great deal of opportunities to money launderers<sup>28</sup>.

The last stage is the so-called “integration”, which involves consolidating the new cleaned money as legal funds in the legitimate economy<sup>29</sup>. Here real estate businesses and negotiations are used, as well as complicit front companies<sup>30</sup>. Besides, the false report of money movements such as import/export statements, for example over accounting, may allow

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<sup>23</sup> M. Riccardi and E. U. Savona, *The identification of beneficial owners in the fight against money laundering*. Trento: Transcrime – Università degli Studi di Trento, 2013, pp. 14-16.

<sup>24</sup> Savona and De Feo, op. cit., p. 26; Riccardi and Savona, *The identification of ...*, op. cit., p. 15; Gilmore, *Dirty money*, op. cit., p. 32.

<sup>25</sup> Gilmore, *Dirty money*, op. cit. 32.

<sup>26</sup> Booth et al., op. cit., p. 211; Riccardi and Savona, *The identification of ...*, op. cit. p. 15.

<sup>27</sup> Savona and De Feo, op. cit., p. 26.

<sup>28</sup> *Ibid.*, pp. 26-27; Riccardi and Savona, *The identification of ...*, op. cit., p. 18; Gilmore, *Dirty money*, op. cit., p. 32.

<sup>29</sup> Booth et al., op. cit., p. 212.

<sup>30</sup> Savona and De Feo, op. cit., p. 28; Riccardi and Savona, *The identification of ...*, op. cit. p. 15.

the entrance of laundered money into the real economy<sup>31</sup>. Moreover, the involvement of overseas financial institutions may be of crucial importance at this stage, as well as in the previous one<sup>32</sup>.

Some authors, among whom van Koningsveld, have recently raised the question of whether the three stages description is thorough or rather restrictive and incorrect<sup>33</sup>. Specifically, according to van Koningsveld, the third stage should be farther divided into two sub-stages that he calls “justification” and “investment”<sup>34</sup>. By splitting the final stage into two separate moments, van Koningsveld wants to stress the different phase of providing a justification for possessing originally illegal money. This could be done “creating fictitious income or profits or by borrowing back one’s own money”<sup>35</sup>. From the final stage of re-investing the money, now completely laundered and cleaned, in the real economy. According to the author, this farther partitioning should better help law enforcement agencies, policy makers, practitioners and obliged subjects (e.g. financial institutions, professionals, etc.) understanding the whole process and tackling areas of it which now appear inaccessible<sup>36</sup>. The three stages approach seems to be oversimplistic and out-dated, being originated in a period (late 1980s) and under specific circumstances (the war against drug cartel in U.S.) in which the three

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<sup>31</sup> Savona and De Feo, op. cit., p. 28; D. L. Crumbley, L. E. Heitger, G. S. Smith “Forensic and Investigative Accounting” Chicago. CCH Incorporated, 2003, p. 33.

<sup>32</sup> FATF Threat Assessment 2010, p. 10.

<sup>33</sup> J. Van Koningsveld “Money laundering – ‘You don’t see it, until you understand it’: rethinking the stages of the money laundering process to make enforcement more effective” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, p. 435.

<sup>34</sup> Van Koningsveld, op. cit., p. 435.

<sup>35</sup> *Ibid*, p. 439.

<sup>36</sup> *Ibid*.



stages were actual and justified<sup>37</sup>. Cartels in fact used to introduce large amount of cash in the economy directly through the banking system<sup>38</sup>.

The following diagrams show the change of operations from a three-stage approach to a four-stage approach<sup>39</sup>.

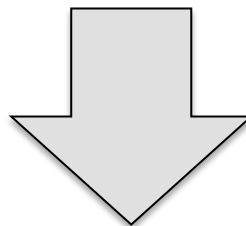
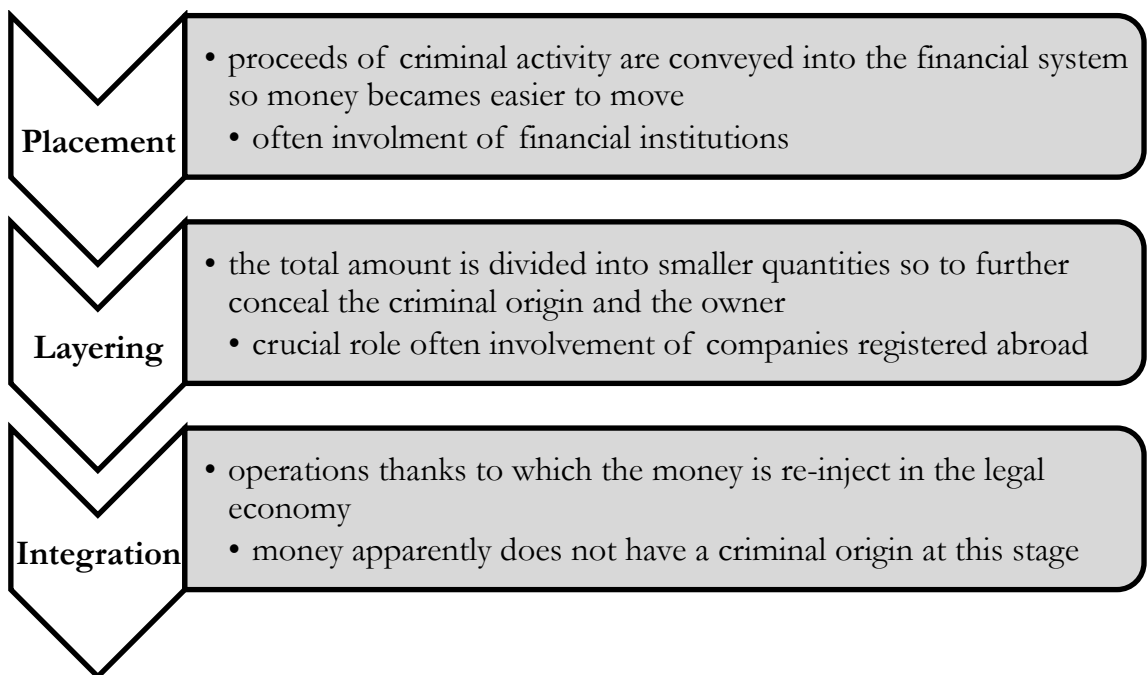
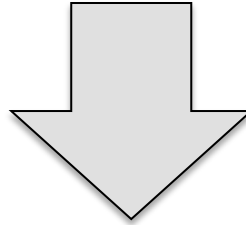
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<sup>37</sup> *Ibid.*, p. 449.

<sup>38</sup> *Ibid.*; Savona and De Feo, op. cit., p. 32; Unger, “Money laundering regulations...”, op. cit. p. 25.

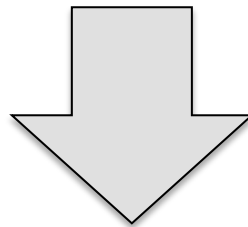
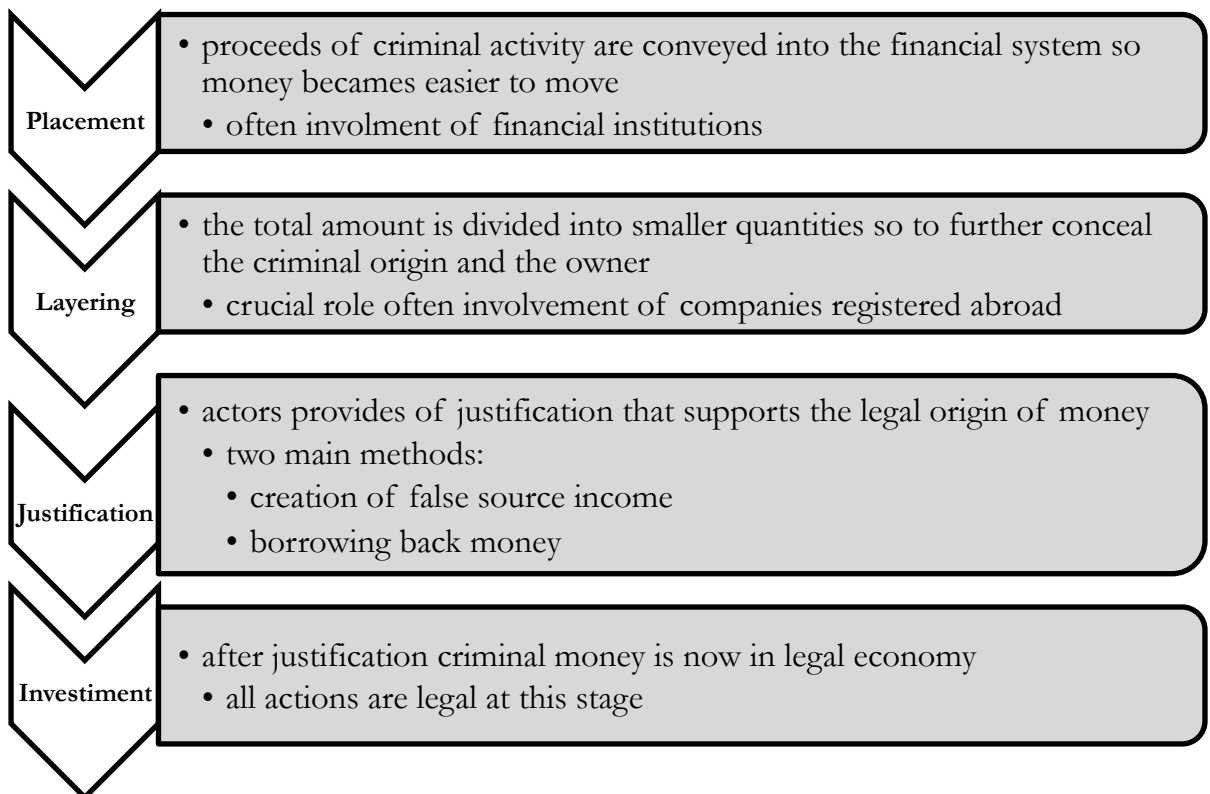
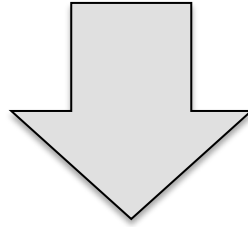
<sup>39</sup> Diagrams from Van Koningsveld, op. cit., pp. 435-440.

# CRIMINAL MONEY



# LEGAL INVESTMENTS

# CRIMINAL MONEY



# LEGAL INVESTMENTS

### 1.1.2 Why to criminalise and combat money laundering?

Money laundering is a challenging issue to deal with and to regulate not only for the complexity of its nature and development, but also for the lack of a common recognition of its consequences, burdens and costs for the community. Since it is a crime apparently without victims<sup>40</sup> it is hard to push efforts toward its criminalisation. According to some theories on regulation<sup>41</sup>, a crucial role in the process of regulating a specific subject is played by the so-called interest groups<sup>42</sup>. In the case of money laundering, since there are apparently no direct victims, not even direct effects at a first glance, there is not a strong push towards its criminalisation and penalisation<sup>43</sup>. Thus, it is crucial to let the public and the various interest groups understand the range of damages that money laundering, even if far from the sight, could bring to the society and economy.

Another obstacle in the regulation of money laundering is that it is a worldwide phenomenon, which takes advantage of the loopholes and incongruences that exists between the laws of different nations<sup>44</sup>. Moreover, the dimensions of the problem are undefined and not fully and sufficiently

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<sup>40</sup> Unger, “Money laundering regulations...”, op. cit., pp. 20-21; Ferwerda, op. cit., p. 40.; L. Groot “Money laundering, drugs and prostitution as victimless crimes” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, p. 58.

<sup>41</sup> In particular “economic theory on regulation” see G. Stigler “The theory of economic regulation”, *Bell Journal of Economics*, 1971, 2: 3-21; G. Becker “Crime and Punishment: an economic approach” *The Journal of Political Economy*, 1968, 76: 169-217, 210. Unger, “Money laundering regulations...”, op. cit., p. 20.

<sup>42</sup> Gilmore, *Dirty money*, op. cit. 32.

<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*; E. U. Savona, S. Decarli, B. Vettori “Use of cash payments for money laundering purposes” Final Report, Transcrime, Università degli Studi di Trento, 2003, p. 15.

quantified<sup>45</sup>. Ferwerda, when talking about money laundering uses the expression “invisible crime”<sup>46</sup>. Furthermore, even if money laundering is usually considered the cleansing of the proceeds of criminal activities, there is a part of wealth, which forms laundered money, which has, to some extent, legal roots<sup>47</sup>. Some of these sources may include, for example, revenues from the evasion or from the black market. Thus, both criminals and tax avoiders play a part in the creation of wealth to be laundered<sup>48</sup>.

Some authors have pointed out the importance of considering money laundering as a crime and thus to criminalise it, stressing the extreme negative outcomes that it carries, especially on the financial and economic level<sup>49</sup>. In particular some authors have drawn the attention on how it could distort and change the economic and financial order of an area, even of a state or of a region<sup>50</sup>. Especially, the presence in the market of operators colluded with crime (especially organised), may distort the underlying economic goals and prejudice competition<sup>51</sup>. Consequently, money laundering could contribute to an overall deterioration of general welfare and could corrupt the reputation,

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<sup>45</sup> P. C. van Duyne “Money laundering policy. Fears and facts.” In: P.C. van Duyne, K. Von Lampe and J.L. Newell (eds.), *Criminal finances and organising crime in Europe*. Nijmegen, Wolf Legal Publishers, 2003, pp. 67-69.

<sup>46</sup> Ferwerda, op. cit., p. 35.

<sup>47</sup> Interesting to see how the Proposal for a Fourth EU Directive pushes for the inclusion of tax evasion as a sensible crime worth money laundering considerations. See chapter 2 for further considerations on the Proposal for a Fourth EU Directive.

<sup>48</sup> Groot, op. cit., p. 57; P. C. van Duyne, “Crime-money and financial conduct” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, p. 233.

<sup>49</sup> M. Condemì, F. De Pasquale “Lineamenti della disciplina internazionale di prevenzione e contrasto del riciclaggio e del finanziamento del terrorismo” in *Quaderni di Ricerca Giuridica della Consulenza Legale*, February 2008, p. 60; G. Castaldi, “Convegno su Normativa Antiriciclaggio. 2° Convegno sull’evoluzione del quadro regolamentare e i connessi aspetti procedurali operativi”, Sassari, 18 febbraio 2011, Banca d’Italia, Filiale di Sassari, 2011, pp. 3-5.

<sup>50</sup> Castaldi, “Convegno su...”, op. cit., p. 4.

<sup>51</sup> *Ibid.*

and thus the functionality, of the financial system, influencing also the macro dynamic of the economic system<sup>52</sup>.

Studies have shown how organised criminal groups are willing to invest in the legal economy<sup>53</sup>, where they tend to make long-term investment (e.g. real estate, companies)<sup>54</sup>, in contrast with the illegal investments, which tend to be short-term. Criminals seem to ultimately want to transform their wealth into a legitimate one. This gives an idea of how important is to tackle money-laundering schemes and to dry out criminals' source of money, wealth and power.

Another crucial reason why money laundering is and has to be criminalised and the motivation that drives law enforcement in detecting it have to do with the fact that it gives police another chance to track down criminals<sup>55</sup>. This is, according to the literature, the main reason why anti-money laundering policies and regulations have come to existence. This framework explains why and how it is difficult to find a common legal, political and practical ground upon which to fight money laundering, but at the same time it proves how much efforts towards a common strategy to combat it are important.

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<sup>52</sup> M. Condemmi, F. De Pasquale, op. cit p. 16; P. J. Quirk, *Macroeconomic Implications of Money Laundering*. [Washington, D.C.]: International Monetary Fund, Monetary and Exchange Affairs Dept, 1996, p. 63.

<sup>53</sup> P. Campana "Eavesdropping on the Mob: the functional diversification of Mafia activities across territories, *European Journal of Criminology*, 2011, 8: 213-228, p. 220; Riccardi and Savona, *The identification of ...*, op. cit., p. 20.

<sup>54</sup> Riccardi and Savona, *The identification of ...*, op. cit., p. 22.

<sup>55</sup> Ferwerda, op. cit., p. 34.

## 1.2 Legal Responses to Money Laundering

### 1.2.1 Historical overview

As it has been pointed out before, even if money laundering has always been part of the criminals' activities, a legislation against it started developing and growing in the late 1980s<sup>56</sup>. The reasons why a push for its criminalisation and regulation came across at that time has to do with the poor outcomes that the American law enforcement was facing in the war against drug<sup>57</sup>. Thus, anti-money laundering regulation first came to life within the framework of the anti-drug regulation, especially in the United States<sup>58</sup>. Consequently, a “war on drug money”<sup>59</sup> started in the 1986 with the promulgation of the Money Laundering Control Act by the American legislator<sup>60</sup>. The Act considered money laundering just within the context of drug trafficking and organised crime<sup>61</sup>, but it had the great credit of having opened an era of increasing interest and concern towards the issue of money laundering. From that moment, the matter became increasingly important, also as a consequence of the “liberalization of financial markets”<sup>62</sup> which opened up a great deal of opportunities for both legal and illegal investors. Two years after the enactment of the Act, the United Nations provided a similar instrument at the international level with the Vienna Convention. Once more, the problem

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<sup>56</sup> Ferwerda, op. cit., p. 35.

<sup>57</sup> *Ibid.*

<sup>58</sup> Savona and De Feo, op. cit., pp. 35-40.

<sup>59</sup> Ferwerda, op. cit., p. 36.

<sup>60</sup> Money Laundering Control Act, P.L. 99-570, 1986.

<sup>61</sup> T. E. Adams, “Tacking on Money Laundering Charges to White Collar Crimes: What Did Congress Intend and What are the Courts Doing?” *Georgia State University Law Review*, 2000, p. 17; Money Laundering Control Act, at Art. 8.

<sup>62</sup> Unger, “Money laundering regulations...”, op. cit., p. 19.

was strictly connected with that of drug trafficking. Since then, a series of international, regional and national legal instruments, together with codes and rules of conduct, recommendations and guidelines for operators have been written as instruments to tackle, combat and prevent money laundering<sup>63</sup>.

### 1.2.2 General Trends: from a ruled-based to a risk-based approach

The first round of anti-money laundering regulation, the one started in late 1980s, was grounded on a rule-based approach<sup>64</sup>. Those regulations comprised clear legal provisions for financial and other relevant actors, which had just the obligation of acting according to the rules. Thus, it was the legislator in charge of defining what was a risky operation (in terms of potential money laundering involvement) and what was not<sup>65</sup>. This regulatory perspective is a procedure that relies on the “*ex ante* indication of pre-defined measures resulting from a general evaluation of risks”<sup>66</sup>. Thus, appropriate actions are precisely indicated in the regulation and there is not much room for interpretation on a case-by-case basis. The rule-based approach should provide a rulebook of comprehensive and prescriptive measures that offers clear responses to all potential cases without giving space for interpretation or

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<sup>63</sup> Gilmore, *Dirty money*, op. cit., p. 19; Unger, “Money laundering regulations...”, op. cit., p. 19.

<sup>64</sup> B. Unger and F. van Warden “How to dodge drowning in data? Rule and risk-based anti-money laundering policies compared” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, p. 400; Gilmore, *Dirty money*, op. cit., p. 19; P. Costanzo “The risk-based approach to anti-money laundering and counter-terrorist financing in international and EU standards: what it entails” in *Research Handbook on Money Laundering*, Ed. by B. Unger and D. van der Linde, Cheltenham: Ed. Edward Elgar Publishing Limited, 2013, at p. 349.

<sup>65</sup> Unger and van Werden, op. cit., p. 402.

<sup>66</sup> Costanzo, op. cit., p. 350.



evaluation<sup>67</sup>. It is clear how the intent of the legislator applying a rule-based approach is that of offering clear and complete instruments, which limit the responsibility of the obliged subjects to the mere application of the provision<sup>68</sup>. The rule-based approach is usually represented by the employment of hard-law provisions, which determine the conducts to take when dealing with specific cases<sup>69</sup>. This procedure does not leave much room for interpretation or to the introduction of soft-law<sup>70</sup>. Later on, both international and national anti-money laundering regulations have opted for the so-called “risk-based” approach. In particular, the risk-based approach was first advocated in the 2003 FATF Recommendations, to which other international, regional and national instruments have followed. Under this perspective, operations have to be controlled and potential risks detected considering the process on a case-by-case basis, thus not necessarily approaching in the same way to apparently similar operations<sup>71</sup>. The risk-based approach is founded on an *ex post* evaluation of the actual situations that has to be done by the obliged subjects themselves<sup>72</sup>. It is clear how this approach invests them with much more responsibility and with a great burden of tasks. This procedure prefers soft-law legal instruments such as guidance, best practices suggestions and handbooks, which need constant updating<sup>73</sup>.

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<sup>67</sup> Unger and van Warden, *op. cit.*, p. 403; Gilmore, *Dirty money*, *op. cit.*, p. 22; Costanzo, *op. cit.*, 350.

<sup>68</sup> Costanzo, *op. cit.*, p. 351.

<sup>69</sup> Financial Action Task Force on Money Laundering “The Forty Recommendations”, 20 June 2003, FATF/OECD (2003 FATF Recommendations); Gilmore, *Dirty money*, *op. cit.*, p. 90; Costanzo, *op. cit.*, p. 352; Unger and van Warden, *op. cit.*, p. 400.

<sup>70</sup> “Soft law refers to rules that are neither strictly binding in nature nor completely lacking legal significance. In the context of international law, soft law refers to guidelines, policy declarations or codes of conduct which set standards of conduct. However, they are not directly enforceable.” from <http://definitions.uslegal.com/s/soft-law/> accessed 12/08/2014.

<sup>71</sup> Gilmore, *Dirty money*, *op. cit.*, p. 92; Costanzo, *op. cit.*, p. 351.

<sup>72</sup> Costanzo, *op. cit.*, p. 351.

<sup>73</sup> Gilmore, *Dirty money*, *op. cit.*, p. 94; Costanzo, *op. cit.*, p. 352.

Evidently, the risk-based approach ask obliged subjects to create their own rules of conduct, taking into consideration the general guidance and their operational characteristics<sup>74</sup>.

Both approaches present strengths and weaknesses that may direct the legislator towards the use of one or the other according to the perceived needs of the system. The rule-based approach needs specific and precise provisions so to allow the financial actors involved to literally apply the rule needed<sup>75</sup>. If this on one side could be guarantee of a strict application of the norms, on the other it needs a wide, precise and likely burdened set of rules which have to cover all the possible cases and scenarios<sup>76</sup>. Thus, it seems hard if not impossible to include all the potential situations, leading to a continuous, strenuous and probably never completely satisfactory updating of the rulebook. Since rules of this sort need time and specific measures to be changed and updated, this approach could easily lead to a chronic delay of actions<sup>77</sup>. Moreover, the rule-based approach does not leave a lot of space to interpretation of specific situation which apparently may fall under a category of suspicious operations but that all-in-all should have a totally different understanding and *vice versa*. Thus, leaving little freedom to the consideration of factual elements<sup>78</sup>. On the other side, the rule-based approach can give more certainty and transparency to competent authorities when dealing with risky operations, relieving them from some responsibility, duties and costs<sup>79</sup>. Not to mention the ease of checking the compliance of obliged subject by

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<sup>74</sup> FATF, *International standards on combating money laundering and the financing of terrorism & proliferation. The FATF Recommendations*, (2012 FATF Recommendations),2012, adopted on 16 February 2012; Costanzo, op. cit., p. 350.

