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The contribute of financial institutions to the effectiveness in preventing money laundering and terrorist financing

A comparative perspective of Portuguese and Spanish frameworks

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Abstract

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Financial crime has become more relevant with the development of financial markets and instruments. More specifically since 1980s, money laundering – one of the types of financial crime considered in this study – has increased popularity, due to its connection with drug trafficking offences. Other considerable financial crime in the scope of this study is terrorist financing, which importance has been amplified after September 11th terrorist attacks. These two types of crimes involve financial and non financial institutions of every country, and their prevention is a responsibility not only of governments but of all entities with favourable conditions to be used as intermediaries to launder money or finance terrorism.

In this study, the role of financial institutions in detecting and preventing these crimes will be analysed. Through the effectiveness of transactions reported from these institutions and the costs they have to support to comply with regulations, an overview of the Portuguese and Spanish frameworks will be developed. Moreover, this study aims to add some value to Portuguese anti-money laundering and combating terrorist financing frameworks, by comparing Portuguese and Spanish compliance level in these issues and understanding to which extend can Portugal improve its framework based on actions performed by Spain.

It was possible to conclude with this study that regarding financial institutions STRs, Portuguese performance was better than Spanish. Furthermore, the costs of compliance were found to be similar in the two countries. Finally, Portugal can improve its framework applying similar measures to the ones present in Spain, such as the issuing of lists with countries that have weak anti-money laundering and combating terrorist financing frameworks or the extension of the duty of keeping records of unusual transactions to all financial institutions.

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List of Abbreviations

AML	Anti-Money Laundering
BdP	Bank of Portugal *(Banco de Portugal)*
BIS	Bank for International Settlements
CFT	Combating the Financing of Terrorism
CMVM	Portuguese Securities Market Commission *(Comissão do Mercado de Valores Mobiliários)*
DCIAP	Central Department for Criminal Investigation and Prosecution *(Departamento Central de Investigação e Acção Penal)*
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FSA	Financial Services Authority
IBA	International Bar Association
ISP	Portuguese Insurance Institute *(Instituto de Seguros de Portugal)*
KYC	Know Your Customer/Counterparts
KYP	Know Your Processes
KYT	Know Your Transactions
ML	Money Laundering
NCCTs	Non-Cooperative Countries and Territories
PEP	Politically Exposed Person
SEPBLAC	Executive Service of the Comission for the Prevention of Money Laundering *(Servicio Ejecutivo de la Comisión de Prevención de Balnqueo de Capitales e Infracciones Monetarias)*
STR	Suspicious Transaction Reported
TF	Terrorist Financing
UIF	Portuguese FIU *(Unidade de Informação Financeira)*
UN	United Nations

Chapter I – Introduction

"The clampdown on money laundering and corruption is the common responsibility of all the countries in the world."

Wang Zhaowen (Spokesman for the Bank of China)

1.1 Background

Money laundering can be described as an activity that occurs when a transaction that takes place involves any type of property or benefit – tangible or intangible – derived from a criminal activity (Hopton, 2009). It started to attract interest in the 1980s, mainly in a drug trafficking context, due to the large amount of profits generated then. This fact led governments to the creation of laws aiming to fight against drug dealers, depriving them of illicit gains, and also to avoid the corruption of governmental structures by criminal organizations dealing with these issues (Steel, 2006). However, since much earlier, people used money laundering techniques not only to transfer money resulting from crime but also to move it from the reach of governments, especially from oppressive regimes that could try to monopolize their wealth (The Anti-Money Laundering Network, 2011). In practical terms, money laundering can be considered as the act of turning dirty money into clean money, whatever the illegal method of earning it and reasons behind this action.

In the same scope of money laundering, another illegal activity that has adverse impacts on society is terrorist financing. However, terrorist financing does not necessarily involve illegal funds since in this process, legally or illegally originated funds are used to support terrorist organizations and their activities. This slightly differs from money laundering since the objective of individuals involved in the financing of terrorism is rather covering the funding activity than the sources of the funds (IMF, 2011). Although this topic increased its popularity after the United States' attacks in 2001, the concept of terrorist financing has been defined a few years earlier and so has started the fight against this problem (The World Bank, 2006).

To deal with these issues, a group of sixteen members – fifteen countries and the European Commission – formed the Financial Action Task Force, in 1989. This group is responsible for setting methods of combating money laundering and terrorist financing, for examining trends and techniques and for reviewing actions performed by countries to fight against these issues. In this sense, Forty Recommendations and Nine Special Recommendations

were published by the Financial Action Task Force in 2003, which shall be used as an action plan by countries in order to develop a solid anti-money laundering and combating financing of terrorism framework. Additionally, other entities such as the United Nations and the Basel Committee have been dealing with these matters (FATF, 2011).

1.2 Problem statement

As mentioned by Wang Zhaowen, the fight against money laundering and terrorist financing is a responsibility of all the countries in the world. In order to do it, governments and entities have to build solid anti-money laundering and combating the financing of terrorism frameworks that incorporate regulations and that are comprehensive in both scope and application. In this sense, it is interesting to understand how countries are building their frameworks and how effective are the measures taken in really combating these issues.

1.3 Aims and Scope

After understanding the activities and some of the more relevant actors in this topic, the specific goal of this dissertation is to understand some of the variables that can influence the effectiveness of anti-money laundering and combating the financing of terrorism frameworks in two neighbouring countries: Portugal and Spain. In this sense, for both Portugal and Spain, what will be considered is the role of financial institutions in contributing to an effective framework, through the number of suspicious transactions reported that derived into further investigations. This will help to understand the weight that operations reported by financial institutions have on the overall investigations conducted by each country. In line with this topic, the amounts frozen in Portugal and Spain will be analysed as well and an effort will be made to understand which institutions reported operations that originated the frozen of funds.

Moreover, it is known that in order to have an effective framework in place, institutions have to perform adjustments to their structure. In financial institutions, these adjustments are reflected, for instance, in the creation of compliance departments aimed to deal with money laundering and terrorist financing regulations. Consequently, this has an impact in costs supported by these institutions that can be more significant as processes, systems and resources implemented are more complex. In this study, costs with compliance offices will

be explored, comparing the costs beard by Portuguese financial institutions that operate in Spain with Spanish financial institutions that operate in Portugal.

Finally, Financial Action Task Force developed Mutual Evaluation Reports of these two countries in 2006, reviewing their performance in implementing the 40+9 Recommendations and as a result creating comprehensive anti-money laundering and combating the financing of terrorism frameworks. From these reports resulted recommendations in how to improve the aspects considered weaken, that should be reviewed every two years by the countries. The last follow up reports of Portugal and Spain, issued in 2010, will be considered in this dissertation, to understand the differences between compliance levels of the two countries and efforts in the creation of effective frameworks. Through this, and focusing on recommendations in which Spain demonstrated to have a higher level of compliance, an advice on how Portugal can improve its framework will be presented.

1.4 Dissertation Outline

The second chapter of this dissertation presents the literature review. Then, in Chapter III is presented the resultant conceptual framework and research questions that conducted the study, the methodology adopted, the data collected and its sources. This data was used to produce an analysis and related discussion, presented in Chapter IV. Finally, the conclusion of the study, limitations and future research are highlighted in Chapters V and VI respectively.

Chapter II – Literature Review

2.1 Conceptual Background

2.1. a) Money Laundering

Money laundering (ML) can be defined, according to the *United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*, most known as *Vienna Convention* (1988), as:

- "The conversion or transfer of property, knowing that such property is derived from any offence or offences or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions" (Vienna Convention, 1988, p. 3);
- "The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences or from an act of participation in such an offence or offences" (Vienna Convention, 1988, p. 3), and;
- "The acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offence or offences or from an act of participation in such offence or offences" (Vienna Convention, 1988, p. 3).

To the underlying criminal activity that generates the proceeds to be laundered, is given the name of "**predicate offence**" (The World Bank, 2006; Truman, 2007). The *Vienna Convention*, explained later on this chapter, limits predicate offenses to drug trafficking offences, excluding crimes like, for instance, fraud, theft and kidnapping (The World Bank, 2006). However, the *Palermo Convention*, which will also be mentioned below on this chapter, considers predicate offences as "any offence as a result of which proceeds have been generated that may become the subject of a *[money laundering]* offence" (Palermo Convention, 2000, p. 6). In fact, although ML concerns started due to its connection to illegal drug trafficking, today illegally gotten profits are obtain through a wide range of criminal activities such as illegal sales of weapons, political corruption and exploitation of human beings (Molander *et al.*, 1998; The World Bank, 2006).

Whatever the crime behind the generation of proceeds, the process of ML always comprises three stages: **placement**, **layering** and **integration** (Steel, 2006; The World Bank, 2006). The

first stage occurs when illegally obtained funds are placed into the financial system, commonly through a financial institution. There is not a single method to do this: the cash can be deposited into a bank account – once or over time, in the same or in different offices and in a single or in multiple financial institutions – but can also be converted into financial instruments – as checks or money orders –, exchanged by another currency or even mixed with legal funds. It is also possible that illegal funds are used to purchase a security or an insurance contract, as a way to place them into the system and avoid suspicions (Peterson, 2008). After the funds have entered the financial system, it is necessary to obscure their origin, what is made by moving them to other institutions. Securities, insurance contracts or investment instruments are then bought and sold through a different (from the one where the money was first placed) institution. In this second stage, in order to disseminate funds, the launderer can also declare their transference as a payment for goods and services, or even transfer the funds to a shell corporation[(1)] (The World Bank, 2006; Woda, 2006). Finally, the illegally gotten funds are integrated into the legitimate economy through the purchase of assets like financial assets, luxury goods or real estate (Madsen, 2009). Moreover, it is also important to mention that the techniques – generally referred as **methods** or **typologies** – to launder money can be different between countries because of unique characteristics of each country regarding complexity of financial markets, economic conditions, anti-money laundering (AML) regimes, international cooperation and enforcement efforts (The World Bank, 2006).

2.1. b) Terrorist Financing

Although the meaning of terrorism is not universally accepted due to political, national and religious implications that are not common from country to country, the United Nations (UN) has made efforts to fight it and the mechanisms used to finance it, even before 2001 September 11th attacks revealed the importance of this issue (The World Bank, 2006). *International Convention for the Suppression of the Financing of Terrorism* (1999), explained later on this chapter, provides the following definitions of **Terrorist Financing (TF)**, adopted by most countries:

[1] According to The American Heritage Dictionary of Business Terms (2010) a shell corporation is "a corporation that has no active business operations and few or no assets. Shell corporations are often formed to acquire the assets of an existing corporation. They are sometimes formed to avoid taxes or

- "An act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex[(2)]" (International Convention for the Suppression of the Financing of Terrorism, 1999, Article 2), and;
- "Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act (International Convention for the Suppression of the Financing of Terrorism, 1999, Article 2)."

The main difference between TF and ML is the fact that the funds terrorists use to support their activities do not necessarily come from a criminal act, as they may be originated from legal sources (Bureau for International Narcotics and Law Enforcement Affairs, 2005). After obtaining the money, either legally or illegally, the two first processes of TF are similar to the ones of ML: there is the **placement** of funds, in which the cash is deposited into accounts followed by the **layering**, when funds are moved to other institutions in order to obscure its origins. However, the third stage – **integration** – differs from ML in the sense that funds are distributed to terrorists and their supporting organizations, and not incorporated into the legitimate economy (Bureau for International Narcotics and Law Enforcement Affairs, 2005; The World Bank, 2006).

In order to combat the financing of terrorism (CFT), it is necessary that countries expand the scope of AML frameworks in order to involve, for instance, non-profit organizations and particular charities, preventing their direct or indirect use to finance or support terrorist activities (FATF, 2009). It is important to bear in mind that, as funds to finance terrorism can come from legitimate sources – as charity donations or cash gifts to organizations – special attention should be given to this subject. In the case that funds come from illegal activities, they may already be covered by the country's AML framework and be easily detected (Giraldo and Trinkunas, 2007; The World Bank, 2006).

2.1. c) ML and TF impacts

ML and TF can weaken financial institutions in different ways. First, there is an increase in the probability that **corrupt individuals within the institution will defraud customers**. As

[2] A list of the treaties listed in the annex of *International Convention for the Suppression of the Financing of Terrorism* is replicated in Appendix 3.

the financial activity increases, financial crime and ML also increase and, in fact, FATF declared in 1997 that, after drug trafficking, financial crime is the most frequent predicate offence (Bartlett, 2002). Moreover, criminal interests can eventually control an entire financial institution, which lead to a **financial failure**. This has higher probability of happening in developing countries due to the predominance of smaller institutions and to the less rigorous regulation applicable to financial institutions (Bartlett, 2002). In addition, the weakening of financial institutions leads to a **reduction in economic growth**, since there is a direct link between the two (Beck *et al.*, 2001). Front companies used by criminals are able to access illicit funds to promote and sponsor its products and services, commonly at a price below the market, what makes it very difficult for legitimate companies to compete and can **compromise economy** (The World Bank, 2006). Consequently, there is an increased probability that the country suffers from **monetary instability**, due to a misrepresentation of asset and commodity prices (McDowell and Novis, 2011).

There are also some risks related to ML and TF activities. The most studied one is the **reputational risk**, which is the potential adverse publicity regarding business practices that a financial institution could be victim of and that could cause a loss of confidence from the customers (The World Bank, 2006). When a financial institution has a loss of reputation for integrity and customers or potential customers believe that the institution is likely to contain individuals willing to commit fraud, that it is a criminal institution itself or that it may become insolvent, they will cease business relations with that institution. Not only customers, but also investors and other financial entities will be loath to start or maintain business with that institution, whether this negative reputation has fundaments or not (Bartlett, 2002; The World Bank, 2006). Financial institutions are very vulnerable to this risk, since they can easily be a victim or a vehicle of illegal activities performed by their customers (BIS, 2011). Furthermore, there is also a **problem of liquidity** for the entity that receives laundered funds, since they might be subject to unanticipated withdrawals of large amounts, what jeopardizes the management of the institution (The World Bank, 2006). ML and TF also comport **operational risks**, which according to Basel Committee on Banking Supervision – which will be referred later on this study –, are "the potential for loss resulting from inadequate or failed internal processes, people and systems, or external events" (BIS, 2011). If customers have the perception that a financial institution cannot manager its operational risk in an effective manner, the business will be seriously affected (BIS, 2001). As customers may also be victims of financial crimes, they can sue financial institutions, making these ones bear law suits, adverse judgments, fines and penalties that involve large costs and that can

even lead to closure of the institution – this represents a **legal risk** for financial entities (The World Bank, 2006). When a financial institution has in place an effective due diligence regime, explained later in this project, the **concentration risk** is reduced. This risk can occur due to a possible loss that results from having a high level of credit or loan exposure to one borrower and a reduced knowledge about that customer. This is particularly important in the context of counterparts and connected lending (BIS, 2001).

