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Emerald Article: The EU's preventive AML/CFT policy: asymmetrical harmonisation

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The EU's preventive AML/CFT policy: asymmetrical harmonisation

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Abstract

Purpose – This article aims to consider the role of the European Union (EU) in the prevention of money laundering and to show that the EU has a lot more to win in this field of policy.

Design/methodology/approach – This article is based on a literature study and a thorough analysis of the EU Directives on the prevention of money laundering.

Findings – Whereas, the material norms for entities subject to regulation have been harmonised and adjusted to the risk-based approach at European level, the norms regarding the enforcement instruments have mostly been left to the Member States' legislation. As a result, there exists a "patchwork" of enforcement mechanisms throughout the EU.

Research limitations/implications – This article focuses on the prevention of money laundering on the level of the EU only; no connection is made to the international or to the national level.

Originality/value – This article does not provide a value judgment on the preventive rules at European level as such, but rather it offers an academic perspective on the role of the EU in the prevention of money laundering.

Keywords European Union, Money laundering, Law enforcement

Paper type Conceptual paper

1. Introduction

Over the past 20 years, a "twin-track approach" against money laundering has evolved (Stessens, 2000, pp. 82 and 108-12). On the one hand, this twin-track approach consists of a preventive policy, which aims at the prevention of money laundering through the setting of identification and reporting obligations. On the other hand, the twin-track approach consists of a repressive policy of which the objective is to punish the money launderer. This article focuses on the preventive anti-money laundering and combating the financing of terrorism (AML/CFT) policy at the level of the European Union (EU).

The EU became involved in the fight against money laundering at the beginning of the 1990s with a directive on the prevention of the use of the financial system for the purpose of money laundering (First Directive) (European Union, 1991). This directive was amended by the Second Directive in 2001, which, among other things, broadened the scope *ratio personae* of the First Directive to also include non-financial institutions like notaries and lawyers[1] (European Union, 2004). Directive 2005/60/EC replaced the First and Second Directive (European Union, 2005). Like the Second Directive, the Third Directive was a response to the revision of the Financial Action Task Force (FATF) Recommendations; its main purpose being to provide a common EU basis for implementing these FATF Recommendations[2].

The development of the preventive AML/CFT policy at European level by means of these three directives is interesting, because of the different approaches that have been employed therein[3]. The First and Second Directive carried a so-called rule-based

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approach, which in essence comes down to the application of one set of rules in every context and all cases by all entities, whereas the Third Directive entails a risk-based approach (Dalla Pellegrina and Masciandaro, 2009, p. 936; Ross and Hannan, 2007). Broadly speaking, the aim of a risk-based approach is to calibrate policies on the risk and implies that entities have some discretion as to what transactions to report to the competent authorities (Unger and Van Waarden, 2009, pp. 2-7; Dalla Pellegrina and Masciandaro, 2009, p. 933). At first sight, the implications of the change from a rule- to risk-based approach can best be seen in the norms that are addressed to the entities subject to regulation. It is, however, assumed that the allowance of the risk-based approach must also be attended with changes to the enforcement of those rules and the enforcement instruments that are available to the supervisory authorities, i.e. the competences are assigned for ensuring compliance with the preventive AML/CFT obligations. This development is very interesting from a legal point of view; it has been pointed out that under the risk-based approach, the design of the relationship between supervisors and reporting entities becomes even more important in order to have effective and efficient regulation (Dalla Pellegrina and Masciandaro, 2009, p. 933; Ross and Hannan, 2007, p. 113).

The question that this article, therefore, tries to answer is whether there are changes to the enforcement instruments in the preventive AML/CFT policy at European level, and if so, whether these are the result of the shift from a rule- to risk-based approach.