<sup>75</sup> Costanzo, op. cit., p. 352; Unger and van Warden, op. cit., p. 400.

<sup>76</sup> Unger and van Warden, op. cit., p. 400.

<sup>77</sup> Unger and van Warden, op. cit., p. 402; Costanzo, op. cit., p. 353.

<sup>78</sup> Costanzo, op. cit., p. 352.

<sup>79</sup> For example the cost of renovating the IT system or to train the personnel.

control authorities, which in this case just need to make sure that the rules have been followed, without considering whether a risky operation has been disclosed or not<sup>80</sup>.

On the contrary, the risk-based approach depends on general rules of conducts and standards of anti-money laundering legal controls, that have to be differently applied and interpreted taking into consideration the potential risk of operations<sup>81</sup>. Even if this approach support and recommend to come together to a common practice, it provides the obliged subjects with “soft indications”<sup>82</sup> which are neither “compulsory” nor “exhaustive”<sup>83</sup>. The risk-based approach is, especially in the short run, much more expensive both for the obliged subjects that need to build their own code of conduct, to train their personnel and to develop their IT systems to comply with the guidance, and for the controller which has a higher burden than in the rule-based approach in checking that compliance<sup>84</sup>. In the long run both effectiveness and efficiency would pay back that initial weight, but initially just effectiveness will be strengthened<sup>85</sup>.

The concept of risk assessment comprises an evaluation of potential dangers both at a micro and macro level. By micro risk assessment, it is intended the evaluation of potential risky operation by obliged subjects such as financial institutions, which need to judge their client through mechanism of customer due diligence<sup>86</sup>. At this point the evaluation needs to be done considering both the characteristics of the client and the potential threats of

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<sup>80</sup> Unger and van Warden, op. cit., p. 402

<sup>81</sup> Costanzo, op. cit., p. 352.

<sup>82</sup> *Ibid.* p. 354.

<sup>83</sup> *Ibid.*

<sup>84</sup> Unger and van Warden, op. cit., p. 402; Costanzo, op. cit., 353.

<sup>85</sup> Costanzo, op. cit., 354.

<sup>86</sup> See chapter 3 for general consideration on CDD and chapter 4 for specific considerations on CDD in UK and in Italy.

the system involved (e.g. a customer operating in a specific business considered at high risk)<sup>87</sup>. On the other side, macro risk assessment is the overall evaluation that should be conducted by the adequate authority, and that need to appraise if the risk-based approached is correctly executed by the obliged subjects<sup>88</sup>. The macro approach is the surveillance mechanism towards the subjects involved in the day-by-day evaluation of potential money laundering threats<sup>89</sup>.

All in all, the general international and European trends toward anti-money laundering regulations have been opted for a risk-based approached in the past ten years<sup>90</sup>. Even if some elements of rule-based procedure, clearly expressed in some legally binding measures proposed in the regulations, the risk-based procedure seems to offer a more effective, and in the long run even efficient, approach to the problem. This trend seems to be further enhanced in the proposal for a fourth EU AML/CFT directive<sup>91</sup>, in which the risk-based approach is hoped for having even greater implementation<sup>92</sup>.

### 1.2.3 *A mix of hard and soft law*

The legal instruments to combat money laundering are very diverse, ranging from criminal, civil and administrative national regulations, to

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<sup>87</sup> Riccardi and Savona, *The identification of ...*, op. cit., p. 54; Costanzo, op. cit., 353.

<sup>88</sup> Costanzo, op. cit., 353.

<sup>89</sup> *Ibid.*

<sup>90</sup> FATF, *The 40 Recommendations on Money Laundering*, 2003, published on 20 June 2003 (FATF 2003 Recommendations); FATF 2012 Recommendations; Gilmore, *Dirty money*, op. cit., pp. 102-105; Unger and van Warden, op. cit., p. 402; Costanzo, op. cit., p. 352.

<sup>91</sup> European Commission, Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, COM/2013/045.

<sup>92</sup> Costanzo, op. cit., p. 364.

international legal instruments of both hard (UN) and soft (FATF) law, to rules of conduct of relevant professions<sup>93</sup>. The push to anti money laundering efforts has been given not only by legislators and enforcement agencies, but also by “public and private sector bodies”<sup>94</sup> which helped issuing general standards and codes of conducts<sup>95</sup> at many different geographical levels. To mention some of the international bodies that pushed for a control of the problem; the Basel Committee on Banking Supervision<sup>96</sup>, the Wolfsberg Group<sup>97</sup>, the Egmont Group<sup>98</sup>, the IMF and the World Bank<sup>99</sup>.

#### 1.2.4 International legal responses: hard law.

As it has been explained before, the anti-money laundering regulation came to life within the anti-drug regulation framework, thus it is not a case that the first international multilateral legal instrument that dealt with the issue of money laundering was the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of the 1988. This Convention is considered “as constituting the essential foundation”<sup>100</sup> of anti-money laundering legislation. Indeed, it is crucially important because at

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<sup>93</sup> Booth et al., op. cit., p. 5.

<sup>94</sup> *Ibid.*, p. 7.

<sup>95</sup> *Ibid.*, p. 8.

<sup>96</sup> “The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide” from <http://www.bis.org/bcbs/> as accessed on 01/08/2014.

<sup>97</sup> “The Wolfsberg Group is an association of eleven global banks, which aims to develop financial services industry standards, and related products, for Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies” from <http://www.wolfsberg-principles.com/index.html> as accessed on 01/08/2014.

<sup>98</sup> “Informal network of FIUs for the stimulation of international co-operation” from <http://www.egmontgroup.org/> as accessed on 01/08/2014

<sup>99</sup> Booth et al., op. cit., p. 8.

<sup>100</sup> Gilmore, *Dirty money*, op. cit., p. 55.

Article 3 it both provides a definition for money laundering<sup>101</sup> and it criminalises its conduct, defining it as an offense in itself<sup>102</sup>. The main purpose of the inclusion in the Vienna Convention of the crime of money laundering is clearly that of targeting the financial foundations of organised criminal groups involved in drug trafficking<sup>103</sup>. This international legal instrument is of extreme importance for it has firstly criminalised the conduct of laundering money, and for its effort of making it an issue of international interest. However, its main limitation is clearly in its restriction to the proceeds of drug related crimes.

Specifically, the Vienna Convention commands international cooperation<sup>104</sup> in the fighting against money laundering, using legal instruments such as the freezing and forfeiture of the illegally acquired assets<sup>105</sup>. The Vienna Convention stresses the importance of the use of confiscation of the proceeds of criminal activities related to drug offences<sup>106</sup>. These legal instruments shall in fact dry out the source of economic power of organised criminal group involved with drug trafficking, thus making them

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<sup>101</sup> Even if it does not refer to it with the wording “money laundering”.

<sup>102</sup> Vienna Convention at Article 3(1)(b) The conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph *a)* of this paragraph, or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions;

The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in accordance with subparagraph *a)* of this paragraph or from an act of participation in such an offence or offences;

<sup>103</sup> Booth et al., op. cit., pp. 7-8.

<sup>104</sup> Vienna Convention at Art. 10.

<sup>105</sup> M. C. Bassiouni and D. S. Gualtieri “International and National Responses to the Globalization of Money Laundering” in *Responding to Money Laundering, International Perspectives*, Ed. by E. U. Savona, London: Routledge,.

<sup>106</sup> Vienna Convention at Art. 5.

weaker and easier to be tackled by law enforcement agencies<sup>107</sup>. Furthermore, the provisions of the Vienna Convention push for the implementation of the national legislation of State Parties and encourage the institution of bilateral agreement<sup>108</sup> to promote it at the international level. The Convention stresses the importance of international co-operation<sup>109</sup> and mutual legal assistance<sup>110</sup>, also considering the typical trans-nationality characteristic of the offence at issue. An addition important point to make is the consideration done in Article 5(3) in which the potential issue of “bank secrecy” is solved by stating that, when dealing with confiscation, bank secrecy cannot be use as a justification for not acting<sup>111</sup>. As of today the Convention has 87 signatories and 189 parties.<sup>112</sup>

More than ten years later, the UN enacted another international multilateral legal instrument that dealt with serious crime and money laundering: the UN Convention Against Transnational Crime<sup>113</sup>. The Palermo Convention dedicates a whole article<sup>114</sup> to the definition and further criminalisation of “the laundering of proceeds of crime”<sup>115</sup>. Moreover, it includes its criminalisation within the scope of action of the Convention

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<sup>107</sup> Gilmore, *Dirty money*, op. cit., p. 19.

<sup>108</sup> Vienna Convention at Art. 5(4)(c).

<sup>109</sup> *Ibid.* at Art. 10

<sup>110</sup> *Ibid.* at Art. 7; Gilmore, *Dirty money*, op. cit., p. 55.

<sup>111</sup> Vienna Convention Art. 5(3) In order to carry out the measures referred to in this article, each Party shall empower its courts or other competent authorities to order that bank, financial or commercial records be made available or be seized. A Party shall not decline to act under the provisions of this paragraph on the ground of bank secrecy; Gilmore, *Dirty money*, op. cit., p. 59.

<sup>112</sup> From UN website:

[https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=VI-19&chapter=6&lang=en](https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=VI-19&chapter=6&lang=en) accessed 12/08/2014.

<sup>113</sup> United Nations Convention against Transnational Organised Crime, General Assembly Resolution 55/25 of 15 November 2000 (Palermo Convention).

<sup>114</sup> Palermo Convention at Art. 6.

<sup>115</sup> *Ibid.*

itself<sup>116</sup>. The definition here given is the same as the one offered in the Vienna Convention, as a proof of the legacy with the previous instrument, which does not come to an end with the concept of money laundering. Moreover, Article 7 offers and compels detailed “measures to combat money laundering”<sup>117</sup>. These actions comprise the constitution of a “domestic regulatory and supervisory regime<sup>118</sup>” for interested actors; the promotion of co-operation between different authorities and actors involved<sup>119</sup> and the creation of financial unit intelligence charged with supervisory tasks<sup>120</sup>; the implementation of “feasible measures to detect and monitor the movement of cash and appropriate negotiable instruments across their borders<sup>121</sup>”; the prompt of the use of guidelines at very different levels to help establishing a national regulatory system<sup>122</sup>. Here it is clear, even if not explicitly mentioned, the reference to the FATF Recommendations<sup>123</sup>; and to “promote global, regional, subregional and bilateral cooperation<sup>124</sup>”. Because of its concern with the characteristic of trans-nationality of these specific type of serious crime, the Convention stresses out the importance of international cooperation and mutual legal assistance, also when dealing with money laundering<sup>125</sup>.

In the 1990 another internationally important instrument was created by the Council of Europe, which adopted the Convention on Laundering,

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<sup>116</sup> Palermo Convention at Art. 3.

<sup>117</sup> *Ibid.* at Art. 7.

<sup>118</sup> *Ibid.* at Art. 7(1)(a)

<sup>119</sup> *Ibid.* at Art. 7(1)(b)

<sup>120</sup> *Ibid.*

<sup>121</sup> *Ibid.* at Art. 7(2)

<sup>122</sup> *Ibid.* at Art. 7(3)

<sup>123</sup> Gilmore, *Dirty money*, op. cit., p. 70.

<sup>124</sup> Palermo Convention at Art. 7(4).

<sup>125</sup> Gilmore, *Dirty money*, op. cit., p. 72.



Search, Seizure and Confiscation of the Proceeds from Crime<sup>126</sup>. The Council of Europe Convention which was a valid “multilateral instrument”, opened also to states which were not adherents to the Council itself, to promote the homogenisation of the anti-money laundering legal instruments at the supranational level<sup>127</sup>. The 1990 Council of Europe Convention was clearly inspired by the 1988 UN Drug Convention, and this is clear in the definition of money laundering<sup>128</sup> that it gives<sup>129</sup>. Nonetheless, its aim is also that of going beyond it by expanding the original offences related to that of laundering to other serious crimes and not just to drug offences<sup>130</sup>.

“the conversion or transfer of property, knowing that such property is proceeds, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of the predicate offence to evade the legal consequences of his actions”<sup>131</sup>

In the 1990 Council of Europe Convention, money laundering has to be related to a “predicate offence” and not limited to drug related crimes. Other great accomplishments of the 1990 Council of Europe Convention worth mentioning are the acknowledged “need to harmonize domestic legislation with international norms”<sup>132</sup> that it underlines in Article 6(1):

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<sup>126</sup> Council of Europe, Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Strasbourg, 1990 ETS No. 141 (1990 Council of Europe Convention).

<sup>127</sup> Bassiouni and Gualtieri, op. cit., 132.

<sup>128</sup> The 1990 Council of Europe Convention uses actually the term “money laundering” for the first time.

<sup>129</sup> Gilmore, *Dirty money*, op. cit., p. 162.

<sup>130</sup> *Ibid.*

<sup>131</sup> 1990 Council of Europe Convention at Art. 6.

<sup>132</sup> Bassiouni and Gualtieri, op. cit., p.109.

“Each Party shall adopt such legislative and other measures as may be necessary to establish as offences under its domestic law, when committed intentionally.”

The Council of Europe Convention was a sign of the new interest and concern that the international community at very different levels was experiencing at that time. Especially in the perceived need for a common, uniform and cooperative reaction transnationally and internationally.

#### *1.2.5 International legal responses: soft law.*

In 1989 the G7 set up the Financial Action Task Force, originally a considered as a provisional body under the OECD<sup>133</sup>, which, in 1990, published Forty Recommendations on money laundering. These Recommendations, further revised in 1996, in 2003 and in 2012, with the introduction in 2001 of 8 further Special Recommendations on the financing of terrorism, additionally enlarged with the a 9<sup>th</sup> one in 2004<sup>134</sup>. The FATF's 40 Recommendations are extremely important for they provided the first and most important definition of money laundering and of anti-money laundering policies, contributing to the raise of recognition and consciousness of the issue at the international level<sup>135</sup>. They are the foundation of international anti-money laundering effort and collaboration, setting international standards<sup>136</sup> and providing an internationally homogeneous framework of action. Starting from other international legal efforts to criminalise and regulate the

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<sup>133</sup> E. Takats, D. Masciandaro 'Economics: The Supply Side', in Masciandaro D., Takats E. and Unger B. *Black Finance: The Economics of Money Laundering*. Cheltenham: Edward Elgar Publishing Limitedp, 2007, p. 234.

<sup>134</sup> Booth et al., op. cit. pp. 8-9.

<sup>135</sup> Gilmore, *Dirty money*, op. cit., p. 91.

<sup>136</sup> Booth et al., op. cit., p. 7.

phenomenon, the UN Drug Convention and the Basel Committee, both issued in 1988, the Forty Recommendations aimed at strengthening the domestic legal systems of State, investing with responsibilities the financial system, and promoting international collaboration<sup>137</sup>. The main scopes of the FATF's criminalisation and regulation of money laundering, are that of deny delinquents access to the proceeds of their illegal activities, and to discourage other potential offenders from taking advantage of the opportunity of committing financial crimes<sup>138</sup>. Thus, the idea is that of "preventing or reducing the incidence of crime"<sup>139</sup>.

The Forty Recommendations aims at criminalising money laundering and at offering procedures and guidelines to detect and prevent this offence<sup>140</sup>. These includes the criminalisation of money laundering according to the Vienna Convention and to the Palermo Convention<sup>141</sup>; the freeze, seize and confiscation of assets as provisional measures, also with the power of the "non-conviction based confiscation"<sup>142</sup>. Special attention is also given to the supervisory and controlling power of financial institutions and "designated non-financial business and professions"<sup>143</sup>. These, through means of customer due diligence, record-keeping, reporting of dubious operations, the implementation of an internal mechanism of control and the training of its operators, should be the front line to detect, tackle and prevent money laundering<sup>144</sup>. Moreover, the Forty Recommendations suggest national and international cooperation between different actors involved, such as policy-

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<sup>137</sup> Gilmore, *Dirty money*, op. cit., p. 92.

<sup>138</sup> Booth et al., op. cit., p. 8.

<sup>139</sup> *Ibid.*

<sup>140</sup> *Ibid.*, p. 9.

<sup>141</sup> 2012 FATF Recommendations at Rec. B(3).

<sup>142</sup> 2012 FATF Recommendations at Rec. B(4).

<sup>143</sup> Booth et al., op. cit., p. 9.

<sup>144</sup> *Ibid.*

makers, financial intelligence units, law enforcement other relevant authorities<sup>145</sup>.

Moreover, the Basel Committee on Banking Regulations and Supervisory Practices Statement of Principles, issued in 1988, promoted banks' honesty as a mean to fight money laundering and thus, ultimately, promote "the stability of the banking system"<sup>146</sup>.

International legal instruments, specifically when dealing with penal matters, constitute a challenging topic, since there is the need to reconcile domestic, international and regional regulations and interests within a framework that involve many fields<sup>147</sup>. Bassiouni and Gualtieri recognise three different levels on which international criminal law in general and the international attempt to regulate money laundering in particular works. These are (1) the creation of a set of multilateral treaties that criminalise specific behaviours; (2) the promotion of inter-state cooperation through the creation of treaties both at a regional and bilateral level; (3) the specification of the need for implementing the international prescriptions at the national level<sup>148</sup>.

### *1.2.6 European Legal Response*

Being an international but above all a transnational crime and issue, anti-money laundering regulations have been developed not only at the international and national level, but also at the regional one, especially in areas where there is a vivid economic exchange. The most important effort to criminalise, regulate and legally fight money laundering at the European level,

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<sup>145</sup> 1990 FATF Recommendations at Rec. A(3).

<sup>146</sup> Savona and De Feo, op. cit., p. 41.

<sup>147</sup> Bassiouni and Gualtieri, op. cit., p.110.

<sup>148</sup> *Ibid.*

has to be found in the 1991 Directive<sup>149</sup> which head the European process of strictly and scrupulously deal with money laundering within Europe and above. Its main concern was that of concentrating on the prevention of the commission of the crime, rather than on its subsequent suppression<sup>150</sup>. In particular, the attention was focused on the integrity and the functionality of the financial system, especially considering the importance that it was gaining within the European border. The 1991 Directive was strongly influenced by the first publication of the FATF's Forty Recommendations. Therefore, it established duties and obligations for bank and financial institutions such as the identification of customers<sup>151</sup> and full co-operation with the authorities in providing sensitive information<sup>152</sup>. Moreover, its scope of action was that of giving State members a strong legal and political framework to deal with money laundering, without burdening them with specific measures to take. In this sense, a lot of discretionary power was given to State parties themselves, by guiding and helping them with standards of conducts and guidelines. Moreover, even if the Directive was brought into living within the European political and legal framework, its scope of action was aimed to reach far beyond its borders, including countries, which were economically linked with it<sup>153</sup>. The 1991 Directive was the first pillar designated to protect the internal financial market of the European Union, protecting it from money laundering intrusions<sup>154</sup>.

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<sup>149</sup> Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, OJ L 166, 28.6.1991 (1991 EU Directive).

<sup>150</sup> Gilmore, *Dirty money*, op. cit., p. 222.

<sup>151</sup> 1991 EU Directive at Art. 3(1).

<sup>152</sup> *Ibid.* Art. 6.

<sup>153</sup> Gilmore, *Dirty money*, op. cit., p. 223.

<sup>154</sup> Circolare n. 83607/2012, "Attività della Guardia di Finanza a Tutela del Mercato dei Capitali", III Reparto Operazioni – Ufficio Tutela Economia e Sicurezza (Circolare GdF), p. 5.

In 2001 another Directive was promulgated, as an evolution of anti-money laundering standards that had to keep the pace with international guidelines and trends, especially those expressed by the new FATF's 1996 Recommendations. One of the major improvements of this new Directive was the inclusion and consideration of other actors, which were not specifically financial ones. In particular, the institutions now considered as obliged subjects in AML duties were: credit institutions, financial institutions, auditors, external accountants and tax advisors, real estate agents, notaries and other independent legal professionals, dealers in high-value goods (precious stones, work of art, auctioneers<sup>155</sup>), casinos<sup>156</sup>. Moreover, the definition of serious crime, offences under which it was possible to apply the anti-money laundering scheme, was further enlarged<sup>157</sup>. The 2001 Directive improved European AML regulation coherently with new international standards, but did not move much away from the rationale behind the first one, remaining its main aim that of ensuring the stability of the European financial system<sup>158</sup>

The Third Directive was issued in 2005 and completely abrogated the previous ones, introducing a completely new framework of action<sup>159</sup>. It fully adopted the dispositions of the FATF Recommendations of 2003, taking into consideration the changes in the international anti-money laundering regulation. In particular, the shift from a rule-based approach to a risk-based approach and the new and increasing concern towards the use of laundered

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<sup>155</sup> Directive 2001/97/CE of 4 December 2001, (2001 EU Directive) at Art. 2(a)(6) "... whenever payment is made in cash, and in an amount of EUR 15 000 or more".

<sup>156</sup> Gilmore, *Dirty money*, op. cit., p. 230; 2001 EU Directive Art. (2)(a).

<sup>157</sup> 2001 EU Directive at Art. 1(E).

<sup>158</sup> Bassiouni and Gualtieri, op. cit., p.110.

<sup>159</sup> Circolare GdF, op. cit., p. 5; V. Mitsilegas and B. Gilmore "The EU legislative framework against money laundering and terrorist finance: a critical analysis in the light of evolving global standards" *ICLQ* vol. 56 January 2007, pp. 119-141, p. 122. J. Peurala "The European Union's Anti-money laundering crusade. A critical analysis of the responses by the EU/EC to money laundering" Report of the police college of Finland 83/2009, p. 67.

money to finance terrorism<sup>160</sup>. Furthermore, the Financial Intelligence Units' (FIU) central role in anti-money laundering schemes, was made a central point in this Directive. Article 21 states that each Member State has to establish a Financial Intelligence Unit, which

“shall be responsible for receiving (and to the extent permitted, requesting), analysis and disseminating to the competent authorities, disclosures of information”<sup>161</sup>

In particular, strong emphasis was put on their importance in administering and promoting transnational cooperation, especially by the mean of exchange of information<sup>162</sup>. Besides, another important innovation of this Directive was the stress upon the important role of supervision that has to be carried out but FIUs or by other competent authorities. In particular, State parties were recommended to institute compete authorities capable of overseeing the activities of anti-money laundering schemes and their compliance with the law<sup>163</sup>. In addition, in order to comply with the new FATF's Recommendations, the III Directive dealt more precisely with the provisions on customer due diligence to which it dedicates a whole chapter<sup>164</sup>, demonstrating to be in line with the international tendency toward the development of a risk-based approach. Specifically, the new approach towards customer due diligence comprise not only the identification of the customer and beneficial owner, but now include the “obtaining information on the

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<sup>160</sup> Concern that evidently exponentially increased after the attack of 09/11.