2.1. d) Standard developers

i. UN

UN is an international organization founded in 1945 with the objectives of "maintaining international peace and security, developing friendly relations among nations and promoting social progress, better living standards and human rights" (UN, 2011). Nowadays, UN has one hundred and ninety-two member states and it is active in the fight of ML through its *Global Programme Against Money Laundering*. This is not recent, since it was the first organization to reveal concerns regarding ML, and had even adopted in 1980 the guide "Measures Against the Transfer and Safekeeping of Funds of Criminal Origin" (UN, 2011; The World Bank, 2006). One important fact of this organization is that it has the ability to adopt conventions and treaties, which have the effect of law in a country from the moment such country signs, ratifies and implements them (UN, 2011; The World Bank, 2006). Three examples of these conventions, relevant to this study, are presented below.

- ***United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (The Vienna Convention)***

UN started an international agreement to combat drug trafficking and ML and adopted, in 1988, the *United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* – also known as *Vienna Convention* due to the city where it was signed. This convention, signed by one hundred and sixty-two countries, deals with requirements to fight the illicit drug trade and related law enforcement issues (UN, 1988). The increasing concern about drug trafficking and the money related entering into the bank system, makes the convention define the concept of "money laundering" and appeals that countries criminalize this activity. Nevertheless, and as mentioned before, Vienna Convention limits predicate

offences to drug trafficking offences and does not address the ways to prevent ML (The World Bank, 2006).

- ***United Nations Convention Against Transnational Organized Crime (The Palermo Convention)***

Palermo Convention, which name is also related to the city where it was signed, was adopted in 2000, aiming to increase the scope of *Vienna Convention* in the fight against international organized crime. In this sense, this convention contains a broad range of requirements to fight organized crime, and oblige countries that sign it to implement these requirements through passage of domestic laws (Palermo Convention, 2000). Regarding ML, according to The World Bank (2006, p. III-3), this convention requires ratifying countries to "criminalize money laundering and include all serious crimes as predicate offences of money laundering, whether committed in or outside of the country, and permit the required criminal knowledge or intent to be inferred from objective facts". Moreover, article seven of Palermo Convention, states that each state party shall institute a regulatory and supervisory regime for banks and non-bank financial institutions, in order to detect all forms of ML, and to require customer identification, record-keeping and reporting of suspicious transactions (Palermo Convention, 2000). It also refers that administrative, regulatory and law enforcement authorities shall cooperate and exchange information at national and international levels and that a financial intelligence unit (FIU), explained later on this chapter, may be established by governments to collect, analyse and disseminate information regarding potential ML (Palermo Convention, 2000). Furthermore, this convention also states that ratifying states shall promote international cooperation (Palermo Convention, 2000). This convention was singed by one hundred and seventy-four countries, ratified by eighty-two countries and it went live in 2003 (The World Bank, 2006).

- ***International Convention for the Suppression of the Financing of Terrorism***

Even before the United States attacks in 2001, the terrorist financing was an international concern due to the worldwide growth of acts of terrorism in all its forms and manifestations and the impact they have on governments and society (UN, 1999; The World Bank, 2006).

In this sense, UN adopted in 1999 the *International Convention for the Suppression of the Financing of Terrorism*. According to this convention, a person commits an offence if he

provides or collects funds with the intention or in the knowledge that they will be used to put into practice an act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex of this convention, replicated in Appendix 2 of this study, or any other act intended to cause death or serious injury to any person (UN, 1999).

ii. FATF

Financial Action Task Force (FATF) was established in 1989 in Paris, by the G-7 Summit[3], with sixteen members: the G-7 member States, the European Commission and eight other countries. It was given the responsibilities of examining ML techniques and trends, reviewing actions taken national and internationally and setting measures in order to combat ML (FATF, 2011).

Therefore, FATF can be considered a "policy-making" institution, working to encourage the political will to create national legislative and regulatory AML and CFT reforms (FATF, 2011). In 1990, FATF published a report with ***Forty Recommendations***, which represent an action plan regarding the fight against ML (FATF, 2011). This report was revised in 2003 to reflect updated circumstances in ML activities, and mainly comprises a framework for AML, setting out principles for action but permitting flexibility for countries in implementing them. These recommendations have been approved by the international community and relevant organizations as being the standard for AML and for these reason countries have to meet them in order to be considered a cooperative country (The World Bank, 2006). The terrorist attacks to the United States in 2001, revealed the importance of detecting, preventing and suppressing the financing of terrorism. Consequently, FATF expanded its mission to develop also the standards in the fight against TF and in 2004 a document was issued by this institution setting out the framework with mandates for countries to deal with these problems: ***Nine Special Recommendations*** on TF (FATF, 2011). Since the publication of these **40+9 Recommendations**, replicated in Appendix 1 of this study, FATF conducts regular evaluations to countries, in order to understand their level of compliance with both AML and CFT principles (FATF, 2011). Moreover, every two years countries shall carry out follow up reports to FATF evaluations, stating progresses that have been made to improve the level of

[3] G-7 is a group of finance ministers of seven developed and industrialized nations: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. This group was formed in 1976, and in 1998 Russia formally joined the group, that became then denominated as the G-8. The members have an annual meeting – denominated Summit – in which the eight countries, plus the Leader of the country holding the Presidency of the European Union and the President of the European Commission, meet to discuss important issues (Summit 2003, 2011).

compliance with recommendations. To score this level of compliance, FATF has a five-level rating scale based on essential criteria, replicated below in Table 2.1.

Table 2.1 – Compliance Ratings

Level of compliance	*Criteria*
Compliant	The Recommendation is fully observed with respect to all essential criteria.
Largely compliant	There are only minor shortcomings, with a large majority of the essential criteria being fully met.
Partially compliant	The country has taken some substantive action and complies with some of the essential criteria.
Non-compliant	There are major shortcomings, with a large majority of the essential criteria not being met.
Not applicable	A requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country e.g. a particular type of financial institution does not exist in that country.

(Source: Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations, FATF 2009)

Currently, and since 2007, thirty-four members compose the FATF, which has also the collaboration of associate members and observers that are presented in Appendix 2 (FATF, 2011). Its primary functions are now to monitor members' progress in implementing measures – by a two-stage process that involves self assessments and mutual evaluations –, to review and report laundering trends, techniques and methods – issuing annual reports referring developments in these areas – and finally, to promote the adoption and implementation of AML and CFT standards globally (The World Bank, 2006). To address this last function, the FATF adopted a process of identifying the "**non-cooperative countries and territories**" (NCCTs) and publish them on a public list. The objective of FATF is to encourage the countries in this list to take sufficient measures in order to be removed from it. In the case a country does not make progresses regarding its compliance with FATF Recommendations, counter-measures are taken to this country that can implicate, for instance, the cessation of financial transactions from FATF-member countries with the non-compliant country. This represents a serious problem for the NCCT, since its financial institutions, businesses and international reputation will be jeopardized (FATF, 2009).

iii. The Egmont Group

The Egmont Group is a group of FIUs, formed in 1995, which meet regularly in order to find ways to cooperate in areas of information exchange, training and the sharing of expertise. Its goal is to improve cooperation in the fight against ML and TF and to promote the implementation of domestic programs in these areas (The Egmont Group, 2009). Furthermore, they provide the exchange of information between financial institutions and law enforcement (The World Bank, 2006). To enter in this group, a FIU must meet the Egmont FIU's definition and commit to act in accordance with the *Egmont Group's Principles for Information Exchange Between Financial Intelligence Units for Money Laundering Cases* (The Egmont Group, 2009; The World Bank, 2006), which include, according to The Egmont Group (2009), conditions for the exchange of information, limitation on permitted uses of information and confidentiality. This group does not have a secretariat and a permanent location, meeting in plenary session once a year and in working groups three times a year (The World Bank, 2006).

For the purpose of this study, it is relevant to present more details regarding the structure of the members that compose this group. According to The Egmont Group (2009), a FIU is "the central national agency responsible for receiving (and as permitted requesting), analyzing and disseminating to the competent authorities, disclosures of financial information concerning suspected proceeds of crime, or required by national legislation or regulation to combat money laundering". In 2004, this definition was extended to include TF. Across countries, four models of FIU can be identified in accordance with the influences that molded their creation: the **Judicial Model**, established and run by the judicial division of the government; the **Law Enforcement Model**, that working under the management of a security force, supports the efforts of law enforcement or judicial authorities; the **Administrative Model**, which gathers and processes information from financial sector and forwards it to judicial or law enforcement authorities; and finally, the **Hybrid Model** that combines two or more of the previous mentioned types (The Egmont Group, 2009). Each model of FIU has its particular advantages and disadvantages that are identified in Table 2.2. Additionally, in Table 2.2 it is possible to see which model of FIU some countries have adopted.

Table 2.2 - Types of FIUs

Model of FIU	*Advantages*	*Disadvantages*	*Countries where the model was adopted*
Judicial	Independence from political power.	High level of trust is necessary to be present between obliged entities and authorities.	Cyprus; Luxemburg.
Law Enforcement	Total use of the information disclosed; fast police reaction; easiness of access to other databases.		Portugal; Germany; Finland; UK.
Administrative	Balanced relationship of independence from the obliged entities and the authorities.	Low level of ability to collect material.	Belgium; Netherlands; Spain; USA.
Hybrid	(Advantages and disadvantages of the combined models that form the hybrid)		Denmark; Norway.

iv. The Basel Committee on Banking Supervision

Since financial institutions are the entities considered in the scope of this study, The Basel Committee on Banking Supervision is an important entity to be referred. This committee meets regularly four times a year, with the objective of enhancing understanding of key supervisory issues and improve the quality of banking supervision worldwide (BIS, 2011). It was formed in 1974 and currently has members from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States, represented by their central bank or by the authority with responsibility for banking supervision (BIS, 2011; The World Bank, 2006).

This Committee does not have supervisory authority or force of law. In this sense, it formulates supervisory standards and guidelines, recommending statements of best practices on a wide range of banking issues, expecting that authorities in each country take measures to implement them. Moreover, it also encourages cooperation among its members and other supervisory authorities (BIS, 2011). Three of the supervisory standards

and guidelines created by the Basel Committee are related to ML and will be briefly explained below:

- ***Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering***

This statement defines policies and procedures that banks should have in place to assist in suppressing ML through the banking system, both domestically and internationally, since banks and other financial institutions may "unwittingly" (Basel Committee, 1988) be used as intermediaries for transfer or deposit money derived from criminal activity. The Committee considers that "the first and most important safeguard against money laundering is the integrity of banks' own managements and their vigilant determination to prevent their institutions becoming associated with criminals or being used as a channel for money laundering" (Basel Committee, 1988). It considers that four principles must be present within all financial institutions: effective customer identification, compliance with laws and ethical standards, cooperation with law enforcement authorities and adherence to the principles present in this statement (Basel Committee, 1988; The World Bank, 2006).

- ***Core Principles for Effective Banking Supervision (Core Principles)***

This list of twenty-five core principles, issued in 1997, provides an effective design for a bank supervisory system, covering a wide range of topics. Core Principle 15 is related to ML and states that banking supervisors must have strict "know your customer" (KYC) rules that promote high ethical and professional standards (Basel Committee, 1997; The World Bank, 2006) in order to avoid the bank from being used by criminals. Furthermore, two years later, Basel Committee created a "Core Principles Methodology", containing specific criteria to help in the assessment of the adequacy of KYC policies (Basel Committee, 1999)

- ***Customer Due Diligence for banks (Customer Due Diligence)***

This document was issued in 2001 due to noted deficiencies in KYC procedures. It provides more specific information regarding Core Principle 15, mentioned before, and it not only helps banks in the fight against ML but also protects their safety and the integrity of banking systems (The World Bank, 2006). More specifically, it provides guidelines on implementing the essential elements of KYC standards such as customer acceptance policies, customer

identification requirements, monitoring of accounts and transactions and risk management. Moreover, it gives directions regarding the role of supervisors and the implementation of KYC standards in cross-borders context. However, these standards might need to be strengthened by additional measures that best fit the risks of particular institutions and countries (BIS, 2001).

2.1. e) ML Directives

The awareness of the potential adverse effects of ML in economies encouraged the European Union to enact the **First Money Laundering Directive** in 1991 (IBA, 2011). This Directive, based on FATF Forty Recommendations, aimed to combat the laundering of drug proceeds through the financial sector. It required obligations on financial sector firms, such as the establishment of customers' identification systems, the report of suspicious transactions (STRs), record keeping and staff training (EurActiv, 2005; FSA, 2011).

Ten years later, an amended was made to the First Directive in order to improve two key areas: the scope of predicate offences, of which reporting was required, was extended from drug trafficking to other offences; the range of obliged entities was widened to non-financial-sector businesses, including lawyers, accountants, notaries, estate agents, casinos, art dealers, auctioneers and jewellers; and finally, it also mandate the creation of FIUs in all member states, to receive STRs from entities (EurActiv, 2005; Financial Services Authority, 2011). The creation of this **Second Money Laundering Directive**, which is in line with conclusions of *Palermo Convention*, generated strong objections mainly from legal and accountancy professions, due to its radical and wide changes. Despite the complaints, in December 2001 the Second Directive was adopted by the European Parliament (Hopton, 2009).

Due to the void of a precise definition of serious crime in the previous Directive and in order to incorporate the revisions of FATF in the Forty Recommendations, a new Directive was introduced (Hopton, 2009; Forwood, 2006). The Directive 2005/60/EC of the European Parliament and of the Council, also named **Third Money Laudering Directive**, adopted in 2005, which was incorporated into the national laws of the Member States, contains more detailed requirements for customer due diligence such as the need to adopt a risk-sensitive approach (Hopton, 2009), to check identity on opening accounts, to check transactions over EUR 15.000 (EurActiv, 2005) and to keep electronic records of ongoing due diligence and transactional filtering (World-Check, 2011). Furthermore, this Directive also defines the

notion of Politically Exposed Persons (PEPs), as "natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons (Directive 2005/60/EC, 2005, Article 3)", and enforces stricter checks on them (EurActiv, 2005). Finally, the Third Money Laundering Directive extends the provisions to financial transactions that might be linked to terrorist activities (Forwood, 2006).