In order to come to an answer, the Section 2 introduces some reflections on the rule- and risk-based approach in AML/CFT policy, in general. It shortly deals with the advantages and disadvantages of both approaches and tries to explain the rationale for opting for the risk-based approach. The Section 3 provides examples of material norms addressed to entities subject to regulation under the rule-based approach, and under the risk-based approach. It is demonstrated that the change in approach is clearly reflected in those norms. The Section 4 is about developments with regard to the enforcement instruments as they have been laid down in the three directives. The Section 5 tries to link these developments to the change from a rule- to risk-based approach. This article ends with a conclusion and some critical remarks.

2. Some reflections on the rule- and risk-based approach

2.1 Rule-based approach

In general, it can be said that a rule-based approach implies that legislators and policymakers adopt detailed norms on what the addressees of those norms must do and what they must abstain from. In the case of preventive AML/CFT policy, this means that the legislator enacts specific norms on which transactions must be reported to the competent authorities. Thereupon, these authorities decide whether a transaction can be called suspicious and whether the report must be referred to the competent law enforcement authorities for further investigation. One example of such a detailed norm is that entities subject to the reporting obligation must make a report on every cash transaction that exceeds the amount of 15,000 EUR. The rule-based approach has been characterised as being passive and static: the norms are always applied by all addressees under all circumstances, notwithstanding the specific context of a case (Dalla Pellegrina and Masciandaro, 2009, p. 936; Ross and Hannan, 2007).

2.1.1 Advantages. Advantages of the rule-based approach that have been highlighted in literature are, *inter alia*, legal certainty, equality and lower costs for the implementation and enforcement of norms (Unger and Van Waarden, 2009, pp. 3-4). This is so because, the specific norms are clear and transparent, do not leave room for discussion, and apply without exceptions to all entities to which the norms are addressed. Last, research has revealed that broad standards – as opposed to precise norms – entail significant costs for the implementation and enforcement of those norms[4], which means that the use of more precise norms will lead to lower costs.

2.1.2 Disadvantages. However, in literature, more attention has been paid to the disadvantages of a rule-based approach. This article highlights in a "random" fashion some of these disadvantages. First of all, the rule-based approach was called ineffective because its formal character led to high costs for entities in order to comply with their reporting duties (Muller *et al.*, 2007, p. 97). It also led to a disproportionate allocation of resources, because the money was not properly divided between the sectors sensitive and the sectors less sensitive to the threat of money laundering. Second, criminals who were familiar with these thresholds and predefined criteria could manipulate their transactions in such a way as to circumvent the standards, the so-called "smurfing" practices (Stessens, 2000, p. 99; Unger and Van Waarden, 2009, p. 4; Dalla Pellegrina and Masciandaro, 2009, p. 933). Third, it was considered that excessive fines in case of non-compliance under a rule-based approach could lead to over-reporting which, in turn, could lead to high reporting costs for the private sector, on the one hand, and to many useless reports for the public authorities, on the other hand. This last problem has been called the "crying wolf problem": institutions just report anything as to prevent that a fine is imposed, but because of this defensive reporting the quality of what is being reported is very low (Takáts, 2007; Ross and Hannan, 2007, p. 107).

These disadvantages gradually took over the advantages that had initially come along with the rule-based approach. They led to grave concerns and to a change of insight on how to prevent and combat money laundering, which eventually resulted in the "invention" of the risk-based approach in preventive AML/CFT policy.

2.2 Risk-based approach

The risk-based approach in preventive AML/CFT policy focuses on actual risk. Financial and credit institutions and other entities subject to regulation must ensure that the measures they take are adequate and proportionate to the level of risk that exists[5]. It should be pointed out that risk has always been an integral part of AML policies, even under the rule-based approach, but that only with the risk-based approach "the concepts of risk, risk assessment and risk management have become central elements" in the preventive AML/CFT policy (Ross and Hannan, 2007, p. 107).

