PREVENTION OF THE USE OF THE FINANCIAL SYSTEM FOR THE PURPOSES OF MONEY LAUNDERING OR TERRORIST FINANCING

Francisco Molina

Land registrar from Spain

At the time of drafting these lines the institutions of the Union are working on two projects on money laundering. On the one hand, a Proposal for a Directive of the European Parliament and of the Council on combating money-laundering through criminal law and, on the other, the Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on prevention of the use of the financial system for the purpose of money laundering or terrorist financing and for the amendment of Directive 2009/101/EC. The Union institutions thus recognize the importance of an issue that goes beyond the free movement of people and capital or the freedoms and facilities for investment, and even beyond fiscal or judicial cooperation, to reach the very heart of the defense of democracy, justice and the rule of law, as an instrument against fraud and corruption. It's in this context, that we must understand Council Directive 2016/2258 of 6 December amending Directive 2011/16/EU as regards the access of tax authorities to information against money laundering , and the opening of an enhanced cooperation procedure - involving Belgium, Bulgaria, Cyprus, Croatia, the Czech Republic, Finland, France, Germany, Greece, Lithuania, Luxembourg, Portugal, Romania, Slovaquia and Spain - to create a European prosecutor's office to investigate, prosecute and bring to justice those responsible for crimes against the financial interests of the Union.

Under EU law, 'money laundering' covers principally the conversion and transfer of property in the knowledge that such property is derived from any criminal activity, for the purpose of concealing or disguising the illicit origin of such property, or to assist persons who are involved in such activity to evade the legal consequences of their acts. (STJUE

T187 / 11, 28-5-2013, Trabelsi and Lejri v Council of the Union). Further, Spanish case law defines money laundering as "*the process by which the assets of criminal origin are integrated into the legal economic system with the appearance of having been lawfully acquired, so that the crime tends to get the subject to obtain a title, apparently legal, on property derived from a criminal activity*" (STS 265/2015, April 29). Therefore, the offense of money laundering is characterized by:

- The existence of a basic offense capable of producing an economic benefit, including the avoidance of payment of tax debts - STS 974/2012, December 5;
- The concealment of the criminal origin of the assets obtained, and the identity of the perpetrator or offenders;
- The creation of a legal and legitimate title appearance for the holding of the assets;
- And the enjoyment of them within the framework of the legal financial system

In the commission of a crime of money laundering and following the FATF, we can distinguish the following phases, which do not have to follow an order and can overlap in time:

1. placement by introducing capital into the legal financial system. In general, financial institutions are required to report any transactions which they presume to be related to money laundering or to illegal activities, in accordance with the principle of "know your client", where it is permissible for the Member State in which an entity resident in another State Member to establish that its activities require to comply with its specific legislation in this matter, without prejudice to the obligations also imposed by the regulations of the domicile (C212 / 11 Jyske Bank Gibraltar Ltd. 04/25/2013). In order to introduce flows of opaque origin into the financial system, techniques such as smurfing can be used, splitting the flows into small amounts that can be placed by different agents, but also buying financial and payment instruments (cashier's checks, payment orders, winning lottery tickets), or to inject the opaque money into cover business in which cash payment is frequent - hotel, small business - inflating real income. At this point, the Commission proposal for the Fifth Directive takles into account new placement modalities, such

as the use of payment systems or virtual currencies, including virtual currency exchange platforms and custody service providers of electronic purses as obliged entities;

2. layering, in which the money circulates successively through financial transactions, in order to disassociate it from its origin, by using electronic transfers to banks or offshore companies located in places where bank and corporate secrecy is enough to ensure that the traceability of money is lost. To do this, launderers acquire and transmit investment products and make fictitious transactions by going to companies created ad hoc and domiciled in tax havens;
3. integration whereby money returns to the launderer with the appearance of legal income, using simulated loans from an offshore center, investments from it in the launderer's business or in third companies, and acquisition of different investment assets.