2.1. f) Efforts to comply with regulations

To respond to regulations related with ML and TF mentioned previously on this report, financial institutions realized the need to perform some adjustments to their structure, such as the creation of compliance offices to deal with duties of identification, due diligence, cooperation and reporting imposed by directives and laws (Steel, 2011; Reuter and Truman, 2004). The functioning of these offices entails additional costs for financial institutions, which despite not being insignificant are relatively difficult to estimate (Masciandaro and Filotto, 2001). This occurs because these costs might be related to different areas – like operations or risk – and regions, include direct and indirect costs and also overlap with processes of regular business activity – as customer relationship management or credit risk (KPMG, 2007).

Whatever the type of regulation enforced by governments, financial institutions should base their functional framework on the combination of three sequential and interdependent objectives: **Know Your Processes (KYP)**, related to training and procedures in compliance; **Know Your Counterparts (KYC)**, which include the processes of customer due diligence, the scoring of customers and the acquisition of lists (with PEPs, terrorists and people declared); and finally **Know Your Transactions (KYT)**, which is linked to the use of appropriate IT systems to monitor and filter transactions, record keeping and parameterization (FSA, 2003). Moreover, based on Deloitte's "Assessment of business compliance costs of the indicative anti-money laundering regulatory requirements" for New Zealand's Ministry of Justice (2008), it is possible to understand some KYP, KYC and KYT activities that are required in order to create and to maintain a compliance office, which consequently bring new costs for the financial institution. A resume of these activities, estimated for New Zealand's banking industry, is replicated in Table 2.3. These activities can similarly be applied to financial institutions in other countries that wish to implement a compliance office due to their concordance with duties imposed by Directives mentioned before.

Table 2.3 - Some activities that generate costs for the compliance offices

Area of Activity	*Activity*
Customer Due Diligence	Conduct standard Customer Due Diligence
	Conduct enhanced Customer Due Diligence
	Conduct enhanced Customer Due Diligence for PEPs
	Enhanced Customer Due Diligence reliance on intermediaries
	Enhanced Customer Due Diligence on cross border correspondent banking
Reporting and Monitoring	Reporting suspicious transactions
	Monitoring suspicious transactions
Record keeping	Record Keeping
AML compliance programs	Designate compliance officers
	Staff training
	AML Program Management Office
	AML Policies and Processes
	Systems
	Assurance of AML compliance

(Adapted from: New Zealand Assessment of business compliance costs of the indicative anti-money laundering regulatory requirements, Deloitte 2008)

Moreover, in 2010[(4)], KPMG in collaboration with UIF developed a report for Portugal related to ML and TF prevention. In this study, financial institutions – more specifically credit institutions and insurance companies – were asked about their perception of a possible increase in ML and TF prevention costs in the next two years. A total of 45% of credit institutions believed that these costs will increase and specified the areas that will cause this increment. These areas, aligned with the ones in Table 2.3, are also representative of the costs a financial institution needs to bear to have a compliance office operating. Areas mentioned in that study were: policies, processes and procedures definition; counterparts identification; remediation of counterparts data; PEPs' lists; penalties' lists; terrorists' lists; counterparts monitoring; operations monitoring; reporting; training.

[4] This was a second study of this type from KPMG and UIF, being the first dated of 2008 (KPMG, 2010).

2.2 AML and CTF in Portugal and Spain

2.2. a) Portugal

Due to its geographical location, Portugal acts as a distribution point of drugs in their way to their final destination in Europe. For instance, between 2003 and 2006, over seventy tons of drugs – including hashish, cocaine, heroin and ecstasy – have been interdicted by the Portuguese authorities (FATF, 2006). On the other hand half of the detentions in Portugal are related with drug trafficking and abuse (Torres and Gomes, 2002). Due to its role on the distribution paths it is highly probable that Portugal is also receiving funds of crimes committed outside its borders. In fact authorities already detected funds in the monetary system, originated from smuggling of alcohol, tobacco and mineral oils. Besides these, other crimes like active corruption, works of art trafficking and extortion, are also generating significant proceeds and some of them will also end up on the Portuguese monetary system. According to investigations carried on by the Portuguese authorities, criminal organizations use local residents for providing logistical support to their drug related activities. Furthermore, from those investigations it also became clear that, in Portugal, the majority of the suspected cases of ML involved cash placement into financial system, followed by the exchange of bank notes (FATF, 2006). It is also known that a huge portion of the money laundered comes from narcotics-related profits (Bankers Academy, 2011).

At this point and regarding terrorist financing, there has been neither the confirmation of the existence of Portuguese terrorist groups nor the financing of any international terrorist group by Portuguese residents (FATF, 2006).

There are three main entities supervising Portuguese financial system: the **Bank of Portugal** (BdP), the **Portuguese Insurance Institute** (ISP) and the **Portuguese Securities Market Commission** (CMVM). The Bank of Portugal is responsible for supervising credit institutions, investment firms and other financial companies (BdP, 2009) while the Portuguese Insurance Institute provides regulation for the insurance, reinsurance and pension funds' companies (ISP, 2011). Finally, the Portuguese Securities Market Commission is responsible for the regulation of securities markets, more specifically activities of all market operators, securities issuers, financial intermediaries in securities, investment institutions and others (CMVM, 2011). Besides the above entities and since 2000, the supervisory system includes also, the **National Council of Financial Supervisors**, with the objective of institutionalise and organise co-operation among the three supervisors mentioned before. Its permanent members are the Governor of BdP, assuming the presidency, the member of the board of

BdP, responsible for supervision, the chairman of CMVM and finally the chairman of ISP (BdP, 2009).

In 2008, **Law 25/2008 of 5 June** was published, with the objective of transposing into national law the above mentioned European Third Money Laundering Directive and to take into consideration the legal frame defined by Vienna and Palermo Conventions and by the 40+9 Recommendations. This law keeps the preventive duties already existing on the previous legal framework (duty of identification, duty of due diligence, duty to refuse to carry out operations, duty to keep documents and records, duty of scrutiny, duty to report, duty to refrain from carrying out transactions, duty to cooperate, duty of confidentiality, duty to control and duty of training) giving more detail regarding some of them, and extends its action to the prevention of terrorist financing. Furthermore, it also brings up the concept of PEPs, new in the Portuguese legislation. The referred law defines FIU as the national authority competent to receive, analyse and disseminate STRs of both ML and TF and it also requires enhanced customer due diligence by financial institutions when having relationships with institutions from third countries (FATF, 2008; FATF, 2010).

Figure 2.1 presents the flow of processes in the prevention and the detection of ML and TF activities, which are followed by the repression process, out of scope of this study. All of the presented processes are complex, involving a large amount of both players and phases. As it can be seen on the Figure, this entire flow is triggered by the report of suspicious activities – one of the duties above cited – from financial and non-financial entities simultaneously to the UIF (Portuguese FIU) and to DCIAP (Central Department for Criminal Investigation and Prosecution). DCIAP is a department of the Attorney General of the Republic. Then, UIF conducts an initial research on the STRs and communicates the relevant cases to DCIAP for further investigation by this department. Moreover, it also provides feedback on the STRs to obliged entities every three months (UIF, 2010). Based on the information provided by UIF, DCIAP can either close the case and file the process, or confirm it and open a formal enquiry for deeper investigation.

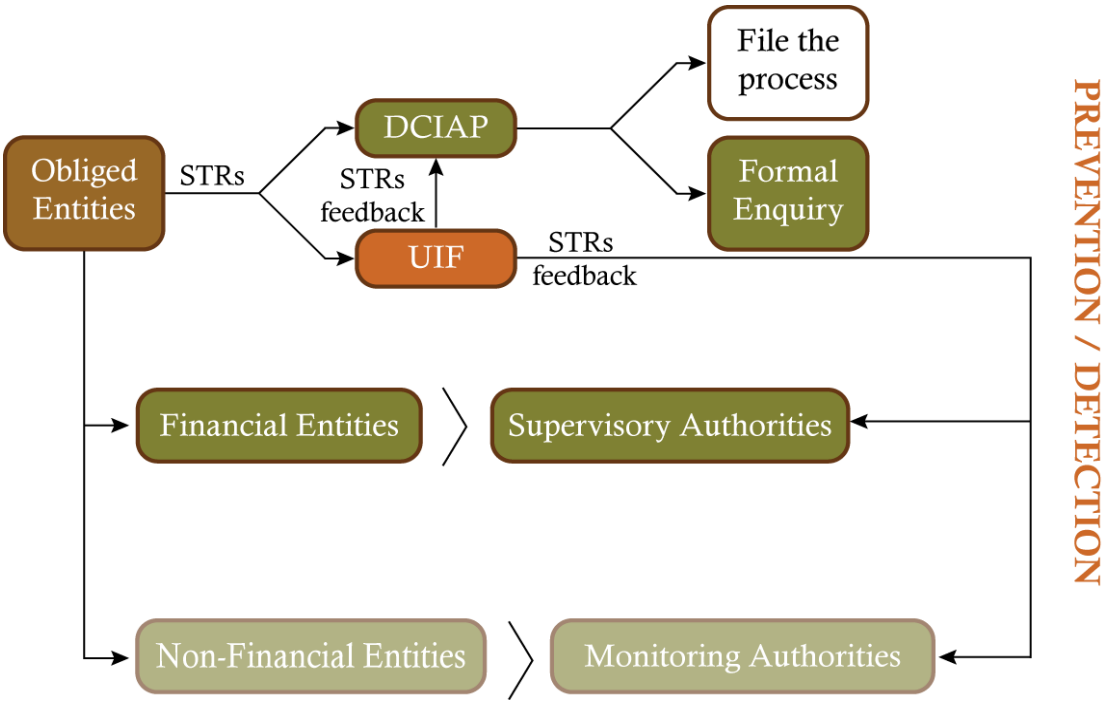


Figure 2.1 - ML and TF prevention and detection in Portugal

2.2. b) Spain

Spanish authorities have detected different methods used by criminals when laundering money, such as constitution of term deposits, transfers abroad through private accounts, use of cash deposits and withdrawals and change to high denomination notes, and others. Moreover, due to its geographical characteristics, underground banking operations between Spain and Morocco have also been identified. Regarding terrorism, Spain has a terrorist organization called ETA, founded in 1959, with the objective of getting independence of North part of the territory– *País Vasco* or *Basque Country* - and the South of France to establish a Marxist-Leninist State. For that they perform murders, kidnappings and extortions of State members. Since it was implemented more than one thousand deaths were attributed to ETA. Furthermore, there is also GRAPO, another terrorist group that aims to overthrow the government in order to establish a Marxist State in the country. It has a similarly history of murders, kidnappings and bombings but in 2002 and 2003 authorities were successful in arresting some of the group's leaders (FATF, 2006).

Spain does not have the prevention and combat to ML and TF only addressed to one specific entity. Similarly to Portugal, there are three entities supervising financial sector, namely the **Bank of Spain**, the **National Securities Exchange Commission**, and the **General Directorate of Insurance and Pension Funds** (FATF, 2006). Furthermore, also included in the framework

are the following units and departments: the **Commission for the Prevention of Money Laundering**, which main functions are to supervise activities to prevent the launder of money, to organise the cooperation between government and private sector and submit proposed sanctions to the Ministry of Economy and Finance (FATF, 2006; Ministerio de Economía y Hacienda, 2011); the **Secretariat of the Commission for the Prevention of Money Laundering**, with the responsibility of preparing draft laws and regulations to combat ML, promoting Spain's participation in international forums and prepare sanction proceedings against reporting institutions (FATF, 2006); the **Executive Service of the Commission for the Prevention of Money Laundering (SEPBLAC)**, which is the Spanish FIU and has the mission of receiving and analyse STRs from financial and non financial institutions, to carry out the supervisory and inspection functions of the AML and CFT frameworks (FATF, 2006); the **Guardia Civil**, that with its two units – Judicial Police and Fiscal Service – combats ML (FATF, 2006; Ministerio del Interior, 2011); the **Directorate General for the Police**, created with the objective of combating ML, drug trafficking and organised crime (FATF, 2006; Ministerio del Interior, 2011); **the Special Prosecutor's Office for the Prevention and Repression of Illegal Drug Trafficking**, which aim is to investigate and prosecute drug dealing and ML offences (FATF, 2006); and finally, **the Special Prosecutor's Office for the Prevention and Repression of Corruption-Related Economic Crimes**, which similarly to the institutions mentioned before, carries out investigations and plays an important role regarding cases that involve public finance, fraud and crimes against public administration and ML when the State Prosecutor General deliberates so (FATF, 2006; Ministerio de Justicia, 2011).

In 2010, Law 10/2010 of 28 April was issued with the objective of transposing the European Third Directive on the prevention of ML and TF to Spanish regulation, similarly to Portuguese Law 25/2008 of 5 June. This law specifies the duties of due diligence, of information and reporting. Moreover it gives directions related to internal control of institutions and payment methods. Finally, Law 10/2010 clarifies the roles of the entities mentioned above and the penalties in cases of misconduct.

2.2. c) Portuguese and Spanish compliance with FATF 40+9 Recommendations

As mentioned before, FATF conducts evaluations to member countries in order to categorize their level of compliance to the 40+9 Recommendations. In the Mutual Evaluation of **Portuguese** AML and CFT regimes, in 2006, the country was found to be compliant with

thirteen recommendations and special recommendations - *Recommendations 4, 8, 10, 14, 19, 20, 28, 35, 36, 37, 38, 39 and 40* –, largely compliant with twenty-three – *Recommendations 1, 2, 3, 5, 11, 13, 15, 17, 18, 21, 22, 23, 26, 27, 29, 30, 31 and Special Recommendations II, IV, V, VI, VIII, IX* –, partially compliant with ten – *Recommendations 7, 12, 16, 24, 25, 32, 33, 34 and Special Recommendations I, III* –, and non compliant with two – *Recommendation 6 and Special Recommendation VII*. Recommendation 9 was considered non-applicable to Portugal (FATF, 2006). Two years later, Portuguese authorities conducted an update to the first report, as a way to address twelve recommendations for which the country was considered partially compliant or non compliant. This update stated that Portugal was compliant with five, but do not have explicit levels of compliance with the remaining seven (FATF, 2008). However, of the six core recommendations considered by FATF as essential for a country to be classified as having a properly functioning AML and CFT regime in place[(5)], Portugal is fully compliant with one and largely compliant with five (Financial Standards Foundation, 2011).

It is important to mention that Portugal created, in 2007, Law Number 59, which introduced changes in the Penal Code, defining ML, expanding the list of crimes related to ML and making legal entities criminally accountable (BdP, 2011; Financial Standards Foundation, 2011). In addition, Law number 25/2008 of 5 June, explained before, was approved. With the creation of this law and the adoption of new measures, for example the implementation of the EC Regulation 1781/2006 through the Decree-Law number 125/2008 of 21 July, Portuguese authorities considered the country compliant with Recommendation 6 and 7 and Special Recommendations I, III and VII.

