



INTERNATIONAL  
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# **Combating Financial Crime in Intermediated Securities Systems: Increased Transparency Requirements and Data Protection Implications**

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A thesis submitted for the degree of

***Master of Laws (LLM) in Transnational and European Commercial Law,  
Banking Law, Arbitration/Mediation***



February 2019  
Thessaloniki – Greece

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I hereby declare that the work submitted is mine and that where I have made use of another's work, I have attributed the source(s) according to the Regulations set in the Student's Handbook.

February 2019  
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## **Abstract**

This dissertation was written as part of the LL.M. in Transnational and European Commercial Law, Banking Law, Arbitration/Mediation at the International Hellenic University.

The present dissertation constitutes an analysis of the intermediated securities systems and their vulnerabilities. Also, it indicates how these vulnerabilities and the inherent characteristics of intermediated holding systems contribute to the creation of fertile ground for the perpetrators of financial crime. The writer refers to the main criminal activities and other undesirable behavior and highlights the threat these illegal activities pose to the integrity, stability and soundness of the financial system. This paper also comments on the recent regulatory developments on a European and international level regarding preventive measures and compliance techniques which set out increased transparency requirements in order to detect and combat financial crime. Finally, it underlines the fine line between the necessity for increased transparency and data protection implications and concludes by proposing the broader adoption of more transparent holding systems.

Sofia K. Tsiantou

Thessaloniki, February 2019



## **Preface**

First and above all, I would like to express my genuine gratitude to my supervisor, Dr Thomas Keijser, for all the support, during the preparation of this work, from the very beginning until the final result. His assistance and academic guidance was of fundamental importance for me, therefore I would like to thank him deeply. Furthermore, his patience, motivation and kindness, constituted an inspiration to me and contributed to the completion of my thesis in the best possible way.

Also, I would like to sincerely thank my parents, family and my fiancé, for their patience and support, all this time until the end of this work.

Sofia K. Tsiantou

Thessaloniki, February 2019





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## Introduction

The practice of money laundering (long-term money laundering) is long-lasting and international. Channels for money laundering are typically used by credit institutions, insurance companies, capital markets, the real estate market, businesses and casinos. In addition, an important issue is that of the financing of terrorism, which takes place (often but not necessarily linked to money laundering) through similar channels. Today, money laundering is a barrier to unimpeded economic stability and prosperity. This is because there are not few cases where global financial stability has been disturbed by the action of groups or individuals involved in terrorist attacks financed by money from illegal economic activities. Flows of illicit money can damage the integrity and stability of the international financial sector and also threaten the internal market of the European Union.

Recent attacks in and outside the European Union have highlighted the need for the EU to work in all policies to prevent and combat terrorism. Terrorist organizations and individual terrorists need funding - to maintain their networks, recruit and supply, and also to commit their terrorist acts. Exclusion from sources of funding, limiting the possibilities of avoiding detection of these funds and using all the information resulting from the funding process in the best possible way can all contribute significantly to the fight against terrorism.

The challenge of financing terrorism is not new. Its key features, such as close links to organized crime networks, have been known for many years and EU criminal law, police cooperation, as well as legislation to prevent and combat money laundering, already contribute significantly. However, new trends have emerged, particularly in criminal organizations such as Daesh, as well as the role of retaliated foreign terrorist fighters.

Therefore certain coordinating measures have been taken at Union and international level. An intermediary holding system contributes to an efficient and cost-effective movement of huge amounts of capital between governments and investors and also to the financing of corporate and financial entities. But, as it is evident, in many cases it is difficult to trace the transfer and the identity of securities and their holders. The information about the beneficial owner of the securities in a system of intermediated securities may not be disclosed and therefore traced, which creates lack of transparency in those transactions. This lack of transparency enables criminals in the context of money laundering to acquire securities with 'dirty money' held in one or more accounts and then use the proceeds from this transaction

as legitimate money. Therefore, the financial system becomes vulnerable, as the origin of a huge funds flow is extremely uncertain when it comes to intermediated securities where beneficial owners of the traded financial assets are difficult to be traced.

The ability to prevent and detect money laundering is a very effective means of identifying criminals and terrorists and the underlying activity from which the money originates. The application of technical information and investigations can be a way of detecting and interrupting the activities of terrorists and terrorist organizations. Because they are dealing with other people's money, financial institutions rely on the integrity of their reputation. A financial institution that has proven to have helped to launder money will be excluded from legitimate businesses. An international financial center used for money laundering can become an ideal financial shelter. Developing countries that attract "dirty money" as a short-term driving force for development can find it difficult to attract the kind of stable long-term foreign direct investment based on stable conditions and good governance, and this can help them to maintain growth and promote long-term growth.

## **Chapter 1: Transparent and non-transparent securities systems and their vulnerabilities**

This first chapter will be about demonstrating the vulnerabilities of intermediated securities systems. It starts with a brief securities evolution and continues with a comparison between direct holding systems and the intermediated holding system. A classification of transparent and non-transparent models follows, in order to explain the importance of the element of transparency in the intermediated holding systems. Subsequently, the vulnerabilities of the intermediated holding systems will be demonstrated. The inherent characteristics of these holding systems do not facilitate the revelation of the investor's identity and thus may possibly provide with an advantage the perpetrators of financial crime. Next, an analysis of money laundering, terrorist financing and financing of proliferation, insider trading and other illegal activities follows. In addition, the interaction of these illegal activities with the intermediated securities system will be demonstrated, highlighting the threat they pose to the soundness, integrity and stability of financial system.

### ***1.1 Intermediated securities system: a comparison to other holding systems and its variations***

#### *1.1.1 Securities evolution: immobilisation and dematerialisation*

The importance of securities can scarcely be exaggerated. Securities, such as bonds and shares, are a key instrument for both governments and businesses all over the world to collect funds. Tremendous amount of securities is also traded in the wholesale financial markets.<sup>1</sup> Securities markets offer space for businesses to raise money by issuing shares and bonds for attracted parties to invest. Last decades securities markets have altered into electronic impersonal spaces that are more reachable by the public largely.<sup>2</sup>

In the distant past, ownership of securities was a quite plain deal, as they were separated into two kinds: bearer securities and registered securities. Widely generalising, debt

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<sup>1</sup> Roy Goode, Herbert Kronke and Ewan McKendrick, *Transnational Commercial Law – Texts, Cases and Materials* (2<sup>nd</sup> Edition, Oxford University Press, 2015) p. 425

<sup>2</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Rights of Account Holders* (Edward Elgar Publishing 2014) p. 21

securities were bearer securities and shares were registered securities. Bearer securities were incorporated in a piece of paper, the person who held that paper was the owner of securities and transfer was conducted by delivery. Registered securities were also represented by a piece of paper, but legal title resulted from the entry on the entity's record and paper was just proof of this. The movement of pieces of paper were necessary condition for both systems, and as the amount of securities and transactions increased, this became complicated and costly in money and time. Moreover, the necessity to register transfers of registered securities in the register kept by the corporation also decelerated trading. Thus, the use of electronic means of settlement contributed to the development of new methods of settlement which help to avoid the credit risk of a time gap between delivery and payment, which could not function if securities were still in paper form.<sup>3</sup> In the last decades, the tremendous progress of technology has contributed to the appearance and extraordinary augmentation of intermediated securities markets. Technology assisted to the transmutation from a system where the physical transfer of paper securities or the registration of a transfer directly in the issuer's register was the rule, to one where transferences of securities are listed as electronic book entries on accounts held by financial intermediaries, such as banks or other financial institutions.<sup>4</sup> Over the last half century the method of holding and disposing of investment securities has mutated significantly. Diverging from the conventional model of custody or deposit of physical certificates, a holding system through intermediaries has been emerged on grounds of effectiveness, operational certitude, velocity and security. In this system, the largest portion of securities is immobilised with a Central Securities Depository ('CSD') and is often dematerialised, which in many legal regimes has become mandatory. The investor holds securities through a chain of intermediaries that are ultimately connected to the CSD. In practice, the transfer of securities and the formation of security and other limited interests thereto, are usually performed by book entries to the securities accounts concerned.

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<sup>3</sup> Louise Gullifer 'Ownership of Securities: The Problems Caused by Intermediation' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities Legal Problems and Practical Issues* (Hart Publishing 2010) p. 1-2

<sup>4</sup> Roy Goode, Herbert Kronke and Ewan McKendrick (eds), *Transnational Commercial Law – Texts, Cases and Materials* (2<sup>nd</sup> Edition, Oxford University Press, 2015) p. 425

The securities themselves are not physically shifted.<sup>5</sup> Intermediated holding chains compose a keystone of the universal financial system. In the modern system of indirect possession of securities, the role of custodians is fundamental. The primary service of custodians is to keep the securities deposited with them (usually by the issuer) either personalized in hard copy or in the form of a single security or accounting. In addition to this basic service, custodians may also , to provide capital management services, securities lending, dividend collection and distribution, corporate / shareholder communications, mediation of corporate actions (such as the exercise of voting rights), etc., and to provide securities settlement and clearing services are in place to complete the transfer of rights. Depository services are provided by central securities depositories (CSDs) and international securities depositories (ICSDs), but also by other institutions such as banks, credit institutions etc. The presence of custodians in cross-border transactions and, more generally, in the international, but also in the internal, financial system contributes to the increased effectiveness of the capital markets and the reduction of the risk theft or destruction.