Certainly the regulation focuses on ownership of financial assets, but real estate rights are and will remain an essential investment asset that represents over 50% of total assets held by the non-financial private sector. It is also an asset present in virtually all markets, where it can reach the consideration of the economy's engine. This makes the real estate sector particularly attractive in the integration phase of money laundering, since:

1. On the one hand, the ownership of the assets or rights allows the adoption of figures of a certain opacity, resorting to national and international legal figures, including modalities of temporal or spatial co-ownership, corporate or other legal entities, trusts and fiduciary figures, which can rise to remarkable levels of complication;
2. The valuation of real estate and the rights thereto has an eminently subjective character, linked to aspects derived both from the property itself and from other circumstances external to it, but influential - location, services, etc. - that lead to very profitable speculation; and
3. In general, real estate activity, in terms of urban land transformation, is linked to local power, which allows the launderer to establish close ties with political powers, promoting criminal behavior related to corruption.

This has been recognized by both the FATF and the Egmont Group and Europol in classifying the real estate as a "*high risk*" sector. It is therefore not surprising that Directive 2015/849 itself provides that "*legal professionals, as defined by the Member States, should be subject to this Directive when participating in financial or corporate transactions, including when providing tax advice, where there is the greatest risk of the services of those legal professionals being misused for the purpose of money laundering the proceeds of criminal activity or for the purpose terrorist financing,*" which, according to the internal legislation of each Member State, could include Property Registrars as obliged entities. Likewise, it will be the national rule that determines the scope of this obligation of collaboration in the framework of the application of due diligence with respect to customers or users. In relation to this we must remember that the purpose of the penal type is to obtain a title of legal appearance unrelated to the illicit origin of the funds, and that the purpose of the Register is precisely to create a legal title on property rights and endow them with Erga omnes effectiveness.

In general, the fight against money laundering in the three phases described is the fight against opacity, against the lack of information or the unreliability of it. The Commission itself, in the recitals in its proposal for the 5th anti-money laundering directive, points out that the success of this fight is to provide transparency to financial transactions, especially as "*the globally interconnected financial system makes it simple to hide and move funds around the world, by quickly and easily setting up layer upon layer of paper companies, crossing borders and jurisdictions and making it difficult to track down the money. Money launderers, tax evaders, terrorists, fraudsters and other criminals are all able to cover their tracks in this way*." The use of external jurisdictions as the location of intermediary entities makes it almost impossible to determine the true owner of the investments that lies behind an entire network of interposed entities. It is necessary, therefore, "*to prevent the large-scale concealment of funds which can hinder the effective fight against financial crime, and to ensure enhanced corporate transparency so that true beneficial owners of companies or other legal arrangements can not hide behind undisclosed identities.*"

In this line, UN Security Council resolutions 2199 (2015) and 2253 (2015) calls for hamper the access of terrorist groups to financial markets, and the G20 declaration of 18

April 2016 calls for "*Improve the implementation of the international standards on transparency, including on the availability of beneficial ownership information, and its international exchange* ". In short, the Commission adopts recommendations 24 and 25 of the FATF and consequent Immediate Outcome 5, insofar as they require States to "*ensure that competent authorities have timely access to adequate, accurate and up-to-date beneficial ownership information*" .

The requirement of transparency therefore focuses on the source of funds, and ownership of the assets, of any kind that these are. At this point, as we have indicated, different types of structures can be used to mask the real ownership of real estate property and rights, which the Commission includes under the corporate and fiduciary categories. According to the FATF, the World Bank or UNODC-StAR, it is possible to conceal the identity of the holders, the true purpose of the assets and the use made of them by means of one of the following techniques :

- Employment of shell companies, without activities or own resources;
- Establishment of complex structures of ownership or control, with different levels of participation in favor of legal persons;
- Unlimited designation of legal persons as administrators;
- Formal appointment of partners and directors, concealing the identity of the person making the appointment;
- Informal appointment of those, among relatives or other close people;
- Use of trusts and other agreements that make it possible to separate the legal ownership of the assets and the perception of the benefit;
- Use of intermediaries in the creation of legal entities.