Finally, in September 2010, a second update report was issued showing legislative and other measures taken as a way to answer to comments made by FATF to recommendations still rated partially compliant.

Just as in the Portuguese case, also a Mutual Evaluation Report was carried out by FATF in **Spain**, in 2006. Spain was found to be compliant with ten recommendations and special recommendations – *Recommendations 4, 10, 11, 14, 19, 21, 36, 37, 38, 39* –, largely compliant with twenty-two – *Recommendations 1, 2, 3, 13, 15, 17, 20, 22, 26, 27, 28, 31, 35,*

[5] According to the FATF (2008), the core Recommendations that should be implemented with priority, are: Recommendation 1 and Special Recommendation II (related to criminalisation of money laundering and terrorist financing); Recommendations 5 and 10 (related to customer due diligence and record keeping); and Recommendation 13 and Special Recommendation IV (related to suspicious transaction reporting) (FATF, 2008).

40 and Special Recommendations II, III, IV, V, VI, VII, VIII, IX –, partially compliant with twelve – *Recommendation 5, 8, 12, 16, 18, 23, 25, 29, 30, 32, 33 and Special Recommendation I* –, and non compliant with three – *Recommendation 6, 7 and 24*. Recommendations 9 and 34 were considered not applicable to Spanish reality (FATF, 2006). In spite of having a high level of compliance in the majority of the recommendations and special recommendations, the country was rated partially compliant with recommendation 5 that is considered a core recommendation. In this sense, Spain was classified as not having a properly functioning AML and CFT regime in place (FATF, 2006; Financial Standards Foundation, 2011).

In October 2010, Spanish authorities conducted a fourth follow up report – preceded by June 2008, June 2009 and June 2010 reports – to reveal the steps taken to address the deficiencies identified in 2006. It was stated that Spain has taken important actions in order to improve compliance with Recommendation 5, and that nearly all of the deficiencies related to the customer due diligence framework have been addressed in the Law 10/2010, explained before. Although there are still some limitations remaining, Spain has reached a level of compliance equivalent to largely compliant. Moreover, Spain also addressed deficiencies related with Recommendations 6, 7 and 24, achieving a level of compliance considered by Spanish authorities as sufficient with these recommendations (FATF, 2010).

In Appendix 4, a comparative perspective of the levels of compliance between countries is given. These levels are updated to the last follow up reports, conducted in 2010 for both countries. It is possible to identify that Portugal is rated "Compliant" in eighteen Recommendations and Special Recommendations, while Spain is only in ten. Regarding the Recommendations and Special Recommendations rated "Largely Compliant", Portugal has a total of twenty-three while Spain achieves thirty-four. Finally, Portugal has seven Recommendations and Special Recommendations with level "Partially Compliant" and Spain has three. None of the countries has "Non-compliant" recommendations.

Chapter III – Methodology and Data Collection

This chapter will be divided in four main fundamental aspects of this study. First, there will be stated the research questions and a framework with the main concepts present in the study. Second, the methodology applied in the project will be explained in detail. Finally, the information sources used to collect data and the data collected will be presented, grouped by research questions and research hypothesis, to facilitate the analysis in Chapter IV.

3.1 Conceptual framework and research questions

Resulting from the previous literature analysis, this study aims to compare Portuguese and Spanish AML and CFT frameworks' effectiveness, focusing the analysis on the financial sector, through the answer of three main questions: *In which country are the STRs from financial institutions more effective? In which of the countries the costs with compliance offices of financial institutions is larger? How could Portugal improve its framework based on actions performed by Spain?*

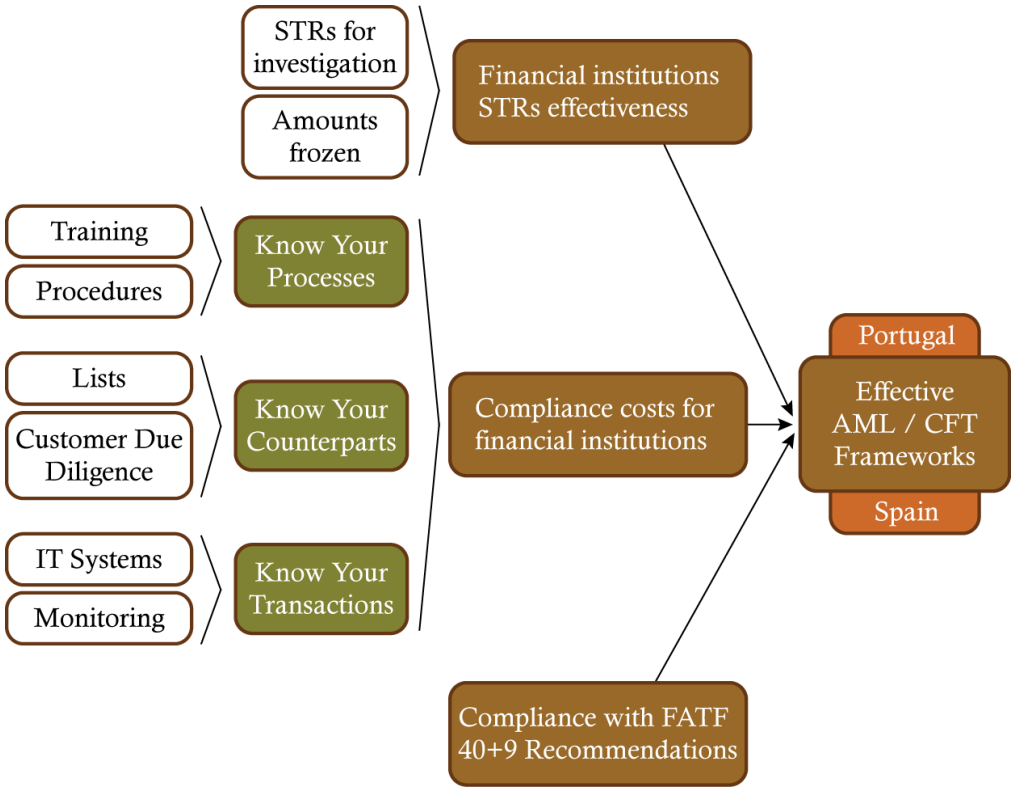


Figure 3.1 - Conceptual Framework

In order to answer the first question and considering two variables that influence the effectiveness of financial institutions STRs, the following hypothesis will be created: H_1 – *The percentage of STRs reported by credit institutions that follow to investigation will be similar in the two countries* and H_2 - *Amounts frozen will derive, in both countries, predominantly from suspicious transactions reported by credit institutions.*

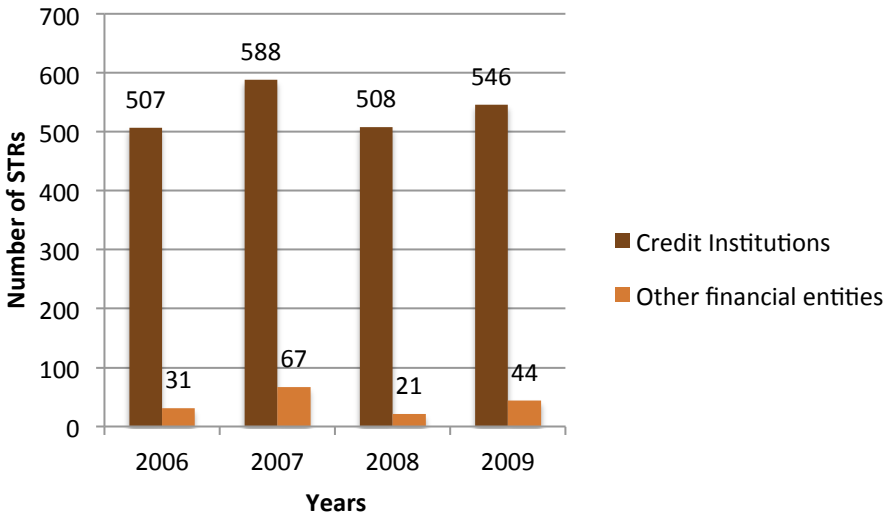
To better understand the impact of the costs of compliance on financial institutions in Spain and Portugal, a hypothesis will be stated: H_3 – *There will be more variables influencing compliance costs in Portugal, what led to higher compliance costs.* This hypothesis is directly related with the first one, since more sophisticated compliance offices in financial institutions can lead to more effective STRs.

Finally, one of the methods through which AML and CFT frameworks' effectiveness can be evaluated is by the results in FATF Mutual Evaluations and the measures performed by countries in order to upgrade their level of compliance with 40+9 Recommendations. In this sense, and based on the level of compliance with the recommendations stated in the last follow up report of Spain and Portugal, it will be given some advise in how Portugal can improve its framework, based on actions carried out by Spain.

3.2 Methodology

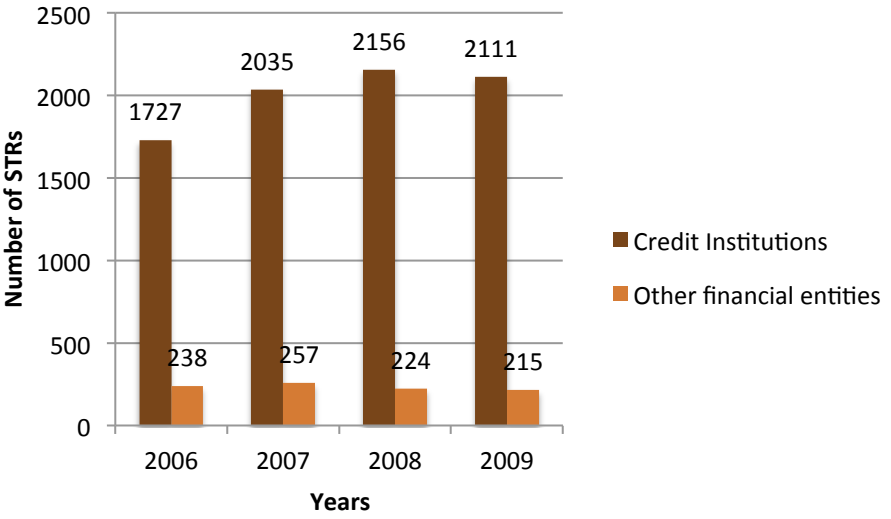
This project focus its analysis on financial institutions. FATF defines financial institutions as entities that conduct a business in "acceptance of deposits and other repayable funds from the public, lending, financial leasing, transfer of money or value, issuing and managing means of payment, financial guarantees and commitments, trading in money market instruments, foreign exchange, exchange, interest rate and index instruments, transferable securities and commodity futures trading, participation in securities issues and the provision of financial services related to such issues, individual and collective portfolio management, safekeeping and administration of cash or liquid securities on behalf of other persons, otherwise investing, administering or managing funds or money on behalf of other persons, underwriting and placement of life insurance and other investment related insurance and money and currency changing" (FATF, 2003, p. 17). However, in this study the scope will be reduced and only "credit institutions" will be considered, as a way to align the research, since these will be the type of institutions interviewed in order to answer the second research question. This was the focus group considered also for a reason of relevance, since among financial entities, credit institutions revealed a much higher level of STRs in the

studied years and in both countries than other financial entities – like insurance companies or foreign exchange –, as it is possible to see in Figures 3.2 and 3.3.



(Source: UIF Annual Reports)

Figure 3.2 - STRs from financial entities received by UIF, Portugal



(Source: SEPBLAC Annual Reports)

Figure 3.3 - STRs from financial entities received by SEPBLAC, Spain

With relation to the type of analysis, this study will be based on **qualitative and quantitative**

analysis. Qualitative analysis is the process by which we transform the qualitative data collected into some explanation, interpretation and understanding of the situations we are investigating (Coffey *et al.*, 1996). In this project, the qualitative method used will be **in-depth interviews**, a technique designed to draw a picture of the interviewee's perspective on the topic. This type of interview is more appropriate to address sensitive problems and to have a broader perspective of the processes in the viewpoint of the interviewed person (Mack *et al.*, 2005) so it will be used in order to answer the second research question, related to compliance costs. On the other hand, to understand the effectiveness of financial institutions' STRs, quantitative analysis will be employed. Quantitative data will be gathered from official reports, published by recognized institutions or entities in the ML and TF prevention. This data will be worked in order to achieve the answers this study is targeted to.

The **reliability** of this project, that is, the precision in the measurement method that can be evaluated through a consistency or stability of this method (Schweigert, 1994), is also safeguarded. It is known that the better way to guarantee the reliability of a certain method is through the achievement of the similar results when the method is repeated for the same person (Schweigert, 1994). Although in this study it will not be possible to conduct interviews to the same person twice due to his availability, the questions prepared for the interviews, will be the same for every contact established. Moreover, other necessary data – mainly statistical figures – will be searched in official documents, reports or previous studies performed by actors in ML and TF prevention.

Finally, this project has **internal validity**. Internal validity refers to the capacity of the study to answer the research questions and also the way the results derive from the variables considered and not from others that were not included in the research (Campbell and Stanley, 1966; Isaac and Michael, 1971). Variables mentioned in in-depth interviews conducted, were found to be similar to the ones researched previously in official reports and studies conducted, which was could guarantee the internal validity of the study to a certain level.

3.3 Information sources

Following is an explanation on where and how information was collected and aggregated for the three topics in research.

3.3. a) Financial institutions STRs' effectiveness

According to the previous analysis of the diverse actors and processes in Portuguese and Spanish AML and CFT frameworks, the number of suspicious transactions reported by financial institutions will be obtained through the annual reports of the departments responsible for receiving them: UIF, in Portugal and SEPBLAC, in Spain. In Portugal, the amounts frozen can also be found in UIF's annual reports and the percentage of them that derive from financial institutions' reports will be identified through UIF data available. On the other hand, SEPBLAC does not disclose information regarding the amounts frozen. In order to perform the study, and to have data that would enable the comparison between the two countries, this information was searched among other entities. In the 2006 FATF Mutual Evaluation Report of Spain, values of amounts frozen in the period between 2001 to 2004 were referred to be a result of police operations carried out by Monetary Offences Investigation Brigade *(Brigada de Blanqueo de Capitales)*, part of Judicial Police, in collaboration with Police Units *(Guardia Civil)*. In this sense, Monetary Offences Investigation Brigade has been contacted four times between April and May, but no information was disclosed and it was mentioned that data being requested for this study is confidential in Spain (although this does not happen in Portugal). Moreover, also the Commission for the Prevention of Money Laundering (*Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias)* – where values for amounts frozen were found until September 2006 – was contacted but no answer received.