<sup>161</sup> Directive 2005/60/EC of 26 October 2005, (2005 EU Directive), at Art. 21(2).

<sup>162</sup> Gilmore, *Dirty money*, op. cit., p. 237.

<sup>163</sup> 2005 Directive at Art. 37.

<sup>164</sup> Chapter 2.

purpose and intended nature of the business relationship”<sup>165</sup> and conducting ongoing monitoring of the business relationship”<sup>166</sup>.

Right now the Proposed 4th EU AML Directive is being discussed. The concern towards money laundering have been going over an ever increasing path in the past twenty years and, considering also the technological and economic changes of the recent years, the need for an up-to-date legislation is strong. The Proposal is consistent with the general trend to go further towards a risk-based approach and aim at fully executing the latest (year) FATF Recommendations. The main changes that the new Directive will introduce regard the extension of the scope of action, a further strengthening of the risk-based approach, a change in the definition and application of simplified and enhanced customer due diligence, new measures on beneficial ownership information and provisions on sanctions (especially administrative), strengthen cooperation between FIUs and Member States and a renewed concern for the protection of personal data<sup>167</sup>. In particular, the scope of action will be enlarged to comprise the whole gambling sector, included the online one<sup>168</sup>; and the “threshold for traders in high value goods dealing with cash payments be reduced from EUR 15 000 to EUR 7 500”<sup>169</sup>. The approach towards the application of simplified or enhanced customer due diligence will change from the one of the third Directive, considered to lenient and indulgent leaving a too large chance for exemption. The new

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<sup>165</sup> 2005 Directive at Art. 8(1)(c).

<sup>166</sup> *Ibid.* at Art 8(1)(d)

<sup>167</sup> Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, COM/2012/045, of 5 February 2013, (EU Proposal), at p. 3.

<sup>168</sup> EU Proposal at p. 7, Art. 2(1)(3)(f) for inclusion, at 3(10) for definition.

<sup>169</sup> EU Proposal, at p. 11.



Directive will prescribe the use of enhanced due diligence<sup>170</sup> for high risk operations and the application of the simplified due diligence<sup>171</sup> for low risk operations. The guidelines to assess the risk of operations should be given by EBA<sup>172</sup>, EIOPA<sup>173</sup> and ESMA<sup>174</sup>, thus stressing the important role of soft law instruments in the risk-based approach to AML. Moreover, specific procedures to use when dealing with foreign and domestic politically exposed persons are given, enhancing the consideration of the risk when they are involved<sup>175</sup>. Furthermore, the Proposal asks for a greater degree of transparency when dealing with the beneficial owner identification<sup>176</sup>, also regarding the access to information. Every Member State is required to provide a risk assessment analysis to keep track of the issue at the national level<sup>177</sup>. The Proposal introduces a regime of administrative sanctions that shall apply to obliged subjects that do not comply with the national provisions derived from the implementation of the IV Directive<sup>178</sup>.

The proposal of the Fourth Directive is in line with general international standards in anti-money laundering regulations which faces both a tendency towards a risk-based approach and an orientation which take into consideration the ever-changing economic, technological and political environment of the European Union and of the world in general.

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<sup>170</sup> EU Proposal at Section 3, Arts. 16-23.

<sup>171</sup> *Ibid.* at Section 2 Arts. 13-15

<sup>172</sup> European Banking Authority (EBA).

<sup>173</sup> European Insurance and Occupational Pensions Authority (EIOPA).

<sup>174</sup> European Securities and Markets Authority.

<sup>175</sup> EU Proposal at Art. 18.

<sup>176</sup> *Ibid.* at Arts. 29-30.

<sup>177</sup> *Ibid.* at Arts. 6-8.

<sup>178</sup> *Ibid.* at Arts. 55-58.



## CHAPTER 2 – CUSTOMER DUE DILIGENCE PRACTICES IN THE INTERNATIONAL AND EUROPEAN LEGAL FRAMEWORK

### 2.1 The Customer Due Diligence concept

The concept of customer due diligence is strictly connected with the idea of investing with responsibilities the subjects involved in the economic sectors at risk of money laundering operations, thus the regulated sector in the AML legislation<sup>1</sup>. In fact, it is not a case that the term customer due diligence (CDD) is strictly connected with the change of trend from a rule-based approach to a risk-based one. Before the entry into force of the risk-based approach, instead of the term “customer due diligence”, the simple expression “customer identification” was used and, more broadly, the concept of “know your customer” (KYC) practices was considered<sup>2</sup>. The KYC idea represents the general gathering of information concerning customers and it is an action that occurs just once: in order to collect information about a customer, a relevant subject collects information about him<sup>3</sup>. On the other side, the concept of CDD is much more extensive and comprises a continuous and on-going process made of checks and monitoring which include KYC practices,

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<sup>1</sup> L. Borlini “EU Anti-money Laundering Regime: An Assessment within International and National Scenarios” at p. 2 from *The Social Science Research Network Electronic Paper Collection* retrievable at <http://ssrn.com/abstract=2144122> as accessed on 12/07/2014.

<sup>2</sup> M. Gill and G. Taylor, “Preventing Money Laundering or Obstructing Business? Financial Companies’ Perspectives on ‘Know your Customer’ Procedure” from *British Journal of Criminology* (2004) 44, 582-594 at p. 587.

<sup>3</sup> *Ibid.*, p. 586-587.

but also successive and continual surveillance and record keeping actions<sup>4</sup>. As already explained in the first chapter, internationally, regionally and nationally, the trend has been that of going from a rule-based to a risk-based approach in regulating money laundering, investing relevant persons with more and more responsibilities<sup>5</sup>. Responsibilities than involve not just the actual customer due diligence practical procedures, but also the selection and internal promulgation of guidelines and codes of conducts, the proper and efficient allocation of resource and the control mechanisms for every sector<sup>6</sup>. According to this approach, a lot of regulatory power is left to national jurisdictions and also, to some extent, to specific sectors<sup>7</sup>. Clearly, the international recommendations, in entrusting nations and actors with great liability, do not leave *carte blanche* to them, but rather provides a series of strong regulatory pillars that defines: what CDD practices are, how to detect and consider a risky operation/customer, and how to manage the whole scenario, given the relevant subjects enough space for action<sup>8</sup>.

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<sup>4</sup> “Anti-Money Laundering – CDD & KYC by Besart Qeremi, AML Consultant, available at: <http://www.slideshare.net/besi123/anti-money-laundering-customer-due-diligenceknow-your-customer>, as accessed 02/08/2014

<sup>5</sup> See chapter 3 for more detailed information on CDD and responsibility of relevant persons; L. Dalla Pellegrina and D. Masciandaro, “The risk based approach in the new European anti-money laundering legislation: a law and economics view” *“Paolo Baffi” Centre on Central Banking and Financial Regulations*, 2008, p. 3, available at <http://ssrn.com/abstract=1182245> as accessed on 12/08/2014.

<sup>6</sup> *Ibid.*, p. 31.

<sup>7</sup> Such as professional orders, bank institutions and so forth.

<sup>8</sup> Peurala, op. cit., p. 43; Dalla Pellegrina and Masciandaro, op. cit., pp. 3-4.

### *2.1.1 CDD in the International Legal Framework – hard law*

In the Drug Trafficking Convention the idea of customer identification is never mentioned. In fact, the Vienna Convention aims just at defining the concept of money laundering within the framework of the anti-drug policy and does not investigate how this should happen and how to successfully deal with it. Its scope is mainly that of providing a definition.

The term “customer identification”, which does not correspond to the concept of customer due diligence, but that first introduce the idea of investing actors with the duty of identifying, checking and eventually controlling their customers, has to be found for the first time in Article 7 of the Palermo Convention<sup>9</sup>. This Article regulates actions to fight the launder of the proceeds of organised criminal activity and requires financial institutions and other bodies sensitive to the issue, to take appropriate measures to identify their clients.

In the Council of Europe Convention of 1990, the concept of “identification” is introduced but just in connection to “properties” and not to “persons”<sup>10</sup>. In particular, when dealing with “investigative and provisional measures”, according to the Council of Europe Convention, State parties should provide their national systems with measures that “enable to identify

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<sup>9</sup> Palermo Convention at Art. 7 “Each State party (a) Shall institute a comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions and, where appropriate, other bodies particularly susceptible to money-laundering, within its competence, in order to deter and detect all forms of money-laundering, which regime shall emphasize requirements for customer identification, record-keeping and the reporting of suspicious transactions”.

<sup>10</sup> Palermo Convention at Art. 3 – Investigative and provisional measures of the Council of Europe Convention 1990.

and trace property which is liable to confiscation<sup>11</sup>”. However, even if providing a limited and limiting definition of the identification duties, the Council of Europe Convention defines and regulates identification procedures. In particular, it disciplines and requires identification measures within the context of investigations and offers a quite specific interpretation connected to *ad hoc* investigative techniques<sup>12</sup>. Moreover, Article 8 mentions the process of identification in relation to “instrumentalities, proceeds and other properties”. It is clear how in the Council of Europe Convention, the process of identification is linked to the physical objects connected to money laundering. This perspective is an exemplification of the more general rule-based approach that the international legislator was using at that time<sup>13</sup>. Furthermore, the identification procedures are considered as special cases of intervention and not as operations to be conducted on a regular base.

### *2.1.2 CDD in the International Legal Framework – soft law*

The first time customer identification procedures and the related duties of relevant actors were directly covered in international legal framework is with the FATF Recommendations 1990. The Recommendations even if kept being within the framework of the rule-based approach, mentions for the

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<sup>11</sup> Properties liable to confiscation are, according to the Convention, “instrumentalities and proceeds of property the value of which corresponds to such proceeds” Art. 2(1) of Palermo Convention.

<sup>12</sup> See for example Art. 6 of Palermo Convention in which identification measures within the special investigation are defined as (2)“Each Party shall consider adopting such legislative and other measures as may be necessary to enable it to use special investigative techniques facilitating the identification and tracing of proceeds and the gathering of evidence related thereto. Such techniques may include monitoring orders, observation, interception of telecommunications, access to computer systems and orders to produce specific documents”.

<sup>13</sup> Dalla Pellegrina and Masciandaro, op. cit., pp. 3-6.

first time the concept of “customer identification” as qualified on both properties and persons and dedicated to it a specific section<sup>14</sup>. In particular, these Recommendations required financial institutions to identify and keep appropriate records of their customers, as well as to refuse to effect operations on “anonymous accounts or accounts in obviously fictitious names<sup>15</sup>”. In addition, financial institutions should acquire further extra information on the “persons” who open an account, and on the “transactions” whether there is a reasonable suspicion that the customer is not really the beneficial owner of the bank account<sup>16</sup>. Moreover, financial institutions are required to keep track and records of the financial movements of accounts for at least “five years” and to maintain an updated documentation of “customer identification”<sup>17</sup>. The main reason why these records have to be kept is to allow competent authorities to better investigate in money laundering suspicious cases<sup>18</sup>. Furthermore, FATF Recommendations of 1990 require an “increased diligence” when dealing with atypically large operations and “unusual patterns of transactions, which have no apparent economic or visible lawful purpose”. Besides, financial institutions should report straight away to competent authorities when they perceive the suspicion that the money in the bank account of their customers comes from illegal activities<sup>19</sup>. The first version of the FATF Recommendations, even if not regulating customer due diligence as it is known today, clearly provides an embryonic treatment of the main structure, elements and procedures of CDD at the international level<sup>20</sup>.

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<sup>14</sup> 1990 FATF Recommendations at Recs. 12-14.

<sup>15</sup> 1990 FATF Recommendations at Rec. 12.

<sup>16</sup> *Ibid.* at Rec. 13.

<sup>17</sup> *Ibid.* at Rec. 14.

<sup>18</sup> *Ibid.* at Rec. 14.

<sup>19</sup> *Ibid.* at Rec.16.

<sup>20</sup> Circola GdF, op. cit., p. 7.

Later on, the FATF Recommendations issued in 1996 presented guidelines for customer identification and record keeping very similar to the one offered and explain in the 1990's version. Differences have to be found in the extra-specification of actions to be taken when dealing with "legal entities", cases upon which financial institutions have to check the "legal existence and structure" both by obtaining information from "public register" and by investigating on customers themselves<sup>21</sup>. Moreover, measures have to be taken in order to confirm that people acting on the behalf of a customer (both in the form of legal entity or natural person) is correctly identified and has the proper authorization to do so<sup>22</sup>.

The first time in which the term "customer due diligence" is used in the international legal framework is, not accidentally, in the FATF Recommendations of 2003. In fact, FATF's recommendations are in general widely considered the generator of the general and world wide recognized guidelines for the treating of anti-money laundering measures at both the macro and micro international and domestic level. Moreover, the Recommendations of 2003 are the first one that see an increased concern for the issue, due to the terrorist act of 11<sup>th</sup> September 2001 and to its financing through laundering schemes and a general renovated concern for the more complex financial environment within which money laundering operations take place. The 2003 Recommendations' governed the change from a rule-based approach to a risk-based one, with the consequent enhanced responsibility for financial institutions and other relevant subjects.

In the 2003 FATF Recommendations, customer due diligence measures are specifically required under certain circumstances and in particular when:

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<sup>21</sup> FATF 1996 Recommendations at Rec. 10(i).

<sup>22</sup> *Ibid.* at Rec. 10(ii).



- “establishing business relations;
- carrying out occasional transactions: (i) above the applicable designated threshold; or (ii) that are wire transfers in the circumstances covered by the Interpretative Note to Special Recommendation VII;
- there is a suspicion of money laundering or terrorist financing; or
- the financial institution has doubts about the veracity or adequacy of previously obtained customer identification data<sup>23</sup>”.

In particular, these measures consist in the ascertaining the identity of the customer with “identification data”, verifying and determining the beneficial owner, acquiring documentation regarding the nature of the transaction and business involved and conducting “on-going due diligence on the business relationship”<sup>24</sup>.

Another change in the 2003 FATF Recommendation is made at Recommendation 12 when customer due diligence duties are extended to a series of other intermediaries and actors besides financial institutions. In particular, to casinos, real estate agencies, dealers in precious metals, certain specific legal professionals and accountants when dealing with definite activities on behalf of their clients<sup>25</sup>.

This structure of CDD measure application and of CDD requirements is of extreme importance for it is the framework which is going to be used by regional and national regulatory bodies to regulate customer due diligence through hard law provisions<sup>26</sup>.

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<sup>23</sup> FATF Recommendations 2003 at Rec. 5.

<sup>24</sup> *Ibid.* at Rec. 5.

<sup>25</sup> Specifically: casinos; real estate agents; dealers in precious metals; lawyers, notaries and other independent legal professionals and accountants; trust and company service providers under certain specific instances, FATF Recommendations 2003 at Rec. 12.

<sup>26</sup> Peurala, *op. cit.*, pp. 43-67; Dalla Pellegrina and Masciandro, *op. cit.*, p. 7-8.

### 2.1.3 CDD in the European Legal Framework

The European trend on AML has been closely following, as it has been already pointed out in chapter 1, the one suggested by the FATF Recommendations. This tendency is traceable also in the treatment of customer identification and due diligence process for financial and (later) non-financial actors. In fact, in the 1991 Directive, “financial institutions” and “insurance companies” are required to identify customers and beneficial owners in the context of the so-called “know your customer” (KYC) strategies<sup>27</sup>. These information have to be collected at the beginning of the business relations between the financial actors and their customers<sup>28</sup>, registered and kept for no less than five years<sup>29</sup>.

Clear shortcomings of the approach offered by the 1991 EU Directive were the lack of detailed guidelines of how this identification procedure should have taken place<sup>30</sup>. Moreover, these identification requirements were limited to new customers, thus pre-existing clients could have easily escaped the KYC preventive measures of the First EU Directive<sup>31</sup>. Furthermore, even if the term “beneficial owner” was mentioned<sup>32</sup>, the concept was not properly defined, nor the issue on its identification were mentioned in the First EU Directive. I can thus be concluded that, in general, the 1991 EU Directive introduced the concept of KYC procedures as customer and beneficial owner

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<sup>27</sup> Peurala op. cit., p. 64.

<sup>28</sup> 1991 EU Directive at Art. 3.

<sup>29</sup> 1991 EU Directive at Art. 4.

<sup>30</sup> Peurala, op. cit., p. 64.

<sup>31</sup> *Ibid.*

<sup>32</sup> In the Preamble of the 1990 EU Directive it was stated that measures applied to customer should have been extended to beneficial owners.

identification, laying the foundations for the treatment of the issue and opening up the debate on it, but without providing a thorough discipline<sup>33</sup>.

The Second EU Directive issued in 2001 improved the KYC procedures by expanding the responsibilities of customer identifications to other business and professions besides the one already disciplined in the First Directive<sup>34</sup>. Nonetheless, the framework was kept within the borders of simple KYC practices and was not expanded with risk-based approach of customer due diligence practise. This clearly has to do with the fact that the 2001 EU Directive still was inspired by the 1996 FATF Recommendations which still proposed a rule-based approach to anti-money laundering regulations<sup>35</sup>.

The Third EU Directive issued in 2005 ruled the change in trend and finally fully introduced the concept of customer due diligence within the risk-based approach as it is conceived today<sup>36</sup>. It is not a case that the main differences between the second and the third directives have to be found in Articles 7-13 that discipline know your customer practices. In particular, “a new generation of the KYC<sup>37</sup>” was introduced with the Third EU Directive, investing with responsibilities the relevant persons and diversifying the application of customer identification and control mechanisms according to the evaluation of risks<sup>38</sup>. Moreover, the risk-sensitive requirements for customer identification in the Third Directive, considered specific class of people (i.e. politically exposed persons) as particularly risky because of their

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<sup>33</sup> Mitsigales and Gilmore op. cit., pp. 127-129.

<sup>34</sup> Integration of Art. 2a of 1990 EU Directive.

<sup>35</sup> Peurala, op. cit., pp. 60-62.

<sup>36</sup> Peurala, op. cit., 62-64.

<sup>37</sup> Peurala, op. cit., 64.

<sup>38</sup> Mistigales and Gilmore, op. cit., p. 126; Dalla Pellegrina and Masciandro 2008, op. cit., pp. 4-6.

political exposure<sup>39</sup>. The aim of the Third Directive of complying with international standards especially when dealing with the new risk-based guidelines on customer identification is fully made clear in the Preamble<sup>40</sup>. In the Third Directive, chapter II and Arts. from 6-19 are completely dedicated to the practice of “customer due diligence”<sup>41</sup>. Coherent with the risk-based approach, the concept of due diligence is not diversified into different level of care depending on the different level of risk<sup>42</sup>. Furthermore, the Directive gives the chance to institutions and professionals involved in the process of customer due diligence, to count, under certain circumstances, on third parties to operate their controls<sup>43</sup> (Arts. 14-19). Third Directive’s improvements comprise the obligation to identify not only the customer, but also the beneficial owner; to acquire relevant information on the nature and scope of the operation and to operate a constant control over the relation between the customer and the actors<sup>44</sup>.

In the Third Directive the KYC is not limited to a instantaneous operation of identifying the customer, but is an on-going process which continues during the whole relationship between the customer and the institution (actor)<sup>45</sup>.

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<sup>39</sup> Dalla Pellegrina and Masciandro 2008, op. cit., p. 125; 2005 EU Directive at Arts. 3(8) and 13(4).

<sup>40</sup> Recital 5 and 9 of the Preamble of the Third Directive, in particular “The Community action should continue to take particular account of the Recommendations of the Financial Action Task Force” and “Since the FATF Recommendations were substantially revised and expanded in 2003, this Directive should be in line with that new international standard” from Recital 5 of the Preamble of Directive 2005/60/EC.

<sup>41</sup> Mitsigales and Gilmore, op. cit. p. 126.

<sup>42</sup> *Ibid.*, p. 126.

<sup>43</sup> *Ibid.*, p. 126.

<sup>44</sup> Circolare GdF, op. cit., p. 7.

<sup>45</sup> Condemi and De Pasquale, op. cit., p. 207.

#### *2.1.4 To sum up, how it is CDD today at the international and European level*

The international and European legal standards in force today are that suggested by the FATF 2003<sup>46</sup> Recommendations and ruled by the Third Directive. They rely, especially when dealing with CDD on the same principles and are clearly fruits of the same approach (in particular the EU Directive accomplished on regional basis the guidelines of the FATF Recommendations). The strong relationship between the two legal means is evident at Art. 7 of the Directive, which present the case in which customer due diligence measures have to be applied using the same wording of Recommendation 5 of FATF Recommendations 2003. In particular, CDD procedures have to be taken when (i) putting in place a “business relationship”, (ii) undertaking “occasional transactions” for amounts bigger than EUR 15 000, both in the case of single or multiple transactions, (iii) when there is the suspects of money laundering or terrorism financing activities, and, finally (iv) when there are doubts on the truthfulness of data on customers<sup>47</sup>. The amount of money is reduced to EUR 2 000 in case of “purchase or exchange gambling chips” for casino customers<sup>48</sup>.

Moreover, both EU Directive and FATF Recommendations provide a list of measures to adopt in order to comply with CDD standards, which comprehend (i) the verification of the identity of the customer, (ii) the authentication of the actual beneficial owner of the transaction, (iii) the knowledge on the nature and motive of the business relationship, and (iv) the

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<sup>46</sup> Even if FATF issued new Recommendations in 2012, they have not be yet implemented with hard law instruments in the European Union; the Proposal for a Fourth Anti-Money Laundering Directive aims at executing the provisions of FATF Recommendations 2012 in the European legal framework.

<sup>47</sup> 2005 EU Directive at Art. 10; 2003 FATF Recommendations at Rec. 5.

<sup>48</sup> 2005 EU Directive at Art. 10; FATF Recommendations provide details on the threshold for applying CDD in the interpretative notes.

control through an “on-going monitoring” mechanism of the operations throughout the whole business relationship<sup>49</sup>.

### 2.1.5 Simplified CDD

Art. 11 of the EU Directive is dedicated to simplified CDD, which are measure that have to be taken in case of low risk operations, business relationships and customer<sup>50</sup>. The simplified procedures are of simpler implementation and maintenance, inflicting a smaller burden on customers and allowing resource savings that can be further re-invest in high-risky operation in need of enhanced due diligence procedures<sup>51</sup>. Simplified CDD are crucially important for maintaining a “facilitative financial inclusion regime”<sup>52</sup> which does not penalise law-abiding clients, which are doing regular and legal business operations. Both FATF Recommendations and the EU Directive provide a series of guidelines and suggestions to recognise a low-risk profile operators. In particular, when information on identity and beneficial title are public. This is for example the case of public listed companies<sup>53</sup>, financial institutions and DNFBPs dependent on anti-money laundering regulatory system coherent with FATF Recommendation<sup>54</sup>, “public

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<sup>49</sup> 2005 EU Directive at Art. 8; 2003 FATF Recommendations at Rec. 5.