Although national and international custodians basically offer the same services, so the repository and depository concepts are used interchangeably, there are, or at least, some differences between them at the birth of the institutions. Local Securities Depositories (CSDs) historically play the central role of the operator of local securities settlement systems. Under this function they keep accounting balance sheets for the issues of securities deposited with them and ensure the irrevocability of entries in the country's accounting records. Traditionally they act as a central point of deposit of securities (either tangible or intangible in the form of mere electronic registrations), carry out basic securities transactions, cash displacements and custody services. In addition, they benefit from close links with central counterparties and regulated markets in order to ensure a smooth and effective trade promotion. However, due to

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<sup>5</sup> Hideki Kanda, Charles Mooney, Luc Thevenoz, Stephane Beraud assisted by Thomas Keijser, *Official Commentary on the Unidroit Convention on Substantive Rules for Intermediated Securities* (Oxford University Press 2012) p.1

the essential services they provide, they are prone to systemic risk. Their clients are primarily financial institutions and not private investors.<sup>6</sup>

The transition from physical delivery of securities to electronic means of transfer was achieved thanks to the use of two aforementioned techniques that were developed in order to handle the problem of too much paper, namely immobilisation and dematerialisation. Immobilising securities, either bearer or registered, was the first technique. Thus, securities are held by a central depository which is connected with one or more intermediaries, who in turn hold either for investors or for other intermediaries. In this scheme, transactions and settlement can take place rapidly and simply between intermediaries, who participate in the relevant exchange, as the intermediaries' records are electronic.<sup>7</sup> In contemporary markets, most securities are immobilised with depositories, instead of moving around as certificates. After securities have been deposited, posterior transfers can be conducted by book entries to the accounts held by the intermediary. Securities may be, and typically are, immobilised at a specially designated institution, known as the Central Securities Depository (CSD), or at a financial institution that offers custodial services to its clients. Securities are immobilised at CSD by depositing the physical certificate or by registering the CSD as the holder of securities on the issuer's records in a dematerialised form. Although, the second has become the more preponderant mode of immobilisation, yet, companies and other financial entities still issue securities in the form of a single certificate, embodying the entire issue, which is delivered as such to a CSD.<sup>8</sup>

The second technique was dematerialising the securities, so that the source of title is neither a piece of paper nor the entity's register, but an electronic entry on the books of a central depository. Dematerialisation permits rapid electronic settlement to occur, which is true for immobilisation as well, and thus eliminates many weak points of the paper-based system. However, it requires relevant legislation to be established. It is

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<sup>6</sup> Luc Thevenoz, 'The Geneva Securities Convention: objectives, history, and guiding principles' in Pierre – Henri Conac, Ulrich Segna and Luc Thevenoz (eds), *Intermediated Securities: The Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge University Press 2013) p. 3-9

<sup>7</sup> Louise Gullifer 'Ownership of Securities: The Problems Caused by Intermediation' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities Legal Problems and Practical Issues* (Hart Publishing 2010) p. 2

<sup>8</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Rights of Account Holders* (Edward Elgar Publishing 2014) p. 36



possible for dematerialised securities to be held through intermediaries, either obligatorily, as mentioned above, or optionally, as in UK's example, where investors can either be direct members of CREST (i.e. a UK-based Central Securities Depository) or can hold through an intermediary which is a member of CREST.<sup>9</sup> In other words, dematerialisation is the procedure where paper certificates are transformed into electronic entries, understood not only as a technological transformation, but also as a legal concept and in order to achieve that renovation, the law must acknowledge this new kind of electronic securities and sufficiently guard the investors' rights. Thus, a new type of uncertificated security appears and this security is now composed and demonstrated by book entries.<sup>10</sup>

### *1.1.2 The intermediated holding chain*

Figure 1 that follows illustrates the intermediated holding chain. It constitutes a generally plain scheme representing the intermediated holding system. Primary actors who take part in this system are the issuer, the central securities depository (CSD), intermediaries and account holders or investors. Typical issuers of securities are governments, in the case of bonds, and private entities, in the case of shares. Between the issuer of the title and the final investor there may be a small or a large number of intermediaries, leading to a multilevel or multidimensional scheme that reflects the relationships that are created during the release of titles in the system in question. The existence of intermediaries generally abolishes the direct relationship between the investor and the issuer. Indeed, there is no direct relationship either between the investor and the central body in which the securities are deposited or registered at the time of issue, as the investor's right is not recorded in the original depository's file. The final investor, therefore, knows only the intermediary person with whom he / she immediately comes into contact and contracted.

The existence of intermediaries is associated with specific advantages for the investor. Firstly, it reduces the risk of a transaction error, as these are specialized persons with the technological infrastructure and financial training to provide this service. In addition,

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<sup>9</sup> Louise Gullifer 'Ownership of Securities: The Problems Caused by Intermediation' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities Legal Problems and Practical Issues* (Hart Publishing 2010) p. 2

<sup>10</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Rights of Account Holders* (Edward Elgar Publishing 2014) p. 34

intermediaries provide other services to their clients, such as managing their portfolio and providing investment advice. Portfolio management and management are particularly important when it comes to a portfolio of domestic and foreign securities.<sup>11</sup>

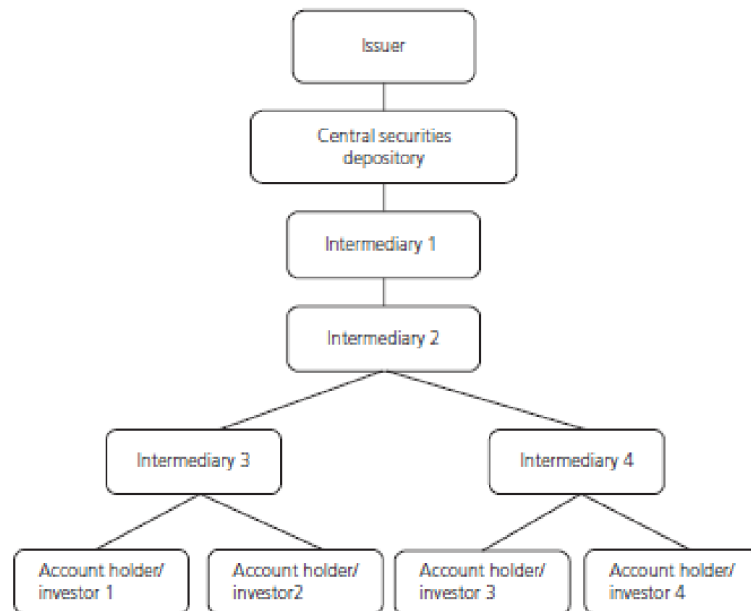


Figure 1: The intermediated holding chain<sup>12</sup>

As it has been demonstrated by the above figure, in contemporary financial markets, securities such as shares or bonds are generally held through intermediaries and traded by electronic book - entries on securities accounts. In its most plain scheme, an intermediated holding system may be perceived as a three - tier pyramid: the investors, who are usually the ultimate account holders, are at the bottom, and their securities are credited to securities accounts held by their intermediaries. The intermediaries, in turn, hold their securities on a book-entry basis with the top-tier intermediary, typically a Central Securities Depository (CSD). Particularly in cross-border transactions, this multi-tiered structure can have more levels. Nevertheless, irrespectively of the number of levels, all intermediated holding systems have in common that no certificates move around, and that the securities are shifted by debiting and crediting to securities

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<sup>11</sup> Roy Goode, Herbert Kronke and Ewan McKendrick (eds), *Transnational Commercial Law - Text, Cases and Materials* (Second edition, Oxford University Press 2015), p.427

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

accounts. Gradually, certificated securities are being substituted by fully dematerialised securities.<sup>13</sup>

### *1.1.3 Direct and intermediated holding systems: their variations*

The consequence of the securities' immobilisation is the gradual erosion of the direct connection among the issuer and the securities' holders. Expediting the enforcement of the rights enclosed in immobilised securities is now duty of intermediaries and the nature of holding systems has converted from direct to the so-called intermediated. On the contrary, in a direct holding system the investor, who holds a security certificate and is listed on the issuer's books, can enforce his rights directly against the issuer. As the investor is not requesting through an intermediary, the issuer's obligations link to the rights of different investors. Securities holders and issuers are in contact. Transactions of securities in a direct holding system are conducted by delivery of the corresponding certificates or registration on the issuer's books which is not the case in an intermediated holding system. In the latter, the investor has not a direct relationship with the issuer, but instead a securities account is kept with an intermediary in his name (investor's), which could also be the CSD. Its rights to the security may be enforced through the intermediary. In such situation, the security holder is not in relation with the issuer, but with its intermediary. As it is mentioned before, in an intermediated holding system, transfers of securities are conducted by book entries to the account holders' securities accounts held by intermediaries.<sup>14</sup>

Regarding direct and intermediated holding systems, the one does not preclude the existence of the other. Nowadays, a small minority of securities is held directly and the majority is held through intermediaries. The legislation concerning securities' holding also mirrors the coexistence of these two holding systems. Even the "Unidroit Convention on Substantive Rules for Intermediated Securities" known as the "Geneva Securities Convention" in its article 29 (1) acknowledges that multiple systems could operate in alongside and does not demand for the contracting states to wholly

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<sup>13</sup> Pierre – Henri Conac, Ulrich Segna and Luc Thevenoz, *Intermediated Securities The Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge University Press 2013) p.xxi

<sup>14</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Rights of Account Holders* (Edward Elgar Publishing 2014) p. 39

substitute their existing systems with an intermediated holding system. The direct holder may endorse the security's certificate, deposit it with an intermediary and accept a credit to his securities account. In reverse, in an indirect system, a securities account holder may claim from its intermediary that his account be debited and a security certificate be delivered to him, unless the implementation of such request is forbidden by the terms of the issuance.<sup>15</sup>