To date, Articles 30 and 31 of the 4th Directive regulate the obligation to provide and collect the information corresponding to the actual holder, completing Articles 32 to 38, as they establish some communication duties.

Please allow me to make a brief reference to the state of the matter from the perspective of the Commercial Registries, knowing that ELRA is an association exclusively of Land

Property Registrars. Article 30 imposes the obligation to obtain and retain information regarding the beneficial ownership and the legal owner, and to provide the same information to the obligated entities when taking due diligence measures. This information must be kept in a National central registry, which will be the commercial register, companies register or a specific public register. The current draft of the Commission presents as the main novelty the removal of the requirement of legitimate interest to access the information. In our view, the measure for the moment is not achieving the desired results. Its full effectiveness would include:

1. to require authentic document for the transfer of corporate shares, and the registration of those transmissions in the relevant public registry, particularly in the Business Registry, when talking about not listed companies. It may be desirable for such inscription to be constitutive;

2. to admit such registration when the transmission has been concluded before a foreign authority. This would fit with the FATF Recommendations 24 and 25;

3. and to enable the circulation of such information. With that:

- Full legal publicity will be given to the beneficial owner, making opaque operations difficult and guaranteeing the correction on the chain of transmissions;
- It will be possible to fully effective the limitations of domain, freezings, liens and forced alienation of the aforementioned corporate shares, as agreed by the judicial or fiscal authorities; and
- Compliance with the Commission's dispositions will be achieved, allowing general and public access to information on beneficial ownership. This implies that the information about the beneficial owner of the companies should also be considered as public domain. Transparency is also conceived as a mechanism to preserve confidence in the integrity of commercial transactions and the financial system, which:
    - Protect minority investors and third parties wishing to do business with the entity or structure, granting them access to reliable property information, including the identity of controlling owners and control

structures of companies;

- Greater control of information by civil society, including the press or civil society organizations;
- Use that information for reputational purposes, so that anyone who can carry out transactions with them is aware of the identity of the beneficiary (s)

These measures are already being implemented by the United Kingdom, France, Germany, Italy, the Netherlands, Luxembourg, Austria, the Czech Republic and Albania, creating the bases for electronic circulation of information through established channels.

We will focus on the case of trust and other similar legal agreements, whose incidence on money laundering appears to be far superior to that of corporate structures, however complex they may be. Such institutions are rarely mentioned in connection with investigations into corruption or money laundering, which, according to the World Bank, only confirms their effectiveness in masking the identity of persons involved in the same.

In a basic trust model or similar arrangement, the original owner of the assets - settlor - assigns them to someone of their trust - trustee - to manage them according to the instructions left by him, in favor of designated beneficiaries who receive the proceeds of those assets while the trust is in force, or will receive the assets themselves at the moment previously set for the extinction of the trust - distribution. Thus configured, the trust generally attends to family interests related to the succession of the disposer, and / or the adequate patrimonial protection of the interests of minors or incapable. However, according to each national regulation, the scheme can be complicated enough:

1. Functionally, the trust could participate in trade agreements, as a mechanism to organize pension funds or investment, etc.;

2. The operation of the trust itself may be modified by the settlor's provisions:

- May establish that there is no distribution;
- Can establish it as a "discretionary trust": the trustees decide when / if the

distribution is made, and / or determine the final beneficiary from a class designated by the settlor, who, in such cases can:

- Leave some guidelines of action in the form of "letter of wishes", which may be kept secret;
- Name a "protector" or "enforcer", which could be the settlor himself, according to national law;
- Grant "power of attorney" to a third party so that the appointed can veto the trustee's decisions, or remove him;

3. In general it is prohibited for the same person to occupy more than two positions in relation to the trust: the settlor can not be beneficiary nor trustee and the trustee can not be beneficiary. But certain jurisdictions do allow one person to occupy all roles, particularly in notorious tax havens.