<sup>50</sup> E. U. Savona, M.A. maggioni, B. vettori, J. Ponticelli, m. Riccardi, F. Andrian, C. Ciurletti, “Cost benefit analysis of transparency requirements in the company/corporate field and banking sector relevant for the fight against money laudnergin and other financial crime” Trento: Transcrime – Università degli Studi di Trento, 2007, p. 46.

<sup>51</sup> Identifying and managing low money laundering risk, L. Koker, “Identifying and managing low money laundering risk: perspectives on FATF’s risk-based guidance” *Journal of Financial Crime*, 4: 334-352, 2009, p. 340.

<sup>52</sup> Koker, op. cit., p. 339.

<sup>53</sup> 21005 EU Directive at Art. 11(2)(a).

<sup>54</sup> 2012 FATF Recommendations at Rec. H(17)(a).

administrations or enterprises”<sup>55</sup> named “domestic public authorities” in the EU Directive<sup>56</sup>, and “beneficial owners of pooled accounts held by notaries and other independent legal professionals”<sup>57</sup>. In addition, the risk can be evaluated taking into consideration the object rather than the subject. Following this classification, life insurance policy with annual premium smaller than EUR 1 000 or single premium minor of EUR 2 500;<sup>58</sup> insurance policy for pension schemes with no surrender clause and without the change to use the policy as a collateral<sup>59</sup>; pensions or similar plans of action that give retirement benefits<sup>60</sup>. In addition, the Third Directive include in the set of simplified due diligence in the case of electronic money where the maximum amount saved is of EUR 150, or, in case the device is rechargeable, the mean does not allow more than EUR 2 500 of transaction a year<sup>61</sup>. FATF Recommendations do not explicitly introduce the concept of “electronic money” within the case due simplified due diligence measures, but more generally mentioned “financial products or services” that offer “limited services” for “financial inclusion purposes<sup>62</sup>”. This definition does not directly refers to electronic money, but rather provides an umbrella definition so to leave the national (in this case regional) legislator the chance to include the relevant cases in point.

FATF Recommendations 2003 also mentioned the factor of country risk within the short-list of risk factors to be taken into consideration to decide whether to apply simplified or enhanced customer due diligence. In

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<sup>55</sup> 2012 FATF Recommendations at Rec. H(17)(a).

<sup>56</sup> 2005 EU Directive at Art. 11(2)(c).

<sup>57</sup> *Ibid.* at Art. 11(2)(b).

<sup>58</sup> *Ibid.* at Art. 11(5)(a); 2003 FATF Recommendations at Rec. H(17)(b).

<sup>59</sup> 2005 EU Directive at Art. 11(5)(b); 2003 FATF Recommendations at Rec. H(17)(b).

<sup>60</sup> 2005 EU Directive at Art. 11(5)(c); 2003 FATF Recommendations at Rec. H(17)(b); Koker, *op. cit.*, p. 340.

<sup>61</sup> 2005 EU Directive at Art. 11(5)(d).

<sup>62</sup> 2003 FATF Recommendations at Rec. H(17)(b).

particular, constitute low risk profile countries those that, according to mutual evaluation<sup>63</sup> and assessment reviews are recognised as using efficacious anti-money laundering framework; and those proved to do not have significant levels of corruption and other criminal activity.<sup>64</sup>

FATF Recommendations 2003 at point H(21) explicitly offers a series of exemplifying measures that could be taken in case of operations showing a low risk, thus operations in which simplified CDD have to be considered. These include in any case the identification of the customer, but suggest a reduction of both the frequency and accuracy of on-going screening. Moreover, it is discouraged the collection of specific information regarding the scope and nature of the business relationship in this low risk situation, so not to burden the course of regular business operations and actions. Moreover, at point 15 the FATF Recommendations 2003 exhort countries to take into consideration “new technologies” in the deliberation on anti-money laundering regulation.

Surprisingly, the Third Directive do not explicitly mention any practical measure that should or could be taken in case of simplified CDD customers or operations, but rather cover just the provision of the recognition and definition of low risk cases. Thus, in 2006 the promulgation of the Commission Directive 2006/70/EC named “laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of ‘politically exposed person’ and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasion or very limited basis’ enlarges and provides a deeper explanation of cases in

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<sup>63</sup> Which is an assessment of countries performance in AML regulations and policies.

<sup>64</sup> 2003 FATF Recommendation at Rec. H(17)(c).



which the simplified CDD shall apply<sup>65</sup>. Moreover, at point (6) it stresses the importance of a certain degree of on-going measures also for low risk customers, so to possibly detect “complex or unusually large transactions” which may hide a money laundering operation. The 2006 Directive comprise the technical criteria of the definitions provided in the Third Directive.

### *2.1.6 Enhanced CDD*

According to the Third Directive there are three cases that absolutely require enhanced customer due diligence: when the customer cannot be identified in person (with the physical presence), in case of “cross-frontier correspondent banking relationships with respondent institutions from third countries<sup>66</sup>”; or when the business relationship goes on with a politically exposed person having his residence in another State party or in a third state.<sup>67</sup> In these cases, extra attention has to be paid and particular customer due diligence practices have to be taken. These go from using additional means to disclose the identity of the customer, proceed to the verification of the documentation provided, checking previous operation done in other credit institutions by the same customer, gather information about the banking system from where the cross-border business relationship comes, consult senior executive in critical operations, provide the institutions with specific “risk-based procedures<sup>68</sup>” that have to be enacted in case of politically exposed persons. Thus, the Third Directive is more attentive to provide a general definition of what is meant by customer due diligence, and by its

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<sup>65</sup> 2005 EU Directive at Art. 3.

<sup>66</sup> *Ibid.* at Art. 13(3).

<sup>67</sup> *Ibid.* at Art. 13(4).

<sup>68</sup> *Ibid.* at Art. 13(4)(a).

distinction into simplified and enhanced than actually to issue State parties with practical procedures to adopt in the specific cases. This, in fact, is left to both State and interested parties serving, coherent with the risk-based approach, more as a framework of tendency than as a series of regulations<sup>69</sup>.

What is clearly established are the worldwide considered risky situations upon which to pay particular attention so to both not interfere with regular and legal business operation and to prevent and detect potential money laundering operations. When dealing with high risk profile countries, the issue of “financial corridor<sup>70</sup>” have to be taken into high consideration. By “financial corridor” it is meant those countries that function as a provisional step to transfer money from a low risk country with strong AML regulation, to a high risk country. These “financial corridor” may be countries which have good financial and regulatory relationships with low risk countries, but that do not have a exhaustive and proper regulation to deal with money laundering overall. Thus, the financial actors involved in these kind of operations should be aware of the potential risks of multiple steps transactions and should treat as high risk places even countries that officially may not be considered as so. It is extremely complicated to detect financial corridors, especially because they change rapidly, but it should be investigate the ultimate destination of a transaction when there are doubts about being a just a step of the process. In particular, management studies have detected how, when the ultimate destination of a transaction is a known to be a risky country, to elements to be taken into consideration for determining high risk profile operations are the amount of the sum (bigger is riskier) and the charitable end<sup>71</sup>. Thus,

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<sup>69</sup> See chapters 3 and 4 for actual implementation and regulation in specific State parties.

<sup>70</sup> M. Viridi, V. Natarajan, I. Das, A. Khera, “Money laundering (from a management perspective), working paper from National Law University, Jodhpur, submitted January-May 2013, p. 5.

<sup>71</sup> Viridi et al., op. cit., p. 6.

investigations on the actual nature of the charity have to be taken. This may seem as an excessive burden for financial institutions and DNFBPs, but it has to be considered that these kind of highly risky operation represents just a small portion of the every-day operations of an operator, thus representing the exception and not the rule.

The customer due diligence requirements have to be implemented both by financial business and by designated non-financial businesses and professions (DNFBPs). The FATF Recommendations explicitly states this in relation to customer due diligence duties, while the Third Directive do it at the beginning by articulating that the Third Directive has to be applied to specific actors.

#### *2.1.7 CDD in the proposal for the fourth directive*

The Proposal for a Fourth Directive covers customer due diligence practices in line with the FATF 2012 Recommendations which intensify, within the risk-based approach, the responsibility of relevant actors<sup>72</sup>. In particular, one of the main changes in the regulation of CDD measures regards Politically Exposed Persons. The discipline on PEPs enhanced DD is extended to people with important public function nationally and also to those employed in international organisations<sup>73</sup>. Furthermore, the extra care that need to be taken when applying enhanced DD measures to PEPs is extended from 12 to 18 months after they finish working in the public

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<sup>72</sup> S. De Vido *Riciclaggio, corruzione e finanziamento al terrorismo* in S. De Vido , Treccani Il Libro dell'Anno del Diritto 2014, Roma, Istituto della Enciclopedia Italiana Treccani, pp. 755-758; E. U. Savona, “La IV Direttiva antiriciclaggio e i professionisti” *Il Commercialista Veneto*, Numero 213 – Maggio/Giugno 2013, p.3.

<sup>73</sup> EU Proposal, p. 10.

office<sup>74</sup>. Finally, when dealing with PEPs, the Fourth Directive regulates the application of risk-based approach, thus considering differently PEPs with variable levels of money laundering involvement risk.

The Fourth Directive enriches the treatment of customer due diligence by emphasising the responsibility in the hands of the relevant subjects and complementing the regulation with an extensive and detailed set of factors that determine the riskiness of different operations and actors<sup>75</sup>. Specifically, the Annex II of the Proposal highlights the dangerousness of cash-intensive businesses and companies with unusual and pointless elaborate ownership organisation.<sup>76</sup>

One of the most important change and innovation of the Proposal is the inclusion of tax crime in scope of action of the Directive. Tax crime shall now be considered as predicate offences. This indirectly will extensively affect customer due diligence measures and responsibilities of some European countries, which have not included so far this crime in the one that could lead to money laundering<sup>77</sup>. In particular, now Article 3(4) defining what a criminal activity is, includes at sub-paragraph (f):

“all offences, including tax crimes related to direct taxes and indirect taxes, 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

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<sup>74</sup> Law society webpage <http://www.lawsociety.org.uk/advice/articles/new-money-laundering-directive/> as accessed 02/09/2014.

<sup>75</sup> J. Holt, “The proposed Fourth EU Anti-Money Laundering Directive. On the preventive of the use of the financial system for the purpose of money laundering and terrorist financing” SHCOG Monthly Meeting – 16 May 2013, p. 7, available at <http://www.european-compliance.com/Library/MMs/201305.pdf> as accessed on 17/09/2014; EU Proposal, Appendix II.

<sup>76</sup> Holt, *op. cit.*, p. 7.

<sup>77</sup> See chapter 4 for a comparison between UK and Italy which face two different approaches towards the criminalisation of tax fraud and evasion.

deprivation of liberty or a detention order for a minimum of more than six months”

All these changes consider both the international trends and procedures in guidelines and recommendations to fight money laundering, and the changing in complexity and methods of the crime in consideration.

## **2.2 The issue of the beneficial owner identification**

The beneficial owner is an extremely important concept for the understanding of money laundering processes and it is crucial for its regulation. The Third Directive defines the beneficial owner as:

“the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted<sup>78</sup>”

The FATF Recommendations 2012 dedicate a whole part of the interpretative notes to better explain this issue<sup>79</sup>. Scholars have demonstrate how the BO is particularly important for the understanding of dynamics behind corporate entities, since this is one of the situation in which it tries more to conceal itself. In the majority of European Union States the definition of beneficial owner has been translated literally from the one suggested by the Third

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<sup>78</sup> EU 2005 Directive at Art. 3(6).

<sup>79</sup> Interpretative note to recommendation 24 (transparency and beneficial ownership of legal persons).

Directive<sup>80</sup>. The term “beneficial owner” emerged for the first time in the 2003 version of the FATF Recommendations<sup>81</sup> within the customer due diligence framework<sup>82</sup>.

The FATF Recommendations of 1990, 1996 and 2003 embraced a “intermediary-based approach”, which means that much responsibility for the anti-money laundering approach is given and left to financial institutions<sup>83</sup>. Thus these actors were designated to gather information on their customers up until verifying the beneficial owner of business relationship. The FATF Recommendations 2012 kept the strong importance and responsibility of financial and other intermediaries institutions, but moved to a “up-front disclosure system<sup>84</sup>” which invest with responsibility companies that have to comply with a set of minimum standards of information gathering and collection on ownership of corporate entities<sup>85</sup>. Furthermore, the burden is extent to countries that have to make sure that documentations on these topics are available both at company and company registry level. In particular, the minimum standards of knowledge and transparency regard the “legal ownership”, the “control structure of the company”, the “status” and “power” of the company, the “shareholders” and the “directors”<sup>86</sup>. Furthermore, a “company registry” should be present in every country and all companies should be registered in it with at least the information above mentioned.

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<sup>80</sup> Deloitte, “Final Study on the Application of the Anti Money Laundering Directive”, 2011, p. 51, available at [http://ec.europa.eu/internal\\_market/company/docs/financial-crime/20110124\\_study\\_amld\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/financial-crime/20110124_study_amld_en.pdf) Deloitte, as accessed on 18/09/2014.

<sup>81</sup> 2012 FATF recommendations at Rec. 3.

<sup>82</sup> Riccardi and Savona, *The identification of ...*, op. cit., pp. 19-20

<sup>83</sup> *Ibid.*, p. 21.

<sup>84</sup> *Ibid.*

<sup>85</sup> *Ibid.*

<sup>86</sup> 2012 FATF Interpretative notes to Rec. 24.

In the European legal framework, the concept of beneficial owner has been presented in the Third Directive and, above all, further explicated in the Commission Directive 2006/70/EC. The beneficial owner is treated within the context of CDD in a way coherent with that of FATF Recommendations. The Proposal promises to enhanced the concept of BO by taking into considerations the development of FATF 2012 Recommendations, the new provisions of the Commission Directive 2006/70/EC, and the findings of the European Union assessment on money laundering and AML measures that have been taken in the last years. In particular, the definition of beneficial owner should be further developed, specifically analysing the concept of “control” over a company or legal entity, possibly diminishing the level of threshold to be considered a beneficial owner to 25% and balancing the trade-off between data protection and access to personal information.

The impact assessment studies conducted in the last years have shown how the need for a better definition of “control” over a company or of a legal entity has to be found. On the contrary, it seems that reducing the threshold to a level lower than the current 25% shall not be of any use. Moreover, the issue of data protection and privacy does not seem a main concern of the regulators, which, on the contrary, stress out the importance of disclosing information and keeping a registry of companies and specifically on their beneficial ownerships in fighting money laundering<sup>87</sup>. Furthermore, the Proposal suggests the introduction of a requisite for legal persons to “hold information on their own beneficial ownership” and making it available to authorities and interested

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<sup>87</sup> Riccardi and Savona, *The identification of ...*, op. cit., p. 27.

entities<sup>88</sup>. In general, the Proposal for a Fourth EU Direct suggests the implementation of FATF 2012 Recommendations' enhanced specifications and provisions on beneficial owner within the European legal framework<sup>89</sup>.

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<sup>88</sup> *Ibid.*

<sup>89</sup> The Proposal delineate this in the Explanatory Memorandum under "General context".



## **CHAPTER 3 - National implementation of international and European standards in UK and Italy**

### **1. Domestic implementation of international and European AML regulation<sup>1</sup>**

The international legal framework, both through means of hard and soft law instruments, provides a solid structure to deal with money laundering and related issue at the global level. However, what is of extreme importance in this context is not only the international breadth of money laundering, but also and mostly, the interaction between international, transnational and national dynamics<sup>2</sup>. The need for international and transnational cooperation both through the mean of legal instruments, policies, exchange of information and operations, is of crucial importance<sup>3</sup>. Thus, international and regional legal instruments are fundamental, but what is even more decisive, also considering the soft law character of some international legal instruments, is their implementation in the national law of every country. Moreover, since the regulatory field of AML regulation involved national criminal law, which is traditionally a national competence<sup>4</sup>, the national implementation have to be done very carefully and taking into consideration both domestic needs and international (or regional) directives<sup>5</sup>. In general, the implementation of international standards into domestic legislation is quite similar in countries

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<sup>1</sup> Simmons, op. cit., p. 588.

<sup>2</sup> *Ibid.*, p. 589.

<sup>3</sup> Circolare GdF, pp. 109-115; Peurala, op. cit., p. 43.

<sup>4</sup> Peurala, op. cit. p. 72

<sup>5</sup> Circolare GdF, p. 64.

adopting FAFT Recommendations<sup>6</sup>. Moreover, if the analysis is narrowed to the European context, these similarities become even bigger, because of the binding character of European Directives and because of the similar geographic and economic area in which countries are located<sup>7</sup>. However, analysing countries in comparative terms, some differences in AML law implementations may arise. In particular, these dissimilarities may be evidence of a different historical approach towards the domestic regulation money laundering and of the degree of importance of the regulated sectors<sup>8</sup>. That is, some countries provide a wider, more extensive and more detailed series of directives to be observed and enforced and may receive different levels of support and compliance from the regulated sectors<sup>9</sup>. Furthermore, because of the nature of criminal conduct in consideration (i.e. money laundering), national legislations apply differently instruments of administrative and criminal law.

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<sup>6</sup> “Comparative Implementation of EU Directives (II) – Money Laundering, The British Institute of International and Comparative Law, December 2006, p. 8.

<sup>7</sup> FATF Report on Money Laundering Typologies 2000/2001 (FATF Report).

<sup>8</sup> J. Walter, C. Budd, R. G. Smith, K. R. Choo, R. McCrusher, D. Rees, “Anti-money laundering and counter-terrorism financing across the globe: A comparative study of regulatory action”, AIC Report, Research and Public Policy Series, 2011, p. xi.

<sup>9</sup> *Ibid.*, p. 33.

## 3.2. Money laundering and AML regulations in UK

### 3.2.1 Money laundering numbers and trends in UK

The laundering of criminal proceeds and thus their injection in the legal economy not only distorts the legitimate economy, but also provides new sources of wealth to criminals, generating a vicious circle of crime generating money generating crime<sup>10</sup>. Evaluations of the ML problem extension in UK conducted in 2007 by the HM Treasury, approximated that organised crime revenues were about £15 billion a year<sup>11</sup>, almost 10 of which were laundered by means of operators that in the regulations are defined as the “regulated sectors<sup>12</sup>”. Moreover, £5 billion constitutes the so-called “capital formation”, £3 billion of which were further invested abroad<sup>13</sup>. It is evident how criminal organisations behave in a similar way to legal companies working in the licit economy, thus affecting the law abiding world through apparently legitimate means.

Since October 2013 the new crime-fighting agency of the United Kingdom is the National Crime Agency. Before that moment, the reference agency was the Serious Organised Crime Agency (SOCA). The Economic Crime Command takes targeting and preventive measures<sup>14</sup> within the NCA money laundering analysis.

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<sup>10</sup> Progetto PON Sicurezza 2007-2013, Trento: Transcrime – Università degli Studi di Trento, 2013 (PON), pp. 23-35.

<sup>11</sup> <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldecom/132/13204.htm>; HM Treasury, The financial challenge to crime and terrorism, February 2007 at p. 8.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> The Economic Crime Command deals also with other economic crimes such as frauds, intellectual property offences, identity crime and counterfeiting.

The last report published by SOCA quantified the amount of criminal proceeds analysing the six of assets seized from criminals by authorities.

<i>Assets denied – category</i>	
Cash seizures	£ 1.5m
Restrained assets (gross)	£ 16.2m
Assets frozen (gross – civil and tax powers)	£ 12.2m
Value of confiscation orders obtained	£ 4.8m
Value of civil recovery orders (gross – including consents orders)	£ 6.3m
Value of assets denied by partners (UK)	£ 18.6m
Value of assets denied by partners (Overseas)	£428m
Total assets denied to criminals	£487.6m

Figure 1: Criminal assets which access was denied in 2013/2014. Source: SOCA Annual Report 2013/2014<sup>15</sup>.

Even if these figures do not tell the exact numbers of criminal money, they give an idea of how complex, articulated and wide the economic power of criminal organisation is, suggesting that the money laundering operations, which are effectively disclosed constitute just a small portion of the whole picture.

According to FATF Report on UK 2007 cash is the pillar of organised criminal groups activities in the country, especially originated by drug trafficking and fraud offences. Moreover, properties (especially real estate)

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<sup>15</sup> SOCA Annual Report 2013/2014 at p. 5, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/330516/SOCA2013-14.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/330516/SOCA2013-14.pdf) as accessed on 18/08/2014, now National Crime Agency (NCA) – A non-Ministerial Department funded by HM Treasury accountable to the Home Secretary.

and front companies are often use in UK as effective way to launder money.<sup>16</sup> Furthermore, the laundering methods that currently worry most law enforcement agencies are cash exchange, “money transmission agents”, “cash rich business and front companies”; high value assets and properties”, “abuse of bank accounts and other over the counter financial sector products”<sup>17</sup>. Overall, several studies have proven how in general cash intensive businesses are the most at risk of money laundering penetration in UK.

### 3.2.2 AML Regulations in UK

The first regulatory approach of United Kingdom dealing with the issue of money laundering has to be found, in line with international trends, within anti-drug policies of late 1980s<sup>18</sup>. However, the English legislator mentions the concept of money laundering (even if with a different wording) in 1986, thus two years before the Vienna Convention, demonstrating an independent interest and development of AML regulation and policies<sup>19</sup>. The UK anti-money laundering domestic regulation, not only started independently, but also developed on patterns that, even if coherent and in line with international and regional standards, are quite unique<sup>20</sup>. Specifically, in the Drug Trafficking Offence Act of 1986, section 24 criminalises the conduct of “assisting another to retain the benefit of drug trafficking<sup>21</sup>”. The inclusion of international standards with the implementation of the Vienna Convention occurred in

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<sup>16</sup> Walter et al., op. cit., p. 16.

<sup>17</sup> FATF Report.

<sup>18</sup> Drug Trafficking Offences Act 1986.

<sup>19</sup> Booth et al., op. cit., pp. 10-12.

<sup>20</sup> *Ibid.*, p. 14.

<sup>21</sup> Drug Trafficking Offences Act 1986, Section 24.

1990 with the Criminal Justice (international Co-operation) Act<sup>22</sup>. The Money Laundering Regulations 2003 contributed to further enhance the legal framework of AML domestic policy, which was improved even more with the 2007 version of the Regulations. The Money Laundering Regulations 2007, in particular, implemented the new trend toward a risk-based approach and an investing with responsibility of the relevant sectors, suggested by both international and regional standards<sup>23</sup>. Besides hard law provisions, the UK AML approach comprises a series of guidelines and codes of conducts provided by elected sectors and professional associations<sup>24</sup>. Some examples of these kind of sources are the Preventing Money Laundering and Terrorist Financing issued by the HM Revenue & Custom, the guidance issued by the Joint Money Laundering Steering Group, the one submitted by the professional group of accountants, namely the Consultative Committee of Accountancy Bodies and the one published by the Law Society, that is the Anti-Money Laundering Practice Note<sup>25</sup>.