Intermediation is at the core of accounts holding systems' legislation.<sup>16</sup> Even in regimes where it is offered to the investor the opportunity to choose between a direct or through an intermediary holding system, the last has many advantages. The most important, among others, is the facilitating of transactions and settlement.<sup>17</sup> Secondly, intermediaries execute numerous critical functions such as founding and holding accounts for their clients, carrying out customers' instructions to transfer assets and funds in and out of those accounts, clearing clients' specific transactions, providing credit to them, offering advice-giving services and cutting down monitoring costs.<sup>18</sup> Nevertheless, one should consider also the several complications and issues generated by intermediated holding of securities and the numerous efforts to deal with these at a national and international level. The fundamental question which rises about the intermediated holding of securities is whether this system of holding enhances the risk for the investor. The business of securities' holding, even directly, inherently contains some level of risk, as the price of shares may go down as well as up depending on issuer's luck, while the price of securities' liability is directly influenced by the issuer's ability to recompense. These jeopardies known as 'issuer risk' are well recognized and are independent of the type of system (intermediated or not) chosen. In case of intermediation, the investor additionally bears 'intermediary risk' which contains the risk of intermediary's economic insolvency and the danger that the intermediary will 'lose' the securities. Additionally, there is a hazard for the holder of losing the privileges that it had as a direct holder, such as voting rights, if the securities are shares, or the

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<sup>15</sup> Ibid at p. 40

<sup>16</sup> Ibid at p. 10

<sup>17</sup> Louise Gullifer 'Ownership of Securities: The Problems Caused by Intermediation' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities Legal Problems and Practical Issues* (Hart Publishing 2010) p. 3

<sup>18</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Rights of Account Holders* (Edward Elgar Publishing 2014) p. 10

right to direct a bond trustee in relation to the enforcement of the bond, in case of debt securities. One method of evaluating the system is to examine how it differentiates the position of an investor who holds intermediated securities from that of a direct holder. However, the evaluation is a process that every investor should do, finding the advantages and disadvantages of intermediation so that the appropriate choice can be made.<sup>19</sup>

Progressively, the attention has transferred to classifying the different types of intermediated holding systems and identifying their complex characteristics. The project that led to the adoption of the Geneva Securities Convention gave momentum to this shift towards identification and classification. Architecturally, all intermediated holding systems resemble. The securities holding pyramid is constituted by the CSD at the top, intermediaries in the middle and account holders at the lower level. Though, the nature of rights and the distinct elements of accounts relationships vary essentially. Initially, as a wide classification, two fundamental types of intermediated holding systems were established: 'indirect' and 'transparent'. While indirect holding systems are considered to have uniform characteristics and structures, the transparent holding systems did not. A typical characteristic of an indirect holding system, in contrast to the transparent holding system, is that the CSD remains unaware of the identity of particular account holders other than its participating intermediaries. In indirect holding systems, the relationships between the intermediaries and account holders are irrespective one from another. In transparent systems mid-level entities hold accounts for investors but the aim of such holding is simply administrative. Only transfers recorded at the CSD level have constitutive effects.<sup>20</sup>

When the laws and rules in one country conflict with those in other countries there might be a situation where one state's legislation influences the legal status of the same primary securities. Each jurisdiction has a detailed legal framework leading this holding chain condition. This domestic legal framework dictate the legal position, the rights and

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<sup>19</sup> Louise Gullifer 'Ownership of Securities: the Problems Caused by Intermediation' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities Legal Problems and Practical Issues* (Hart Publishing 2010) p. 4

<sup>20</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Rights of Account Holders* (Edward Elgar Publishing 2014) p. 41-42

responsibilities of every partaker in the holding chain, covering the position of the investor, the intermediary or intermediaries, and the CSD. It is significant to highlight that domestic law only rules the whole holding chain between investor and issuer as long as the holding chain is clearly domestic. As soon as foreign intermediaries are involved, it is extremely possible that foreign law applies to certain parts of it.

There are five fundamental holding models for securities, which will subsequently be examined, because it is important for the reader to understand the differences between transparent and non-transparent systems in order to evaluate the element of transparency in the intermediated holding chain. These models are the trust model, the entitlement model, the unshared property model, the pooled property model and the transparent model.<sup>21</sup>

#### *The trust model*

The trust model is defined as the legal relationship between a trustee (or more) and one (or more) beneficiary, according to which the trustee is required to manage property, the ownership of which (or other right in rem, ) is transferred to him for the benefit of the beneficiary. The property transferred to his trustee belongs formally (technically), that is, according to the term used, the legal title or legal ownership. As to third parties, he appears as the legal owner of the property. The beneficiary, on the other hand, has a beneficial ownership or equitable interest, that is, a right to the income derived from the asset the trustee has the legal ownership of. This right also extends in return for the sale of the assets.

The beneficiary's right, however, is not only liable to the trustee for fulfilling his obligations. He has a right in rem in the estate of the trust, which allows him to claim the property both by the trustee and by the persons to whom it comes (even in the case of bankruptcy or death of the trustee), without his consent (unless the acquirer is a bona fide third party). In other words, this property is an autonomous unity that is separate from the trustee's property and, according to the law, cannot fall to its heirs and be disposed of to the demands of its personal creditors.

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<sup>21</sup> European Parliament, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy, Economic and Monetary Affairs, *Cross-border issues of securities law: European efforts to support securities markets with a coherent legal framework* (IPA/ECON/NT/2011-09 May 2011) p.13-14

Regarding the conditions for credibility of trust, the following should be observed: While there is no problem with the first two conditions in the system of indirect securities, the latter condition has been a matter of case law and theory in the countries of Anglo-Saxon law - the trust model is mainly found in jurisdictions as England and Wales; coherent models are also encountered in Ireland, Australia, and other common law countries. In this respect, it should first of all be said that the subject of the trust may be both movable and immovable, even rights, whether real or involuntary, provided they are identifiable. A trust relationship can only be established if its subject is specific. This is not a problem when the object is a house, a plot or some tangible mobile thing. However, in the case of intangible securities held in collective accounts and fungible bulks, where there is no allocation of specific securities to particular investors, it is questionable whether the third requirement for credible trust formation is fulfilled.<sup>22</sup>

#### *The security entitlement model*

The security entitlement model appears similarities to some degree with the trust model, but also displays differences. This model is encountered in the USA and Canada. The CSD in the USA is named Depository and Trust Company (DTC). A securities contract to ensure the fulfillment of obligations under another contract takes up a significant part of international transactions. This development is due to the continuous development of securities lending and repos, the establishment of central counterparties and the use of cash by central banks in the settlement of securities transactions. The provision of financial security in international transactions ensures the smooth operation of the settlement through the continuous liquidity it ensures, guarantees the fulfillment of the obligations undertaken in the course of trade, helps to cover the credit risks to which an international depository is exposed in the exercise of its activities, it facilitates the exercise of collateral management and strengthens the financing of s, thus encouraging the participation of international investment funds in local markets. However, its main importance lies in the fact that the recipient of the security-lender is satisfied first of all in the event of the debtor's bankruptcy or other reason for failure to fulfill the obligation.

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<sup>22</sup> Ibid at p.14-15

The provision of security includes the transfer of rights by the debtor to the lender and can take place in two ways: (a) by the transfer of the full ownership of the securities constituting the security to the lender - securities and repo agreements); and (b) the acquisition of a limited interest or security interest in the collateral, while ownership remains with the collateral provider. In the former case, the collateral provider transfers ownership of the securities to the collateral taker and acquires a contractual right to return, in the performance of its obligations, equivalent and equivalent securities to those provided as collateral. The collateral taker acquires the full ownership of the securities and is entitled to have them as desired. If he fails to redeem the securities, he has to pay their market value. If the collateral provider fails to fulfill his obligations under the borrowing agreement, the collateral taker may set aside his obligation to repay equivalent securities against his claim against the collateral provider, provided this is permitted by the law applicable to the collateral arrangement.<sup>23</sup>

#### *The undivided property model*

In legal jurisdictions where this category of rights is recognized (such as in France, where the CDS is called Euroclear), the single collective account maintained on behalf of investors is treated as a distinct asset segment in which investors have joint ownership rights. The specific features of the rights in this distinct set may differ from fair to legal, but generally include co-ownership of a set of securities resulting from the accounting records of the intermediary's records with which each investor contributes. The advantage of such rights is that the intermediary does not own the securities and its personal creditors cannot be satisfied with them. Consequently, in the event of bankruptcy, such securities are not part of his bankruptcy estate.

The right of joint ownership may be either a co-ownership rights traceable to actual pools of securities or a co-ownership rights in notional pools of securities. In the first case, it is the ownership rights of all the (immobilized) securities deposited with the depositary. As in the category of direct ownership rights, the intermediary plays no role, since the whole range of intermediaries is penetrated to the original custodian and the rights refer to all the titles on it. Rights of this kind are considered functionally identical

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<sup>23</sup> Ibid at p.16



to traditional rights in liens on individual discrete securities. In the case of the securities account, the right of joint ownership does not depend on the actual place where all the securities are located. This is a right of joint ownership, which is evidenced only by the accounting records of the intermediary's record, regardless of where the individual securities or the actual set of securities are. This means, for example, that the pledge is not recommended on the underlying securities (found in the original custodian), but on the debtor's joint ownership of all the securities.<sup>24</sup>

#### *The pooled property model*

Germany and Austria, also Japan, apply the pooled property model. The issuer deposits its securities with Clearstream Banking in Germany or OeKB (Oesterreichische Kontrollbank) in Austria and the investor obtains, under this system, a shared interest in a pool of securities which is placed at the level of the CSD. It is a *sui generis* kind of shared property which only exists in this exact framework. The investor's right, registered with accounts in the account managed by the intermediary, is treated as a *sui generis* set of rights and interests, which are opposed only to the intermediary with which the investor contracted and whose records he has open a relevant securities account. The relationship between the client investor and the counterparty intermediary is a central axis of this legal construction.

