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COMMISSION STAFF WORKING DOCUMENT

Accompanying the document

Report from the Commission to the European Parliament and the Council

**on the assessment of the risks of money laundering and terrorist financing affecting the
internal market and relating to cross-border activities**

{COM(2017) 340 final}

1. INTRODUCTION

As required under Article 6 of Directive (EU) 2015/849, this paper complements the first Commission Report on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities "the Report")¹. It aims to provide a factual overview of the risk analysis performed on the different sectors in the internal market. The details of the risk analysis are presented in **Annex 1**.

2. CONTEXT

The risk assessment provides a tool for the Commission to understand risks and elaborate policies that address risks of money laundering and terrorist financing in the internal market. As outlined in the European Security Agenda, assessing money laundering and terrorist financing risks is considered a key priority in designing the Commission's internal security strategy². It is also listed as one of the key deliverables in the Commission's action plan on strengthening the fight against terrorist financing³. This was echoed by the Council of the EU which specifically requested that the assessment focus on terrorist financing and emerging risks such as virtual currencies⁴. The Council invited the Commission to carry out this assessment as a matter of priority⁵.

Directive (EU) 2015/849 describes how to conduct the supranational risk assessment and specifies that:

(i) the scope of the assessment should cover the risks of money laundering (ML) and terrorist financing (TF) affecting the internal market and relating to cross-border activities. It should include the areas of the internal market that are at greatest risks; the risks associated with each relevant sector and the most widespread means used by criminals by which to launder illicit proceeds.

(ii) the input the Commission should consider when conducting the assessment should include the Joint Committee of the European Supervisory Authorities' affecting the European Union's financial sector⁶, the expertise of Member States representatives competent for anti-money laundering and countering financing of terrorism (AML/CFT), and input from the Financial Intelligence Units and other relevant EU-level bodies.

(iii) the Commission's risk assessment should take the form of a report identifying, analysing and evaluating the risks of money laundering and terrorist financing. In addition, the Commission should make recommendations to Member States on the measures suitable for addressing the identified risks. Member States should follow these recommendations on a "comply or explain" basis.

(iv) the Commission's report should be made available to Member States and obliged entities to help them to identify, understand, manage and mitigate the risks of money laundering and terrorist financing. Every two years, this report should be revised on the basis of the findings of the regular risk assessments and the actions taken based on those findings.

¹ (2017)/xxx

² COM(2015) 185 final

³ COM(2016) 50 final

⁴ Joint declaration Commission-Council, COREPER 2 February 2015

⁵ Council conclusions on the fight against the financing of terrorism, 12 February 2016

⁶ [https://esas-joint-committee.europa.eu/Publications/Opinions/ESAS%20Joint%20Opinion%20on%20the%20risks%20of%20money%20laundering%20and%20terrorist%20financing%20\(JC-2017-07\).pdf](https://esas-joint-committee.europa.eu/Publications/Opinions/ESAS%20Joint%20Opinion%20on%20the%20risks%20of%20money%20laundering%20and%20terrorist%20financing%20(JC-2017-07).pdf)

Given the large size of the EU internal market in relation to the rest of the world and its significance in the financial sector, the supranational risk assessment (SNRA) is particularly important, both for the EU but also for non-EU countries.

More specifically, the EU is one of the three largest global players for international trade, next to the United States and China. In 2014, the EU's exports of goods were equivalent to 15.0% of the world total. They were surpassed for the first time since the EU was founded by China's exports of goods (15.5 %), but were still ahead of the United States (12.2 %), which had a larger share of world imports (15.9 %) than the EU (14.8 %) or China (12.9 %). Europe is the world's largest exporter of manufactured goods and services, and is itself the biggest export market for around 80 countries. The EU's trade in goods with the rest of the world was worth EUR 3 517 billion in 2015.