The evolution of AML regulations in UK has developed on a similar path to that of the international tendency, but has always created its own view on the phenomenon, implementing and following admittedly international standards, but also creating a interpretation on its own. The main difference in the early domestic regulation from the international standards has to be found within the specification of the mental elements, which are required to determine whether a person is associate (i.e. assisting) with the proceeds of drug trafficking. In fact, whereas international regulations request the manifest “knowledge”, in the UK approach to be culpable “having reasonable grounds

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<sup>22</sup> Booth et al., op. cit., pp 14-16.

<sup>23</sup> Booth et al., op. cit., p. 28.

<sup>24</sup> *Ibid.*, p. 30.

<sup>25</sup> *Ibid.*

to suspect<sup>26</sup>” is enough to be investigated and potentially prosecuted. . Moreover, the need criminal intent was not necessary as it was in other jurisdiction<sup>27</sup>.

The Proceeds of Crime Act 2002 provides the first and most important definition of money laundering in the UK legal system.<sup>28</sup> Compared to international standards of both hard and soft law, the definition of money laundering offences in the POCA is more extensive<sup>29</sup>. In fact, subsections from (2) to (11) of section 340 of the POCA, discipline and explain several concept necessary to interpret the criminalising provision at sections from 327 to 332 of Part 7 of POCA. In doing so, the Proceeds of Organised Crime Act extend the breadth and application of money laundering offences by mean of wider notions of “criminal conduct<sup>30</sup>” and “criminal property<sup>31</sup>”. Within the criminal conducts, it includes three main classical money-laundering related crimes: the concealing<sup>32</sup>, the arrangements<sup>33</sup> and the acquisition, use and possession<sup>34</sup> of “criminal proceeds”; but also include the offence of “failure to disclose<sup>35</sup>”. Considering instead the notion of “criminal property”, it includes several different variants and variables that go from actual material benefits, to suspect of immaterial interest. Moreover, according to POCA, it is considered a crime also the “tipping off<sup>36</sup>”, which means that a person, knowing that a disclosure of money laundering suspicious operations has been made, reveal

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<sup>26</sup> See case law on chapter 4 for further considerations.

<sup>27</sup> Booth et al., op. cit., p. 17.

<sup>28</sup> Proceeds of Crime Act 2002 (POCA) Part 7 ss. 327-334.

<sup>29</sup> Booth et al., op. cit., at p. 17.

<sup>30</sup> Booth et al., op. cit., p. 17; in particular, the concept of criminal conduct was extended to include even “notional proceeds” and benefits deriving from an offence without the necessity of the criminal intention behind the launderer.

<sup>31</sup> Explained from subsection (3) to subsection (10) of section 340 of the POCA.

<sup>32</sup> POCA ss. 327 sub(1).

<sup>33</sup> POCA ss. 328 sub(1).

<sup>34</sup> POCA ss. 329 sub(1).

<sup>35</sup> POCA ss. 330, 331, 332.

<sup>36</sup> POCA s. 333(a)(1).

this information undermining investigations and proceedings on the matter. Furthermore, it is considered an offence also revealing that an investigation on a money laundering matter has been going on if this undermines the investigation itself<sup>37</sup>.

Another crucial difference from the international and regional recommendations is the inclusion of an exception, namely “authorised disclosure” that free relevant persons from committing money-laundering offences. Specifically:

- (2) But a person does not commit such an offence if
  - (a) he makes an authorised disclosure under section 338 and (if the disclosure is made before he does the act mentioned in subsection (1)) he has the appropriate consent;
  - (b) he intended to make such a disclosure but had a reasonable excuse for not doing so;
  - (c) the act he does is done in carrying out a function he has relating to the enforcement of any provision of this Act or of any other enactment relating to criminal conduct or benefit from criminal conduct<sup>38</sup>.

The rationale behind the inclusion of the provision of “authorised disclosure” has to be found in the high punitive penalty regime within the POCA legal framework. In fact, section 334 of POCA regulates penalties for all money laundering related offences. This means also for the “failure to disclose” criminal conduct, which is a critical situation in which relevant persons of specific sectors could potentially be in touch with in their business relationships<sup>39</sup>.

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<sup>37</sup> POCA s. 333(a)(3).

<sup>38</sup> POCA s. 338 *Authorised disclosures*.

<sup>39</sup> See chapter 4 for more considerations on this issue.



The UK legal system requires the existence of a predicate offence, an initial criminal conduct that generated the proceeds that are subsequently laundered, to apply AML regulations to laundering actions. However, the predicate offence needs to exist and be recognised but the prosecution of the offender that committed the initial crime is not necessary to apply AML laws<sup>40</sup>.

### 3.3 AML regulatory approach in Italy

#### 3.3.1 Money laundering in Italy

The issue of money laundering is extremely important and widespread in Italy and, because of its strict connection with serious criminal organisations, it has severe implications<sup>41</sup>. In particular, studies conducted on Italian criminal organisations<sup>42</sup> have investigated the reasons why criminal organisations launder money and invest it in the legal economy<sup>43</sup>. These reasons are mainly ascribable to the need of providing the organisation with more financial resources (thus, investing in some sector of the licit economy might be profitable); to the necessity of eluding investigations and prosecutions by hiding criminal money (ultimately transforming it into legal wealth); to enhance their control over the territory. By investing in the legal economy with considerable amount of money, criminal organisations can

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<sup>40</sup> <http://www.lawsociety.org.uk/advice/practice-notes/aml/money-laundering-offences/>; Booth et al., op. cit., p. 39.

<sup>41</sup> PON, p. 32.

<sup>42</sup> The more powerful and dangerous are Cosa Nostra in Sicily, 'Ndrangheta in Calabria and Camorra in Campania; Camorra and 'Ndrangheta are the more profitable ones (thus the one that launder more money).

<sup>43</sup> PON, p. 8.

both raise their influence and social control; not least by gaining consent because of economically wealthy conditions they create<sup>44</sup>.

The table below shows the level of profits of criminal organisations in Italy divided for criminal source.

	Min Profit		Max Profit		Average	
	mln€	%	mln€	%	mln€	%
Sexual exploitation	1778,15	10,0%	7540,96	22,3%	4659,56	18,1%
Arms	46,77	0,3%	148,78	0,4%	97,78	0,4%
Drugs	4541,46	25,6%	10911,92	32,3%	7726,69	30,0%
Counterfeiting	3027,52	17,0%	6055,03	17,9%	4541,27	17,6%
Gambling	326,69	1,8%	522,44	1,5%	424,56	1,6%
Waste	378,22	2,1%	756,40	2,2%	567,31	2,2%
Tobacco	661,39	3,7%	841,76	2,5%	751,58	2,9%
Usury	2242,61	12,6%	2242,61	6,6%	2242,61	8,7%
Extortion	4763,41	26,8%	4763,41	14,1%	4763,41	18,5%
<b>Total</b>	<b>11766,22</b>		<b>33783,31</b>		<b>25774,76</b>	

It can be seen how almost all criminal conducts constitute extremely serious offences, especially considering drug and sex trafficking and extortions<sup>45</sup>. However, the scenario in Italy is more diverse than in other European countries and demonstrates the complexity of both the phenomena of criminal organisations and money laundering in Italy<sup>46</sup>.

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<sup>44</sup> *Ibid.*, p. 6.

<sup>45</sup> Extortion in particular represents a huge burden for many people in some areas in the South of Italy highly controlled by criminal organisations

<sup>46</sup> PON, pp. 36-63.

The graph below represents the distribution of the investment of laundered criminal proceeds in the legal economy.

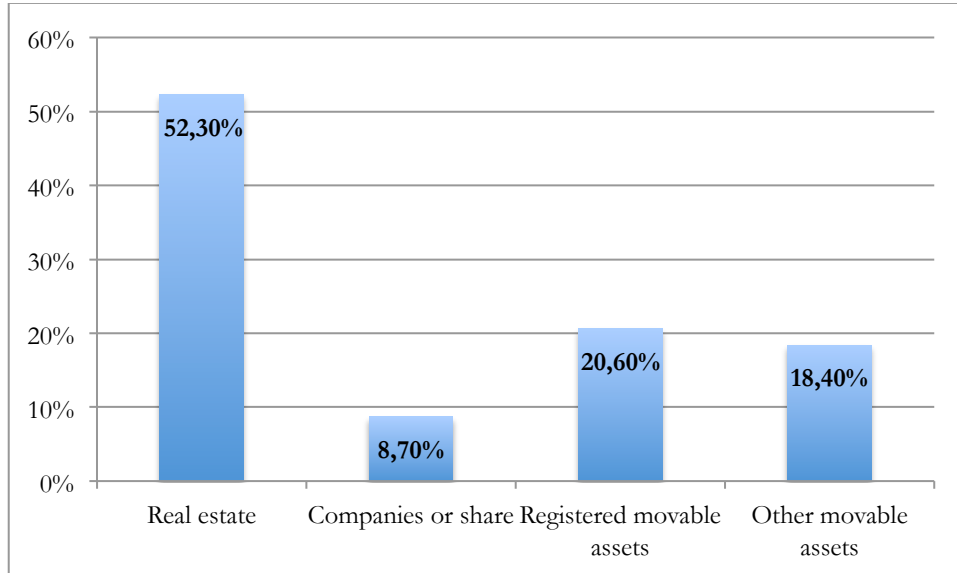


Figure 2: Organised crime investment based on confiscated assets from 1983 to 2012 (N = 19991). Source: PON Sicurezza.

It is visible how real estate is an extensively used sector, showing a different trend compared to other countries<sup>47</sup>. These outcomes should be taken into consideration when dealing with AML regulations in Italy.

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<sup>47</sup> PON, pp. 88-93.

### 3.3.2 AML Regulations in Italy

The strong connection between money laundering and organised crime make it an extremely sensitive topic for Italy. The fight against organised crime has always been an Italian domestic issue, even before the international raise of awareness to the issue of transnational organised crime. Thus, in order to understand the evolution and choices of the Italian legislator on the matter of money laundering, the whole picture of domestic regulations to fight organised crime has to be widely taken into consideration. In particular, the trend of the Italian legal system has been that of trying to provide an ever-changing set of rules that took into considerations the renovated need to discipline an extremely dynamic phenomenon<sup>48</sup>. This way of approaching the criminalisation of organised crime, thus providing an extremely variable and detailed series of cases in point, have hardly influenced also the behaviour towards AML policies.<sup>49</sup>

AML regulation in Italy developed within the context of organised crime repression and it is first recognisable in the Law 18 May 1978, n. 191<sup>50</sup>. This law introduced in the Penal Code the Article 648-*bis*<sup>51</sup>, which criminalised the “substitution of money or values”<sup>52</sup> deriving from certain crimes obtained from crimes such as robbery with violence, extortion with violence and kidnapping for ransom<sup>53</sup>.

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<sup>48</sup> A. Scialoja and M. Lembo, *Antiriciclaggio*, Maggioli Ed, 2013, p. 72.

<sup>49</sup> *Ibid.*, pp. 72-73.

<sup>50</sup> *Norme penali e processuali per la prevenzione e la repressione di gravi reati*.

<sup>51</sup> *Sostituzione di denaro o valori provenienti da rapina aggravata, estorsione aggravata o sequestro di persona a scopo di estorsione*.

<sup>52</sup> Even if the term “money laundering” was not used. *Sostituire denaro o valori provenienti dai delitti di rapina aggravata, di estorsione aggravata o di sequestro di persona a scopo di estorsione*.

<sup>53</sup> Art. 648-*bis* as of 1991.

The first attempt to regulate and impose the identification and control over customers by relevant actors, has to be found at Art. 13 of the Law 16 February 1980, n. 15<sup>54</sup>. This law was the first so-called “*antimafia* law” and regulated that persons that undertake operations of payment, deposit, cashing or withdrawal for sums bigger than L. 2 000 000<sup>55</sup> by civil service, post offices, companies or credit institutes, have to be identified by the operators working in those institutions and in charge of the operation.<sup>56</sup>

In 1990 the second *antimafia* law was promulgated<sup>57</sup>, changing Art. 648-*bis* of the Penal Code and introducing for the first time the term money-laundering (i.e. *riciclaggio*). Moreover, the law introduced Art. 648-*ter*<sup>58</sup>, which criminalised the employment of money coming from a criminal conduct. Thus, the concept of money-laundering in the Italian legislation became a twofold one, including both the substitution and the employment of the proceed of criminal activity<sup>59</sup>. Furthermore, Art. 13 dealing with the primitive development of customer identification was improved extended the duty of identifying customers to all the subjects that were undertaking an financial transaction<sup>60</sup>.

The Law 197/1991<sup>61</sup> was the first important legal intervention against money laundering within the Italian legislation<sup>62</sup>. It was structured in such a

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<sup>54</sup> *Misure urgenti per la tutela dell'ordine democratico e della sicurezza pubblica.*

<sup>55</sup> Corresponding to about EUR 1 000 today.

<sup>56</sup> Art. 13 L. 6 February 1980, n. 15 translated by the author; Scialoja and Lembo, op. cit., p. 72.

<sup>57</sup> Law 19 March 1990, n. 55 *Nuove disposizioni per la prevenzione della delinquenza di tipo mafioso e di altre gravi forme di manifestazione di pericolosità sociale.*

<sup>58</sup> *Impiego di denaro, beni o utilità di provenienza illecita.*

<sup>59</sup> Scialoja and Lembo, op. cit., p. 75.

<sup>60</sup> *Chiunque compie operazioni che comportano trasmissione o movimentazione di mezzi di pagamento di qualsiasi tipo.*

<sup>61</sup> The law was later changed with some legal provisions above which it is worth mentioning: legislative decree 1 September 1993, n. 385, legislative decree 26 May 1997, n. 328, legislative decree 25 September 1999, n. 374, legislative decree 20 February 2004, n. 56, legislative decree 56/2004 .

way to provide certain limitations of action within the financial and economic sectors, when dealing with the employment of cash, the use of bearer's bankbook and other payment methods<sup>63</sup>; and to impose some duties on relevant actors, such as customer identification, transactions record keeping, methods of information gathering and storing, report of suspicious operations<sup>64</sup>.

Italy can be considered a forerunner in AML regulation, both because money laundering has been considered a crime since 1978<sup>65</sup>, and because the offence has been related to different type of criminal conducts and not just to drug trafficking. In particular, money laundering as presented in 1978 could be associated with the offences of robbery with violence (*i.e. rapina aggravate*), extortion (*i.e. estorsione*), kidnapping (*i.e. sequestro di persona*) and drug trafficking (*i.e. drug trafficking*). This initially original framework later on presented some problems in relation to its diversity with the international recommendations (once other type of criminal conducts were introduced), especially<sup>66</sup>. Thus, the Article was modified with the Law 9 August 1993 n. 328, which made it coherent and consistent with international standards<sup>67</sup>. Thus, according to this new approach, in order to commit the crime of money laundering, it needs to be proven that the subject acted voluntarily (*i.e. dolo generico*) and not necessary with the intent to gain profits from it (*i.e. dolo specifico*)<sup>68</sup>. While Art. 648-*bis* criminalises the management of proceeds of criminal activities, Art. 648-*ter* states that also the employment and use of such illegal profits is punishable.

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<sup>62</sup> Scialoja and Lembo, op. cit., p. 73.

<sup>63</sup> *Ibid.*, p. 93.

<sup>64</sup> *Ibid.*, pp. 92-93.

<sup>65</sup> Even if with a different wording, in the Art. 648-*bis* Penal Code since the law n. 191 of 1978.

<sup>66</sup> Scialoja and Lembo, op. cit., p. 95.

<sup>67</sup> *Ibid.*

<sup>68</sup> R. Razzante, "La configurazione del reato di 'riciclaggio'", in *La regolamentazione antiriciclaggio in Italia*, Giappichelli Ed., 2011, p. 4.

This Article was first introduced with the Law n. 55/1990 and further modified by the law n. 328/1993.

Money laundering is defined and criminalised with two different Italian legal instruments: the Penal Code and the Legislative Decree 231/2007. In particular, the conducts punished by the penal code at Art. 648-*bis* are that of substituting (i.e. *sostituzionee*), transferring (i.e. *trasferimento*) or perform other operations (i.e. *compimento altre operazioni*). Thus, with this last definition the legislator wanted to comprise a wide range of acts that, even if did not ultimately translate in the substitution or transfer of criminal proceeds, were intended to do so<sup>69</sup>. Moreover, in the Italian legal system, the crime of money-laundering implies the existence of a presupposed offence which, in the Italian regulation has to be an intentional crime (i.e. *delitto non colposo*).

In the Italian penal code the offence of money-laundering (i.e. *riciclaggio*) is considered a *reato concorsuale e associativo*, thus a crime that has to be committed by a person unrelated to the original unlawful act that produced the economic benefit<sup>70</sup>. Thus, money-laundering is intended just the management of the proceeds of criminal activities. In fact, according to the Italian penal system, the offence of money-laundering is constituted by two stage: the perpetration of a criminal activity which can be conducted by anyone, and the subsequent intervention of another subject, different from the offender of the first stage, who, knowing the criminal origin of the proceeds, manage them by converting, transferring the property<sup>71</sup>, hiding or dissimulating its origin<sup>72</sup>, acquiring, detaining or using the property<sup>73</sup>. The limitation of the Italian penal code approach is that money laundering as an offence can be recognised and

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<sup>69</sup> See Cass. 23 September – 9 November 2005; Scialoja and Lembo, op. cit., p. 80.

<sup>70</sup> Razzante, op. cit., p. 5.

<sup>71</sup> L.D. 2007 at Art. 2(1)(a).

<sup>72</sup> *Ibid.* at Art. 2(1)(b).

<sup>73</sup> *Ibid.* at Art. 2(1)(c).

punished just if the original criminal conduct has been identified<sup>74</sup>. In fact, for the Italian penal system the money laundering charge does not apply to the person that committed the original criminal conduct<sup>75</sup>. In fact, the laundering of the proceeds of the aforesaid offence has to be considered as a not punishable *post factum*<sup>76</sup>. Thus, the subjective element of money-laundering offence has to be different from the one that have committed the criminal conduct that originated the economic outcome laundered<sup>77</sup>.

The main national legal instrument against money laundering in Italy is the legislative decree n. 231 of 21 November 2007, which implemented the Directive 2005/60/EC. Up until that moment, anti-money laundering practices in Italy were regulated by the law n. 197 of 5 July 1991 and by the legislative decree n. 56 of 20 February 2004. The legislative decree of 2007 was further complemented and changed in 2009 with the legislative decree n. 151 of 25 September 2009, because of some considerations done by the Italian financial operators and supervisory authorities after two years of realisation<sup>78</sup>.

The aim of the legislative decree was that of providing a strong legal instrument to prevent money laundering infiltration in the legal economy<sup>79</sup>; so to protect the integrity of the financial and economic system<sup>80</sup>. In order to

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<sup>74</sup> Razzante, op. cit., p. 6.

<sup>75</sup> Art. 648-bis *Fuori dei casi di concorso nel reato*.

<sup>76</sup> Razzante, op. cit., p. 12.

<sup>77</sup> Cass 14 July 1994 “*non configura l’attività delittuosa prevista dagli articoli 648-bis e 648-ter codice penale l’impiego nelle proprie attività economiche del denaro ricavato dal traffico di sostanze stupefacenti svolto dal medesimo soggetto*”.

<sup>78</sup> Scialoja and Lembo, op. cit., pp. 90-95.

<sup>79</sup> From Article 3 of the Legislative Decree 231/2007 “to prevent the carrying out of money laundering transactions and terrorist financing” (*per prevenire e impedire la realizzazione di operazioni di riciclaggio o di finanziamento del terrorismo*).

<sup>80</sup> At Art. 2(5) of the Legislative Decree 231/2007 “In order to prevent use of the financial system and the economy for the purpose of money laundering and terrorist financing, this decree lays down measures aimed at safeguarding these systems’ integrity and proper conduct”.



prevent the use of the financial system and the economy for the purpose of money laundering and terrorist financing, this decree lays down measures aimed at safeguarding these systems' integrity and proper conduct<sup>81</sup>. Coherently with the international and regional recommendations, the 2007 decree provides a definition of "relevant persons", investing them with different degree of awareness, and giving them the responsibility to collaborate to prevent and fight money laundering<sup>82</sup>. Moreover, extra-responsibility is given by this Decree to control and surveillance authorities, conferring especially on the UIF, determined within the Bank of Italy, (i.e. *Banca d'Italia*), the professional associations and to the *Guardia di Finanza*<sup>83</sup>.

The 2007 Decree introduced for the first time also an administrative definition of money laundering, so to target the issue in a preventive manner<sup>84</sup>. Article 2 provides in fact a definition of money laundering which includes the intentional "conversion or transfer of property"; "hiding or dissimulating the real nature", "acquisition, detention or use of property" and the "participation" in one of the abovementioned activities.

In the Italian legislative framework, the mental element necessary to apply anti-money laundering regulations, is treated similarly to international and European recommendations. In particular, Art. 2(3) states that:

The knowledge, intention or purpose that must be an aspect of the actions referred to in paragraph 1, may be inferred from objective factual circumstances"

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<sup>81</sup> See also Art. 2(5).

<sup>82</sup> Circolare GdF, p. 46.

<sup>83</sup> Art. 5 of the Legislative Decree 231/2007.

<sup>84</sup> Circolare GdF, p. 15.

The term “objective factual circumstances<sup>85</sup>” in the Italian legal system is considered a series of circumstantial evidences so serious and unequivocal that imply the logic conclusion of the certainty<sup>86</sup>.

As far as customer identification duties, the 2007 Legislative Decree introduced customer due diligence obligations for operators, developing it on a three levels stage: standard, simplified and enhanced due diligence<sup>87</sup>. Customer due diligence responsibilities are treated in the Decree coherently with the international and regional trends and guided by the risk-based approach. In particular, the elements to be considered in order to determine whether a customer is risky are juridical nature, the prevalent activity performed and the behaviour kept during the management of the operation and when entering into the business relationship<sup>88</sup>.

The Law 30 July 2010 n. 122<sup>89</sup> introduced few interesting novelties in the AML legislative framework. The main one is the introduction of a *black list* of risky countries compiled by the Minister of Economics and Finance. This means that financial operators and other relevant persons cannot engage in relationships with subjects that are part of trust companies, trusts, anonymous companies or controlled through shares to shareholders with premises in black-list countries<sup>90</sup>.

The Decree invested with more responsibilities not just the private sector represented by the relevant persons, but also the public one. In fact, the Minister of the Economy<sup>91</sup> (through the Comitato di Sicurezza Finanziaria –

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<sup>85</sup> In Italian “*indizi*”.