The current situation, contained in Article 31 of the 4th Directive, is as follows:

1. only the identification of the beneficial owner of the "express trusts" is required, without giving a definition thereof;
2. the singular is used when referring to the different subjects, thus enabling the identification of only one of the various settlers, trustees, beneficiaries, protectors or any other persons involved;
3. collection of data on beneficial owners is required, only when dealing with trusts with fiscal effects, which are not defined, and, in fact, these fiscal effects are irrelevant if the purpose is to prevent money laundering;
4. such data should be collected in a central registry, which is not specified to be public, which, in relation to the above, leads to the fact that these are mainly administrative records for taxation purposes, and thus, no public and general access is granted;
5. the definition of the point of connection in determining the jurisdiction in which the registration of the trust is to be carried out is deficient, inasmuch as it refers exclusively to trust "subject to its legislation". This can be interpreted as:
    1. trust created and regulated by national law - domestic law trusts - even if there is no further connection with it - none of the intervening parties is resident and does not have assets in the territorial scope;

2. trust with some point of connection with national law - domestically managed trusts - which will normally be the residence of the subjects, basically the trustee. But in that case the residence of all of them, or only the principal, or the professional trustee, may be required, making it easy to circumvent the legal requirement. The same can happen - require the residence of all of them - if the requirement is applied to the settlors or beneficiaries, or even if the connection point is the location of the assets - all, the main...

The consequence of all this is an alarmingly diverse situation as regards the incorporation to any record of the data, and that results in an evident inefficacy of the intended measures. If we consider the registration in any registry of all trusts subject to national law, and / or all those subject to foreign law when a trustee is resident in national territory, we can find us, according to the Financial Secrecy Index of 2015, with the following table:

1. only the Czech Republic, Hungary and San Marino prescribe the registration of all trusts of both types;
2. in Italy and Monaco trusts managed in the territory are registered, but trusts can not be created according to national law;
3. in Ireland all trusts managed under national law are registered, irrespective of the law of their constitution;
4. in Andorra, Belgium, Cyprus, Denmark, Estonia, Finland, Greece, Latvia, the Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain and Sweden trusts can not be created according to national law, and not all trusts constituted according to foreign law but managed according to the national law are registered;
5. in France, exclusively trusts constituted in accordance with national law are registered;
6. In Austria, Germany, Luxembourg, Malta, and the United Kingdom, neither all trusts established under the law nor all those constituted under foreign law but managed according to the national law are registered.

The full effectiveness of the measure can only be achieved if the information refers to all

types of trusts created or regulated by national law, all subjects involved in them, and it's deposited in a public registry, such as the Land Property Registry, which makes it possible to clarify the identity of the true owners of the economic assets, by means of full legal publicity and with the highest reliability that each system is able to offer, also allowing the circulation of this information.

The proposal of the 5th Directive now presented by the Commission continues to speak of "*express trusts*" and uses the singular to refer to the subjects, and continues to be invoked to a central register without requiring that it be a public register. However, the reference to trusts with tax effects has been deleted, and the connection rule is clarified by stating that the data will be kept in the register of the jurisdiction in which the trust is administered and that it will be considered to be managed in The member state in which the trustees are established. In addition, on this point it differentiates:

- Trusts and similar legal arrangements that carry out commercial activities for profit, in which case the considerations on the need to give a legal and general publicity to the real holder are the same as those presented for the case of the corporate entities;

- Trusts and legal arrangements whose purpose is to preserve the family patrimony, or to serve charitable or other beneficial purposes for the community, and therefore not qualified as a type of business, in which case it considers justified to guarantee greater privacy to the real owners, whose data will only be provided to persons or organizations with an accredited legitimate interest. Parliament's opinion, however, does not go along this line, and seems to understand that maximum publicity must be given in any case.