The essence of this approach is that resources should be directed in such a manner that the highest risks receive most attention (FATF, 2007, p. 2). Thus, with regard to money laundering:

> [. . .] [h]igher risk areas should be subjected to enhanced procedures: for the financial services sector, this would include measures such as enhanced customer due diligence checks and enhanced transaction monitoring. It also follows that in instances where risks are low, simplified or reduced controls may be applied (FATF, 2007, p. 2).

Risk categories that can be distinguished are, for example, geographical risk, customer risk and services risk (FATF, 2007, pp. 22-4). Within these risk categories, various risk variables such as the size of the transaction undertaken or the level of regulation and oversight play an important role (FATF, 2007, pp. 24-5).

2.2.1 Advantages. Several advantages of the risk-based approach were outlined when the approach was first introduced. Some of these advantages will be explained here. First, compared to the rule-based approach the norms that are applied under the risk-based approach are far more flexible (Muller *et al.*, 2007, p. 97; Unger and Van Waarden, 2009, p. 4; Dalla Pellegrina and Masciandaro, 2009, p. 933). Second, as a consequence of leaving more discretion to the entities to identify the level of risk, defensive reporting would occur less and the quality of the reports could be increased[6] (Ross and Hannan, 2007, p. 107; FATF, 2007, p. 3). Third, because of the discretion that the entities have in developing their own criteria for money laundering cases, the preventive AML/CFT policy can become more effective. Entities themselves know best where the highest risks are and can focus themselves on those risks, instead of spending the scarce and valuable resources to low-risk situations of money laundering (FATF, 2007, p. 3; Unger and Van Waarden, 2009, p. 4). Fourth, this means that more active behaviour of the private sector is required:

> [. . .] [t]he regulated entity specifies the risks that must be managed and implements the most appropriate regulatory strategies. (. . .) Regulated authorities must now be proactive agents in the mitigation of money laundering risk (Ross and Hannan, 2007, pp. 108-11).

Unger and Van Waarden (2009, p. 4) call this the benefit of more democracy: "citizens and companies, subjects of the law, are treated as resourceful actors, rather than ignorant children who have to be taught a lesson". As a consequence, there is a shift of ultimate responsibility. Not the legislators and policymakers bear ultimate responsibility for the effectiveness of the AML policy anymore, but with a risk-based approach this responsibility lies with the entities themselves (Unger and Van Waarden, 2009, p. 108). It is assumed that this shift in ultimate responsibility serves as an extra encouragement for the private sector to prevent money laundering. Finally, a great advantage of the risk-based approach is that money launderers cannot know beforehand how the risk will be measured: each situation must be assessed on its merits. It is not simply the exceeding of a certain threshold anymore that obliges entities to send a report to the FIU. Hence, the risk-based approach makes it more difficult for criminals to abuse financial and credit institutions and designated non-financial businesses and professions as it prevents the occurrence of smurfing practices.

2.2.2 Challenges. However, the risk-based approach does not only have advantages. Two challenges to the risk-based approach are highlighted here. Flexibility, which was just mentioned as an advantage of the risk-based approach, also makes the risk-based approach more demanding. As explained, each institution is expected to develop its own internal risk policy. Of course, the underlying idea is that the private sector knows its own risks best, but what does the concept of risk actually entail? It has been submitted that it is an elusive concept, which involves a certain amount of uncertainty and can be defined in several ways (Ross and Hannan, 2007, p. 108 *et seq*). The second challenge to the development of risk management and risk policies by entities subject to regulation is that it brings about higher costs for the private sector. For example, entities subject to regulation must develop procedures and systems, keep those procedures and systems up-to-date, and they must train their staff in applying those procedures and systems (Dalla Pellegrina and Masciandaro, 2009, p. 942; FATF, 2007, pp. 4-5). This brings along extra costs.

Despite its challenges, it seems that the risk-based approach is the best approach for the prevention of money laundering and terrorist financing. Therefore, this approach is now the key element in the regulatory AML/CFT framework at international, European and national level.