Finally, this study will focus its analysis in transactions reported between 2006 and 2009, after the creation of the Third Money Laundering Directive. Table 3.1 summarizes the sources used in this project to obtain the information needed.

Table 3.1 - Information sources and years of study

Information	*Country*	*Information Source*	*Years in study*
Suspicious transactions reported by financial institutions	Portugal	UIF Annual Reports	2006-2009
	Spain	SEPBLAC Annual Reports	
Investigations started (reports sent to investigation)	Portugal	UIF Annual Reports	2006-2009
	Spain	SEPBLAC Annual Reports	
Amounts frozen	Portugal	UIF Annual Reports	2006-2009
	Spain	Commission for the Prevention of Money Laundering	

Amounts frozen that derived from financial institutions' reports	Portugal	UIF Reports	2006-2009
	Spain	*(no data)*	

3.3. b) Compliance costs for financial institutions

With the objective of understanding the differences between financial institutions compliance offices' costs in the countries studied, four in-depth interviews will be conducted with both Spanish financial institutions operating in Portugal and Portuguese financial institutions operating in Spain, to understand the differences between Headquarters and affiliates. In Appendix 5, it is possible to see a guide of these interviews. This guide takes into consideration the difficult task of estimating costs with compliance, mentioned previously on this report. In this sense, interviews were conducted aiming to understand the variables that influence the compliance costs for the financial institutions, both in Portugal and Spain.

3.3. c) Compliance with FATF 40+9 Recommendations

A comparative perspective of the compliance levels in Portugal and Spain was given previously on this report, based on 2010 follow up reports on the countries. There will be further analysis on recommendations in which Spain performance was higher than Portuguese and discussion of measures that Portugal can implement in order to reach the top level of compliance in these recommendations.

3.4 Data collection

Tables and figures below present information collected and aggregated by each topic that this research aims to answer.

3.4. a) Financial institutions STRs' effectiveness

In Table 3.2 it is presented data collected regarding transactions reported and investigations started in Portugal and Spain, retrieved from UIF and SEPBLAC Annual Reports. Furthermore, Table 3.3 presents values of amounts frozen, in the studied years, for both countries that can be found in UIF Annual Reports and Commission for the Prevention of Money Laundering website.

Table 3.2 - Transactions reported and investigations started

		2006	2007	2008	2009
Suspicious transactions reported by financial institutions *(A)*	Portugal	507	588	508	546
	Spain	1.727	2.035	2.156	2.111
Investigations started (reports sent to investigation) *(B)*	Portugal	584	724	568	634
	Spain	2.895	3.067	3.336	3.283
% investigations derived from credit institutions' reports *(A/B)*	Portugal	86,8%	81,2%	89,4%	86,1%
	Spain	59,7%	66,4%	64,6%	64,3%

Table 3.3 - Amounts frozen

		2006	2007	2008	2009
Amounts Frozen	Portugal	EUR 22.086.457 USD 250.000	EUR 15.523.476 GBP 330.000,00 USD 24.631.570	EUR 8.209.019 USD 20.000	EUR 14.261.392
	Spain	EUR 17.086.351[6]	*(no data)*	*(no data)*	*(no data)*
Amounts frozen that derived from credit institutions' reports	Portugal	EUR 22.086.457 USD 250.000	EUR 15.523.476 GBP 330.000,00 USD 24.631.570	EUR 8.209.019 USD 20.000	EUR 14.261.392
	Spain	*(no data)*	*(no data)*	*(no data)*	*(no data)*

3.4. b) Compliance costs for financial institutions

As the value of implementing necessary processes for the functioning of compliance offices was found to be very difficult to estimate as expected, none of the institutions was able to answer question Q_3. In this sense, financial institutions mentioned qualitatively the characteristics of all the aspects that influence the costs of the department, based on the interviews conducted. Interviews' results are replicated in Appendix 6.

[6] Value until September, 2006.

3.4. c) Compliance with FATF 40+9 Recommendations

As it is possible to see below in Figures 3.4 and 3.5, Portugal has more recommendations rated "Compliant" than Spain, but also a higher level of "Partially Compliant" recommendations. In spite of having more recommendations with the highest rating, it is possible to identify in Appendix 4 that there are two in which Spanish level is "Compliant" and Portuguese level is only "Largely Compliant": Recommendations 11 and 21.

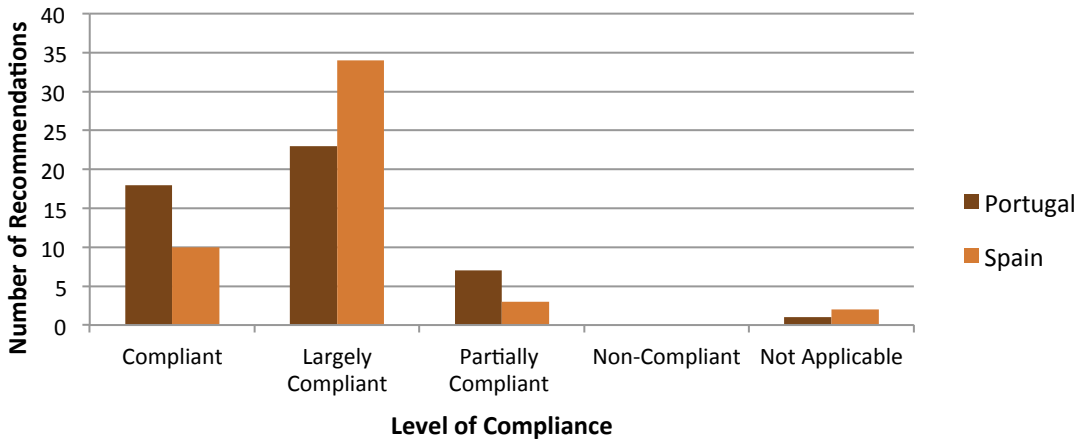


Figure 3.4 - Compliance level with FATF 40+9 Recommendations in Portugal and Spain, updated to 2010 follow-up reports (absolute values)

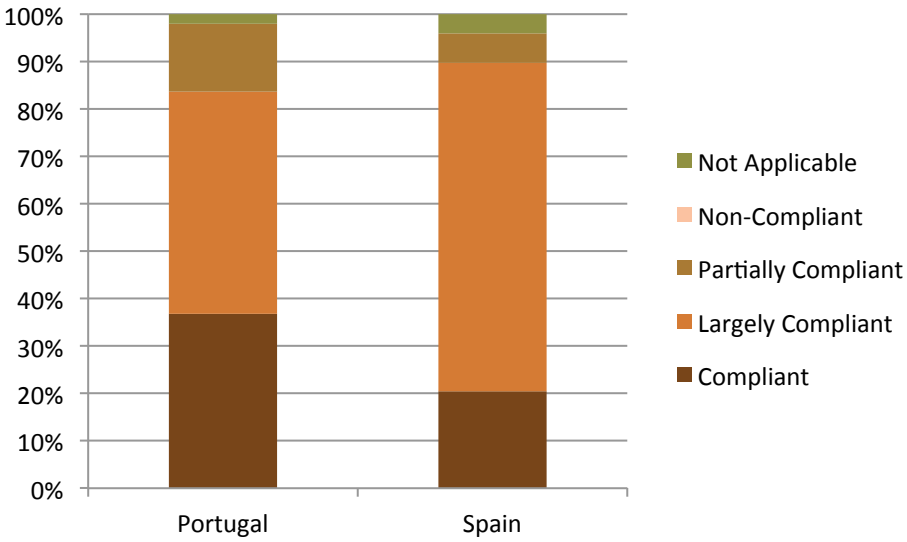


Figure 3.5 - Compliance level with FATF 40+9 Recommendations in Portugal and Spain, updated to 2010 follow-up reports (percentage values)

Chapter IV – Data analysis and Discussion

In order to analyse the data collected, in this chapter research hypothesis related with each research question will be discussed.

4.1 Financial institutions STRs' effectiveness

H_1 – The percentage of STRs reported by financial institutions that follow to investigation will be similar in the two countries.

As it is possible to see in Table 3.2, the percentage of investigations that derive from financial institutions STRs in Portugal is higher than in Spain for the four analysed years. The difference of this ratio between the two countries is approximately of 20% in every year, achieving Portugal ratios between 80% and 90% for the studied years while Spanish ratios are between 60% and 70%. For this reason, there is no evidence to justify this hypothesis.

The study of these variables revealed that in Portugal, transactions reported by financial institutions between 2006 and 2009 were very effective, as they represented almost all of the transactions that went to further investigation. This can be an indicator that mechanisms implemented to monitor and filter operations in financial institutions, and consequently the control that it is done of transactions, has been generating favourable results. Moreover, as mentioned previously on this report, there are several features of compliance offices that can also influence the good quality of these institutions' reports. These are, for instance, employees' training, acquisition of a wide variety of lists and counterparts monitoring. Other factor that can influence the good performance of Portugal in starting investigations from financial institutions STRs is the model of FIU present. Portugal has in place a Law Enforcement FIU, what allows a fast police reaction to suspicious situations. This means that, when situations are reported to FIU, it is possible to start with investigations faster, and additionally, since a Law Enforcement FIU has to be close to obliged entities and has easy access to other databases, there could be more sensitivity to identify relevant suspicious transactions and send them to further investigation.

Although Spanish level of STRs from financial institutions that went to investigation was not as high as the Portuguese, it can be considered satisfactory. Methods used in financial institutions to detect suspicious operations, can be, similarly to Portugal, responsible for this favourable results. On the other hand, Spain has an Administrative model of FIU in place, which main disadvantage, stated in Chapter II of this study, is the low level of ability to

collect data. This can lead to a lower number of investigations started from the financial institutions STRs, since less data could be gathered in order to justify the following of reports to investigation.

H_2 - Amounts frozen will derive, in both countries, predominantly from suspicious transactions reported by financial institutions.

Regarding the Portuguese situation, it was possible to identify in Table 3.3 that frozen funds were entirely reported by financial institutions. This reveals a high level of effectiveness of these entities and is in line with the first hypothesis stated in this study. In fact, these two hypotheses are related and it would be expected that the majority of frozen amounts would derive from financial institutions' reports, since the cases that went to investigation – and that in this sense could lead to the freezing of funds – are mainly derived from their activity.

Unfortunately, it is not possible to draw conclusions based on data regarding Spanish situation, due to an absence of publicly available figures and of answers from entities when contacted. However, and comparing with the Portuguese case, it is possible that amounts frozen in Spain were not only derived from financial institutions reports, since they level of STRs that went to investigation was lower than the Portuguese. This means that, as in Spain around 45% of investigations started due to other entities' reports, amounts frozen probably derived also from these entities identified situations and not only from financial institutions' monitoring.

Based on the previous analysis, it is possible to conclude that the effectiveness of financial institutions' STRs is larger in Portugal. This is revealed through a higher percentage of investigations and money frozen triggered from financial institutions' STRs. This can be a result of good monitoring systems placed in Portuguese financial institutions, high quality training of employees in transactions' monitoring, the use of more comprehensive lists, covering a larger spectrum of suspicious customers or the type of FIU present in Portugal, which can allow more in depth analysis of financial institutions STRs. However, the level of effectiveness of financial institutions' STRs in Spain can be considered acceptable, since for the available data this effectiveness was around 65% for the studied years.

4.2 Compliance costs for financial institutions

H_3 – There will be more variables influencing compliance costs in Portugal, what led to higher compliance costs.

It is possible to understand through the analysis of interviews' conducted that there are similarities among practices of Portuguese and Spanish institutions. First, the four studied institutions have different compliance offices in the two countries. There are cases where the report to Headquarters is direct, meaning that the department has the duty to regularly report operations or that the hierarchical responsible for the department is not in the affiliate but in the Headquarters. On the other hand, there were cases where this report is not so direct, meaning that some directives regarding procedures might come from the Headquarters or some exceptional report may be necessary. Overall, in both types of institutions – Portuguese and Spanish – the more frequent case is the indirect report to Headquarters, although direct might exist.

It was noted that in the majority of the cases, compliance offices were restructured after year 2000. This might have happened due to a necessity of incorporation of new regulations, imposed by the passage to national laws of Money Laundering Directives.

Regarding the resources allocated to ML and TF issues, in the financial institutions interviewed the average is of seven for Portugal and four for Spain. As it was expectable, financial institutions concentrate a higher number of employees in the compliance office of the country where they have a superior business volume, which is normally the one where Headquarters are located. Consequently, it was noted that Portuguese institutions have few resources in Spain, and Spanish institutions have also less resources in Portugal. However, the average of resources in the two countries is approximately the same.

For monitor and filter transactions, the interviewed institutions revealed to have comparable methods. In almost all the cases studied, two applications – software – are used to perform these processes. Although applications can be different between institutions, in their names or databases used, their scope and objectives are the same. This was also verified between countries, since in many cases there was a global application that was just adjusted or improved to better answer requirements of a specific country. Lists were found to be similar among studied cases, even though their handling could be different.

Finally, the level of training in Portuguese and Spanish financial institutions was one of the characteristics found to be more similar between the studied countries. All the interviewed institutions have specific AML and CFT e-learning courses in both countries, available to all

employees. Moreover, the participation in seminars and specific AML and CFT in-class courses is common within the institutions. It was noted that a high relevance is given to training, mainly in areas with direct contact with customers, and that at least e-learning was mandatory for new employees.

Based on this analysis, there is no evidence to accept the hypothesis stated. The costs with compliance offices, and specifically to deal with MT and TF issues, in Portugal and Spain will be similar, since variables influencing costs are the same between these countries. This fact can be justified with the creation of national laws in Portugal and Spain (Law 25/2008 of 5 June and Law 10/2010 of 28 April, respectively) to implement the Third Money Laundering Directive, which led to similar directions on KYP, KYC and KYT procedures. Moreover, these two neighbour countries are considered to be in a similar level of compliance with FATF 40+9 Recommendations, as presented in Figures 3.4 and 3.5, what can be an indicator of similarities within the frameworks and, as a result, of institutions' processes and performance in AML and CFT issues.

4.3 Compliance with FATF 40+9 Recommendations

It is possible to identify, in Figure 3.5, that the percentage of FATF Recommendations in which Portugal was rated with the highest level of compliance is superior to the Spanish. In fact, Portugal has eighteen Recommendations rated "Compliant" while Spain has only ten. However, within these ten Recommendations there are two in which Spanish performed better than Portugal: Recommendation 11 and Recommendation 21, both related with the monitoring of transactions and relationships.