<sup>86</sup> Sentenza sez VI 1995 9090.

<sup>87</sup> Title II Item I Arts. 15-24.

<sup>88</sup> See chapter 4 for further information of CDD regulations in Italy.

<sup>89</sup> *Misure urgenti in materia di stabilizzazione finanziaria e di competitività economica*.

<sup>90</sup> M. D’Agostino, *Antiriciclaggio. Vademecum per l’operatore*, Bancaria Ed., 2014, p. 164.

<sup>91</sup> L. Starola, *Antiriciclaggio (D. lgs. 231/2007) Linee guida per l’adeguata verifica della clientela*, Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili, Aprile 2010, p. 6.

CFS) is invested with political responsibilities, the surveillance authorities (Banca d'Italia, Consob, Isvap) have to supervise the observance of the regulations of their members and stipulate the internal regulations, guidelines and procedures of their group, the Financial Intelligence Unit (Unità d'Informazione Finanziaria) which functions as a link between the private and public sectors and as a coordinator at the national, regional and international level<sup>92</sup>.

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<sup>92</sup> Castaldi, *op. cit.*, p. 6-7.



## CHAPTER 4 - Customer due diligence in UK and Italy

### 4.1 Customer due diligence approach in UK

Customer due diligence came into force in UK, as it is covered today, within the context of risk-based approach that, even if just begun around 2005 with FATF Recommendations, is now widely and extensively applied in United Kingdom<sup>1</sup>. The Money Laundering Regulations 2007 provide an extensive control and regulation of CDD practices, placing great degree of responsibility on “relevant persons”<sup>2</sup>.

The approach on CDD is based on three levels of awareness, the standard DD, which is exercised in all situations but the one requiring a specific consideration, the simplified DD and the enhanced DD. These last two are specifically covered and explained according to a classification and definition, which is coherent with the international and regional standards<sup>3</sup>.

The CDD burdens in the Regulations include customer identification, beneficial owner recognition and the achievement of knowledge on the “purpose and intended nature of the business relationship”<sup>4</sup>. Moreover, a specific and extensively explained set of definitions and provisions is dedicated to the definition of “beneficial owner” and to the tasks to be covered when considering “on-going” monitoring.

Customer due diligence is regulated in the UK legal system by Money Laundering Regulations 2007 which dedicate the whole Part 2 to its discipline. Recommendation 5 that defines what actions CDD practice comprises.

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<sup>1</sup> Booth et al., op. cit., p. 206.

<sup>2</sup> In particular, Part 2 of the Regulations, from Reg. 5 to 18, is dedicated to CDD practices.

<sup>3</sup> Booth et al., op. cit., p. 22-23

<sup>4</sup> Money Laundering Regulations, Reg. 5(c).

Specifically, the identification and verification of the identity of the customer and of the beneficial owner, and the acquisition of information on the “purpose and intended nature of the business relationship<sup>5</sup>”. The first issue in the implementation of the European Directive arises when regulating the concept of “beneficial owner” due to the difference in ruling of the Trust in the UK<sup>6</sup>. This is the reason why the concept of “beneficial owner” is extensively and explicitly regulated in the Regulations to which the whole Regulation 6 is dedicated. In particular, distinctions are made between the BO of a body corporate<sup>7</sup>, of a partnership<sup>8</sup>, of a trust<sup>9</sup> and of a legal entity or a legal arrangement not previously specified<sup>10</sup>. According to this specific discipline, in case of trusts, the relevant person is not ordered to identify all the members of the group<sup>11</sup>, but should act the relevant control and identification procedure “on a risk-sensitive basis<sup>12</sup>”. Another exception applied to trust is that relevant persons do not have to apply customer due diligence when their customer is a trustee of debt issues<sup>13</sup>, specifically, trustee are not asked to ascertain the BO of the instruments<sup>14</sup>.

Customer due diligence practices have to be conducted on a regular basis, starting from the day in which the business relationship<sup>15</sup> begun. In particular, the term “on-going monitoring” is used in the Regulations 2007 and means that a careful examination of the business relationship with the customer has to be conducted throughout its whole existence, paying

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<sup>5</sup> Money Laundering Regulations at Reg. 5(c).

<sup>6</sup> Booth et al., op. cit., p. 211.

<sup>7</sup> *Ibid.*, at Reg. 6(1).

<sup>8</sup> *Ibid.*, at Reg. 6(2).

<sup>9</sup> *Ibid.*, at Reg. 6(3).

<sup>10</sup> *Ibid.*, at Reg. 6(6).

<sup>11</sup> *Ibid.*, at Reg. 7(4).

<sup>12</sup> *Ibid.*, at Reg. 7(3)(a).

<sup>13</sup> *Ibid.*, at Reg. 12.

<sup>14</sup> Booth et al., p. 212

<sup>15</sup> *Ibid.*, at Reg. 7(a).

attention that operations are consistent and coherent with the information in possession about the customer<sup>16</sup>. Moreover, the on-going monitoring comprehend “keeping the documents, data or information obtained for the purpose of applying customer due diligence measures up-to-date<sup>17</sup>”. Thus, relevant persons have the duty to collect and keep in an accessible database the identification information retrieved<sup>18</sup>

These measure of control on customers have to be taken by the relevant person when a new business relationship starts, when he is engaged in an occasional operation<sup>19</sup> with a customer, when he has a suspicion that a money laundering action is taking place, and when he nourishes doubts on the truthfulness of the data regarding the identity of the customer collected<sup>20</sup>. It is interesting to point out that in case a relevant persons suspect of a money laundering involvement of a customer, CDD measures extent to disclosure and report duties covered by the more stringent provisions of POCA rather than those of the Regulations 2007<sup>21</sup>.

#### *4.1.1 Relevant Persons*

In the UK AML legal framework, the regulated sectors with customer due diligence duties are constituted by the a series of “relevant persons” when these subjects are conducting business within the United Kingdom.<sup>22</sup> To be specific, these subjects towards whom the Regulations apply are “credit and

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<sup>16</sup> Money Laundering Regulations at Reg. 8(1)(a).

<sup>17</sup> *Ibid.*, Reg. 8(1)(b).

<sup>18</sup> Booth et al., op. cit., p. 234.

<sup>19</sup> The occasional transaction has to be for an amount of EUR 15 000 or bigger.

<sup>20</sup> Money Laundering Regulations, at Reg. 7.

<sup>21</sup> POCA s. 330, in particular the disclosure has to be done to a nominated officer or an authorised person of the SOCA.

<sup>22</sup> Money Laundering Regulations at Reg. 3.

financial institutions, auditors, insolvency practitioners, external accountants and tax advisers, independent legal professions, trust or company service providers, estate agents, high value dealers, and casinos<sup>23</sup>”. These actors are people burden with the responsibility of being in the front line to prevent and detect potential money laundering operations<sup>24</sup>. The definition of relevant persons managed by the Money Laundering Regulations 2007 is coherent with the broader view of FATF Recommendations 2012, which recognised certain businesses and professions particularly at risk of being exploited for money laundering purposes<sup>25</sup>.

The primary task of these relevant persons is that of taking customer due diligence measures<sup>26</sup>, but they are also invested by the Regulations with other responsibilities. In particular, of managing on-going checks on the business relationships with their customers<sup>27</sup>; of storing the records of relevant operations and information of business relationships<sup>28</sup>; of reporting suspicious operations<sup>29</sup>. Thus, relevant persons need to be continuously informed and aware of the conditions of their business relationship.

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<sup>23</sup> *Ibid.*, Reg. 3.

<sup>24</sup> Booth et al., op. cit., p. 200.

<sup>25</sup> *Ibid.*, p. 200.

<sup>26</sup> Since CDD actions are the first contact with a potential money laundering operations

<sup>27</sup> Money Laundering Regulations at Reg. 8.

<sup>28</sup> *Ibid.*, Reg. 19.

<sup>29</sup> *Ibid.*, Reg. 20.



#### 4.1.2 Simplified CDD

Besides standard DD, the Regulations provide for situations in which, according to the level of risk, simplified customer due diligence may apply<sup>30</sup>. Simplified CDD applies on a risk-based analysis that could classify both low risk customers and low risk products<sup>31</sup>. The low-risk elements on the customer side applies when the subject is a credit or financial institution regulated by Third EU Directive<sup>32</sup>; is a company with guarantees recorded on a controlled market with specific publishing of information duties<sup>33</sup>; is an “independent legal professional operating a client account<sup>34</sup>”; is a public authority within the UK<sup>35</sup> or a non-UK one with public responsibilities “pursuant to the Treaty on the European Union, the Treaties on the European Communities or Community secondary legislation<sup>36</sup>”. Thus, simplified due diligence measures apply to a set of customers that, for their legal nature, are provided with identification documents with a higher level of guarantee. On the side of products, the commodities that require just simplified due diligence are life insurance with low premium<sup>37</sup> or pension schemes with contract without surrender clause<sup>38</sup>; low value electronic money<sup>39</sup>; and child trust fund<sup>40</sup>. In order to understand whether a country has

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<sup>30</sup> *Ibid.*, Reg. 13(1).

<sup>31</sup> Booth et al., op. cit., p. 218.

<sup>32</sup> 2005 EU Directive.

<sup>33</sup> Money Laundering Regulations at Reg. 13(3).

<sup>34</sup> Booth et al., op. cit., p. 218; Rec. 13(4)

<sup>35</sup> *Ibid.*, Reg. 13(5).

<sup>36</sup> *Ibid.*, Schedule 2 Reg. 2(a).

<sup>37</sup> No more than 1,000 euro for annual premium and no more than 2,500 euro for single premium; Rec. 13(7)(a).

<sup>38</sup> Money Laundering Regulations Reg. 13(b).

<sup>39</sup> In particular, no more than 150 euro for non-rechargeable cards and with a limit of 2,500 euro for transaction a year if it is a rechargeable mean.

<sup>40</sup> Money Laundering Regulations Reg. 13(9).

a similar AML regulation, the European Commission provides a record of countries with equivalent anti-money laundering regulation<sup>41</sup>.

Simplified due diligence consists in just gathering the information necessary to recognise and classify the customer or product as qualified to this CDD measures. Once this is done, the relevant person does not need to investigate the purpose and nature of the operations and does not have to ascertain the beneficial owner of such business relationship. Under simplified due diligence, a relevant person will be required to apply subsequent standard CDD measures and on-going supervision just in case he will suppose in future that the customer is involved in money laundering transactions<sup>42</sup>. Therefore, products worth simplified DD have specific characteristics of either being tied to other controlled services, or of being bound to low value transactions.

#### *4.1.3 Enhanced CDD*

Enhanced due diligence measures are, on the contrary, extra control provisions that apply on a risk-sensitive basis to customers of operations considered in danger of money laundering penetration. The situations considered at a high risk, thus requiring extra CDD measures, occur when the customer is not physically present to be identified<sup>43</sup>, when the correspondent is a credit institution that “has or propose to have a correspondent banking relationship with a respondent institution (‘the respondent’) from a non-EEA state”<sup>44</sup>; or the customer manifests the intention to undertake a business

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<sup>41</sup> This list is available at: [http://ec.europa.eu/internal\\_market/company/docs/financial-crime/3rd-country-equivalence-list\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/financial-crime/3rd-country-equivalence-list_en.pdf) accessed on 18/08/2014.

<sup>42</sup> Law society webpage <http://www.lawsociety.org.uk/> as accessed 18/08/2014.

<sup>43</sup> Money Laundering Regulations Reg. 14(2).

<sup>44</sup> Money Laundering Regulations Reg. 14(3) so with a state with different AML binding Regulations.

relationship or a casual transaction with a politically exposed person<sup>45</sup>. Moreover, the Regulations provide for a clause that establishes that enhanced due diligence measures can be applied “in any other situation which by its nature can present a higher risk of money laundering or terrorist financing<sup>46</sup>”. This may include, for example, operations involving risky jurisdictions<sup>47</sup>. For this purpose, both the Financial Action Taskforce at the international level and the HM Treasury at the domestic level, supply a list of jurisdiction considered at risk of money laundering operations<sup>48</sup>.

When enhanced due diligence measures apply, the relevant person shall consider whether it is suitable to investigate more carefully on the customer and beneficial owner identification. This should be done both by obtaining information on the ownership, on the structure of the business involved, and of the purpose of the business relationship, soliciting the provision of extra information. Moreover, relevant persons have to maintain a constant monitoring throughout the whole business relationship. In particular, in case the customer is not present for physical identification, the relevant person shall employ compensatory initiatives to lower the risk of money laundering and gathering extra information on the identity of the customer<sup>49</sup>. In case of “correspondent relationship”, the relevant person is required to acquire information on the actual nature of the business relationship, to ascertain and

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<sup>45</sup> Money Laundering Regulations Reg. 14(4).

<sup>46</sup> [http://www.lawsociety.org.uk/Reg. 14\(1\)\(b\)](http://www.lawsociety.org.uk/Reg.14(1)(b)).

<sup>47</sup> Law Society Website, thus, risky jurisdictions that are indirectly involved in the transactions for which the previous provisions do not apply .

<sup>48</sup> The UK one is available at: <https://www.gov.uk/government/publications/preventing-money-laundering>, so *black-list*.

<sup>49</sup> Booth et al., op. cit., p. 219; this shall be done by “(a) ensuring that the customer’s identity is established by additional documents, data or information; (b) supplementary measures to verify or certify the documents supplied, or requiring confirmatory certification by a credit or financial institution which is subject to the money laundering directive; (c) ensuring that the first payment is carried out through an account opened in the customer’s name with a credit institution”.

establish the reputation of the respondent from “publicly-available information”<sup>50</sup>; evaluate AML controls, get the approval from a senior manager before establishing the risky business relationship, understand and record the responsibilities of all parts.

Finally, in case of politically exposed persons extra considerations need to be done. First of all, by politically exposed persons, the Regulations intend people that have “prominent public functions<sup>51</sup>”, their immediate family members and their close associates. Furthermore, the rationale behind requiring extra identification and on-going monitoring measures for this kind of people has to be found in the Third Money Laundering Directive which, in the preamble states that subjects holding important political position, especially in countries with a high level of corruption, “may expose the financial sector in particular to significant reputation and/or legal risks<sup>52</sup>”. In particular, the extra control measures that have to be taken when dealing with PEPs are the obtainment of approval from senior management before starting the risky business relationship<sup>53</sup>; carefully investigate on the origin of the property and funds implicated in the transaction<sup>54</sup>; and manage an on-going monitoring of the operations throughout the whole business relationship<sup>55</sup>. In

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<sup>50</sup> Money Laundering Regulations Reg. 14(3)(b).

<sup>51</sup> In particular, (i) heads of state, heads of government, ministers and deputy or assistant ministers.

(ii) members of parliaments;

(iii) members of supreme courts, of constitutional courts or of other high-level judicial bodies whose decisions are not generally subject to further appeal, other than in exceptional circumstances;

(iv) members of courts of auditors or of the boards of central banks;

(v) ambassadors, *chargés d'affaires* and high-ranking officers in the armed forces; and

(vi) members of the administrative, management or supervisory bodies of state-owned enterprises from Regulations 2007 Schedule 2.

<sup>52</sup> Paragraph 25 of the Preamble to the 2005 EU Directive.

<sup>53</sup> Money Laundering Regulations Reg. 14(4)(a).

<sup>54</sup> *Ibid.*, Reg. 14(4)(b).

<sup>55</sup> *Ibid.*, Reg. 14(4)(c).

general, enhanced due diligence measures aim at raising potential risk awareness in the relevant person, so to force him to apply extra care in acquiring truthful and extensive information on customer and operations. These measures could translate into the simple extra provision of documentations, or with a suspicious operation report (SAR) to the competent authority.

#### *4.1.4 Consequences for non-compliance with the Regulations*

A relevant person has to apply the appropriate CDD approach (simplified, standard, enhanced) and according to the level of potential risk. If he is not able to employ customer due diligence actions, he shall not carry out a business relationship with that client and, in case a relationship is already in progress, he should terminate it<sup>56</sup>. Moreover, POCA regulation determines the disclosure mechanisms that apply to the regulated sector<sup>57</sup>. Which means that relevant person's responsibilities do not end by terminating the business relationship, but in case he suspects an actual money laundering involvement, he shall report it to the competent authority.

Failing to comply with anti-money laundering regulations in UK could lead to disciplinary and criminal consequences; a whole part of the Recommendations is dedicated discipline enforcement from the part of designated authorities. Behaviours that fail to comply with anti-money laundering regulations may cause disciplinary actions that range from an order to comply, to a sanction, to an imprisonment term. The penalties management is controlled by the supervision authority in charge of the

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<sup>56</sup> Money Laundering Regulations Reg. 11(1).

<sup>57</sup> Thus, professions and activities disciplined by that AML regulations.

relevant person in question and disciplined by the relevant set of rules (POCA, Money Laundering Regulations *ad hoc* guidance). In particular, this consequences could materialise in warning letters; initial penalty followed by an increased one in the of a continuative non-compliance; removal from the fit and proper status for specific individuals involved in MSBs and TCSPs, meaning that they could not exercise duties requiring the passing of such tests; nullification of a business registration; a criminal investigation and subsequent prosecution eventually leading to a sanction, possibly a fine, community service or prison sentence<sup>58</sup>. The CDD regulatory system in UK invest relevant persons with higher responsibility, but also provide them many legal instruments to be relieved from the extra liability<sup>59</sup>.

#### 4.1.5 CDD case law in UK

UK case law involving AML regulations is provided with many sentences. This has to be trace back both to the nature of UK legal system<sup>60</sup>, both to the high number of charges and appeals related to “disclosure mechanisms”. The first case is that of Mr Pattinson, an estate agent and provider of financial services, was convicted of “entering into a money laundering arrangements, contrary to section 328(1) of the Proceeds of Crime Act 2002. Moreover, Phillip John Griffith, a solicitor and friend of Pattinson, was convicted for not having disclosed a suspicious activity when he took the demise of a property bought, as a significantly lessened price, by a friend and associate of him (Mr Pattinson) from a supplier with criminal records. The

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<sup>58</sup> From the HM Revenue & Customs webstie, MLR1PP4200 available at: <http://www.hmrc.gov.uk/manuals/mlr1ppmanual/MLR1PP4200.htm>.

<sup>59</sup> See authorised disclosure in the last paragraph of chapter 4.

<sup>60</sup> Common law.

charge was that of having failed the communication to the authorities of the suspicious transaction going on, as he, as a solicitor, was an actor actively involved in AML operations. He was initially sentenced to 15 months of imprisonment, later reduced to 6 months on appeal and he was stop from practice his profession anymore. In particular, the charge against Phillips John Griffiths was contrary to section 330(1) of the same Proceeds of Crime Act 2002. Specifically, the sentence states that Mr Griffiths “was convicted of failing of make a required disclosure to the authorities, having reasonable grounds for knowing or suspecting that other persons [...] were engaged in money laundering<sup>61</sup>”. This sentence is important because this sentence recognised the principle of customer due diligence for operators which are not financial ones, but that are members of sensitive professions that can be in contact with money laundering operations (such as solicitors). The sentence quotes two other previous cases in which the case issue of “failing to disclose knowledge or suspicion of money laundering”: Duff [2003] 1 Cr App R (S) [2002] EWCA Crim 2117 and McCArtea [2004] NICA 43<sup>62</sup>. In particular, Duff case suggests a resolute line of judgment when dealing with similar cases where a professional is involved, which ultimately has to end with a (even if short in time) period of custody to deter other potential offenders. The sentence recognises as the motive driving the conduct of Mr Griffiths the consequence of a “lapse in the high standards expected of a solicitor in his position rather than a desire to benefit by criminal activity” and in keeping a firm line of judgement in case like this aim at underlying the important of responsibility for actors. This is made clear and explicit in the final lines of the sentence which assert: “we do not leave the case without underlining to all professional people involved in the handling of money and with an

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<sup>61</sup> Sentence at point 5.

<sup>62</sup> Northern Irish case.

involvement in financial transactions the absolute obligation to observe scrupulously the terms of this legislation and the inevitable penalty that will follow failure so to do”.

Another interesting case regulating customer due diligence is that between K Ltd and Westminster Bank Plc EWCA Civ 1039 of 2006. This sentence calls Section 328 of the Proceeds of Crime Act 2002 which regulate “arrangements<sup>63</sup>”. In particular, this was a case in which NatWest, because of a suspect of entering in an arrangement with the involvement of criminal property, advanced, according to the English AML regulation, “authorised disclosure” in order to receive the “appropriate consent” to finalise the suspicious operation. The consent was given within the 31 moratorium period days, but after the 7 working days provided for notice period. In doing so, the bank could not and did not go farther with the transaction in question and the regular business operations with customer (K Ltd) were blocked. The bank refused to execute the transaction when, while waiting for the consent from HM Revenue and Customs, K Ltd requested an “interim injunction” to constrain the Natwest to conduct the operation anyway. K Ltd argued that the bank was contravening their business agreement by refusing to process the transaction when urged to act by the customer. The court adjudicated that the bank was fully acting according to the legal provisions and thus dismiss the accusation of the K Ltd. Here the controversy is the trade-off between the free flow of business activities and the concern to protect the system from potential money laundering infiltration. According to this case, a minimum level of interference with regular business has to be taken into considerations in order to prevent money-laundering invasion of the business world. To say

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<sup>63</sup> According to the Act, “a person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates the acquisition, retention, use or control of criminal property by or on behalf of another person”.



it with the words of the sentence “Parliament has considered that a limited interference is to be tolerated in preference to allowing the undoubted evil of money-laundering to run life in the commercial community”.

These sentences confirm the principles of the risk-based approach, which invest financial intermediaries and other actors<sup>64</sup> with both the responsibility and power to detect and communicate suspicious operations. In particular, the sentence *K Ltd v National Westminster Bank* reaffirms the presence of the element of “suspicion” is sufficient to apply the anti-money laundering measures related to customer due diligence report. Suspicion here consists of the “mental element” of the anti-money laundering law<sup>65</sup>. The crucial role of suspicion in the English legislation is evident also in the Court of Appeal case *R v Da Silva*<sup>66</sup>, in which it was declared, “to have a suspicion means to think that there is a possibility, which is more than fanciful, that the relevant fact exist”<sup>67</sup>. The appeal case *R v Silva* in particular take into consideration suspicion as presented in the section 93A(1)(a) of the Criminal Justice Act 1988<sup>68</sup>, so also in case of an arrangement as explained in *K Ltd v National Westminster Bank* case. Thus, *K Ltd v National Westminster Bank* applied “suspicion” in arrangements as regulate in POCA and *R v Da Silva* applies the same key concept in the framework of the section 93A(1)(a) of the Criminal Justice Act 1988.

The verdict Griffiths & Anor is based on the same key mental element of suspicion but stresses how it is not only in power of actors to have strong instruments to check money laundering, but also part of the job tasks. Nonetheless, the concept of “suspicion” applied here referred to the

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<sup>64</sup> Consider, for example, solicitors.