A feature of this set of rights is that the investor is not allowed to penetrate the entire chain of intermediaries by exercising directly a right in rem against the original depository to which the securities are deposited or registered or against the issuer. The justification for the arrangement is that each intermediary is only aware of the identity and financial standing of his client - who may be the final investor or another intermediary who also holds securities accounts for his own clients - while it is not possible to know who customers are clients of or their customers in the pyramid of operators. It should be noted, however, that although rights are only opposed to the investor's direct counterparty, it is more than a common guilty claim. Satisfaction of the rights of the account holder takes precedence over the claims of the personal, non-privileged, creditors of the direct ombudsman to a potential bankruptcy of the latter. In

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<sup>24</sup> Ibid at p.17

other words, the account holder does not risk the activities of the intermediary with which he / she is cooperating.<sup>25</sup>

#### *The transparent model*

This approach is adopted by Nordic countries, Greece and Poland and also outside Europe, China and Brazil have structures which are similar to this approach. In case of purely national holdings, there are no intermediaries tangled in a transparent system, besides the CSD and each investor holds his account directly with the CSD. According to this principle, investors in intermediated securities do not under normal circumstances enjoy direct rights of action against the issuer, but must rely on the Relevant Intermediary to assert, or arrange for the assertion of, the rights associated with their holdings on their behalf. The banks carrying out the securities business do not hold an account for the investor but only operate the one held by the CSD under a special legal and operational background and for this reason they are also called account operators. The investor has a direct and unshared property interest in the securities. For cross-jurisdictional holdings, the transparent system does not function, because the foreign intermediaries that are involved cannot directly operate the accounts in the CSD as they are not part of that highly integrated national system. Consequently, the regime for cross-jurisdictional holdings in a transparent system is similar to the pooled property model.<sup>26</sup>

It should be noted, that only transparent holding systems are truly 'direct'. Therefore, in the technical debate, the concepts of 'direct' and 'indirect' should be abandoned in favor of the models designated before.<sup>27</sup>

#### *1.1.4 The existing gap between the issuer and the investor*

One issue arisen and commented by academics and participants of the financial services industry was the extensive number of intermediaries providing their services in this field. According to the Lamfalussy report<sup>28</sup>, *"a large number of transaction and clearing and settlement systems...fragment liquidity and increase costs, especially for*

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<sup>25</sup> Ibid at p.18

<sup>26</sup> Ibid at p.19

<sup>27</sup> Ibid at p.19-20

<sup>28</sup> Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (Brussels, 15 February 2001)

*cross-border clearing and settlement*". As it is noticed in the first report of the Giovannini Group<sup>29</sup> the EU market is 'highly fragmented' in clearing and settling transactions. Especially in case of cross-border clearing and settlement, it involves 'very high cost' as the intermediaries should cover the cost of operating facilities and personnel, and additionally, the majority of intermediaries should profit enough to recompense the investors. Yet, the cost is not the only burden that an investor (in an intermediated holding system) suffers, but intermediation rises also the inherent legal risk for the investor's interests which may not be sufficiently protected because of the existence of numerous layers of intermediation between the ultimate investor and the issuer, forming a significant gap. This gap should be highlighted, as inherent legal risks resulting from this gap threaten the protection of the investor's interests, economic, corporate and others. As the number of intermediaries enlarges, the same happens to the risk. Domestic laws of each jurisdiction regulate the level of protection of the investors. Nevertheless, the inherent legal risk of an intermediated holding chain because of the gap still stands, even though the investor may have certain privileges and there is integrity and efficiency in the financial markets.<sup>30</sup>

### **1.2 The element of transparency in holding systems**

As it was mentioned before, in transparent holding systems, the identification of the beneficial owner seems to be a quite simple work. The CSD remains aware of the identity of all its account holders and retains a relationship with them while all transactions are recorded on a central register. Recording the transfers at the CSD level has constitutive effects and, except from the presence of a top-level intermediary, there may be further banks or further financial institutions sharing functions. On the contrary, in non-transparent holding systems the CSD cannot detect the identity of their exact account holders. The relations between the CSD and the intermediaries are detached from the relations between the intermediaries and the account holders.<sup>31</sup> All data flows regarding the holding and transfer of securities happen only between the transacting partakers.

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<sup>29</sup> The Giovannini Group, *Cross-border Clearing and Settlement Arrangements in the European Union* (Brussels, November 2001)

<sup>30</sup> Eva Micheler, 'Transfer of Intermediated Securities and Legal Certainty' in Thomas Keijser (ed), *Transnational Securities Law* (Oxford University Press 2014) p. 119

<sup>31</sup> Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts – The Right of Account Holders* (Edward Elgar Publishing 2014) p. 42

Each partaker is only aware of the partaker immediately lower or upper in chain, i.e. an intermediary knows its account holders but if these account holders operate as account providers too, has no information about their clients – account holders or any other account holders down the chain, and certainly does not know the ultimate investor. Because of the aforementioned absence of briefing, the rights of the account holders are restricted to the intermediary directly above them, which establishes the “no-look-through principle” mentioned above.<sup>32</sup>

All the aforementioned end up to the conclusion that information on the identity of the beneficial owner of securities, whether it is a legal entity or a natural person, its professional doings and probably the origins of its assets, all can be found to the data noted in the original account contract signed with the bank or the financial institution performing as an account provider. These information flows are inconsistent with the legal construction of an intermediated holding system, where every intermediary connects with the directly down or up in chain participant and also a tension with the attractive results of the no-look-through principle is observed. Certainly, the presence of that principle has contributed to the reinforcement of the legal certainty within the intermediated securities system in the notion that every intermediary and the CSD are only responsible for meeting their obligations encompassed in the contracts they signed as account holders or account providers and not for actions or omissions of other participants down or up in chain. Furthermore, the same principle is related to the effectiveness and the scale economies unrolled within that holding chain. Intermediated securities are relocated by crediting these securities to that account holder’s securities account. In the example of pooled accounts, the transference of securities between two clients of the similar intermediary is technically easy and plain and involves no retardations, while netting is much more facile, meaning that transfers of securities between participants of the holding chain, according to their position within the context of the holding chain, may take place quicker and in a cost-effective manner because every instruction that ends up to the accounts’ crediting and debiting is not implemented distinctly and outwardly but is rather a part of an offsetting procedure

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<sup>32</sup> Louise Gullifer, ‘Ownership of Securities - The Problems Caused by Intermediation’ in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities Legal Problems and Practical Issues* (Hart Publishing 2010) p. 14-15

between the values of multiple locations and payments due to be exchanged between participants and, thus, an ultimate net position is noted on the accounts of the relevant intermediaries contributing to the rapidity and comfort of transfer and settlement.<sup>33</sup> Subsequently, someone could claim that the legal construction of the intermediated securities holding system built on the no-look through principle is depicted by a fundamental feature: the lack of a direct link between the ultimate investor and the trading and settlement process of the financial assets that he owns or, elsehow, a type of limitation in the investor's capacity to enforce its rights against the issuer, not only because the investor may lose the ability to directly assert claims against upper-tier intermediaries or the issuer, but also due to the fact that the identity of the securities and the identity of that investor, are not easy to be traced within the chain of intermediaries. Particularly when netting via pooled accounts take place, it almost turns out to be tremendously difficult to trace the securities' transfer from one account to another, or for a credit entry to be matched with a particular debit entry.<sup>34</sup>

### ***1.3 Securities market vulnerabilities and financial crime***

The aforementioned inherent characteristics of non-transparent intermediated securities systems, compared to other holding systems, provide with a privilege the potential perpetrators of financial crimes and they pose a threat to the soundness, integrity and stability of the financial system and the financial institutions.

According to the "EU Directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing" combating the financing of terrorism is vital for the security of citizens, but taking further steps to eliminate the possibilities of terrorist financing can also threaten the lives and economic activity of citizens and businesses across the Union. Money laundering can also threaten the internal market of the Union as well as international growth.<sup>35</sup>

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<sup>33</sup> Ibid at p. 12-14

<sup>34</sup> Ibid at p. 14

<sup>35</sup> Directive 2015/849/EU of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC [2015] OJ L141/73, recital (1)

Money laundering is, though, a fundamentally simple concept. It is the process by which proceeds from a criminal activity are disguised to conceal their illicit origins.<sup>36</sup> Money laundering is generally defined as consisting of three stages: Placement, layering and integration. Nevertheless, not all money laundering transactions contain all three separate stages and some could include more. The placement stage encompasses the physical movement of money or assets coming from illegal activities to a position or type less suspicious to law enforcement authorities. Proceeds are imported into financial institutions or into the retail markets. The second stage is defined as layering and involves the separation of proceeds from their illegal foundation by using multiple compound financial transactions to obscure the audit trail and hide the resources. The third stage is the so-called integration, in which, illegal proceeds are transformed into apparently legitimate professional incomes through normal financial or commercial activities.<sup>37</sup>