Recommendation 11, states that *"Financial institutions should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors"* (FATF, 2003, p. 7). In this sense, FATF considered that Portugal is missing a requirement that mandates a recording of findings from entities under CMVM supervision. However, it is safeguarded that, since the majority of these entities conduct financial intermediation, they are also regulated by BdP directions, which include a mandate for the record of findings (FATF, 2006).

In Spain, Recommendation 11 is fully met since all reporting entities – financial and non financial – are covered in Law 19/1993 of 28 December, which requires any transaction that

might be linked to laundering of funds to be examined and records of these examinations kept. In the Portuguese case, although many of these institutions might do this, since they are also regulated by BdP instructions, there are others such as venture capital or securitization companies that are excluded from BdP monitoring scope (FATF, 2006) and, as a result, do not have regulations that obligate them to keep findings concerning atypical transactions.

The blank in Portuguese legislation can be addressed with an extension of the requirements stated in CMVM Regulation[7] to incorporate the duty of keeping records of unusual transactions in institutions that are under CMVM supervision, similarly to Spanish law that embraces all institutions in the same regulation.

Furthermore, FATF Recommendation 21 refers that *"Financial institutions should give special attention to business relationships and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply the FATF Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities. Where such a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate countermeasures."* (FATF, 2003, p. 9). FATF considered that Portugal is not clearly articulating in the law the requirement to monitor relationships with NCCTs or with countries that insufficiently apply FATF Recommendations. In fact, Law 25/2008 of 5 June refers duty of identification of the counterparts involved, and special monitoring of business relationships with NCCTs are only explicitly required in BdP and ISP Circular Letters. Moreover, FATF pointed out that there is an absence of mechanisms to inform institutions regarding concerns or limitations in AML and CFT frameworks of other countries (FATF, 2006).

On the other hand, FATF 2006 Mutual Evaluation considers that Spain is completely compliant with this Recommendation. Spanish law specifically mentions that examination of certain transactions, such as movements of capital to or from accounts held in countries that are considered by the Ministry for Economic and Financial Affairs – as tax havens and NCCTs –, should be practised by reporting entities. Moreover, these transactions are subject to systematic reporting, mentioned in Chapter II of this study and non face-to-face creation of

[7] CMVM Regulation 12/2000, which obliges financial entities to develop enhanced due diligence, more specifically, the collection of information of the financial situation of clients, their investment experience and objectives for the relation with the institution (CMVM, 2011).

business relationships is not permitted when the opening deposit is from one of the listed countries mentioned before and therefore, face-to-face identification procedures have to be followed. Moreover, in Spain, the Commission for the Prevention of Money Laundering advises financial institutions of weaknesses in AML and CFT systems of other countries and additionally, institutions are required to report problems in applying standards of Spanish framework in subsidiaries abroad. In this sense, it is possible to indentify that Spain has a clear definition of measures that should be put in place by reporting entities when dealing with NCCTs, since transactions with this countries must pass through an enhanced analysis, be included in systematic reporting and the use of funds limited to face-to-face business relations (FATF, 2006).

In contrast, similar measures are not so clearly defined in Portugal. This lack can be addressed in several manners, following the Spanish methods to deal with the topic referred in FATF 2006 Mutual Evaluation. First, Law 25/2008 imposes that everyone involved in operations with NCCTs must be identified. NCCTs are defined through a decision made public in BdP, ISP or CMVM Circular Letters further delivered to subject entities. However, this measure can be enhanced through the issue of a list with countries considered non cooperative or weak in applying FATF Recommendations, by a general authority – like in Spain, where it is issued by a Minister – that could made it public. Although there could be clear political costs of keeping this list publicly available, Portugal can adopt the same position of Spain and consider that a public list of NCCTs would improve the understanding and uniform application of diligence by reporting entities. The specific information of weaknesses in these countries' AML and CFT systems is also important to be public as a way to increase attention to operations with them. This is a task that can be covered likewise by a general entity, such as UIF or the Public Prosecution, similarly to Spain. Equally relevant is the monitoring of these operations and so, to comply with this requirement, Portugal can include duties of special examination of transactions in the actual law instead of present this duty to financial institutions only through BdP Circular Letters as occurs now. Finally, it could be relevant to apply some measures present in Spain regarding NCCTs' jurisdictions, such as the advisory of sectors to enhance due diligence with transactions and clients of these countries, the consideration of the origin of funds when incorporating the Portuguese financial system and the advisory of additional risks that business relationships with these jurisdictions might implicate.

Chapter V – Conclusions

From the data analysed and discussed above it is possible to conclude that in Portugal the STRs from financial institutions are more effective, since they represent a higher percentage of investigations started than the one verified in Spain. This finding can indicate that the methods used to monitor operations in Portuguese financial institutions can be more effective and that Spain still has room for improvement in this area. Moreover, it can also be an indicator that the model of FIU present in Portugal can be more effective in starting investigations than the Spanish one. However, although Portuguese financial entities revealed a superior effectiveness in STRs, in Spain the majority of investigations also derived from financial institutions STRs, for what is possible to refer that financial sector is the most effective in both countries.

The methods mentioned that could have influenced the good performance of financial institutions regarding the detection of money laundering and terrorist financing issues, are directly related with the variables that influence the costs of a compliance office. These are, for instance, the resources available in the office, the systems and lists to monitor and filter operations and the training given to compliance officers. All of these variables, used to perform effective KYP, KYC and KYT objectives and that help in the prevention of risks associated with ML and TF mentioned previously, were found to be applied equally in the two countries, and just small differences between financial institutions were identified. The level of sophistication of methods used is equivalent from institution to institution and in the two countries, although some specifications are adapted from the Headquarters to the affiliate. This probably occurs because both countries transposed the Third Money Laundering Directive and FATF 40+9 Recommendations to national law, and in this sense, the duties of obliged entities are similar. For this reason, it is possible to conclude that costs with compliance offices are the same in Portugal and Spain, since variables influencing them are also the same.

As both countries have transposed these European regulations to national law, it could be considered that they have presented a similar level of compliance in FATF Mutual Evaluations. In fact, none of the countries was found non compliant with Recommendations, however, Portugal reached the higher compliance level with FATF 40+9 Recommendations in eighteen of the Recommendations while Spain only achieved this level in ten. When analysed the different compliance levels presented by the two countries, it is possible to

identify that Spain is fully compliant with Recommendations 11 and 21, in which Portugal was only declared partially compliant.

In this sense, it was interesting to understand how Portugal could improve its framework in order to be more effective in preventing and suppressing money laundering and terrorist financing, based on actions performed by Spain. Analysing the two FATF Recommendations mentioned before, it was identified that Portugal can increase the compliance level with Recommendation 11 by incorporating the duty of keeping records of unusual transactions in CMVM supervised institutions, similarly to what happens in BdP and ISP. Moreover, and regarding Recommendation 21, there are several things that can be considered to improve Portuguese performance. First, it would be important, in spite of the political costs associated, to issue a public list with NCCTs, available for all institutions to increase the uniform application of diligence measures when dealing with these type of counterparts. Furthermore, also the duties of special examination of transactions should be implemented in the Law, since in the present they are imposed through Circular Letters. Finally, sectors should be advised on a regular basis about the necessity of enhanced due diligence and additional risks supported when dealing with NCCTs.

Chapter VI – Limitations and Future Research

During the completion of this study, some limitations arise. These limitations had to do essentially with the necessity of data, which many times was declared to be confidential by entities or individuals. In fact, since money laundering and terrorist financing are considered financial crimes and involve people and transactions that sometimes are important players at the national or international level, the process of information disclosure is not simple.

In this sense, a significant limitation was the absence of data relative to Spanish frozen amounts for the studied years. To obtain this information, essential to discuss one of the research hypothesis, several entities were contacted but without success. This information, available for previous years in FATF Mutual Evaluation Reports and in Commission for the Prevention of Money Laundering and Monetary Offences (*Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetárias)* website, was considered to be confidential and despite all the contacts, it was not disclosed.

Moreover, some reluctance to share information was noted in the in-depth interviews. None of the interviewed institutions was able to quantitatively describe the costs supported with the compliance office, and it was not clear where these costs are allocated in the financial institution structure. The majority of the interviewed institutions were not willing to disclose more information than the requested one. This means that it was difficult to understand the perspective of the interviewee in the topic, a main objective in in-depth interviews, since the questions were asked and a direct and reduced answer was given with no space for comprehend the point of view of the compliance officer.

Although only four financial institutions were interviewed, many were contacted in a tentative of enlarging the sample used and increase reliability of this study. However, there was an absence of answers or unavailability for being interviewed of other institutions.

Further research on this topic could include an extension of the sample to include all Portuguese financial institutions with operations in Spain and all Spanish institutions operating in Portugal. It could also be interesting to understand the role of non financial institutions in the frameworks, such as a comparison between financial versus non financial sector effectiveness and costs to comply with regulations.

Moreover, it could also be appealing to reproduce the same study comparing Portugal with other countries, in order to understand to what extend is the Portuguese AML and CFT framework more effective.

Finally, complementary researches on AML and CFT frameworks' effectiveness can be performed, through the analysis of other variables that can influence this effectiveness, like the level of implementation of Money Laundering Directives into national law.

Appendix

Appendix 1 – FATF 40+9 Recommendations

i. Forty Recommendations on Money Laundering *(Source: FATF, 2003)*

A. LEGAL SYSTEMS

Scope of the criminal offence of money laundering

1. Countries should criminalise money laundering on the basis of the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the Vienna Convention) and the United Nations Convention against Transnational Organized Crime, 2000 (the Palermo Convention).

Countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences. Predicate offences may be described by reference to all offences, or to a threshold linked either to a category of serious offences or to the penalty of imprisonment applicable to the predicate offence (threshold approach), or to a list of predicate offences, or a combination of these approaches.

Where countries apply a threshold approach, predicate offences should at a minimum comprise all offences that fall within the category of serious offences under their national law or should include offences which are punishable by a maximum penalty of more than one year's imprisonment or for those countries that have a minimum threshold for offences in their legal system, predicate offences should comprise all offences, which are punished by a minimum penalty of more than six months imprisonment.

Whichever approach is adopted, each country should at a minimum include a range of offences within each of the designated categories of offences.

Predicate offences for money laundering should extend to conduct that occurred in another country, which constitutes an offence in that country, and which would have constituted a predicate offence had it occurred domestically. Countries may provide that the only prerequisite is that the conduct would have constituted a predicate offence had it occurred domestically.

Countries may provide that the offence of money laundering does not apply to persons who committed the predicate offence, where this is required by fundamental principles of their domestic law.

2. Countries should ensure that:

a) The intent and knowledge required to prove the offence of money laundering is consistent with the standards set forth in the Vienna and Palermo Conventions, including the concept that such mental state may be inferred from objective factual circumstances.

b) Criminal liability, and, where that is not possible, civil or administrative liability, should apply to legal persons. This should not preclude parallel criminal, civil or administrative proceedings with respect to legal persons in countries in which such forms of liability are available. Legal persons should be subject to effective, proportionate and dissuasive sanctions. Such measures should be without prejudice to the criminal liability of individuals.

Provisional measures and confiscation

3. Countries should adopt measures similar to those set forth in the Vienna and Palermo Conventions, including legislative measures, to enable their competent authorities to confiscate property laundered, proceeds from money laundering or predicate offences, instrumentalities used in or intended for use in the commission of these offences, or property of corresponding value, without prejudicing the rights of bona fide third parties.

Such measures should include the authority to: (a) identify, trace and evaluate property which is subject to confiscation; (b) carry out provisional measures, such as freezing and seizing, to prevent any dealing, transfer or disposal of such property; (c) take steps that will prevent or void actions that prejudice the State's ability to recover property that is subject to confiscation; and (d) take any appropriate investigative measures.

Countries may consider adopting measures that allow such proceeds or instrumentalities to be confiscated without requiring a criminal conviction, or which require an offender to demonstrate the lawful origin of the property alleged to be liable to confiscation, to the extent that such a requirement is consistent with the principles of their domestic law.

B. MEASURES TO BE TAKEN BY FINANCIAL INSTITUTIONS AND NON-FINANCIAL BUSINESSES AND PROFESSIONS TO PREVENT MONEY LAUNDERING AND TERRORIST FINANCING

4. Countries should ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations.

Customer due diligence and record-keeping

5. Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names.

Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers, when:

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

The customer due diligence (CDD) measures to be taken are as follows:

a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information.

b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer.

c) Obtaining information on the purpose and intended nature of the business relationship.

d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

Financial institutions should apply each of the CDD measures under (a) to (d) above, but may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction. The measures that are taken should be consistent with any guidelines issued by competent authorities. For higher risk categories, financial institutions should perform enhanced due diligence. In certain circumstances, where there are low risks, countries may decide that financial institutions can apply reduced or simplified measures.

Financial institutions should verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers. Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering

risks are effectively managed and where this is essential not to interrupt the normal conduct of business.

Where the financial institution is unable to comply with paragraphs (a) to (c) above, it should not open the account, commence business relations or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transactions report in relation to the customer.

These requirements should apply to all new customers, though financial institutions should also apply this Recommendation to existing customers on the basis of materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

6. Financial institutions should, in relation to politically exposed persons, in addition to performing normal due diligence measures:

a) Have appropriate risk management systems to determine whether the customer is a politically exposed person.

b) Obtain senior management approval for establishing business relationships with such customers.

c) Take reasonable measures to establish the source of wealth and source of funds.

d) Conduct enhanced ongoing monitoring of the business relationship.

7. Financial institutions should, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal due diligence measures:

a) Gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action.

b) Assess the respondent institution's anti-money laundering and terrorist financing controls.

c) Obtain approval from senior management before establishing new correspondent relationships.

d) Document the respective responsibilities of each institution.

e) With respect to "payable-through accounts", be satisfied that the respondent bank has verified the identity of and performed on-going due diligence on the customers having direct access to accounts of the correspondent and that it is able to provide relevant customer identification data upon request to the correspondent bank.

8. Financial institutions should pay special attention to any money laundering threats that may arise from new or developing technologies that might favour anonymity, and take measures, if needed, to prevent their use in money laundering schemes. In particular, financial institutions should have policies and procedures in place to address any specific risks associated with non-face to face business relationships or transactions.

9. Countries may permit financial institutions to rely on intermediaries or other third parties to perform elements (a) – (c) of the CDD process or to introduce business, provided that the criteria set out below are met. Where such reliance is permitted, the ultimate responsibility for customer identification and verification remains with the financial institution relying on the third party.