The European Union as a trading power — Trade in goods in 2015 (million EUR)

Country	Exports	Imports	Total
EU	1 791 534	1 727 125	3 518 659
China	170 484	350 424	520 909
United States	371 223	248 437	619 660
Japan	56 550	59 768	116 318

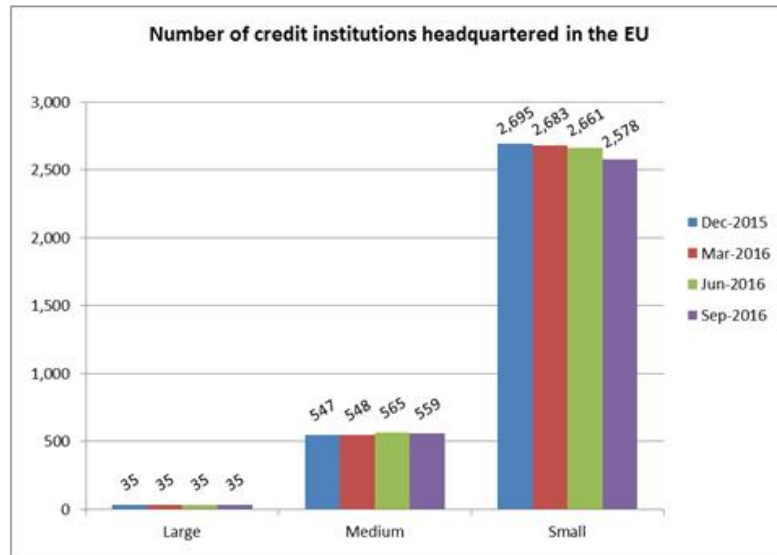
Source: European Commission, 2015⁷

The EU financial sector is one of the largest in the world. According to the consolidated banking data published by the European Central Bank⁸, 3172 credit institutions were headquartered in the EU in September 2016 representing total assets of EUR 33 974 billion. In 2015, the number of employees of domestic credit institutions amounted to 2 864 106 individuals in the EU. The EU structural financial indicators⁹ provide further information about the structure of the EU financial sector and the market concentration. The number of credit institutions slightly decreased over the last year.

⁷ http://ec.europa.eu/eurostat/statistics-explained/index.php/International_trade_in_goods

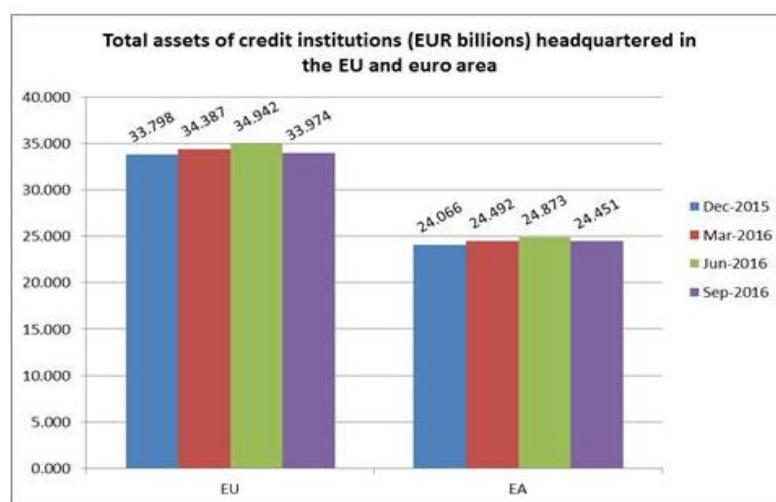
⁸ <https://www.ecb.europa.eu/press/pr/date/2016/html/pr160706.en.html>

⁹ <http://sdw.ecb.europa.eu/reports.do?node=1000002869>



Total assets of these credit institutions

headquartered in the EU evolved from EUR 33 798 billion to EUR 33 974 billion bn over the period December 2015 to September 2016.



Source: European Central Bank (2017)¹⁰

In terms of size of the EU financial system, the ECB maintains lists of the following five groups of institutions, based on information provided regularly by all members of the European System of Central Bank. This information covers the following institutions:

- Monetary financial institutions (MFIs): MFIs are resident credit institutions as defined in EU law, and other resident financial institutions. Their business is to receive deposits and/or close substitutes for deposits from entities other than MFIs. They also grant credits and/or make investments in securities, for their own account (at least in economic terms). In March 2017, there were 7 517 MFIs in the EU in total.
- Investment funds (IFs): IFs are collective investment undertakings that: i) invest in financial and non-financial assets, within the meaning of the European system of national and regional accounts in the Community (ESA 95), their objective being to invest capital raised from the public; and ii) are set up under Community or national

¹⁰ <https://www.ecb.europa.eu/press/pr/date/2017/html/pr170214.en.html?b3de046566de84e2d87dfa742d643995>

law. In March 2017, there was a total of 52 295 funds in the euro area and 3 570 in the non-euro area.