The Financial Action Task Force on Money Laundering (FATF), which is recognized as the international standard setter for anti-money laundering (AML) efforts, defines the term “money laundering” briefly as “the processing of criminal proceeds to disguise their illegal origin in order to legitimize the ill-gotten gains of crime”. A money laundering predicate offence is the primary criminal activity that produced proceeds, which when laundered, ends up to the offence of money laundering. The predicate offences were limited originally to drug trafficking offences by the terms of the ‘UN Convention against illicit traffic in narcotic drugs and psychotropic substances, 1988’, the so-called *Vienna Convention*. Over the years, though, international community has established the understanding that predicate offences for money laundering should go far beyond drug trafficking. Thus, FATF and other international instruments have extended the Vienna Convention’s definition of predicate offences to embrace other serious crimes. Nowadays, the FATF Recommendations ‘International Standards on combating money laundering and the financing of terrorism and proliferation’ (updated October 2018) integrates the technical and legal definitions of money laundering set out in the Vienna

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<sup>36</sup> Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism*, The World Bank (January 2006), p.I-1

<sup>37</sup> Peter Reuter and Edwin M. Truman, *Chasing Dirty Money – The Fight against Money laundering* (November 2004), p. 25

and Palermo<sup>38</sup> Conventions and lists, today, 21 elected categories of offences that are considered as predicate offences for money laundering.<sup>39</sup>

The initial FATF Recommendations were drafted in 1990 as an initiative to fight the abuse of financial systems by individuals who laundered drug money. In 1996 the Recommendations were revised for the first time to keep pace with developing money laundering trends and practices, and to widen their scope well beyond drug-money laundering. In October 2001 the FATF extended its command to deal with the problem of the funding of terrorist acts and terrorist organisations, and went ahead to the significant step of forming the Eight (later expanded to Nine) Special Recommendations on Terrorist Financing. The FATF Recommendations were revised a second time in 2003, and these, along with the Special Recommendations, have been approved by over 180 countries and they are recognised as the international standard for anti-money laundering and countering the financing of terrorism (AML/CFT).<sup>40</sup> The proliferation of weapons of mass destruction is also a substantial security concern, and in 2008 the FATF's command was extended to contain dealing with the funding of proliferation of weapons of mass destruction.<sup>41</sup>

Thus, the original legislation has now been extended in the majority of countries to include terrorist financing, and more lately, to embody funds generated by any illegal act. The financing of terrorism is also a fundamentally simple concept. It is the financial sustenance, of any kind, of terrorism or those who embolden, design, or participate in terrorism. More difficult project, is, however, to describe terrorism itself, due to the substantial political, spiritual and national implications that may be derived by the term from country to country.<sup>42</sup>

The practices used to launder money are fundamentally similar to those used to cover up the origins of, and uses for, terrorist financing. Resources used to fund terrorism could also emanate from legitimate sources, as well as criminal activities, or both.

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<sup>38</sup> UN Convention Against Transnational Organized Crime, November 15, 2001

<sup>39</sup> Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism*, The World Bank (January 2006), p.I-2, I-3.

<sup>40</sup> The FATF Recommendations 'International Standards on combating money laundering and the financing of terrorism and proliferation' (updated October 2018), p.6.

<sup>41</sup> Ibid at p.7.

<sup>42</sup> Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism*, The World Bank (January 2006), p.I-1.

However, hiding the fountain of terrorist financing, irrespectively of whether the fountain is legitimately or illicitly originated, is crucial. If the fountain can be obscured, it remains accessible for future terrorist financing actions. In the same way, it is vital for terrorists to cover the use of the funds as well, so that the financing activity goes unnoticed.<sup>43</sup>

The securities market performs a core role in the international financial sector. This market has for a long time been defined by such characteristics, as the velocity in executing transactions, the worldwide range, and the ability to adapt, that could make itself attractive to those who would misuse it for illegitimate purposes, such as money laundering and terrorist financing. Furthermore, the securities market is possibly the only one among industries that can be used both to launder illegal proceeds which were acquired elsewhere, and to produce illegal proceeds within the industry itself through fraudulent activities. Trades and practices related to money laundering and the particular predicate securities offences are usually challenging to separate, which is why the hazards linked with the several categories of intermediaries, products, payment methods and customers involved in the securities industry should be clarified. Contrasting to other kind of markets, the dangers appear mostly not in the placement stage of money laundering, but rather in the stages of layering and integration. Characteristic laundering patterns related to securities frequently include a sequence of transactions that do not suit the investor's profile and do not seem planned to provide yield on the investment. Reporting suspicious business deals in the market is still rather low and that could be explained by a number of potential reasons, counting the lack of information and inadequate securities-specific indicators. The reported cases of money laundering in the securities market long exceed those concerning terrorist financing. Nevertheless, the securities market is still exposed to both money laundering and terrorist financing.<sup>44</sup>

Although money laundering in general includes the import of illegal funds into the financial system, securities can also act as a vehicle for producing illegal funds within the financial system. The FATF glossary contains among the list of "designated categories of offences", three predicate offences to money laundering which are encountered

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<sup>43</sup> Ibid at p.1-5.

<sup>44</sup> FATF Report, *'Money Laundering and Terrorist Financing in the Securities Sector'* (October 2009), p.5



especially in securities market: insider trading, market manipulation, and fraud, i.e. securities-related fraud.<sup>45</sup> Recognizing and reporting these three securities-specific designated offences, which are encompassed in an important number of jurisdictions, could contribute to the prevention of money laundering.<sup>46</sup>

While *insider trading* is illegitimate behavior, it does not imply that business insiders, such as officers, directors and employees, can never have dealings with shares of the company's securities. In several regimes, though, these dealings should be reported to officials and the public under specific conditions. Nevertheless, insider trading implicates situations where the buyer and seller of securities, whether it is a corporate insider or not, holds substantial, non-public information regarding the security and infringes a fiduciary duty or other affiliation of trust and confidence in that respect. This could also involve situations where this person possessing substantial, non-public information offers it to someone else for trading and the addressee of that information could also infringe insider trading laws. The illegitimate proceeds produced by insider trading can be laundered through the securities market itself or other parts of the financial system.<sup>47</sup>

*Market manipulation*, in general, relates to a deceitful behavior to the detriment of investors by controlling or artificially influencing the market for a security. Specifically, the manipulator's target is to direct the value of a security up or down so that he can benefit from value differences. Manipulators use several techniques to accomplish these effects and the most erosive market manipulation technique includes the so-called "pump-and-dump" scheme. This scheme includes pushing a firm's stock with false or misleading statements, often in combination with securities transactions that elevate the value of the security or make it look as if the securities trading volume is higher than it truly is. Therefore the security value is artificially upraised ("pumped"), the security is then sold ("dumped") for a profit. Usually the original security is low priced, illiquid, and trades with little volume.<sup>48</sup>

*Securities fraud* mostly refers to deceptive practices in relation with the offer and sale of securities. From this point of view, securities fraud includes insider trading and market

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<sup>45</sup> Ibid at p.7

<sup>46</sup> Ibid at p. 48

<sup>47</sup> Ibid

<sup>48</sup> Ibid at p. 50.

manipulation. However, the real vendors of these generally of no value shares are usually established in a different country from the buyer, making hard the access to those who commit the fraud.<sup>49</sup>

Furthermore, other criminal activity linked to money laundering in securities markets is tax evasion and corruption. Corporate enterprises, in order to avoid or minimize taxation outflows, often use schemes with securities that usually involve transactions for the purchase or sale of securities in diverse tax periods, exploitation or differing taxation rules between different countries.<sup>50</sup>

In addition, securities transactions can also be used to make payments in order to corrupt officials and politically exposed persons (PEPs). For example, transferring bearer securities which either be sold or deposited as collateral for a loan or selling securities at off-market prices to PEPs indicates a method of recompensing PEPs for corrupt services without leaving a cash-based audit trail.<sup>51</sup>

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<sup>49</sup> Ibid at p. 53-54

<sup>50</sup> MONEYVAL, Committee of experts on the evaluation of anti-money laundering measures and the financing of terrorism, *Typology research – Use of securities in money laundering schemes* (2008) p. 63

<sup>51</sup> Ibid at p. 66

## **Chapter 2: International and European Provisions – the increased transparency requirements**

This second chapter will focus on the increased transparency requirements, through the prism of international and European legislation. It will refer to the recent 5th AML Directive, the international FATF Standards (e.g. customers due diligence, record keeping, financial intelligence units etc.), the IOSCO 'Principles on Client Identification and Beneficial Ownership for the Securities Industry' and the ISSA 'Financial Crime Compliance Principles for Securities Custody and Settlement'.