3. Substantive norms under the rule- and risk-based approaches

As explained, the implications of the change from rule- to risk-based approach can best be seen in the norms that are addressed to the entities subject to regulation. This section is not aimed to provide a full and thorough overview of the development of the substantive norms in the directives (Mitsilegas, 2003, pp. 52-101; Mitsilegas and Gilmore, 2007). Rather, it provides some examples of the way in which the different approaches have been reflected in the directives.

3.1 The rule-based approach and the First and Second Directive

3.1.1 Example 1: obligation to perform customer due diligence. This first example relates to the customer identification requirements as laid down in both the First and Second Directive. This example relates to the customer due diligence (CDD) requirements. The duty of credit and financial institutions to require identification of their customers was laid down in Article 3 of the directives. This provision stipulated, *inter alia*, that identification was required:

- when entering into business relations, particularly when opening an account or savings accounts, or when offering safe custody facilities; or
- with customers, when a transaction with a customer takes place, involving a sum amounting to ECU[7] 15,000 or more, whether the transaction is carried out in a single operation or in several operations which seem to be linked.

One can see that the obligation for customer identification in these situations was based on quite specific situations. These “fixed” situations seem to be based on the rule-based approach. After all, no matter the circumstances, when entering into a business relationship or performing a transaction of a value of ECU 15,000 or more, CDD had to be performed.

3.1.2 Example 2: timing of CDD. The second example relates to the timing of these CDD requirements. Hereby, it is important to point out that in the First and Second Directive the customer identification procedure always had to be completed before a business relationship was established, or before a transaction would take place. There were no exceptions to this rule and, hence, all entities subject to regulation were obliged to apply this rule under all circumstances. As explained in the previous chapter, these are characteristics of a rule-based approach (Dalla Pellegrina and Masciandaro, 2009, p. 936; Ross and Hannan, 2007).

3.2 The risk-based approach and the Third Directive

3.2.1 First example: level of CDD. A first example of the risk-based approach is derived from the CDD measures in the Third Directive. It is interesting to see that the provisions with regard to CDD have been enormously extended. There not only are standard CDD measures, as under the First and Second Directive, but also simplified and enhanced CDD procedures. The level of CDD can differ and may be determined on a risk-sensitive basis, provided that the entities subject to regulation are able to demonstrate to the supervisory institutions and self-regulatory bodies (SRBs) that the measures are appropriate[8]. The risk-based approach is thus clearly reflected in the CDD measures that entities must take: the level of risk – low, normal or high – determines the level of CDD – simplified, normal or enhanced.

Under normal circumstances, standard CDD must be applied. However, on the basis of a low-risk profile, a simplified CDD can take place. The more detailed rules on simplified CDD are laid down in the Implementing Directive[9]. It should be stressed that it is up to the entities subject to regulation to prove that the customer concerned does comply with the requirements of "low risk". By contrast, when there is a higher risk of money laundering or terrorist financing, enhanced CDD must take place[10]. The Third Directive thus adds a great deal more detail to the previous CDD measures. It indicates certain high risk-situations, such as no physical presence of the customer for identification purposes, cross-frontier correspondent banking relations with respondent institutions from third countries, transactions or business relationships with politically exposed persons, and last, products or transactions that might favour anonymity[11]. Because, the Third Directive employs the term "at least" with regard to the above-mentioned situations, it can be concluded that this list is a non-exhaustive list.

3.2.2 Second example: ultimate beneficial owner. The second example presented here is about the CDD requirements regarding the ultimate beneficial owner (UBO). UBO means "the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted" (art. 3, sixth paragraph, Third Directive). The First and Second Directives were only directed to CDD requirements on the customer[12], yet the Third Directive decides that CDD shall also comprise the identification of the beneficial owner[13]. Subsequently, the directive states that the CDD on UBOs should be performed by:

> [. . .] taking risk-based and adequate measures to verify his identity so that the institution or person covered by this Directive is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts and similar legal arrangements, taking risk-based and adequate measures to understand the ownership and control structure of the customer.