- Financial vehicle corporations (FVCs): FVCs are undertakings set up under national or Community law which i) carry out securitisation transactions primarily and are insulated from the risk of bankruptcy or any other default of the originator; and; b) issue securities, securitisation fund units, other debt instruments and/or financial derivatives and/or legally or economically own assets underlying the issuance of securities, securitisation fund units, other debt instruments and/or financial derivatives offered for sale to the public or sold on the basis of private placements. There were 3 676 FVCs in the euro area and 14 FVCs in the non-euro area in Q4-2016.
- Payment statistics relevant institutions (PSRIs): PSRIs are payment service providers (including electronic money issuers) and payment system operators. PSRIs offer payment services and/or are entitled to do so. They can be classified in different institutional sectors. In Q4-2015, the euro area had 5 768 PSRIs and the non-euro area 1 423 PSRIs.
- Insurance corporations (ICs): ICs are financial corporations or quasi-corporations that are principally engaged in financial intermediation as a consequence of the pooling of risks, mainly in the form of direct insurance or reinsurance. There are 3 387 ICs in the euro area and 627 ICs in the non-euro area in Q3-2016.

3. METHODOLOGY FOLLOWED FOR THE SUPRANATIONAL RISK ASSESSMENT

Definitions of money Laundering and terrorist financing used in the methodology and the risk assessment

Money laundering is the process of:

- the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, 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 activity to evade the legal consequences of that person's action;
- 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 criminal activity or from an act of participation in such an activity;
- the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such an activity;
- the participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions referred to in previous points converting or transferring of property, concealing and disguising the identity of illegally obtained proceeds.

The process serves to making the origin appear legitimate and leaving no link to the real source of the funds, their real owner or intended beneficiary. The cycle of money laundering is separate in three processes.

(1) placement: in this phase money is placed into the legitimate financial system. It is the most risky phase.

(2) layering: money launderers move funds from one country to another, the aim of this phase is to separate the illicit money from its source.

(3) integration: The criminal proceeds are now fully integrated into the financial system and can be used for any purpose. The money is returned to the criminal from what seem to be legitimate sources (normal business or personal transaction).

Terrorist financing means the provision or collection of funds, by any means, directly or indirectly, with the intention that they be used or in the knowledge that they are used, to carry out terrorist activities. Funds can be raised from legitimate sources (personal donations, charitable organisations...) or criminal sources (drug trade, fraud...).

Description of the methodology

The Commission drew up a specific methodology for conducting this assessment as a guarantee of a robust and reliable process. This methodology covers key aspects such as methodological guidelines, governance, working arrangements and project charter. The relevant documents are attached as **Annexes 2 and 3**.

The methodology provides a common understanding for assessing the risks. The risks are defined as "**the ability of a threat to exploit the vulnerability**" of a sector for the purpose of money laundering or terrorist financing. The methodology is therefore based on two major components for assessing each relevant sector:

(1) the "likelihood" of terrorist groups or organised crime organisations misusing products/services provided by this relevant sector for illicit purposes (i.e. **level of threat**). This level of threat is determined by the intent and the actual capacity of perpetrators to use those *modi operandi*.

(2) the potential weaknesses of these same products or services which allow terrorist groups or organised crime organisations to misuse them for illicit purposes (i.e. **level of vulnerability**). The weaknesses are assessed according to three criteria: (i) inherent risk exposure of the product/service due to its inherent characteristics (based on the product, geographical or customer risks); (ii) risk awareness of the sector/competent authorities that these products/services may be misused (organisational framework of the sector, availability of a risk assessment, level of suspicious transactions reporting); and (iii) legal framework and controls in place (existing legal framework, current implementation of the controls and of the customer due diligence requirements, level of cooperation with competent authorities).

Based on the criteria for the threat and vulnerability, each product/service is qualified from a low to moderately to highly significant level of risk. The supranational risk assessment covers both current risks posed by sectors covered by AML/CFT obligations and emerging risks.