The criteria that should be met are as follows:

a) A financial institution relying upon a third party should immediately obtain the necessary information concerning elements (a) – (c) of the CDD process. Financial institutions should take adequate steps to satisfy themselves that copies of identification data and other relevant documentation relating to the CDD requirements will be made available from the third party upon request without delay.

b) The financial institution should satisfy itself that the third party is regulated and supervised for, and has measures in place to comply with CDD requirements in line with Recommendations 5 and 10.

It is left to each country to determine in which countries the third party that meets the conditions can be based, having regard to information available on countries that do not or do not adequately apply the FATF Recommendations.

10. Financial institutions should maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal activity.

Financial institutions should keep records on the identification data obtained through the customer due diligence process (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the business relationship is ended.

The identification data and transaction records should be available to domestic competent authorities upon appropriate authority.

11. Financial institutions should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors.

12. The customer due diligence and record-keeping requirements set out in Recommendations 5, 6, and 8 to 11 apply to designated non-financial businesses and professions in the following situations:

a) Casinos – when customers engage in financial transactions equal to or above the applicable designated threshold.

b) Real estate agents - when they are involved in transactions for their client concerning the buying and selling of real estate.

c) Dealers in precious metals and dealers in precious stones - when they engage in any cash transaction with a customer equal to or above the applicable designated threshold.

d) Lawyers, notaries, other independent legal professionals and accountants when they prepare for or carry out transactions for their client concerning the following activities:

- buying and selling of real estate;
- managing of client money, securities or other assets;
- management of bank, savings or securities accounts;
- organisation of contributions for the creation, operation or management of companies;
- creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

e) Trust and company service providers when they prepare for or carry out transactions for a client concerning the activities listed in the definition in the Glossary.

Reporting of suspicious transactions and compliance

13. If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit (FIU).

14. Financial institutions, their directors, officers and employees should be:

a) Protected by legal provisions from criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative

provision, if they report their suspicions in good faith to the FIU, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

b) Prohibited by law from disclosing the fact that a suspicious transaction report (STR) or related information is being reported to the FIU.

15. Financial institutions should develop programmes against money laundering and terrorist financing. These programmes should include:

a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.

b) An ongoing employee training programme.

c) An audit function to test the system.

16. The requirements set out in Recommendations 13 to 15, and 21 apply to all designated non-financial businesses and professions, subject to the following qualifications:

a) Lawyers, notaries, other independent legal professionals and accountants should be required to report suspicious transactions when, on behalf of or for a client, they engage in a financial transaction in relation to the activities described in Recommendation 12(d). Countries are strongly encouraged to extend the reporting requirement to the rest of the professional activities of accountants, including auditing.

b) Dealers in precious metals and dealers in precious stones should be required to report suspicious transactions when they engage in any cash transaction with a customer equal to or above the applicable designated threshold.

c) Trust and company service providers should be required to report suspicious transactions for a client when, on behalf of or for a client, they engage in a transaction in relation to the activities referred to Recommendation 12(e).

Lawyers, notaries, other independent legal professionals, and accountants acting as independent legal professionals, are not required to report their suspicions if the relevant information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege.

Other measures to deter money laundering and terrorist financing

17. Countries should ensure that effective, proportionate and dissuasive sanctions, whether criminal, civil or administrative, are available to deal with natural or legal persons covered by these Recommendations that fail to comply with anti-money laundering or terrorist financing requirements.

18. Countries should not approve the establishment or accept the continued operation of shell banks. Financial institutions should refuse to enter into, or continue, a correspondent banking relationship with shell banks. Financial institutions should also guard against establishing relations with respondent foreign financial institutions that permit their accounts to be used by shell banks.

19. Countries should consider the feasibility and utility of a system where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerised data base, available to competent authorities for use in money laundering or terrorist financing cases, subject to strict safeguards to ensure proper use of the information.

20. Countries should consider applying the FATF Recommendations to businesses and professions, other than designated non-financial businesses and professions, that pose a money laundering or terrorist financing risk.

Countries should further encourage the development of modern and secure techniques of money management that are less vulnerable to money laundering.

Measures to be taken with respect to countries that do not or insufficiently comply with the FATF Recommendations

21. Financial institutions should give special attention to business relationships and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply the FATF Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities. Where such a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate countermeasures.

22. Financial institutions should ensure that the principles applicable to financial institutions, which are mentioned above are also applied to branches and majority owned subsidiaries located abroad, especially in countries which do not or insufficiently apply the FATF Recommendations, to the extent

that local applicable laws and regulations permit. When local applicable laws and regulations prohibit this implementation, competent authorities in the country of the parent institution should be informed by the financial institutions that they cannot apply the FATF Recommendations.

Regulation and supervision

23. Countries should ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. Competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution.

For financial institutions subject to the Core Principles, the regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, should apply in a similar manner for anti-money laundering and terrorist financing purposes.

Other financial institutions should be licensed or registered and appropriately regulated, and subject to supervision or oversight for anti-money laundering purposes, having regard to the risk of money laundering or terrorist financing in that sector. At a minimum, businesses providing a service of money or value transfer, or of money or currency changing should be licensed or registered, and subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing.

24. Designated non-financial businesses and professions should be subject to regulatory and supervisory measures as set out below.

a) Casinos should be subject to a comprehensive regulatory and supervisory regime that ensures that they have effectively implemented the necessary anti-money laundering and terrorist-financing measures. At a minimum:

- casinos should be licensed;
- competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest, holding a management function in, or being an operator of a casino
- competent authorities should ensure that casinos are effectively supervised for compliance with requirements to combat money laundering and terrorist financing.

b) Countries should ensure that the other categories of designated non-financial businesses and professions are subject to effective systems for monitoring and ensuring their compliance with requirements to combat money laundering and terrorist financing. This should be performed on a

risk-sensitive basis. This may be performed by a government authority or by an appropriate self-regulatory organisation, provided that such an organisation can ensure that its members comply with their obligations to combat money laundering and terrorist financing.

25. The competent authorities should establish guidelines, and provide feedback which will assist financial institutions and designated non-financial businesses and professions in applying national measures to combat money laundering and terrorist financing, and in particular, in detecting and reporting suspicious transactions.

C. INSTITUTIONAL AND OTHER MEASURES NECESSARY IN SYSTEMS FOR COMBATING MONEY LAUNDERING AND TERRORIST FINANCING

Competent authorities, their powers and resources

26. Countries should establish a FIU that serves as a national centre for the receiving (and, as permitted, requesting), analysis and dissemination of STR and other information regarding potential money laundering or terrorist financing. The FIU should have access, directly or indirectly, on a timely basis to the financial, administrative and law enforcement information that it requires to properly undertake its functions, including the analysis of STR.

27. Countries should ensure that designated law enforcement authorities have responsibility for money laundering and terrorist financing investigations. Countries are encouraged to support and develop, as far as possible, special investigative techniques suitable for the investigation of money laundering, such as controlled delivery, undercover operations and other relevant techniques. Countries are also encouraged to use other effective mechanisms such as the use of permanent or temporary groups specialised in asset investigation, and co-operative investigations with appropriate competent authorities in other countries.

28. When conducting investigations of money laundering and underlying predicate offences, competent authorities should be able to obtain documents and information for use in those investigations, and in prosecutions and related actions. This should include powers to use compulsory measures for the production of records held by financial institutions and other persons, for the search of persons and premises, and for the seizure and obtaining of evidence.

29. Supervisors should have adequate powers to monitor and ensure compliance by financial institutions with requirements to combat money laundering and terrorist financing, including the authority to conduct inspections. They should be authorised to compel production of any information from financial institutions that is relevant to monitoring such compliance, and to impose adequate administrative sanctions for failure to comply with such requirements.

30. Countries should provide their competent authorities involved in combating money laundering and terrorist financing with adequate financial, human and technical resources. Countries should have in place processes to ensure that the staff of those authorities are of high integrity.

31. Countries should ensure that policy makers, the FIU, law enforcement and supervisors have effective mechanisms in place which enable them to co-operate, and where appropriate co-ordinate domestically with each other concerning the development and implementation of policies and activities to combat money laundering and terrorist financing.

32. Countries should ensure that their competent authorities can review the effectiveness of their systems to combat money laundering and terrorist financing systems by maintaining comprehensive statistics on matters relevant to the effectiveness and efficiency of such systems. This should include statistics on the STR received and disseminated; on money laundering and terrorist financing investigations, prosecutions and convictions; on property frozen, seized and confiscated; and on mutual legal assistance or other international requests for co-operation.

Transparency of legal persons and arrangements

33. Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures.

Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

34. Countries should take measures to prevent the unlawful use of legal arrangements by money launderers. In particular, countries should ensure that there is adequate, accurate and timely

information on express trusts, including information on the settlor, trustee and beneficiaries, that can be obtained or accessed in a timely fashion by competent authorities. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

D. INTERNATIONAL CO-OPERATION

35. Countries should take immediate steps to become party to and implement fully the Vienna Convention, the Palermo Convention, and the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism. Countries are also encouraged to ratify and implement other relevant international conventions, such as the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and the 2002 Inter-American Convention against Terrorism.

Mutual legal assistance and extradition

36. Countries should rapidly, constructively and effectively provide the widest possible range of mutual legal assistance in relation to money laundering and terrorist financing investigations, prosecutions, and related proceedings. In particular, countries should:

a) Not prohibit or place unreasonable or unduly restrictive conditions on the provision of mutual legal assistance.

b) Ensure that they have clear and efficient processes for the execution of mutual legal assistance requests.

c) Not refuse to execute a request for mutual legal assistance on the sole ground that the offence is also considered to involve fiscal matters.

d) Not refuse to execute a request for mutual legal assistance on the grounds that laws require financial institutions to maintain secrecy or confidentiality.

Countries should ensure that the powers of their competent authorities required under Recommendation 28 are also available for use in response to requests for mutual legal assistance, and if consistent with their domestic framework, in response to direct requests from foreign judicial or law enforcement authorities to domestic counterparts.

To avoid conflicts of jurisdiction, consideration should be given to devising and applying mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country.

37. Countries should, to the greatest extent possible, render mutual legal assistance notwithstanding the absence of dual criminality.

Where dual criminality is required for mutual legal assistance or extradition, that requirement should be deemed to be satisfied regardless of whether both countries place the offence within FATF 40 Recommendations the same category of offence or denominate the offence by the same terminology, provided that both countries criminalise the conduct underlying the offence.

38. There should be authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and confiscate property laundered, proceeds from money laundering or predicate offences, instrumentalities used in or intended for use in the commission of these offences, or property of corresponding value. There should also be arrangements for co-ordinating seizure and confiscation proceedings, which may include the sharing of confiscated assets.

39. Countries should recognise money laundering as an extraditable offence. Each country should either extradite its own nationals, or where a country does not do so solely on the grounds of nationality, that country should, at the request of the country seeking extradition, submit the case without undue delay to its competent authorities for the purpose of prosecution of the offences set forth in the request. Those authorities should take their decision and conduct their proceedings in the same manner as in the case of any other offence of a serious nature under the domestic law of that country. The countries concerned should cooperate with each other, in particular on procedural and evidentiary aspects, to ensure the efficiency of such prosecutions.

Subject to their legal frameworks, countries may consider simplifying extradition by allowing direct transmission of extradition requests between appropriate ministries, extraditing persons based only on warrants of arrests or judgements, and/or introducing a simplified extradition of consenting persons who waive formal extradition proceedings.

Other forms of co-operation

40. Countries should ensure that their competent authorities provide the widest possible range of international co-operation to their foreign counterparts. There should be clear and effective gateways to facilitate the prompt and constructive exchange directly between counterparts, either spontaneously or upon request, of information relating to both money laundering and the underlying predicate offences. Exchanges should be permitted without unduly restrictive conditions. In particular:

a) Competent authorities should not refuse a request for assistance on the sole ground that the request is also considered to involve fiscal matters.

b) Countries should not invoke laws that require financial institutions to maintain secrecy or confidentiality as a ground for refusing to provide co-operation.

c) Competent authorities should be able to conduct inquiries; and where possible, investigations; on behalf of foreign counterparts.

Where the ability to obtain information sought by a foreign competent authority is not within the mandate of its counterpart, countries are also encouraged to permit a prompt and constructive exchange of information with non-counterparts. Co-operation with foreign authorities other than counterparts could occur directly or indirectly. When uncertain about the appropriate avenue to follow, competent authorities should first contact their foreign counterparts for assistance.

Countries should establish controls and safeguards to ensure that information exchanged by competent authorities is used only in an authorised manner, consistent with their obligations concerning privacy and data protection.

ii. Nine Special Recommendations on Terrorist Financing (Source: FATF, 2001)

I. Ratification and implementation of UN instruments

Each country should take immediate steps to ratify and to implement fully the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism.

Countries should also immediately implement the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts, particularly United Nations Security Council Resolution 1373.

II. Criminalising the financing of terrorism and associated money laundering

Each country should criminalise the financing of terrorism, terrorist acts and terrorist organisations. Countries should ensure that such offences are designated as money laundering predicate offences.

III. Freezing and confiscating terrorist assets

Each country should implement measures to freeze without delay funds or other assets of terrorists, those who finance terrorism and terrorist organisations in accordance with the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts.

Each country should also adopt and implement measures, including legislative ones, which would enable the competent authorities to seize and confiscate property that is the proceeds of, or used in, or intended or allocated for use in, the financing of terrorism, terrorist acts or terrorist organisations.

IV. Reporting suspicious transactions related to terrorism

If financial institutions, or other businesses or entities subject to anti-money laundering obligations, suspect or have reasonable grounds to suspect that funds are linked or related to, or are to be used for terrorism, terrorist acts or by terrorist organisations, they should be required to report promptly their suspicions to the competent authorities.

V. International Co-operation

Each country should afford another country, on the basis of a treaty, arrangement or other mechanism for mutual legal assistance or information exchange, the greatest possible measure of assistance in connection with criminal, civil enforcement, and administrative investigations, inquiries and proceedings relating to the financing of terrorism, terrorist acts and terrorist organisations.

Countries should also take all possible measures to ensure that they do not provide safe havens for individuals charged with the financing of terrorism, terrorist acts or terrorist organisations, and should have procedures in place to extradite, where possible, such individuals.

VI. Alternative Remittance

Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.

VII. Wire transfers

Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain.

Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).

VIII. Non-profit organisations

Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused:

(i) by terrorist organisations posing as legitimate entities;

(ii) to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and

(iii) to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.

IX. Cash Couriers

Countries should have measures in place to detect the physical cross-border transportation of currency and bearer negotiable instruments, including a declaration system or other disclosure obligation.

Countries should ensure that their competent authorities have the legal authority to stop or restrain currency or bearer negotiable instruments that are suspected to be related to terrorist financing or money laundering, or that are falsely declared or disclosed.