In addition, the Commission has introduced an Article 32a relating to the establishment of automated centralized mechanisms "*as central registers or electronic central data inquiry systems*" in relation to the beneficial owners of payment accounts, bank accounts and safe-deposit boxes.

The draft of the 5th Directive in this area, as a whole, seems to us unrealistic:

1. On the level of mercantile companies, as far as capitalist companies, to demand the full traceability of capital is to denaturalize their very essence and to abolish de facto the mechanisms of representation and transmission of the shares of corporations;
2. The creation of a national central trusts registry is only reasonable insofar as the figure, not of the trust, but the trust of the Anglo-Saxon model, is recognized in the corresponding national legal order. The adaptation of the Directive on this point therefore appears to be complex. In fact, the FATF recommendations differentiate "requirements for trust law countries" and "common requirements for all countries";
3. In any case, a rigorous application of these dispositions would lead to the disappearance of the public limited company and the trust, so it is more credible that, in practice, there would be a relaxation of the requirements established;
4. On a more theoretical basis, the solutions adopted by the Union won't be effective, as long as it is possible to operate in Europe through societies or trusts resident in third states that offer great facilities for the creation and management of legal persons and apply restrictions on the exchange of information on matters of the beneficial owner. It is therefore necessary to reach agreements within the framework of the OECD.

In its report of 9 March Parliament proposes a series of amendments affecting the articles to which we are referring. In the mercantile field, the need to make the information about the beneficial owner accesible to the general public, with minimum contents, is emphasized. Regarding trusts:

1. It includes a more extensive but still exemplary list of legal agreements comparable to the trust: fiducie, Treuhand, waqf or fideicomiso, Stiftung, Privastiftung, Usufruct fiducia, and all othersimilar, in terms of structure or function, existing or future legal arrangements. It is intended to provide general access to the information on beneficial owner, but the wording is unclear;
2. The connecting point rule is extended to cover legal structures created or governed by the rule of a Member State, or whose governing body is ultimately in one, which

are linked to it by residence of one or more of the actual owners, or by holding assets in the same, or shares or voting rights in legal persons which are resident in such Member State, or by holding bank or payment accounts in a credit institution located in a Member State;

3. The information relating to the beneficial owner in this case "shall be kept in the central *register referred to in Article 30, paragraph 3*", that is to say, the commercial register, companies register or public register. If there are fiduciary structures that carry out commercial activities, but in many countries trusts are only recognized in order to safeguard familiy property interests, to demand the constancy of all of them in the Business Registry lacks the minimum systematic and technical logic. Anyway, there's an advance since the data relating to these institutions must be recorded in a Public Registry, so this information should also be considered as public domain. Given that the proposal by the Commission already provides for beneficial ownership of financial assets to be incorporated into a single electronic register, it would appear that the field in which it is necessary to focus would be the real estate, and the Property Registry meets the precise characteristics for the appropriate treatment of the information required. Parliament's position, therefore, seems to be based on a profound lack of awareness of national institutions and legal technique.

The main novelty comes, however, from the 59th amendment, introduced by the Legal Affairs Committee on 18 January 2017, adding a new Article 32b, which we analyze in some detail. In short, it is a question of the creation of a repository of real estate titles, which will have to be supplied with the information provided by the competent authorities in order to decide with full probative value in each Member State on the property rights, that is to say, the Land Registry. In fact, such a repository already exists at the national level, at least in all those Member States whose Land Property Registries are interconnected. In Spain, for example, a simple on-line consultation through the FLOTI system - locator file of registered entitlements - allows to know at the moment on how many properties in the whole national territory a given person holds a registered right, as well as obtain detailed information on the legal status of anyy of them, providing their identification data.