Process

This analysis was conducted over the last 2 years. The Commission organised a series of meetings to identify the relevant *modi operandi* (scoping), carry out the analysis (risk analysis) and define mitigating measures (risk management). In addition to internal Commission expertise gathered from all relevant departments, the level of risks has been defined through a series of meetings organised with experts from the Member States (including regulators, supervisors, police, intelligence services, Financial Intelligence Units) and EU bodies (Europol, European Supervisory Authorities). Six workshops were organised in 2015-2016 with those experts to analyse both the risks of money laundering and terrorist financing. Further consultation was carried out in the context of the Commission's experts groups (EU's FIU platform, Expert Group on Money Laundering and Terrorist Financing (EGMLTF), Expert Group on Gambling Services).

The Commission also conducted three rounds of consultation with representatives of the private sector and civil society. These led to a better understanding of the private sector's practices in term of AML/CFT internal controls and policies. The consultations also helped to better identify what the private sector needs to improve its sectorial risk assessment and the implementation of its obligations.

In addition, the EGMLTF collected statistics on the number of obliged entities and suspicious transaction reports (STRs) by Member States. The results were used for the risk assessment and are attached as **Annexes 4 and 5**.

The legal framework

The legal framework in place is one of the key criteria to assess the level of risks. It is possible to mitigate risks through effective application of rules and controls. When assessing a risk, it is important to acknowledge if the existing legal framework is commensurate to the risks inherent to a specific sector, or if it covers only marginally those risks.

The risk assessment needs to provide a snapshot of the money laundering and terrorist financing risks and requires a clear-cut timing. The assessment of risks affecting the EU was carried out at a time when the relevant legislative framework was still Directive 2005/60 (EC). Even though Directive (EU) 2015/849 was adopted in May 2015, its transposition has not been completed yet¹¹. In addition, in the aftermath of the terrorist attacks and after the revelations of the Panama Papers, the Commission adopted a new legislative proposal¹² to revise through a targeted approach, the AML/CFT legal framework. In this legislative proposal, new mitigating measures are also proposed; these new measures could not be taken into consideration, as the text is still under negotiation and has not entered into force yet.

Therefore the supranational risk assessment is based on the EU legislation implemented at the time of the assessment. This is particularly important to stress since some sectors were not, or only limitedly, covered by the obligations in Directive 2005/60 (EC). Therefore the risk level

¹¹ Article 67 of Directive (EU) 2015/849 establishes the transposition deadline to 26 June 2017.

¹² COM (2016) 450 final

may be assessed differently for those Member States having already applied the stricter regime of Directive (EU) 2015/849.

Therefore, at the time of this analysis, the applicable legal framework was:

- Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing¹³
- Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of ‘politically exposed person’ and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis
- Regulation (EC) No 1781/2006 of the European Parliament and of the Council of 15 November 2006 on information on the payer accompanying transfers of funds¹⁴

This framework is complemented by other EU legislation. An indicative list of such other relevant legislation is attached as **Annex 6**.

As additional documents, an index of abbreviations used in the risk analysis and a list of bibliography are attached in **Annex 7** and **Annex 8**.

4. OUTCOMES OF THE SUPRNATIONAL RISK ASSESSMENT

Through the implementation of the SNRA methodology and based on the internal and external input received, the Commission has identified 40 products or services that are considered potentially vulnerable to ML and TF risks at the level of the internal market. These 40 products cover 11 professionals sectors, including:

- the sectors defined by Directive (EU) 2015/849, i.e. credit and financial institutions, money remitters, currency exchange offices, high value goods and assets dealers, estate agents, trust and company service providers, auditors, external accountants and tax advisors, notaries and other independent legal professionals, gambling service providers.
- the sectors that are not included in the scope of the Directive (EU) 2015/849 but were considered relevant for the risk assessment, such as use of cash, virtual currencies, crowdfunding or non-profit organisations. It also covers certain illegal means used by perpetrators such as Hawala and other similar informal value transfer services providers.
- The analysis was based both on quantitative data (statistics) and qualitative information (consultation of experts).

¹³ This Directive is replaced by Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 the prevention of the use of the financial system for the purposes of money laundering and terrorist financing (4AMLD) – to be transposed by 26 June 2017

¹⁴ This Regulation is replaced by Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds (2d Funds Transfer Regulation) which is applicable as of 26 June 2017, i.e. at the end of the transposition deadline of the AML Directive)