<sup>65</sup> Booth et al, op. cit., p. 44.

<sup>66</sup> [2007] 1 WLR 303

<sup>67</sup> Booth et al, op. cit., p. 46.

<sup>68</sup> Assisting another to retain the benefit of criminal conduct.

“reasonable suspicion”, in particular it claims section 330 of the POCA where the mental elements can be knowledge, belief or suspect and particularly having “reasonable grounds for knowing or suspecting<sup>69</sup>”. This concept of suspicion is an objective one, and Griffiths and Pattison case is an example of having a reasonable ground to suspect, since is not the subjective element of interpretation of the solicitor in question, but rather the objective concept of him having a suspect. The legal principle behind this interpretation has to be found in the purpose of the new trend of anti-money laundering regulation, which is that of, within a risk-based approach, investing actors with responsibility. This means also training the people involved and that have to judge what is a risky operation and what not, specifically, for example, an objective reasonable ground for knowing or suspecting. Thus, the training precondition is crucially important in anti-money laundering regulation.

#### *4.1.6 Datas*

The National Crime Agency (NCA<sup>70</sup>) publishes every year a Suspicious Activity Reports (SARs) Annual Report, with statistical, descriptive and analysis information on potential money laundering operations reported by relevant actors<sup>71</sup>. The first report was published in 2007<sup>72</sup> and since then the number of suspicious operations reported has been always increasing: from 220,484 SARs in 2007 to 316,527 in 2013. Most of the reports were made

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<sup>69</sup> POCA; Booth et al., op. cit., p. 49.

<sup>70</sup> Before it was named SOCA.

<sup>71</sup> The report is available at <http://www.nationalcrimeagency.gov.uk/publications/94-sars-annual-report-2013/file> as accessed 12/07/2014.

<sup>72</sup> The same year of the publication of the new Money Laundering Regulations.

electronically<sup>73</sup>, demonstrating how this practice facilitates the observance of the report requirement.

From the data and statistic of the SARs it can be noticed how the sectors with more reports are the financial ones (banks, money service businesses and financial services). This could be both a demonstration of a higher presence of money laundering risky operations in these spheres, or a consequence of a better and more consistent regulation of such sectors; or even of a easier access to reporting mechanism for financial institutions.

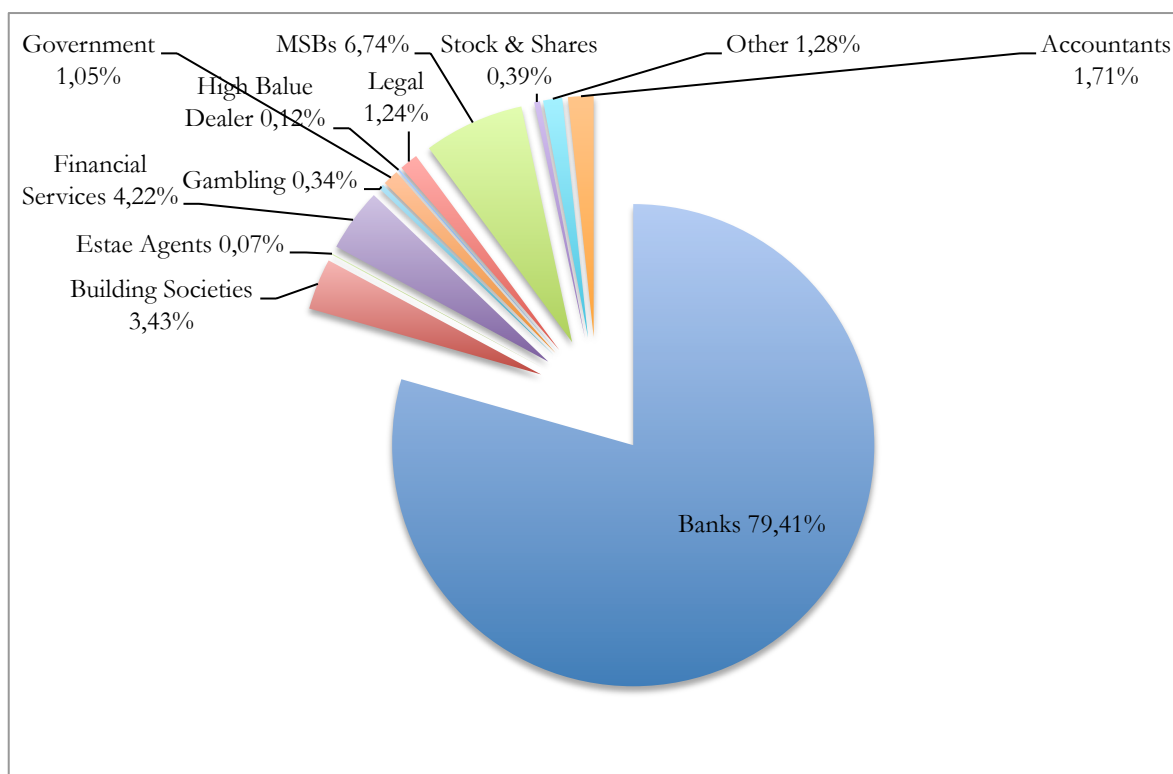


Figure 3: SARs submitted by sector in 2012/2013. Source: SARs Annual Report 2013.<sup>74</sup>

<sup>73</sup> SARs Annual Report 2013, at p. 6 available <http://www.nationalcrimeagency.gov.uk/publications/94-sars-annual-report-2013/file> as accessed on 12/08/2014.

<sup>74</sup> SARs Annual Report 2013, p. 8.

## 4.2 Customer due diligence approach in Italy

Customer due diligence is regulated in Italy in the legislative decree 2007, in line with the contemporary international trend of risk-based approach and investing of responsibility of relevant persons. The Legislative Decree regulates differently customer due diligence for financial intermediaries and other persons engaged in financial activity<sup>75</sup>, for professionals and external auditors<sup>76</sup> and for other persons<sup>77</sup>.

Before the introduction of this legal instrument, customer identification obligations were regulated in the l. 197/1991 at Article 2 and at Articles 2 and 3 of the Legislative Decree 56/2004<sup>78</sup>. The identification duties were classified according to the role of the relevant actors. In particular, the personnel appointed of taking care of the business relationship had to identify the person who performed the operation. Another obligation burdened the person that was carrying out the transaction in case he was not acting on his behalf<sup>79</sup>. Both obligations contributed to the creation of the customer identity, which was then used to understand which transactions and persons were potentially risky<sup>80</sup>. Moreover, identification procedures were outlined and explained by the Regulation UIC 24 February 2006<sup>81</sup> at Regulation 142, which in particular identifies direct identification as the one conducted by financial intermediaries in the presence of the client<sup>82</sup>; indirect identification when the

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<sup>75</sup> L.D. 231/2007 at Art. 15.

<sup>76</sup> L.D. 231/2007 at Art. 16.

<sup>77</sup> L.D. 231/2007 at Art. 17.

<sup>78</sup> Scialoja and Lembo, op. cit., p. 167.

<sup>79</sup> *Ibid.*, p. 167-168.

<sup>80</sup> *Ibid.* at p. 168.

<sup>81</sup> Provvedimento UIC 24 febbraio 2006

<sup>82</sup> L.D. 231/2007 at Art. 6.

client is not physically present but his data can be found in public documentations or in authenticated private official papers<sup>83</sup>; finally on distance identification in case the identity of clients was previously ascertained by other recognised financial institutions<sup>84</sup>.

It is clear to understand the provisions of customer identification in the Italian legal system before the entering into force of the Legislative Decree 231/2007 were much less precise and demanding on the side of financial operators (relevant actors). Nonetheless, the extension of customer identity provisions together with its complexity, render the Italian regulatory system has one that pay a lot of attention and put a lot of efforts in the regulation of know your customer procedures compared to other countries<sup>85</sup>.

Another crucially important innovation of the Legislative Decree of 2007 is that the CDD obligation has to be fulfilled on a regular basis throughout the whole business relationship between the relevant person and the customers<sup>86</sup>. Thus, relevant persons have to adjust their preventive measures of control according to the different level of potential risk that their customers demonstrate<sup>87</sup>. The CDD is thus not the single fulfilment of identification duty at the beginning of a business relationship, but rather the permanent rule of conduct to fulfil throughout the whole business relationship<sup>88</sup>. With this new approach is not just a single suspicious operation that should raise awareness on potential money laundering undergoing operations, but divergences and anomalies from the regular functioning. In this framework, reporting a suspicious operation to the authorities is not

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<sup>83</sup> Scialoja and Lembo, op. cit., p p. 168; L.D. 231/2007 at Art. 7.

<sup>84</sup> L.D. 231/2007 at Art. 8.

<sup>85</sup> Castaldi, op. cit., p. 5.

<sup>86</sup> *Ibid.*

<sup>87</sup> *Ibid.*

<sup>88</sup> *Ibid.*

considered the report of an offence, but rather the collaboration between different subjects in the public fighting of money laundering<sup>89</sup>.

It is particularly interesting the notion of responsibility the emerged from the Legislative Decree 231/2007 from the combined interpretation of provisions set in Article 19<sup>90</sup> and 21<sup>91</sup>. Article 19 explains the responsibility of relevant actors that have to take appropriate measures to properly identify their customer. Whereas Article 21 disciplines the duties of customers themselves, that have to collaborate and provide all the answers and information needed<sup>92</sup>. In case relevant persons are not capable of provide the identification information necessary<sup>93</sup>, they have to abstain from engaging in a business relationship with that customer<sup>94</sup>.

The execution of CDD duties is extremely important one since it is the first one in action when a business relationship starts and also because, in case of collateral evidence, it could trigger a series of other preventive, protective and repressive measures<sup>95</sup>.

An important instrument for the execution of anti- money laundering provisions is the regulation issued by the Bank of Italy in 2011: “Measures regarding the execution of organizational, procedural and internal auditing for the prevention of laundering and terrorist financing through the utilization of intermediaries or other subjects, as per section 7, paragraph 2 of the legislative decree dated 21st November 2007, n.231”. Later on, the *Istruzioni in materia di adeguata verifica della clientela* promulgated by the Bank of Italy in April 2013

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<sup>89</sup> *Ibid.*, p. 6.

<sup>90</sup> Manner of satisfying the requirements (of customer due diligence) – *Modalità di adempimento degli obblighi*.

<sup>91</sup> Obligations of the customer – *obblighi del cliente*.

<sup>92</sup> D’Agostino, op. cit., p. 30-31.

<sup>93</sup> According to the level of diligence required by the specific situation (i.e. standard, simplified, enhanced).

<sup>94</sup> D.L. 231/2007 at Art. 23 Obligation to refrain - *obbligo di astensione*.

<sup>95</sup> D’Agostino, op. cit., p. 27.

assign to financial intermediaries the role of detecting potential risky operations and especially potential risky customers by checking the existence of criminal proceedings pending on the customer or on his relatives<sup>96</sup>. These provisions, even if do not burden the financial sector with excessive investigative burdens, still provide it with a lot of responsibility and concern. Moreover, the Bank of Italy adopted on 3 April 2013<sup>97</sup> a pronouncement on CDD measures following Section 7(2) of the Legislative Decree 231/2007; and a regulation on the keeping of the Single Financial Transactions Database (SFTD)<sup>98</sup> which follows Section 37(7)(8) of the Legislative Decree. The Bank of Italy issued these measures after having heard CONSOB and the Italian insurance market regulator<sup>99</sup>.

The CDD approach in Italy is fully regulated in the Legislative Decree 231/2007 according to the Third Directive and its execution is further improved by the Regulations of the Bank of Italy. In particular, since the CDD approach has to be conducted by analysing the risky factors, the Bank of Italy Regulations offer a strong guideline to help relevant actors assessing the risk of specific operations or customers, especially for banks<sup>100</sup>. The

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<sup>96</sup> L. Donato, A. Saporito, A. Scognamiglio, “Aziende sequestrate alla criminalità organizzata: le relazioni con il sistema bancario - Questioni di Economia e Finanza, Banca D’Italia no. 202 Settembre 2013, p. 21, available at [https://www.bancaditalia.it/pubblicazioni/econo/quest\\_ecofin\\_2/qef202/QEF\\_202.pdf](https://www.bancaditalia.it/pubblicazioni/econo/quest_ecofin_2/qef202/QEF_202.pdf) as accessed on 12/08/2014.

<sup>97</sup> Published in the Official Gazette 7 May 2013, no. 105, come into force on 1 January 2014.

<sup>98</sup> *Archivio Unico Informatico*.

<sup>99</sup> *Istituto per la Vigilanza sulle Assicurazioni, IVASS*; Giovanni Carotenuto, “Recent Developments in the Italian Anti-Money Laundering Legislations available at: <http://www.mondaq.com/unitedstates/x/288818/Financial+Services/RECENT+DEVELOPMENTS+IN+THE+ITALIAN+ANTIMONEY+LAUNDERING+LEGISLATION> accessed on 08/10/2014.

<sup>100</sup> L. Borlini, “EU Anti-money Laundering Regime: An Assesment within Intenrational and National Scenarios”, *Paolo Baffi” Centre on Central Banking and Financial Regulation*, Paper Series No. 2012-125, available at <http://ssrn.com/abstract=2144122> as accessed on 17/08/2014.

banking system in fact is provided also with IT instruments that help operators to assess potentially risky operations<sup>101</sup>.

#### *4.2.1 Relevant persons*

The Legislative 231/2007 make a distinction between “persons covered by the decree”<sup>102</sup>, and relevant persons for the sake of customer due diligence obligations. In fact, this second category of actors is disciplined specifically within Title II Chapter I (Customer due diligence). Moreover, different type of customer due diligence obligations are provided for different actors. In particular “financial intermediaries and other persons engaged in financial activity” have to apply the CDD conditions regulated at Article 15. Specifically, the kind of CDD measures that financial intermediaries have to take are similar to those already explained within the Third Directive and FATF framework<sup>103</sup>. Thus, in case of a continuous relationship or occasional transaction for amount higher than EUR 15 000; when suspecting money laundering involvement and when the identity of the customer is regarded as false<sup>104</sup>.

What is different within the Italian legislative framework, though, is that different customer due diligence requirements are explicitly applied to distinct relevant persons. Thus, Article 16 discipline the conditions for the application of CDD for professionals and external auditors that have to deal with the provisions when executing their job in case there are payments bigger

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<sup>101</sup> See for example GIANOS (Generatore indici di anomalia per operazioni sospette – Generator of anomaly indices for suspects operations).

<sup>102</sup> Disciplined in D.L. 231/2007 at Art. 10.

<sup>103</sup> Very similar and coherent with the one explained at p.

<sup>104</sup> D.L. 231/2007 Art. 15.



than EUR 15 000 involved or of undefined amount; or for financial intermediaries, when they suspect money laundering involvement or are not sure about the customer identity<sup>105</sup>. Finally, the Legislative Decree provides CDD requirements for so-called “other persons<sup>106</sup>”. Specifically, these “other persons” shall meet CDD requirements when instituting a continual business relationship with a customer, when involved in a occasional operation involving amount of money bigger than the threshold of EUR 15 000, and clearly, when suspecting money laundering involvement and when the identity of the customer is regarded as false.

Italian regulations thus provide explicitly specific CDD requirements for different types of relevant persons, binding professional orders and similar entities and associations with specific law requirements to abide. The Italian legal framework provides a differentiated treatment of CDD measures for different “relevant actors”.

#### *4.2.3 Simplified due diligence*

Simplified DD is regulated in the L.D. 231/2007 by Article 25 (i.e. *simplified requirements*) and applied to EC financial intermediaries, credit and financial institutions established outside of the EU but with equivalent requirements in terms of AML regulations to those imposed by the Third Directive and so implemented in the Italian system through the Legislative

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<sup>105</sup> D.L. 231/2007 Art. 16.

<sup>106</sup> By “other persons” the decree explains how it refers to Articles 14(1)(a), 14(1)(b), 14(1)(c) and 14(1)(f), thus: persons performing activities in which “is conditional on having the licences or authorisation or being entered in the registers, r on the prior declaration of commencement of activity, specifically required by the provisoins shown next to each activity:” “(a) credit recovery on behalf of third parties, (b) custody and transport of cash and securities or valuables by mean (or (c) without) of sworn private security guards, real-estate brokin

Decree 2007<sup>107</sup>. A list of other financial and insurance products benefits from the same enhanced DD<sup>108</sup>, together with public administration offices or other institutions and organisation operating public functions, coherently with what established by the Third Directive<sup>109</sup>.

#### 4.2.4 *Enhanced due diligence*

Enhanced due diligence measures are disciplined at Article 28 which stipulates that in case the risk of money laundering is greater, the institutions and persons included in the Legislative Decree 231/2007, shall apply extra identification and on-going monitoring measures<sup>110</sup>. These risky situations occurs generally when the customer is not present at the time a new business relationship is established<sup>111</sup>; when a operation is conducted through a correspondent account based on a non-EU financial or credit institution<sup>112</sup>; in case of business relationships with politically exposed persons<sup>113</sup>; operations involving shell banks<sup>114</sup>; any other indicator of riskiness is present. Regarding this last case references are made to the “anomaly indicators” documents published by the Bank of Italy<sup>115</sup>.

#### 4.2.5 *Reporting suspicious operations*

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<sup>107</sup> In particular the literature refers to this “equivalent” countries as member of the *white list*

<sup>108</sup> See D.L. 231/2007 Art. 25(A)(1)(b)(c).

<sup>109</sup> D’Agostino, op. cit., p. 28.

<sup>110</sup> *Ibid.*, p. 28; Scialoja and Lembo, op. cit., p. 297.

<sup>111</sup> D.L. 231/2007 Art. 28(2).

<sup>112</sup> D.L. 231/2007 Art. 28(4).

<sup>113</sup> D.L. 231/2007 Art. 28(5).

<sup>114</sup> D.L. 231/2007 Art. 28(6).

<sup>115</sup> See next paragraph for further information.

The appropriate application of customer due diligence procedures could ultimately lead to the report of suspicious operations to the competent authority, the FIU (Financial Intelligence Unit). Operations in order to be defined as “suspicious” need to be considered mainly under three different elements: the characteristics of the operation, the entity of the operation and its nature. Article 41 of the Legislative Decree 231/2007 regulated the Reporting of suspicious transactions<sup>116</sup> and establishes that the Italian FIU have to periodically issue “anomaly indicators” so to help relevant actors detecting the risky operations. These “anomaly indicators” are currently included in a document issued by the Bank of Italy the 24<sup>th</sup> of August 2010<sup>117</sup>. Moreover, with FIU communication of 24 September 2009 the Bank of Italy provided extra measures to understand the riskiness of specific sectors: companies in crisis and situation of usury involvement<sup>118</sup>.

#### *4.2.6 Consequences for non-compliance with the Regulations*

The Legislative Decree of 2007 provides both penal and administrative sanctions for not complying with its regulations. In particular, criminal penalties are disciplined at Article 55, whereas administrative sanctions are regulated from Article 56 to Article 60 of the Legislative Decree<sup>119</sup>.

The main conducts that imply the application of criminal sanctions are the failing of respecting the provisions concerning customer identification due

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<sup>116</sup> *Segnalazione di operazioni sospette.*

<sup>117</sup> *Provvedimento recante gli indicatori di anomalia per gli intermediari*, Banca d'Italia, Provvedimento 24 agosto 2010.

<sup>118</sup> Comunicazione UIF del 24 settembre 2009. Schemi rappresentativi di comportamenti anomali ai sensi dell'art. 6, co. 7, lett. B) del D.Lgs 231/2007 – imprese in crisi e usura

<sup>119</sup> Scialoja and Lembo, op. cit., p. 306.

diligence<sup>120</sup>; contravening to identify the person in the name of whom an executor is doing an operation, or providing false details on the aforesaid person<sup>121</sup>; not providing information “on the purpose and nature of the continuous relationship or the professional service or who provides false information in this regard”<sup>122</sup>.

Sanctions can be criminal and administrative for both relevant actors and customers. Specifically, Art. 55 paragraphs 1, 5 and 8 discipline criminal sanctions for the relevant person and Article 57 paragraph 4 and Article 58 paragraphs 5, 6 and 7 regulate administrative sanctions for the same subject. On the contrary, Article 55 paragraphs 2, 3 and 9 define the criminal consequences for customers, and Article 58 paragraphs 1, 2, 3, and 8 explain the administrative punitive actions for clients<sup>123</sup>.

The Italian framework of sanctions is extremely complex, not only comparing it with the UK one, but also and foremost, taking as example the Third Directive, regional legal instrument that the Legislative Decree should implement in the Italian legal system. Giovanni Castaldi, director of the Italian FIU explains how criminal sanctions are excessive and inaccurate for they punish leniently subjects, which are easily barred by the statute of limitations<sup>124</sup>. Thus, his suggestion is that of reducing criminal penalties to few cases in point, but with coherent and applicable penalties and to regulate within the administrative framework the other matters in hand<sup>125</sup>. Moreover, Castaldi evidences how even administrative counter measures as they are

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<sup>120</sup> D.L. 231/2007 at Art. 55(1), punished with a fine from EUR 2 600 to EUR 13 000.

<sup>121</sup> D.L. 231/2007 Art. 55(2), punished with imprisonment term form 6 to 12 months and fines from EUR 500 to EUR 5 000.

<sup>122</sup> D.L. 231/2007 Art. 55(3), in this case the punishment is the reclusion from 6 months to 3 years and a fine from EUR 5 000 to EUR 50 000.

<sup>123</sup> Scialoja and Lembo, op. cit., p. 306.

<sup>124</sup> Castaldi, op. cit., p. 10.

<sup>125</sup> *Ibid.* at p. 11.

disciplined today in within the Legislative Decree 2007 framework are not satisfactory. In particular, problems can be found in the fact that today the sanction (and the regulations in general) is based on the responsibility of the natural person rather than in that of the legal person<sup>126</sup>. This could lead into problems especially considering the complex organisation and structures of several companies, which are in the frontline of anti-money laundering prevention mechanisms. Furthermore, other potential issues concern the amount of the pecuniary sanctions. In particular, Castoldi considered them too variables and not proportionate to the obligor<sup>127</sup>.

#### 4.2.7 Italian Case Law

The context of AML case law in Italy is more complex than the on in UK because of the lack of a constituent number of sentences, the presence of much less charges and prosecutions, and the judicial and bureaucratic delays of the Italian system. In fact, the sentences that can be now studies, still apply the regulations in force when the fact occurred, thus previous to the Legislative Decree 231/2007 legal framework. Even if after the legislative decree of 2007, there have been several investigations and prosecutions of employees of banks charged with failure of compliance with anti-money laundering regulations.<sup>128</sup> There are few sentence that can be considered case law, that apply L.D. 231/2007. One sentence worth mentioning is that of the

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<sup>126</sup> *Ibid.* at p. 11.

<sup>127</sup> *Ibid.* at p. 12.