Countries should ensure that effective, proportionate and dissuasive sanctions are available to deal with persons who make false declaration(s) or disclosure(s). In cases where the currency or bearer negotiable instruments are related to terrorist financing or money laundering, countries should also adopt measures, including legislative ones consistent with Recommendation 3 and Special Recommendation III, which would enable the confiscation of such currency or instruments.

Appendix 2 – FATF Members, Associate members and observers *(Source: FATF, 2011)*

i. FATF Members

- Argentina
- Australia
- Austria
- Belgium
- Brazil

- Canada
- China
- Denmark
- European Commission
- Finland
- France
- Germany
- Greece
- Gulf Co-operation Council
- Hong Kong, China
- Iceland
- India
- Ireland
- Italy
- Japan
- Kingdom of the Netherlands (*the Kingdom of the Netherlands: the Netherlands, Aruba, Curaçao and Saint Maarten*)
- Luxembourg
- Mexico
- New Zealand
- Norway
- Portugal
- Republic of Korea
- Russian Federation
- Singapore
- South Africa
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom
- United States

ii. FATF Associate Members

- The Asia/Pacific Group on Money Laundering (APG)
- Caribbean Financial Action Task Force (CFATF)
- Eurasian Group (EAG)
- Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)
- The Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL)
- The Financial Action Task Force on Money Laundering in South America (GAFISUD
- Inter Governmental Action Group against Money Laundering in West Africa (GIABA)
- Middle East and North Africa Financial Action Task Force (MENAFATF)

iii. FATF Observers

- African Development Bank
- Asian Development Bank

- Basel Committee on Banking Supervision (BCBS)
- Commonwealth Secretariat
- Egmont Group of Financial Intelligence Units
- European Bank for Reconstruction and Development (EBRD)
- European Central Bank (ECB)
- Eurojust
- Europol
- Inter-American Development Bank (IDB)
- International Association of Insurance Supervisors (IAIS)
- International Monetary Fund (IMF)
- International Organisation of Securities Commissions (IOSCO)
- Interpol
- Interpol/Money Laundering [English]
- Organization of American States / Inter-American Committee Against Terrorism (OAS/CICTE)
- Organization of American States / Inter-American Drug Abuse Control Commission (OAS/CICAD)
- Organisation for Economic Co-operation and Development (OECD)
- Offshore Group of Banking Supervisors (OGBS)
- United Nations
- Office on Drugs and Crime (UNODC)
- Counter-Terrorism Committee of the Security Council (UNCTC)
- The Al-Qaida and Taliban Sanctions Committee (1267 Committee)
- World Bank
- World Customs Organization (WCO)

Appendix 3 – Annex of International Convention for the Suppression of the Financing of Terrorism – Treaties listed *(Source: UN, 1999)*

1. Convention for the Suppression of Unlawful Seizure of Aircraft, done at The Hague on 16 December 1970.
2. Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, done at Montreal on 23 September 1971.
3. Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents, adopted by the General Assembly of the United Nations on 14 December 1973.
4. International Convention against the Taking of Hostages, adopted by the General Assembly of the United Nations on 17 December 1979.

5. Convention on the Physical Protection of Nuclear Material, adopted at Vienna on 3 March 1980.
6. Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, done at Montreal on 24 February 1988.
7. Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation, done at Rome on 10 March 1988.
8. Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf, done at Rome on 10 March 1988.
9. International Convention for the Suppression of Terrorist Bombings, adopted by the General Assembly of the United Nations on 15 December 1997

Appendix 4 – Compliance level in Portugal and Spain, updated to 2010 follow-up reports *(Source: FATF Follow up Report Spain, 2010; FATF Follow up Report Portugal, 2010)*

	Portugal	*Spain*
Legal Systems		
Recommendation 1 *ML offence*	Largely compliant	Largely compliant
Recommendation 2 *ML offence – mental element and corporate liability*	Largely compliant	Largely compliant
Recommendation 3 *Confiscation and provisional measures*	Largely compliant	Largely compliant
Preventive measures		
Recommendation 4 *Secrecy laws consistent with the Recommendations*	Compliant	Compliant
Recommendation 5 *Customer due diligence*	Largely compliant	Largely compliant
Recommendation 6 *Politically exposed persons*	Compliant	Largely compliant
Recommendation 7 *Correspondent banking*	Compliant	Largely compliant
Recommendation 8 *New technologies & non face-to-face business*	Compliant	Largely compliant
Recommendation 9	Not applicable	Not applicable

Third parties and introducers		
Recommendation 10 *Record keeping*	Compliant	Compliant
Recommendation 11 *Unusual transactions*	Largely compliant	Compliant
Recommendation 12 *DNFBP – R.5, 6, 8-11*	Partially compliant	Largely compliant
Recommendation 13 *Suspicious transaction reporting*	Largely compliant	Largely compliant
Recommendation 14 *Protection & no tipping-off*	Compliant	Compliant
Recommendation 15 *Internal controls, compliance & audit*	Largely compliant	Largely compliant
Recommendation 16 *DNFBP – R.13-15 & 21*	Partially compliant	Largely compliant
Recommendation 17 *Sanctions*	Largely compliant	Largely compliant
Recommendation 18 *Shell banks*	Largely compliant	Largely compliant
Recommendation 19 *Other forms of reporting*	Compliant	Compliant
Recommendation 20 *Other NFBP & secure transaction techniques*	Compliant	Largely compliant
Recommendation 21 *Special attention for higher risk countries*	Largely compliant	Compliant
Recommendation 22 *Foreign branches & subsidiaries*	Largely compliant	Largely compliant
Recommendation 23 *Regulation, supervision and monitoring*	Largely compliant	Largely compliant
Recommendation 24 *DNFBP - regulation, supervision and monitoring*	Partially compliant	Largely compliant
Recommendation 25 *Guidelines & Feedback*	Partially compliant	Partially compliant
Institutional and other measures		

Recommendation 26 *The FIU*	Largely compliant	Largely compliant
Recommendation 27 *Law enforcement authorities*	Largely compliant	Largely compliant
Recommendation 28 *Powers of competent authorities*	Compliant	Largely compliant
Recommendation 29 *Supervisors*	Largely compliant	Largely compliant
Recommendation 30 *Resources, integrity and training*	Largely compliant	Largely compliant
Recommendation 31 *National co-operation*	Largely compliant	Largely compliant
Recommendation 32 *Statistics*	Partially compliant	Partially compliant
Recommendation 33 *Legal persons – beneficial owners*	Partially compliant	Partially compliant
Recommendation 34 *Legal arrangements – beneficial owners*	Partially compliant	Not applicable
International Co-operation		
Recommendation 35 *Conventions*	Compliant	Largely compliant
Recommendation 36 *Mutual legal assistance (MLA)*	Compliant	Compliant
Recommendation 37 *Dual criminality*	Compliant	Compliant
Recommendation 38 *MLA on confiscation and freezing*	Compliant	Compliant
Recommendation 39 *Extradition*	Compliant	Compliant
Recommendation 40 *Other forms of co-operation*	Compliant	Largely compliant
Nine Special Recommendations		
Special Recommendation I *Implement UN instruments*	Compliant	Largely compliant
Special Recommendation II	Largely compliant	Largely compliant

Criminalise TF		
Special Recommendation III *Freeze and confiscate terrorist assets*	Compliant	Largely compliant
Special Recommendation IV *Suspicious transaction reporting*	Largely compliant	Largely compliant
Special Recommendation V *International co-operation*	Largely compliant	Largely compliant
Special Recommendation VI *AML requirements for money/value transfer services*	Largely compliant	Largely compliant
Special Recommendation VII *Wire transfer rules*	Compliant	Largely compliant
Special Recommendation VIII *Non-profit organisations*	Largely compliant	Largely compliant
Special Recommendation IX *Cash Couriers*	Largely compliant	Largely compliant

Appendix 5 – Interview Guide

INTERVIEW GUIDE

Section I – Overview

Q_1 Are the compliance offices of your bank different for Portugal and Spain?

In the case the answer to Q_1 is YES: ask $Q_{1.1}$ and continue the interview, asking the questions for both countries:

$Q_{1.1}$ Are there any relations between the compliance offices of the countries?

Q_2 When was the compliance office of your bank created?

Section II – Compliance Costs

Section II. a) Costs

Q_3 Is it possible for you to determine quantitatively the costs for the compliance office? (In the case that the costs are specifically stated in Annual Reports)

In the case the answer to Q_3 is YES:

$Q_{3.1}$ Can you please specify the costs of the compliance office?

$Q_{3.2}$ Which area (KYP, KYC, KYT) has a higher impact on these costs?

In the case the answer to Q_3 is NO: continue the interview in the following sections:

Section II. b) Resources

Q_4 What is the dimension of the compliance office in your bank?

Q_5 How many resources are allocated to money laundering/terrorist financing issues?

Section II. c) Transactions'monitoring and filtering

Q_6 Which methods are used in order to monitor transactions (systems, verification of transactions, vigilance)?

Q_7 Which lists (terrorists, PEPs) are used to filter customers and how are they integrated with other methods?

Section II. d) Training

Q_8 Which types of training in AML/CFT issues are used (in-class training, e-learning)?

Q_9 Is this training given to all employees?

Q_{10} Is any type of specific training given to compliance officers?

Section II. e) Other

Q_{11} Do you think that there is any other variable that influences the costs of the compliance office?

Appendix 6 – Interviews' results

Financial Institution 1 (Portuguese)	**Answer to Q_1**	Different compliance offices in Portugal and Spain.	
	Answer to $Q_{1.1}$	Spain should report its activity directly to Portugal, such as all compliance offices abroad. They may have to report immediately in the case of relevant transactions. Portuguese compliance office monitors on-site and off-site the performance of compliance offices abroad.	
	Answer to Q_2	Created in 2005 but restructured in 2009.	
	Answer to Q_3	No.	
		Portugal	**Spain**
	Answer to Q_4	28	5
	Answer to Q_5	14	(all dealing with the different issues)
	Answer to Q_6	Profiling: - Software gives alerts to suspicious transactions and registers the transactions of clients; Filtering: - Software to identify and monitor operations of clients in the lists. Give a risk profile to each client.	Profiling: - Software gives alerts to suspicious transactions and registers the transactions of clients; Filtering: - Software to identify and monitor operations of clients in the lists. Give a risk profile to each client.
	Answer to Q_7	Lists of sanctioned clients and PEPs are in a database and incorporated in the Filtering software.	Lists of sanctioned clients and PEPs are in a database and incorporated in the Filtering software.
	Answer to Q_8	Classroom training and e-learning.	In-class training and e-learning.
	Answer to Q_9	e-learning for all employees; in-class training with representatives of the commercial area.	e-learning for all employees.
	Answer to Q_{10}	Post-graduations in compliance; seminars.	Post-graduations in compliance; seminars.
	Answer to Q_{11}	No.	No.

Financial Institution 2 (Portuguese)	**Answer to Q_1**	Compliance office in Portugal, but one person in Spain reporting to Portugal.	
	Answer to $Q_{1.1}$	Compliance officer in Spain has to report directly to Portuguese compliance office.	
	Answer to Q_2	Created in 2008.	
	Answer to Q_3	No.	
		Portugal	**Spain**
	Answer to Q_4	10	1
	Answer to Q_5	4	(all dealing with the different issues)
	Answer to Q_6	Two types of software used for monitoring: - National transactions monitoring; - All SWIFT[8] transactions monitoring; This software also generates scoring of customer, which is changed with customer's interaction with the financial institution.	The software is the same since it was acquired with licences to all the countries were the financial institution has activities). Spain does monitoring and filtering and reports to Portugal.
	Answer to Q_7	PEPs, national and European lists of sanctioned clients are incorporated into financial institution's databases.	PEPs, national and European lists of sanctioned clients are incorporated into financial institution's databases.
	Answer to Q_8	Classroom training and e-learning courses.	e-learning courses.
	Answer to Q_9	Classroom training for new employees; e-learning courses for all employees.	e-learning courses for all employees.
	Answer to Q_{10}	e-learning created specifically for compliance; special compliance courses for compliance officers.	e-learning courses.
	Answer to Q_{11}	No. All have been	No.

[8] SWIFT code is a standard format of Bank Identifier Codes (BIC) and it is a unique identification code for a particular bank. These codes are used when transferring money and messages between banks (SWIFT Codes, 2011)

		mentioned.	
Financial Institution 3 (Spanish)	**Answer to Q_1**	Different compliance offices in Portugal and Spain.	
	Answer to $Q_{1.1}$	Portuguese compliance office reports functionally to Spanish compliance office.	
	Answer to Q_2	Separated from Auditing department in 1997, restructured in 2000.	
	Answer to Q_3	No.	
		Portugal	**Spain**
	Answer to Q_4	8	40
	Answer to Q_5	(all dealing with the different issues)	(no information)
	Answer to Q_6	Monitoring: - One corporate application, in which each country developed own specifications (Portugal has improved the initial application). Filtering: - One centralized software to generate operations' alerts, which includes a scoring system to order clients and alerts.	Monitoring: - One corporate application, in which each country developed own specifications. - One centralized software to generate operations' alerts. Scoring is done manually.
	Answer to Q_7	- Lists are bought and linked to databases, controlled daily but out of the system.	- Lists are bought and linked to databases, controlled daily but out of the system.
	Answer to Q_8	e-learning.	e-learning.
	Answer to Q_9	e-learning for all employees.	e-learning for all employees.
	Answer to Q_{10}	Seminars in Portugal and abroad; share of experiences at work.	Seminars in Spain and abroad; share of experiences at work.
	Answer to Q_{11}	No.	No.
Financial Institution 4 (Spanish)	**Answer to Q_1**	Different compliance offices in Portugal and Spain.	
	Answer to $Q_{1.1}$	Portuguese compliance office provides monthly activity reports to Spanish compliance office.	

	Answer to Q_2	Created in 1999 but restructured in 2005.	
	Answer to Q_3	No.	
		Portugal	**Spain**
	Answer to Q_4	6	15
	Answer to Q_5	2	5
	Answer to Q_6	Monitoring: - One application, based on an Access database. Gives alerts of transactions.	Monitoring: - Different application from the Portuguese one, but with similar criteria.
	Answer to Q_7	PEPs list is uploaded in the monitoring system.	(no information)
	Answer to Q_8	In-class training and e-learning.	In-class training and e-learning.
	Answer to Q_9	Basic training to all employees.	(no information)
	Answer to Q_{10}	University courses in ML, seminars, change of experiences with Spanish compliance office.	University courses in ML, seminars, change of experiences with Portuguese compliance office.
	Answer to Q_{11}	No.	No.

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