The CDD requirement on UBOs may be performed on a risk-sensitive basis, which is a clear expression of the risk-based approach.

3.2.3 Third example: timing of CDD. A third example relates to the timing of these CDD requirements. Whereas, under the First and Second Directive CDD should always be performed beforehand, the Third Directive explicitly allows for exceptions to this rule with regard to the verification of the identity of the customer or the beneficial owner. Article 9, second paragraph, Third Directive states that by way of derogation from the rule that verification of the identity of the customer and the beneficial owner takes place before the establishment of a business relationship or the carrying-out of the transaction:

> Member States may allow the verification of the identity of the customer and the beneficial owner to be completed during the establishment of a business relationship if this is necessary not to interrupt the normal conduct of business and where there is little risk of money laundering [or terrorist financing] occurring.

This exception enables entities more flexibility in case of low-risk situations and thus expresses the risk-based approach.

4. Enforcement instruments in the norms directed to supervisory authorities

This section deals with the provisions that are meant for national supervisory authorities as laid down in the three EU Directives. Attention is paid to the enforcement instruments of the supervisory authorities, by which is meant the competences that supervisory authorities are assigned for ensuring compliance with the preventive AML/CFT obligations like, *inter alia*, the CDD and the reporting obligation. Enforcement is here to be understood in a broad sense, covering both the supervision and the sanctioning in case of non-compliance.

4.1 First Directive

The First Directive established customer identification, due diligence and reporting obligations for financial and credit institutions. It is remarkable that the directive hardly paid any attention to the supervision on compliance with those obligations. Only two provisions dealt with the enforcement of the preventive AML/CFT policy: First of all, Article 10 referred to "inspections carried out [...] by the competent authorities". However, this provision was in fact directed to the Member States that had to ensure that when the authorities responsible for supervision on credit or financial institutions discovered facts that could constitute evidence of money laundering, they would inform the "authorities responsible for combating money laundering".

Second of all, Article 14 called on Member States to take appropriate measures to ensure the full application of all the provisions of the directive. The First Directive did not say what these appropriate measures should be, nor did it provide any examples. This was completely left to the Member States' national legislation. More importantly, Article 14 also referred to the sanctions for non-compliance with obligations laid down in the directive. It stipulated that Member States had to "determine the penalties to be applied for infringement of the measures adopted pursuant to this Directive". The directive did not provide any guidance on the nature of these sanctions.

It can be seen that no enforcement instruments were prescribed in the First Directive. It provided some starting points for enforcement of the preventive AML/CFT policy, but it did not go further than laying down very broad obligations such as "appropriate measures" and "penalties". This means that it was completely left to national procedural law to design this enforcement system (Jans *et al.*, 2007, pp. 18-22 and 40; Craig and De Búrca, 2008, pp. 306-08). This is not very surprising in the light of the EU doctrine of national procedural autonomy. National procedural autonomy is a species of institutional autonomy and essentially means that, unless EU law provides otherwise, national law and national organs must ensure that the Community Rule is applied and complied with (after implementation in national law). So far, in two areas, only does EU legislation itself lay down rules for the enforcement, namely, in customs law and in the field of public procurement.

4.2 Second Directive

The entry into force of the Second Directive did not bring about any important changes with regard to the enforcement instruments. Still, references to supervisory authorities were very scarce and in fact, the only change was the addition of a new paragraph to Article 10:

> Member States shall ensure that supervisory bodies empowered by law or regulation to oversee the stock, foreign exchange and financial derivatives markets inform the authorities responsible for combating money laundering if they discover facts that could constitute evidence of money laundering.

This provision was inserted to ensure that the supervisors on the financial markets would cooperate with the supervisors for money laundering in case these supervisory authorities were not one and the same institution. Article 14 with regard to the sanctions in case of non-compliance remained the same.