### ***2.1 International Provisions***

#### *2.1.1 The FATF Recommendations*

The Financial Action Task Force (FATF) is an inter-governmental body founded in 1989 by the Ministers of its member jurisdictions. The objectives of the FATF are to put standards and promote efficient application of legal, regulatory and operational measures in order to combat money laundering, terrorist financing and other criminal activities posing threat to the integrity of the international financial system. Hence, the FATF is a policy-making body, which tries to bring forth the essential political will in order to proceed with national legislative and regulatory improvements in these areas. The FATF has established for this reason a series of recommendations that are acknowledged as the international standard to combat money laundering and the financing of terrorism and proliferation of weapons of mass destruction. These recommendations set the foundation for a coordinated reaction towards the aforementioned threats and assist in guaranteeing a level playing field. Originally issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003 and lately, in February 2012, the FATF concluded an in-depth revision of its standards and published the revised FATF Recommendations, in order to ensure that they are still up to date and relevant, and they are meant to be of worldwide application. This revision targeted to reinforce universal safeguards and further preserve the integrity of the financial system by offering governments more powerful instruments to take action against financial crime. In addition, they have been extended to deal with new threats, such as the

financing of proliferation of weapons of mass destruction, and to be more explicit on transparency and stricter on corruption. Moreover, the Nine Special Recommendations on terrorist financing have been fully integrated with the measures against money laundering and this has led to a stronger and clearer set of standards.<sup>52</sup> Having in mind that countries have different legal, administrative and operational frameworks and diverse financial systems, and so cannot all take the same measures to fight these threats, the FATF Recommendations, therefore, set an international standard, which countries should adopt through measures depending on their particular circumstances. In other words, the FATF Recommendations establish the necessary measures that countries should implement in order to identify the dangers, chase money laundering, terrorist financing and the financing of proliferation, implement preventive measures, enhance the transparency and accessibility to beneficial ownership information, and facilitate international cooperation.<sup>53</sup>

The main changes regarding the FATF Recommendations are:

*The Risk-based approach:* Countries should clearly comprehend the money laundering and terrorist financing risks which have impact on them, and adjust their anti-money laundering/countering the financing of terrorism (AML/CFT) systems depending on the nature of these risks by implementing either enhanced measures where the risks are higher or simplified measures where the risks are lower. The FATF has set out the risk-based approach so that the countries and the financial intermediaries will be qualified to target their assets more efficiently. A well-applied risk-based approach results that the AML/CFT system will be more efficient, and will support countries adopt measures to embolden financial inclusion, as called for by the G20.<sup>54</sup>

*Transparency:* The absence of transparency about the ownership and control of legal persons and legal arrangements, or about the parties to wire transfers, makes those instruments exposed to abuse by launderers and terrorists. The FATF has reinforced transparency requirements in these areas. Now, reliable information is required to be available about the beneficial ownership and control of companies, trusts, and other

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<sup>52</sup> Dennis Cox, *Handbook of Anti Money Laundering* (Wiley, 2014) p. 21, 22

<sup>53</sup> The FATF Recommendations 'International Standards on combating money laundering and the financing of terrorism and proliferation' (updated October 2018), p. 6

<sup>54</sup> FATF Recommendations 2012 – Press Handout, available at <http://www.fatf-gafi.org/media/fatf/documents/Press%20handout%20FATF%20Recommendations%202012.pdf>

legal persons or legal arrangements. Also more strict requirements are implemented on the information which must come along with wire transfers. Measures to enhance transparency, applied on a universal base, will make it more difficult for launderers and terrorists to conceal their activities.<sup>55</sup>

*International Cooperation:* With the growing globalization of money laundering and terrorist financing threats, the FATF has also reinforced the scope and application of international cooperation between authorities. The revised Recommendations permit more efficient exchanges of data for investigative, supervisory and prosecutorial purposes. This will also help countries in tracing, freezing, and confiscating illegal assets.<sup>56</sup>

*Operational Standards:* The FATF Recommendations regarding law enforcement and Financial Intelligence Units have been extended considerably. The revisions clarify the role and functions of the operational agencies in charge of combating money laundering and terrorist financing and establish the variety of investigative practices and powers which should be available to them, e.g., to acquire and analyse financial information about a suspected criminal's accounts and transactions.

*New Threats & New Priorities:* The FATF encounters new intensified threats such as:

- *Financing of Proliferation:* The proliferation of weapons of mass destruction is a serious security concern, and financial measures can be an efficient way to combat this threat. The FATF has adopted a new Recommendation intended to guarantee consistent and effective implementation of targeted financial sanctions when these are called for by the UN Security Council.

- *Corruption & Politically Exposed Persons:* The FATF Recommendations reinforce the requirements on financial institutions to identify politically exposed persons (PEPs) – who may signify a higher risk of corruption due to the positions they hold. The requirement which already exist to apply enhanced due diligence to PEPs has been expanded to foreign PEPs, with new risk-based requirements applied to domestic PEPs and PEPs from international organisations, and to the family and close associates of all PEPs – mirroring the techniques used by corrupt officials to launder the profits of corruption.

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<sup>55</sup> Ibid

<sup>56</sup> Ibid

- *Tax Crimes*: The list of predicate offences for money laundering has been extended to embrace serious tax crimes. The profits of tax crimes are introduced within the scope of the powers and authorities used to investigate money laundering. The smuggling offence has also been clarified to contain offences regarding customs and excise duties and taxes, contributing to improved synchronization between law enforcement, border and tax authorities, and eliminate possible impediments to international cooperation concerning tax crimes.

- *Terrorist Financing*: The financing of terrorism remains a significant concern for the international community and issue of major importance for the FATF Standards. The FATF's nine Special Recommendations on terrorist financing have been integrated fully within the Forty Recommendations, indicating how terrorist financing is a long-standing concern and the linking between anti-money laundering measures and measures to counter the financing of terrorism.<sup>57</sup>

*Clarifying obligations*: The FATF has updated its Recommendations to illustrate practices in the financial sector such as to establish clearer requirements for financial groups and to apply the experience gained from the implementation of the FATF Recommendations by countries, by clarifying customer due-diligence requirements where countries have had practical difficulties with implementation.<sup>58</sup> As far as Customer Due Diligence (CDD) obligations concerned which are reinforced, the new version of Recommendation 10 obliges countries to set CDD obligations in law whether this is through legislation or legally binding regulations. Financial institutions should be prohibited from keeping anonymous or fictitious accounts. In addition, they should be required to undertake customer due diligence (CDD) measures when establishing business relations, carrying out occasional transactions or when has doubts about the veracity or adequacy of previously obtained customer identification data. The CDD measures to be taken are Identifying the customer or the beneficial owner and verifying its identity using reliable information and taking reasonable measures to accomplish that and conducting ongoing due diligence on the business relationship.<sup>59</sup> Moreover, the requirement to comprehend the nature and purpose of a business relationship expands on the prior

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<sup>57</sup> Ibid

<sup>58</sup> Ibid

<sup>59</sup> The FATF Recommendations 'International Standards on combating money laundering and the financing of terrorism and proliferation' (updated October 2018), Recommendation 10, p. 12

requirement to simply collect data, which mirrors the advanced corporate and financial structures used today.<sup>60</sup> Furthermore, the obligation for record-keeping has been reinforced from merely an obligation to keep records to an obligation to keep all records, and the explicit inclusion of an analysis undertaken is coherent, with the emphasis on taking a risk-based approach. Moreover, the reference to occasional transactions displays how contemporary business is done, and the obligation by law to keep records further confirms the refined reinforcement of this provision.<sup>61</sup>

### *2.1.2 IOSCO principles on client identification and beneficial ownership for the securities industry*

On a global level, the alarms concerning financial crime within the universal financial system and mostly in the securities industry, had as a result that the members of the financial system were led to the implementation of particular principles and guidelines. The International Organisation of Securities Commissions (IOSCO) published on May 2004 the “Principles on Client Identification and Beneficial Ownership for the Securities Industry”, so that these principles constitute as guidelines for the securities regulatory authorities as well as for accredited securities services providers. The aforementioned principles underline the mutual characteristics between the diverse regulatory approaches to client and beneficial owner identification of IOSCO members, notwithstanding the fact that dissimilar legal structures are applied in diverse jurisdictions. Also, they intend to support the implementation of a client due diligence process (CDD) in the securities market in order to impede its misuse through illegitimate deeds such as money laundering and financing of terrorism. Particularly, according to Principle 1, “*authorized securities service providers (ASSPs) when establishing a business relationship with a client, should identify and verify the client’s identity using reliable, independent source documents data or other information*”. Moreover, according to Principle 1a “*ASSPs should have specific Client Due Diligence policies for omnibus accounts*”. When the client establishing the omnibus account is a domestic financial institution, the risk of illegal activity is lower. The application of simplified identification and verification procedures in relation to such accounts may be suitable. However,

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<sup>60</sup> Dennis Cox, *Handbook of Anti Money Laundering* (Wiley, 2014) p. 31-33

<sup>61</sup> *Ibid* at p. 34

when the client establishing the omnibus account is a foreign financial institution, the risks associated with the account in some circumstances may be considered to be potentially higher, and enhanced procedures may be required. These enhanced procedures include gathering sufficient information regarding the financial institution to understand its business, assessing the adequacy of that financial institution's CDD process, determining whether the financial institution has a physical presence in the jurisdiction where it is incorporated, assessing the regulatory regime of the country in which the financial institution is located, and documenting the respective responsibilities of each institution. Furthermore, "ASSPs should obtain sufficient information in order to identify persons who beneficially own or control securities accounts" as it is set up in Principle 2. According to this Principle, whenever securities appear to be acquired or maintained through an account are beneficially owned by a party other than the client, that party should be identified using client identification and verification procedures established in accordance with the criteria set out in Principle 1 and 1a, following a risk-based approach. When establishing a business relationship, all clients should be required to specify whether they are acting for their own account or for the account of beneficial owners and representatives. ASSPs should take reasonable measures to identify and verify the beneficial owners of client accounts, including reasonable measures to understand the ownership and control structure of clients that are non-natural persons. The recommended actions include that the client is required to certify to the account provider the identity of the persons who exercise ultimately effective control over a legal person. Know your client (KYC) practices, record keeping on the CDD process for at least five years, third party reliance, enhanced powers to the regulator and cooperation between jurisdictions and authorities, constitute the total of the principles of IOSCO.<sup>62</sup>

### *2.1.3 ISSA financial crime compliance principles for securities custody and settlement*

The International Securities Services Association (ISSA) issued the 'Financial Crime Compliance Principles for Securities Custody and Settlement' on 27 August 2015 and first revised on May 2017, in order to provide global guidance on the establishment and