<sup>128</sup> M. Capocci, “La Normativa antiriciclaggio e le sue implicazioni sull’attività lavorativa: una lettura dalla parte del bancario”, p. 1 available at [http://www.fibanovara.it/public/all\\_varie/ANTIRICICLAGGIO.pdf](http://www.fibanovara.it/public/all_varie/ANTIRICICLAGGIO.pdf) as accesse on 12/08/2014.

Supreme Court n. 23017/2009<sup>129</sup>. The regulatory framework of this sentence is that of the law n. 197/1991 because the events took place when this was the law into force. However, since the legislative decree has enriched the previous law without twisting its core meaning and purpose, this sentence can still be used to understand Italian case law trends<sup>130</sup>.

The fact is that in 2001 the Ministry of the Economy enjoined the director of a bank to pay a fine of 79 million liras<sup>131</sup> because he omitted to report suspicious operations consisting in deposit operations of large amount of money, conducted also by people that were not account holders of the bank. Initially the sentence of the Court of Appeal was that the bank director did not have any obligation to report the transactions since, even if they were highly risky according to the Bank of Italy (FIU) indicators, the long term business relationship between some customers and the bank could have lead the director to underestimate the danger. Afterwards, the Ministry of Economy appealed to the Supreme Court in virtue of the fact that the motive of the law n. 197/1991 was that of providing the risky operation were disclosed and reported on the base of objective evaluations (present in the case in question) and that a suspicion was enough to trigger reporting mechanisms. The final sentence of the Supreme Court found for the Ministry of the Economy since it recognised that the motivation of the Italian anti-money laundering regulation is that of fighting and preventing money laundering, by limiting the use of specific financial instruments which are recognised to be highly risky. Moreover, the Italian regulation together with the Bank of Italy directions provide a set of objective instruments that can help relevant actors in understanding when money laundering operations

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<sup>129</sup> Quinta Sezione Civile della Corte Suprema di Cassazione n. 23017/2009: Violazione dell'obbligo di segnalazione.

<sup>130</sup> Capocci, op. cit., p. 1.

<sup>131</sup> About 40 000 EUR.

might be involved. Thus, the duty of a bank director is that of, according to these objective indicators, report the suspect operations and customers to the Italian FIU. The ultimate responsibility to report the risk operations to the FIU falls on the business management, thus on the director. The consequences of the violation of these report obligations are just personal responsibilities that fall on the business manager. Thus, this sentence provides both that the ultimate responsible of an institution such a bank is the manager (director), both that since the relevant person is provided with indicators and guidelines of action, he shall objectively applied those provisions.

Another case worth mentioning is the sentence of the civil Supreme Court n. 9089 of 2007. This court decision is based on similar observations and analysis of the purpose of Italian anti-money laundering regulations and states that the reporting mechanism has to take into considerations the objective indexes provided by the provisions of law instruments and of specific guidelines (i.e. objective factual circumstances<sup>132</sup>) and not by subjective interpretation<sup>133</sup>. Moreover, this sentence provides that the obligation to report suspicious operations and customers to the authorities is not bound to the individuation of the initial criminal conduct; nor to the presence of circumstantial evidence of money laundering operations. To sum up, the bank and financial intermediaries need just to apply to the letter the indications of the provisions of law of guidelines and, when these envisage the reporting mechanism, they need to disclose the risky operation to the FIU. In this case the legislative instrument applied is that of the legislative decree of the 3 may 1991 n. 193<sup>134</sup>, but since the legislative decree of 2007 does not twist its motives and purposes but rather improves it, this sentence can be

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<sup>132</sup> *Indizi*.

<sup>133</sup> <http://www.altalex.com/index.php?idnot=37669> as accessed on 29/07/2014.

<sup>134</sup> *Provvedimenti urgenti per limitare l'uso del contante e dei titoli al portatore nelle transazioni e prevenire l'utilizzazione del sistema finanziario a scopo di riciclaggio*.

effectively considered as an interesting Italian case law. Thus, the sentence strengthens the Italian legal approach towards the mental element of the offences. Clearly the Italian regulator does not leave any space to subjective interpretations of “reasonable ground to suspect”, unless this is determined by obviously objective indexes.

#### *4.2.8 Datas*

The Italian FIU (*Unità di Informazione Finanziaria per l'Italia*) publishes every year a report on money laundering which, above many other information and statistical analysis, provides the number of SARs received on a year. These tables show the numbers of SARs first divided by type of notification (thus, whether for a money laundering offence, terrorism or arms financing); and then classified by the relevant sector.



	2009	2010	2011	2012			2013		
				I sem.	II sem.	Tot.	I sem.	II sem.	Tot.
<b>Total</b>	<b>21,066</b>	<b>37,321</b>	<b>49,075</b>	<b>34,296</b>	<b>32,751</b>	<b>67,047</b>	<b>31,520</b>	<b>33,081</b>	<b>64,601</b>
Money Laundering	20,660	37,047	48,836	34,214	32,641	66,855	31,402	33,013	64,415
Terrorism financing	366	222	205	78	93	171	69	62	131
Financing AMDP <sup>135</sup>	40	52	34	4	17	21	49	6	55

Figure 4: number of SARs received by the FIU during the period 2009-2013 divided by main categorisation of offence. Source: Unità di Informazione Finanziaria per l'Italia<sup>136</sup>.

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<sup>135</sup> Arm Mass Destruction Proliferation.

<sup>136</sup> Available at <http://www.bancaditalia.it/homepage/notizie/uif/Quaderno-antiriciclaggio-II-sem-2013.pdf> as accessed on 02/09/2014.

	2012			2013		
<b>Total</b>	<b>34,296</b>	<b>32,751</b>	<b>67,047</b>	<b>31,520</b>	<b>33,081</b>	<b>64,601</b>
<b>Financial intermediaries</b>	<b>33,185</b>	<b>31,492</b>	<b>64,677</b>	<b>30,313</b>	<b>31,452</b>	<b>61,765</b>
Banks and post offices	30,199	28,730	58,929	26,851	26,894	53,754
Financial intermediaries ex art. 106 and 107 d. lgs. 385/1993	1,970	1,869	3,739	2,748	2,897	5,645
Insurance companies	135	234	369	273	329	602
IMEL <sup>137</sup>	137	398	535	169	1,135	1,304
Trust companies	133	137	270	155	108	263
SGR and SICAV	79	79	158	76	58	134
SIM, investment companies	17	19	36	22	23	45
Other financial intermediaries	615	26	641	19	8	27
<b>Professionals and other non financial operators</b>	<b>1,111</b>	<b>1,259</b>	<b>2,370</b>	<b>1,207</b>	<b>1,629</b>	<b>2,836</b>
Notaries	844	1,032	1,9876	902	922	1,824
Accountants	42	48	90	65	33	98
Associated studies of lawyers	1	9	10	14	7	21
Lawyers	2	2	4	6	8	14
Auditors	2	3	5	3	7	10
Other professionals	1	2	3	12	6	18
<b>Non-financial operators</b>	<b>219</b>	<b>163</b>	<b>382</b>	<b>205</b>	<b>646</b>	<b>851</b>
Gamble administrators	164	119	283	158	616	774
Precious metal dealers	24	30	54	18	8	26
Other non financial operators	31	14	45	29	22	51

Figure 5: number of SARs received by the FIU during the period 2009-2013 divided by the relevant sector that reported. Source: Unità di Informazione Finanziaria per l'Italia

<sup>137</sup> Electronic money.

As for UK, the relevant sector with higher SARs is the financial one, especially banks. Interesting information here are the not irrelevant numbers of reports coming from gamble administrators, and the increasing number of SARs deriving from electronic money managers. This finding might be taken into consideration to develop further domestic AML recommendations within the Italian context.

### **3. AML Regulation and CDD in UK and in Italy in comparison**

Both UK and Italy have fully implemented the provisions of the Third EU Anti-money laundering Directive in their national legislation. Nonetheless, there have done so taking into consideration their different legislative systems<sup>138</sup>, historical approach toward money laundering and related offences, different regulation of the business and financial sector, different criminal law and criminal justice system; thus, providing sometime different outcomes. Both countries are characterised with an intense money laundering presence, especially related to the activity of criminal organisation, but while UK is particularly sensitive on drug related offences, Italy has a worldwide known, serious and deep-rooted problem with the actual presence of several criminal organisations. Both countries have introduced anti-money laundering regulations before it was suggested by the international community and formally required by the European Union. This has consequently contributed to the creation and development of singular AML regulatory distinctiveness. Some main differences are going to be analysed here, especially with regard to customer due diligence or related measures, so to provide a comparison between different duties, requirements and potential consequences for relevant persons that should compose the frontline to prevent and fight money laundering.

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<sup>138</sup> The biggest visible difference between the two countries is that UK is a common law legal system, while Italy is a civil law one

### 3.1 The Mental Element

The mental element in law is the concept that requires the guilty mind or *mens rea* in order to charge a person with a criminal conduct. In general, in order to have a guilty mind, a person needs to “acts purposely, knowing, recklessly or negligently”<sup>139</sup>. The mental element and thus the *mens rea* can be differently defined according to the law applied. Even if this concept is not specifically explained within the regulation of CDD procedures, it is of crucial importance because, according to its meaning, different compliance level can be required to operators involved with CDD operations and thus, eventually, disclosure or reporting duties.

The mental element within the context of AML regulation is the degree of knowledge or suspicion that it is asked to subjects in order to be charged or not with money laundering related crimes. Starting from the idea of “mental element” in the definition of money laundering offence, UK legal system provides in Sections 328 and 340 that, “suspecting” to be part of an arrangement that assists money laundering operations, or that a benefit comes from a criminal proceeds is enough to be charged with money laundering related offences. Moreover, the “criminal intent” is not required by the AML UK legal provisions to be considered culpable and responsible. In the Money Laundering Regulations 2007, this idea is amplified by including as a mental element “having reasonable grounds for knowing or suspecting”. These conditions apply to all relevant actors within the money laundering regulated sectors, thus also to operators and relevant persons in general, in charge of administering on-going customer due diligence and controls over their clients.

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<sup>139</sup> From Britannica website available at <http://www.britannica.com/EBchecked/topic/143120/criminallaw/303256/Requirements-of-jurisdiction#303258> as accessed 02/09/2014.

Thus, within the UK system, having “reasonable ground to suspect” could lead to an accusation of money laundering or related offences<sup>140</sup> also in case of non-compliance with “disclosure procedures” which are a duty that could apply to relevant persons as a consequence of proper CDD measures application. Consequently, the only way a relevant person has to avoid liability in money laundering crimes is to disclose or report any suspicious operation, even if the degree of supposition implies just “reasonable ground to suspect”.

Italian regulations have a different approach towards the mental element of money laundering but, within the context of reporting suspicious operations on the side of operators covered by the Legislative Decree 231/2007, it uses the same wording “having reasonable ground to suspect”. This is coherent with the Third Directive, which uses this definition of the mental element just at Article 22 when dealing with informing the FIU.

Although, what is even more worth noticing is that case law seems to confirm that UK has a much stricter application to this concept of “reasonable grounds”. In particular, in both case law studies analysed in paragraph (Pattinson v Griffiths and Griffiths & Anor), the mental element of “reasonable grounds to suspects” was considered enough by the Court to charge the subjects with the responsibility of knowing that a crime was happening. On the contrary, from the Italian case studies analysed in the previous section<sup>141</sup>, it is evident how the degree of suspicion required by the Italian legal system is much more strict and bounded to the presence of an evident and objective circumstantial evidence. In particular, this objective element was present in the Supreme Court sentence 23017/2009 where bank director had access to objective indicators and thus was charged with non-compliance with reporting a suspicious transaction; but not in the Civil

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<sup>140</sup> Booth et al., op. cit. p. 22.

<sup>141</sup> *Ibid.*

Supreme Court case 9089/2007 where, according to the guidelines and indications in possession of the subject, there was no sufficient ground for factual application of “clear and objective circumstantial element” requirements.

Furthermore, this different in treatment of the necessary mental element of money laundering crime, seems to be proven also by different numbers of prosecutions and convictions for money laundering related offences in the two countries<sup>142</sup>. Eventually, this translates into different amounts of suspicious operations reports in UK and in Italy<sup>143</sup>.

Italy appears to be more conservative when dealing with the responsibility of operators covered by AML regulations, whereas UK regulations require a higher degree of liability. Even if the Italian approach is consistent with the requirement of the Third Directive, the UK perspective represents better the trends of anti-money laundering regulations towards a higher degree of responsibility in risk evaluation and management that seem to be the aim also of the Proposal for a Fourth AML EU Directive.

### *3.2 On-going monitoring*

The concept of on-going monitoring of transactions and customers is considered and explained in both UK and Italian regulations. However, the Money Laundering Regulations 2007 dedicate a whole Regulation to the explanation of what on-going monitoring is intended to be.

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<sup>142</sup> Comparative Implementation of EU Directives (II) – Money Laundering, The British Institute of International and Comparative Law, December 2006, p. 8.

<sup>143</sup> *Ibid.*

8. (1) A relevant person must conduct ongoing monitoring of a business relationship.

(2) “Ongoing monitoring” of a business relationship means—

(a) scrutiny of transactions undertaken throughout the course of the relationship (including, where necessary, the source of funds) to ensure that the transactions are consistent with the relevant person’s knowledge of the customer, his business and risk profile; and

(b) keeping the documents, data or information obtained for the purpose of applying customer due diligence measures up-to-date.

(3) Regulation 7(3) applies to the duty to conduct ongoing monitoring under paragraph (1) as it applies to customer due diligence measures.

This Regulation provides actual and extensive indication of how to fully comply with the reporting duties required to relevant persons.

Within the Italian legal framework, the on-going monitoring is regulated just as a part of the customer due diligence obligations. Article 18(d) states, in fact, that part of the CDD measures that have to be taken, there is “conducting ongoing monitoring of the continuous relationship or professional service”. Moreover, Article 20 explains how customer due diligence duties have to be applied doing a precise consideration on customers and operations, which is jointly conducted by analysing day-by-day the risk involved. Even in the Italian AML regulatory system the on-going control is disciplined and considered important<sup>144</sup>, but Money Laundering Regulations 2007 provide more specification that might be extremely useful for operators that many times feel to be burdened with many requirements and duties but

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<sup>144</sup> Guidelines, codes of conducts and handbook for specialised sectors usually provide explanation for this requirement.



few directions of how to actually implement those directions<sup>145</sup>. Clearly, in the framework of a risk-based approach, some regulatory space is left to entities such as orders and associations of professionals and institutions. However, since this approach often ends<sup>146</sup> in the presence of a diverse and confusing set of different guidelines, directives and codes of conduct, having a clear definition of the requirement asked to the relevant person, might ease the complexity of day-to-day tasks.

### *3.3 General regulatory system*

Overall Italian anti-money laundering regulation is extremely complex and potentially penalise many conducts related to money laundering. Nonetheless, the application of such norms, the prosecution of offenders and ultimately their punishment is extremely rare. These has to trace back to a judicial system which is overload with cases to clear, but also to a legal framework that, besides a relatively strong set of reference framework, is overburden with provisions and requirements provided by associations, professional orders, bank institutions, and so on<sup>147</sup>.

One of the more severe juridical vacuum in the Italian system is that the crime of “self-laundering” is not considered and penalised. Thus, many offenders hide behind other crimes punished more leniently by the Italian legislator. A clear example of this practice is the self-accusation of tax evasion that some criminals make in order to be charged just under tax evasion law<sup>148</sup>.

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<sup>145</sup> M Gill and G. Taylor, “Preventing money laundering or obstructing business? Financial Companies’ Perspectives on ‘Know Your Customer’ Procedures”, *British Journal of Criminology*, 2004, 44: 582-594, pp. 586-588.

<sup>146</sup> Especially within the Italian legislative framework.

<sup>147</sup> Specifically the L.D. 231/2007 and the Penal Code Article 648-*bis* and 648-*ter*

<sup>148</sup> Legislative Decree 74/2000.

In Italy, since the criminalisation of money laundering is considered just as a crime in itself<sup>149</sup> when the offender of the criminal conduct originating the proceeds is different from the one that actually committed the offence of laundering money, it is convenient for money launderers to self-accuse themselves of tax evasion so not to be contemporarily charged with money laundering related offences<sup>150</sup>. In fact, Italian law provides a maximum incrimination of 6 years of imprisonment term for tax evaders (rarely applied), compared to a maximum detention of 12 years for money launderers. This issue of the Italian system might be forced to be overcome by the enter into force of the Fourth Directive, since its Proposal suggest the introduction of tax evasion above the criminal conducts to be considered when applying AML regulations. In fact, even if the Italian law does not envisage the possibility of charging a person with accusations of both money laundering and other criminal conducts that actually created such wealth, the Italian legislator should be aware and sensitive to the international and regional standards of conduct and regulatory trends.

### *3.4 Disclosure and report mechanisms*

Both UK and Italy have a two-fold regulation of money laundering: on one side a law which the main aim is the of extensively criminalise and tackle money laundering, especially connected with more serious crimes<sup>151</sup>; and a set provisions, generally inspired by FATF Recommendations 2003 and by the Third Directive with the purpose of further regulating the system that

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<sup>149</sup> Art. 648-bis of the penal code states: “apart from cases of complicity in the offence, anyone ...”

<sup>150</sup> Savona, “La IV Direttiva antiriciclaggio ...”, op. cit., p. 7.

<sup>151</sup> POCA for UK and Articles 648-*bis* and 648-*ter* for Italy.

gravitates around money laundering issues in order to enhance prevention<sup>152</sup>. It is not a coincidence that these last instruments were issued in the same year both in UK and Italy. This new set of regulations represent, at the domestic level, the new trend towards anti-money laundering policies, which is that of investing relevant actors with responsibilities and promoting the application of preventive measures based on risk evaluation of customers and operations. This appointment of responsibility, as already seen in previous chapters, starts from the front line of customer due diligence practices, and ends with report obligations of suspicious operations. Italy and UK appear to be very similar so far. However, when dealing with disclosure and report mechanism of suspicious operations, they differ quite a bit.

The UK regulator mentions reporting duties of relevant subjects in Money Laundering Regulations 2007 just at Rec. 20, when dealing with policies and procedures. In particular, it states that: “A relevant person must establish and maintain appropriate and risk-sensitive policies and procedures relating to (...) (b) reporting”. Nonetheless, the Regulations do not discipline in any way this reporting duties and mechanism. The notification to the competent authorities to suspicious operations is in fact regulated by POCA under the regime of disclosure and Suspicious Activity Reports (SARs). Even if differently organised, the UK discipline of SARs is coherent with FATF Recommendations and with the Third Directive in most of the elements<sup>153</sup>, with the exception of the specific case in point of the “authorised disclosure” joined with the “request for consent to transact” which allow relevant actors to circumvent penal responsibilities<sup>154</sup>.

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<sup>152</sup> The Money Laundering Regulations 2007 for UK and the Legislative Decree 2007 for Italy.

<sup>153</sup> FATF UK Mutual Evaluation Report 2007 maintained that UK was complying with FATF Recommendations.

<sup>154</sup> Booth et al., op. cit., p. 93.

The fact that disclosure and report duties and mechanisms are regulated by the Proceeds Of Crime Act and specifically the point that “failure to disclosure” is criminalised in a specific section as a money laundering related offence, evidently provide the UK legal system with a much stronger judicial instrument to punish relevant persons that fail to comply with the Regulations’ and Act’s provisions. The responsibility with which relevant actors are invested in both Italian and UK regulatory systems, is strengthened in United Kingdom as a result of this stronger penal device functioning as a strong deterrence. Reporting obligations in the Italian legal system are instead regulated in a whole chapter of the Legislative Decree 2007<sup>155</sup> and, as usual within this legal instrument, are divided according to which is the relevant person considered.

As far as POCA disciplines the disclosure and reporting duties and provides sanctions for failure of disclosing, these penalties are much stronger than the one presented in the Legislative Decree 231/2007 in Italy. Actually, in the Italian framework the penalty for failure to disclose a suspicious operation is an administrative sanction that can go from 1% to 40% of the operation not reported<sup>156</sup>. Within the POCA regulatory framework, the same irregular conduct is punished with:

- “(a) on summary conviction, to imprisonment for a term not exceeding six months or to a fine not exceeding the statutory maximum or to both, or
- (b) on conviction on indictment, to imprisonment for a term not exceeding five years or to a fine or to both<sup>157</sup>”

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<sup>155</sup> D. L. 231/2007 Chapter III Title II.

<sup>156</sup> D. L. 231/2007 Art. 57(iv).

<sup>157</sup> Money Laundering Regulations, s. 334(2).

Under this framework it becomes clear why the UK legislator provides the system with way out to avoid criminal liability in the hands of relevant actors. Specifically, this is the “authorised disclosure” through which the relevant actors

“Authorised disclosure” is defined as “a defence of money laundering offences” regulated so to enhanced the cooperation of financial institutions and the disclosure of information<sup>158</sup>.

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<sup>158</sup> Money Laundering Regulation Compliance; Risk and Costs Queen Mary London



## FINAL CONSIDERATIONS

The complex and dynamic economic and financial world of today offers increasing opportunities both for legal and illegal actors. Criminal organisations invest in the legal economy by laundering the proceeds of their activities. Thus, tackling money coming from criminal conducts before it enters the legal market is of crucial importance to both drain criminal organisations' resources, and to protect the legal market and the legal consumers. The international effort is thus, that of providing a set of common and worldwide-recognised rules and practices to detect, tackle and, above all, prevent money laundering. Hence, the FATF Recommendations provide the anti-money laundering framework that every country should aim at implementing (and, possibly, improving). The trend in the last ten years has been that of focusing specifically on the prevention side, by investing the relevant actors with important responsibilities and leading them to apply a risk-based approach towards money-laundering detecting mechanisms.

This thesis analysed the AML international legal framework and its implementation in the UK and Italian domestic jurisdiction, especially on the matter of customer due diligence. What emerged was a generally satisfying picture in line with the international current practice and tendencies for the future. However, Italian AML regulations may exhibit some shortcomings in matters such as penalties for non-compliance with the law, responsibility of relevant persons and the lack of "self-laundering" crime in the legal system.

Italy penalties are much lenient compared to the one the British legal system suggests and rarely imply a detention order. Furthermore, the lack of self-laundering crime is a problem today when the criminals find it relatively easy to disguise money laundering practices under the veil of "tax evasion".

Since economic crimes in Italy are not harshly penalised, this translates into unpunished laundering activities.

Comparative studies are crucially important for they evidence how practices applied in a country could potentially benefit others. Thus, with due careful considerations, and bearing in mind the deep differences between the Italian and UK legal systems, some practices in use in UK may be considered for similar application in Italy.

British AML regulations seems perfectly in line with the new trends toward a higher level of investment with responsibility of the relevant persons and in the direction of a stronger discipline and penalisation of economic crime. On the contrary AML regulations in Italy, even if possessing good foundations, generally in line with FATF standards, may be improved and modernised so to better receive the next generation of AML regulations suggest by the Proposal for a Fourth EU money laundering Directive.





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