Again, no enforcement instruments were demanded and it seems that, like under the First Directive, enforcement was not truly a point of attention in the Second Directive. This confirms the thought that the Member States themselves were considered to be the driving forces behind the enforcement of preventive AML/CFT policy (Jans *et al.*, 2007, pp. 18-22 and 40; Craig and De Búrca, 2008, pp. 306-8).

4.3 Third Directive

The Third Directive pays more attention to the enforcement of preventive AML/CFT policy. Supervision takes a central place in the Third Directive, and a special section is dedicated to this subject (Chapter V, Section 2). A special section is also devoted to penalties (Chapter V, Section 4). Supervisory authorities are obliged to monitor whether all the requirements from the Third Directive, especially the CDD measures, reporting obligation and record keeping measures, are complied with.

From the text of the Third Directive, Rietrae has deduced six categories of entities that must be supervised. Rietrae argues that the level of supervision depends on each supervisory category. The categories that Rietrae (2007, pp. 21-3) distinguishes are:

- banks, securities firms, investment funds, life insurance companies, insurance intermediaries and casinos;
- currency exchange offices and money transmitters;
- trust and company service providers;
- other financial institutions subject to the Third Directive;
- lawyers, notaries, accountants and tax advisors; and
- other entities subject to the Third Directive.

The Third Directive makes clear that supervisory authorities must always be able to effectively monitor compliance, to take the necessary measures to ensure compliance with regard to the obligations derived from the directive, to have adequate powers "including the power to compel the production of any information that is relevant to monitoring compliance and performance checks", and to have adequate resources to perform the supervisory functions[14].

But, the Third Directive also indicates that some supervisory authorities need to be able to take additional supervisory measures. In the first place, regarding financial and credit institutions the directive lays down the requirement that certain specific financial entities need a licence or need to be registered in order to operate on the market, which can be refused "if supervisors are not satisfied about the integrity of management and the beneficial owner of these entities[15]" (Rietrae, 2007, p. 22). The second additional measure that applies to financial and credit institutions and casinos is the obligation for Member States to assign to the supervisory authorities enhanced supervisory powers with a possibility for on-site inspections[16]. In the second place, lawyers and notaries are not subjected to licensing requirements. In Article 37(5), however, the Third Directive gives the possibility for SRBs to act as supervisors for the purpose of the prevention of money laundering and terrorist financing. SRBs are organisations that exercise regulatory authority over a profession. They often already have some controlling activities over this group and it appears from this directive that compliance with preventive AML/CFT policy may be added to these controlling activities. The Third Directive allows supervisory authorities to focus their supervisory activities on the more risky entities only[17]. In the third place, other entities subject to the Third Directive are only supervised in a limited way: they are not subjected to licensing or registration requirements and the supervision on these entities can be focused on the most risky entities only (Rietrae, 2007, pp. 22-3).

In all cases, supervisory authorities can impose sanctions in case of infringement of the obligations that are derived from the Third Directive and which must be effective, proportionate and dissuasive. Without prejudice to criminal sanctions that can be imposed, the Member States must now also ensure that administrative measures or administrative sanctions can be imposed upon the financial and credit institutions for non-compliance with the preventive AML/CFT obligations[18]. No similar provision can be found with regard to lawyers, notaries, accountants, tax advisors, or other entities subject to regulation.

Hence, it can be seen that the Third Directive pays more attention to supervision and sanctioning than the earlier directives. Whereas, the First and Second Directive only imposed very broad obligations and left the enforcement of preventive AML/CFT policy, in essence, to the Member States, the Third Directive imposes various minimal standards which enforcement must meet. There, thus, seems to have taken place a change of thought at European level as regards the involvement of the EU in the enforcement of preventive AML/CFT policy.

5. Changes in the enforcement instruments: influenced by a risk-based approach?

The previous chapter has presented several interesting changes with regard to the enforcement instruments assigned by the EU Directives to national supervisory authorities. It, however, remains the question whether these changes are the result of the shift from a rule- to risk-based approach. This section will try to find an answer to that question.