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<sup>62</sup> The International Organization of Securities Commissions, *Principles on Client Identification and Beneficial Ownership for the Securities Industry* (MAY 2004) p.1-12



maintenance of cross-border securities custody relationships. Under ISSA terminology, a professional securities custodian may be defined as a regulated financial institution providing securities custody / safekeeping accounts, securities settlement and other related services. Thus, these principles aim to provide guidance to securities custodians, on how to best manage the risks that arise from the layers of intermediation between securities issuers and ultimate beneficial owners, and also provide to market participants with practical guidance on the question of transparency of ownership and control in the intermediated securities custody arrangements.<sup>63</sup> The custodians are used by its customers for the safekeeping of proprietary and third party interests in securities, and the settlement and clearing of securities trades.<sup>64</sup> All account holders of the custodian shall be subjected to appropriate due diligence that will seek to satisfy the custodian that it is comfortable conducting business with a particular account holder, in the light of that account holder's risk profile and the nature of the business relationship that it will have with the custodian. A strong indication that the account holder is not suspicious of conducting illegitimate business is the possible compliance of the account holder within a regulatory environment that applies and implements the principles of the Financial Action Task Force (FATF). However, the custodian should not rely solely on the account holder's regulatory status but should, as appropriate, take into account other information through the due diligence process. The custodian's policies and procedures shall require that the information on the account holder is reviewed and updated on a periodic basis. The relevant risk indicators that should be taken into account include the account holder's ownership and management structures, its geographic risk, account holder's business franchise and the anti-money laundering and compliance controls. Consequently, control methodologies must focus on asset holdings and not just on the execution of transactions by asset owners. Therefore, in dealing with custody accounts established for the purpose of safekeeping and transacting in securities interests ultimately owed to third party clients, the custodian shall apply the ISSA Principles and in order to ensure that the custodian can meet its obligations and fulfil the objectives of its compliance policies, it should communicate its requirements

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<sup>63</sup> The International Securities Services Association (ISSA), *Financial Crime Compliance Principles for Securities Custody and Settlement* (First Revision May 2017) p. 4

<sup>64</sup> *Ibid* at p. 5-6

to its account holders and obtain representations and undertakings relating to them contractually.<sup>65</sup> According to policies and standards that should be followed, it is the responsibility of the custodian to communicate to its account holders any relevant Know Your Customer (KYC) standards and other compliance and risk-based requirements that it expects them to follow. It is though the responsibility of the account holder in turn to comply with those standards and requirements. Where the account holder has direct clients who themselves accept deposits of third party client securities, it is the responsibility of the account holder to notify the clients that by holding securities cross-border they will be subject to the requirements of the jurisdictions in which the securities entitlements are held, including the standards of the relevant custodian. It is the responsibility of the account holder to sub-deposit securities with the custodian only when the ultimate asset owners have been subjected to satisfactory due diligence. In the case of omnibus client accounts kept for numerous clients of the account holder, specific factors of the account holders' business are controlled by the custodians. Whether the account holders are regulated and authorized to accept client assets, the regulatory framework under which they execute their operations, whether they have applied and implemented any particular requirements of the custodian concerning their compliance policies, all these establish relevant factors required to be taken into account by the custodians in order to commence or continue to do business with account holders that want to open or maintain with the custodian omnibus accounts commingling securities kept for their clients. The custodian has the right to request the beneficial ownership of assets deposited on omnibus client accounts to be disclosed to the custodian via an agreed operational procedure based on predetermined risk factors. Pursuant to Principle 17, the custodian should be entitled to require its account holder to disclose the identities of the ultimate buyers or sellers of securities within a reasonable period in response to a specific request predicated on risk factors.<sup>66</sup>

The above framework, including guidance and principles of IOSCO and ISSA, establishes the pillar stone of the anti-money laundering policies of intermediaries that take part in the intermediated holding chain.

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<sup>65</sup> Ibid at p. 8-10

<sup>66</sup> Ibid at p. 11-14

## **2.2 The EU Legislation**

The intensification of money laundering and terrorist financing along with tax evasion and national austerity programs resulted to the introduction of combating money laundering and financial crime onto the European Union political agenda. This has urged a series of directives to be passed through the European Commission. The common purpose of all these directives was guarding the universal financial system from being used for illegitimate purposes. The several EU money-laundering directives are the means how the EU integrates the FATF's international standards in order to provide consolidated money-laundering legislation, while simultaneously underlining particular further concerns which are of importance to EU lawmakers. As with all EU law directives, it is required by national governments to transform these requirements into domestic law.<sup>67</sup>

The First EU AML Directive (1991)<sup>68</sup> focused on combating the laundering of drug proceeds through the financial sector. Explicit obligations were placed on businesses in the financial sector for customer identification, staff training, record -keeping and the reporting of suspicious transactions. The Second AML Directive (2001)<sup>69</sup> amended the First by expanding the scope of predicate offences for which suspicious transaction reporting was obligatory from drug trafficking to all serious offences and by extending the scope of the Directive to include a number of non-financial activities and professions. The Third AML Directive (2005)<sup>70</sup> also extended its scope to combat the financing of terrorism. It is fundamentally based on the FATF Recommendations, adopting a risk-based approach to address money-laundering deterrence, which is encouraged throughout several provisions, particularly within due diligence requirements.<sup>71</sup> The Fourth AML Directive (2015)<sup>72</sup> restates pre-existing measures. The

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<sup>67</sup> Dennis Cox, *Handbook of Anti Money Laundering* (Wiley, 2014) p. 60

<sup>68</sup> Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering

<sup>69</sup> Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering

<sup>70</sup> Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

<sup>71</sup> Dennis Cox, *Handbook of Anti Money Laundering* (Wiley, 2014) p. 61-62

<sup>72</sup> Directive 2015/849/EU of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending

'risk-based' approach to the prevention and detection of money-laundering is preserved and reinforced. But four noteworthy developments are appeared. First, greater provision is set to remove the veil of secrecy by which natural persons act behind trusts, or who own or control a legal entity through direct or indirect ownership of shares, or voting rights or by "other means". This contains a requirement that Member States acquire and hold sufficient and reliable beneficial ownership information on a central register. Secondly, specific categories of natural and legal persons are acknowledged to be at risk of being targeted and misused by money-launderers. These include professionals and entities in charge of creating trusts, and corporate structures, as well as entities through whom the profits of crime may be laundered. Thirdly, further provision is made for obliged entities to apply customer due diligence measures and enhanced measures under specified conditions, especially concerning "high risk" third countries. Fourthly, it is mostly highlighted the collaboration "to the greatest extent possible" between Member States, their respective Financial Investigation Units (FIUs), and with the Commission.<sup>73</sup>

On April 19, 2018, the EU Commissioners welcomed the adoption by the European Parliament of the 5th Anti- Money Laundering Directive.<sup>74</sup> Almost a year after the implementation of the 4th Anti-Money Laundering Directive, the European Parliament has adopted a new directive which intends to supplement further layers to the European anti-money laundering framework. The 5<sup>th</sup> Anti-Money Laundering Directive ("5AMLD"), published on June 19, 2018, should be fully implemented into national law by the Member States by 10 January 2020. The declaration observed that the ambitious round of negotiations over the 5th Directive began in July 2016 in the corollary of the terrible terrorist attacks that struck the EU and the massive financial transactions revealed by the "Panama Papers." It provides with a series of measures in order to enhance the countering of the financing of terrorism and to ensure increased transparency of financial transactions, the most important of them are: *a. Register of Beneficial Owners*

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Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC

<sup>73</sup>Rudi Fortson, *'Intensifying anti-money laundering laws-the last 30 years'* [2016] Archbold Review, 4, p.6

<sup>74</sup>Directive 2018/843/EU of the European Parliament and of the Council of 30 May 2018 amending Directive 2015/849/EU on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU

- The 4th Anti-Money Laundering Directive obliged EU Member States to acquire and hold precise and up-to-date information on corporate and other legal entities, and to make such information available to persons with a "legitimate interest." The 5AMLD has proceeded one step further and requires that all EU citizens should have access to such information without needed to prove a legitimate interest in such information. In addition, the beneficial ownership register requirements also apply to trusts and similar arrangements, subject to the "legitimate interests" requirements. In this regard, Member States are also provided with the discretion to permit wider access to beneficial ownership information on trusts.<sup>75</sup> The beneficial ownership registers for legal entities are public. This wider access to part of the beneficial ownership information strengthens public scrutiny and contributes to preventing the misuse of legal entities for money laundering and terrorist financing purposes. The access to information on the beneficial owner of trusts is possible without any limitations to competent authorities, Financial Intelligence Units, the professional sectors subject to Anti-Money laundering rules, such as banks, lawyers, etc. and is available to other persons who can demonstrate a legitimate interest. Moreover, when a trust is a beneficial owner of a corporation, access to this information can be requested via a written request. The national registers on beneficial ownership information are interconnected directly to assist collaboration and exchange of information between Member States. Additionally, Member States have to set up confirmation mechanisms of the beneficial ownership information collected by the registers to support improve the accuracy of the information and the trustworthiness of these registers.<sup>76</sup>

*b. Strengthening FIUs* - To ensure that FIU'S start receiving and sharing information in an efficient and timely way, the new directive demands that EU Members should start providing with automated information systems, such as central registers. Moreover, the 5 AMLD provides for the enhanced powers of FIUs, who shall be allowed access to information from entities on their own initiative and without the need of a prior report being made.