However, this repository is not to be publicly accessible, when the Parliament itself has considered that there are no grounds for imposing restrictions on access to information concerning trusts. If the attribution contained in the amendment corresponding to Article 31 to the Business Registries is otherwise, as it's technically more correct, assigned to Land Property Registry, this new Article 32b would be superfluous and unnecessary. The final result of this new provision is the same as that pursued by the interconnection project: to create a single portal that allows access to legal information on real property rights entitlements contained in the national property registries. The interconnection project, with its essential tool IMOLA, also provides detailed information on the scope and content of the registration information itself, and the content of the rights to which it refers, in a structured and understandable way, thanks to the glossaries and thesaurus. Parliament's proposal on this point seems redundant and unambitious and would only confirm that the Interconnection of Property Registries not only addresses market interests and judicial cooperation, but also combating money laundering and tax evasion, a role that, in fact, Property registries already play at national level.

We will focus, finally, on the last paragraph of this article:
"*4. Member States shall cooperate with each other and with the Commission to establish before 1 January 2018 a European ownership registry in accordance with paragraph 1 on the basis of the European Property Information Service (EULIS).*"

A provision with such content deserves the following considerations:

1. The date of January 1, 2018 lacks any realism, unless it is considered to be limited to the creation of a central electronic data retrieval systems as estated in paragraph 1, but this is far from what a Land Registry is. The truth is that there is a change of terminology (registries - register) difficult to understand, and it makes the provision systematically incomprehensible.
2. anyway, the circulation of legal information on ownership does not under any circumstances pass through the need to create a European Property Registry, but it's covered by the effective implementation of the interconnection between national registries;
3. in any case, if it is a question of creating an institutional structure of the Union, it

does not appear that the directive, required of transipostion at national level, is the most appropriate regulatory instrument;

4. for us, Article 345 of the TFEU appears to veto the imposition of a European Land Registry by the authorities of the Union, since the registration model of each state is a reflection of the system of real rights and of the transmission of the same that is in force, which conditions while being conditioned by it. Imposing a certain model of Registry would affect the structure of property rights, and "treaties in no way prejudge the ownership regime in member states";
5. and, if the interconnection mechanism itself has come to assume that its implementation will be voluntary, it does not take much imagination to suppose the reaction of the national authorities to the creation of a European Land Registry;
6. the reference to EULIS seems out of place and all logic:
    1. by the very condition of the European Economic Interest Group, and therefore, of a private entity, which EULIS has;
    2. by the current situation of EULIS, whose Board, at its meeting in Dublin on 7 February, has already agreed to its dissolution and liquidation;
    3. because EULIS does not constitute, in any case, a Land Property Registry whose model is applicable at national or European level, but, to this end, a portal for access to legal-real estate information provided by the National Property Registries, a portal whose closure is scheduled for 31 July.

It is for this reason that we consider that the amendment should be redirected towards invoking the effective establishment of interconnection mechanisms, in the way the Commission is working on it, and the enhancement of the task developed by Land Property Registries as instruments of transparency in the ownership of real estate assets, and therefore in the fight against money laundering and tax evasion:

- Giving light to the true ownership of real estate assets, when publishing the different operations on them, and the subjects that have intervened in their formalization, which allows establishing relations with other subjects or other assets that could *prima facie* have been hidden;
- Giving effect to precautionary measures adopted during the judicial investigation

and to pecuniary and custodial sanctions imposed on the launderer's estate;

- Applying, in accordance with State regulations, due diligence measures to identify risk assumptions and to communicate them to the competent authorities for their investigation.

Only the full availability of the data relating to the actual owners of the different types of assets can achieve the full effectiveness of the measures established for the prevention of money laundering. Creating restricted access registers or databases does not appear to be justified, and Parliament has contradictions. There is also a clear lack of perspective in predicting the collection of the data of all types of trust in the Mercantile Registry, regardless of whether or not they develop commercial activities, and by establishing a purely informative repository of real estate ownership, when at most Reasonable, and there is already a forecast for such a repository for financial assets, would be to take advantage of the possibilities already provided by Property Registries and to promote the circulation of information related to real estate ownership, betting on the project of interconnection of the Commission.