5.1 First development: more rules concerning enforcement

The first interesting development is that throughout the directives, there are more and more detailed rules concerning the enforcement of preventive AML/CFT legislation. Whereas the First and Second Directive in essence only dealt with sanctioning, the Third Directive devotes a special section to both supervision and penalties. It cannot be said with certainty that this development has been the result of the change to a risk-based approach. It can be explained in two ways. On the one hand, one could argue that if entities subject to regulation are given more discretion, like they are under the risk-based approach, that there is also a greater need for rules concerning the enforcement. This situation can be called "the paradox of supervision" and may justify the idea that the increased interest for enforcement is the result of the shift to a risk-based approach (Schueler, 2004, p. 14). On the other hand, one could argue that this change is not a real change, but rather the result of a gradual and natural development that has taken place and that fits within the picture of the increased attention for money laundering, in general. This may justify the idea that the increased interest for enforcement is not the result of a shift to a risk-based approach, but rather a self-standing development that took place at the same moment.

5.2 Second development: explicit reference to various enforcement instruments

It has furthermore been demonstrated that throughout the directives increased attention has been paid to specific enforcement instruments for supervisory authorities. Whereas in the first two directives attention was paid to sanctioning only, the Third Directive states that supervisory authorities must be assigned "adequate powers in order to perform their functions", and that they must at least:

- have the possibility to request the production of information that is necessary to verify compliance;
- have the possibility of on-site inspections with regard to certain entities; and
- have a licensing or registration requirement in place for certain financial and credit institutions and casinos.

But are these three enforcement instruments the result of the shift to a risk-based approach? It seems that the answer to this question must be "no". When one takes a look at the first two enforcement instruments, one cannot identify any relation to the notion of risk. One may even argue that these two instruments could also have been assigned to supervisory authorities under the rule-based approach. Furthermore, when one examines the licensing requirement that the Third Directive imposes, one will also conclude that it actually has nothing to do with a risk-based approach. The Third Directive points out that this licensing requirement only applies to certain specific entities, namely, currency exchange offices, trust and company services providers, casinos and money transmission and remittance offices[19]. Whereas the Third Directive is considered to take a risk-based approach, this provision seems to reflect the rule-based approach in that it only applies to certain entities, under all circumstances, without any exceptions. Thus, these three enforcement instruments are in my opinion not the result of the shift to a risk-based approach. They are most likely included in the Third Directive, because they are considered to be of extra importance for the enforcement of the preventive AML/CFT obligations.

5.3 Third development: sanctioning

The third development concerns the sanctions for non-compliance with the preventive AML/CFT policy. Whereas, the requirement of imposing effective, proportionate and dissuasive penalties has remained the same, the Third Directive introduces the requirement for Member States to ensure an administrative law sanctioning system for credit and financial institutions for non-compliance with the preventive AML/CFT rules. Here, it also seems difficult to link this addition to the change to a risk-based approach.

5.4 Fourth development: levels of supervision

The last development is the change with regard to the levels of supervision. Whereas, in the First and Second Directives, the enforcement level was the same for all the entities subject to regulation, the Third Directive allows for differentiated levels of enforcement. As one could see with the categorisation of Rietrae, different groups of entities could thereby be distinguished. Moreover, within the group of designated non-financial businesses and professions, the Third Directive explicitly allows supervisory authorities to perform their supervisory tasks on a risk-sensitive basis. This feature can be regarded a reflection of the risk-based approach, which offers more diversity in preventive AML/CFT legislation.

6. Conclusion and critical remarks

6.1 Conclusion

The question to which this article has tried to give an answer is to whether there are changes to the enforcement instruments of the preventive AML/CFT policy on European level by way of the three directives, and whether these are the result of the shift from a rule-based approach in the First and Second Directives to a risk-based approach in the Third Directive.