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<sup>75</sup>Bruce Zagaris, 'EU Adopts 5<sup>th</sup> AML/CFT Directive and Directive on Use of Financial and Other Information in Criminal Cases', [2018] International Enforcement Law Reporter, 34 (5), p. 328

<sup>76</sup> Věra Jourová, *Strengthened EU rules to prevent money laundering and terrorism financing*, Directorate-General for Justice and Consumers, European Commission, Fact sheet, 9 July 2018

*c. Enhanced Due Diligence for High Risk Countries* - At present, EU Member States are at liberty to regulate their own enhanced due diligence procedures regarding high risk third countries, and this has resulted in several differences. The 5AMLD targets to create a standardised approach to professional relations involving high risk countries and creates unified enhanced due diligence measures across the EU.<sup>77</sup>

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<sup>77</sup> Bruce Zagaris, 'EU Adopts 5<sup>th</sup> AML/CFT Directive and Directive on Use of Financial and Other Information in Criminal Cases', [2018] *International Enforcement Law Reporter*, 34, (5), p. 328

### **Chapter 3: Access to beneficial ownership information and data protection implications**

This last chapter underlines the complications between increased transparency requirements and protection of data and privacy rights.

The effort on the way to transparency in the framework of money laundering, terrorist financing and other unwanted behavior, nonetheless, might conflict with concerns and requirements as regards privacy, data protection, confidentiality and (banking) secrecy that by nature prevent transparency. For example, IOSCO Principles underline that ‘no domestic secrecy laws, regulations, codes or provisions’ should obstruct or constrain the gathering of data and records by the regulator and, in terms of international cooperation, the provision of client identification information. Simultaneously, regulators have to make sure that the information gained by foreign regulators are utilized ‘consistent with requirements concerning privacy and data protection’. Under the revised FATF Recommendations, it is required that authorities make certain that national cooperation in the area of money laundering and terrorist financing is compatible with ‘Data Protection and Privacy rules and other similar provisions’ and also that countries ‘should ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations’. Furthermore, the ISSA Principles bring up the issue of ‘local legal or regulatory requirements that make compliance with the above Principles unlawful without appropriate consents or at all’. Moreover, in Fifth Anti-Money Laundering Directive is stated that access to certain beneficial ownership information shall be ‘in accordance with data protection rules’.<sup>78</sup>

As it is indicated in previous chapter, the Fifth Anti-Money Laundering Directive (5 AMLD) targets to enable even greater financial transparency, particularly by offering authorities and FIUs with timely and unrestricted access to beneficial ownership information and through the implementation of public registers. An explanation for improving access to beneficial ownership information on corporate entities and trusts is that the comprehension of such information is essential to reduce the threat of financial

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<sup>78</sup> Thomas Keijser and Charles W Mooney, ‘Intermediated Securities Holding Systems Revisited: A View Through the Prism of Transparency’ in *Intermediation and Beyond*, Louise Gullifer and Jennifer Payne (eds), (Hart Publishing 2019) p. 330

crime and shape prevention policies. Enhancing public access to beneficial ownership, assist to the prevention of the misuse of corporate entities and trusts through greater scrutiny. Furthermore, the expansion of access to beneficial ownership information to those with a 'legitimate interest' raises several concerns regarding the possible tension between the privacy and transparency of a trust. Parties with a 'legitimate interest' were described as any person or organisation who can demonstrate engagement with or proven track record in activities related to fighting money laundering and terrorist financing, or 'associated predicate offences' activities. Moreover, constraining public access to central register information on trusts to those with a legitimate interest may appear as a reasonable and practical compromise to moderate concerns about confidentiality and privacy breaches. However, due to the lack of clearer guidelines about the fundamental sense of 'legitimate interest', there is the peril of dissimilar legal senses adopted by Member States which could affect the scope of access to information. Therefore, a serious concern is raised by the European Data Protection Supervisor (EDPS) about regulating access by parties claiming a 'legitimate interest' in order to escape opportunistic access. Additionally, Member States could permit broader access to register information which indicates that the transparency net can be thrown even broader beyond those with a 'legitimate interest'. The broadening scope of accessibility brings into surface the relevant question whether transparency could balance with privacy and data protection. For example, a trustee has a duty of confidentiality as a fiduciary. However, this confidentiality duty may be overridden on public interest grounds or under coercion of law. Someone could argue that there may be solid policy grounds for allowing disclosure on public interest grounds if the privacy that the trust scheme provides, can be used as a cover for abuse and corruption. In contrast, the increasing request for enhanced financial transparency accompanied by wider disclosure of and access to confidential information creates tension with the fundamental concept of privacy.<sup>79</sup>

The common basis, regarding which personal data and beneficial ownership information may be collected, comes with the extension of the policy objectives for such collection

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<sup>79</sup> Simone Wong, 'The New EU Anti-Money Laundering Directive: Farewell to transparency of UK trusts' [2017] *Trust Law International*, 31 (3). pp. 137-151



as well as the processing and use of the information. As far as data protection is concerned, two related principles deserve extra research, i.e. the ‘purpose limitation’ principle and the ‘proportionality principle’. The ‘purpose limitation’ principle targets to make sure that personal data are collected for ‘specified, explicit and legitimate’ purposes. The Fifth Anti-Money Laundering Directive, according to the EDPS<sup>80</sup>, causes insecurity regarding the aims pursued on those who are processing the data, i.e. the data controllers, which decrease data protection defenses, such as the proportionality among processing personal data and the aims of such processing. Secondly, the principle of proportionality is a well-founded principle which demands proportionality among the measure taken that conflicts with data protection and the aims pursued to be accomplished. Furthermore, the wide approach taken in the Fifth AML Directive concerning whose data should be collected and when these data should be disclosed and registered raises further concerns. While the Fourth AML Directive clearly supported a risk-based approach, the amendments by the Fifth AML Directive designate that risk only may not be adequate and increased requirements appeared for ongoing monitoring of particular existing clients. Moreover, the reporting obligations included in the Fifth AML Directive in relation to trusts indicate that a bigger amount of data may need to be reported about trusts irrespectively of whether they cause e.g. tax consequences or pose any efficient risk to money laundering, terrorist financing or other related predicate offences. With the formation of public central registers added, access is provided to not only law enforcement authorities and FIUs but also the public, though on a limited basis, which may raise a further potential for issues of proportionality to arise.<sup>81</sup>

The EDPS questions whether the broader access offered by the Fifth AML Directive is truly needed and argues that, if the purpose of policy of beneficial ownership information’s publicity is detecting and combating money laundering, terrorist financing and other criminal activities, such as, tax evasion, in a timely and effective way, it may

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<sup>80</sup> European Data Protection Supervisor, Opinion 1/2017, ‘Opinion on a Commission Proposal amending Directive (EU) 2015/849 and Directive 2009/101/EC: Access to beneficial ownership information and data protection implications’, (2 February 2017), p.8-14, available at [https://edps.europa.eu/sites/edp/files/publication/17-02-02\\_opinion\\_aml\\_en.pdf](https://edps.europa.eu/sites/edp/files/publication/17-02-02_opinion_aml_en.pdf)

<sup>81</sup> Simone Wong, ‘The New EU Anti-Money Laundering Directive: Farewell to transparency of UK trusts’ [2017] Trust Law International, 31 (3). pp. 137-151

be done in an equivalent way by ensuring that such data is transferred to competent authorities, without the requirement for public access. Thus, when public access to personal data is provided, it is crucial that careful consideration should be given to the proportionality of the measures providing such access. It would appear that once a third party, even though one with a 'legitimate interest', gains access to such data, the confidential information is questionably within the public domain and thus loses its right to the protection of confidentiality. This may be challenging given that there is no clarity yet regarding the numerous aims for processing the data and who amongst numerous data controllers should be considered reliable. Therefore, these privacy concerns have driven the EDPS to phrase explicitly serious worries about the scope of the Fifth AML Directive and its solid possibility to violate data protection and privacy rights on the grounds of proportionality.<sup>82 83</sup>

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<sup>82</sup> Ibid

<sup>83</sup>European Data Protection Supervisor, Opinion 1/2017, 'Opinion on a Commission Proposal amending Directive (EU) 2015/849 and Directive 2009/101/EC: Access to beneficial ownership information and data protection implications', (2 February 2017), p.8-15, available at [https://edps.europa.eu/sites/edp/files/publication/17-02-02\\_opinion\\_aml\\_en.pdf](https://edps.europa.eu/sites/edp/files/publication/17-02-02_opinion_aml_en.pdf)

## Conclusions

The vulnerabilities of the securities sector in the financial system is exceedingly elevated, having always in mind the complexity and the speed of the performed transactions in this market, which frequently take place in a cross-border context. If one adds the inherent characteristics of the non-transparent intermediated holding systems that would not contribute to the revelation of the investor's identity it is evident that these vulnerabilities are much elevated. The so-called 'no- look-through' principle in these systems forms a gap among the investor and the issuer, including the (upper-level) intermediaries between them, which causes significant problems in identifying the investor and the source of its funds. This situation may be abused by the perpetrators of financial crime, which may misuse the financial system and the securities sector particularly for money laundering, financing of terrorism and proliferation, insider trading, market manipulation and other undesirable behavior.

In this context, a regulatory framework was developed in order to detect and prevent the movement of illegitimate funds within the financial system, by implementing increased transparency requirements both in International and EU level. Indeed, the adoption of more transparent holding systems could reduce significant problems caused by intermediation. Although, such transparency requirements should be implemented, as already discussed, with respect to the protection of data and privacy of individuals', in terms of two interconnected principles, the 'purpose limitation' principle and the 'proportionality' principle.



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