It has been shown that there have been few changes in the enforcement instruments of the preventive AML/CFT policy, for example, with regard to the inclusion of enforcement instruments like the request for the production of information, and the licensing requirement and on-site inspections with regard to certain specific entities. However, although the Third Directives gives some indications of a relationship between the changes with regard to the enforcement instruments and the shift to a risk-based approach, like the differentiated levels of supervision, it appears that, in general, it can be concluded that these changes of the enforcement instruments are not the result of the shift to a risk-based approach. They rather seem to be the result of a gradual and natural development that has taken place and that fits within the picture of increased attention to money laundering, in general, over the past 20 years.

6.2 Critical remarks

This means that although the obligations for entities subject to regulation are rather harmonised and well adjusted to a risk-based approach by the EU Directives, the way in which compliance is enforced by the supervisory authorities remains to great extent dependent on the national systems.

As a result, the change from a rule- to risk-based approach at the European level has led to some sort of "asymmetrical harmonisation" where the material norms for entities subject to regulation have been harmonised and adjusted to the risk-based approach, whilst the norms regarding the enforcement instruments have mostly been left to national legislation. As a consequence, there exists a "patchwork" of enforcement instruments and systems throughout the EU and it cannot be verified, at least not at European level, whether the enforcement instruments in national preventive AML/CFT policies are also well adjusted to the risk-based approach.

But would it not be more desirable if the EU Directives were to pay more attention to the enforcement instruments by harmonising, of course with respect to the national procedural autonomy, more basic aspects of the enforcement system with regard to preventive AML/CFT legislation? Would that not ensure that both the material norms directed at entities subject to regulation and the norms regarding the enforcement are better adjusted to each other by ensuring that both aspects hold the same approach? Especially in this field of law this is of utmost relevance, since money laundering is regarded as a grave danger to society. Moreover, since it has been stressed that money laundering is frequently carried out in an international context, the basic premise behind the EU Money Laundering Directives has been to have a more harmonised and integrated preventive AML/CFT legislation throughout the EU to protect the integrity of the financial systems as a whole. If only the material norms are harmonised but not the enforcement thereof, there remains a lot to wonder whether this harmonisation really takes place. That leaves us with the question: why only do half the job?

Notes

1. Article 2a paragraphs 3-7, Second Directive. This article will not elaborate on this extension and the problems that have accompanied this extension (Luchtman and van der Hoeven, 2009; Komárek, 2008).
2. Consideration 5, Third Directive.
3. However, it must be acknowledged that this change of approach has been prompted by developments at the international level, especially in the FATF (FATF, 2003, p. 15; FATF, 2007, p. 1; Wolfsberg Group, 2006).
4. Unger and Van Waarden (2009, p. 3), refer to a study concluded by Posner in 1998.
5. There is no single way of measuring risk (De Nicola and McCallister, 2006).
6. This idea is, however, not shared; Unger and Van Waarden (2009, p. 6) point at the danger of leaving the entities to decide what to report, namely, the risk that entities do it sloppy or arbitrarily. This, of course, would not increase the quality of the reports.
7. This has now changed into Euro (EUR).
8. Article 8(2) Third Directive; Katz (2007, p. 209).
9. Article 11(2) Third Directive and Article 3 Implementing Directive.
10. Note the difference with the "may" regarding the simplified CDD in the paragraph above.
11. Article 13(2), 13(3), 13(4), and 13(6) Third Directive.
12. Although, interestingly, one consideration to the First Directive stated that "whereas such provisions must also be extended, as far as possible, to any beneficial owners". However, no mention whatsoever was made of beneficial owners in the text of the directive.
13. Article 8(2) Third Directive.
14. Article 37(1) and 37(2) Third Directive.
15. Article 36(2) Third Directive.
16. Article 37(3) Third Directive.
17. Article 37(4) and 37(5) Third Directive.
18. Article 39(2) Third Directive.
19. Article 36(1) Third Directive.

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