

Improving Anti-Money Laundering Policy

Blacklisting, measures against
letterbox companies, AML
regulations and a European executive



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Abstract

This study evaluates four measures discussed by the European Parliament, the European Commission and others, to improve anti-money laundering policy. First, identifying high-risk countries through blacklisting. Second, reducing laundering through letterbox or shell companies. Third, harmonising EU AML policies through regulations. Fourth, strengthening the European executive, e.g. through a European public prosecutor, a European FIU, a European supervisor, or a European police also in the light of COVID-19.

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AML	Anti-Money Laundering
1st AMLD	The First Anti-Money Laundering Directive, EU Council Directive 91/308/EEC of 10 June 1991 on the prevention of the use of the financial system for the purpose of money laundering
2nd AMLD	The Second AML Directive, Directive 2001/97/EC of the European Parliament and of the Council extended the scope of Directive 91/308/EEC
3rd AMLD	The Third AML Directive, Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (2005)
4th AMLD	The Fourth AML Directive, Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing
5th AMLD	The Fifth AML Directive, Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU of 19 th of June 2018
AML/CFT	Anti-Money Laundering/Countering the Financing of Terrorism
AMLD	Anti-Money Laundering Directive
ATAD	Anti-Tax Avoidance Directive
BAMLI	Basel Money Laundering Indicator
BEC	Business email compromise
BEPS	Base erosion and profit shifting
BIS	Bank of International Settlements
BO	Beneficial owner(ship)
CDD	Customer due diligence

CDIS	Coordinated Direct Investment Survey
CEO	Chief Executive Officer
CESR	Committee of European Securities Regulators
CHIPS	Clearing House Interbank Payments System
COFFERS	Combatting Fiscal Fraud and Empowering Regulators
CPI	Transparency International Corruption Perception Index
CPR	Centrale Person Registernummer (Civil registration number, Denmark)
CRO	Companies Registration Office
CTHI	Corporate Tax Haven Index
CVR	Centrale Virksomhedsregister (Central Business Register, Denmark)
DAC6	Directive on administrative cooperation - Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements
DAR	Danish Address Register
DBA	Danish Business Authority
DNFBP	Designated Non-financial Businesses and Professions
EBA	European Banking Authority
EC	European Community
ECPR	European Consortium for Political Research
EDP	European delegated prosecutor
EEC	European Economic Community
e-ID	Electronic identification
EPP	European public prosecutor
EPPO	European Public Prosecutor's Office

EU	European Union
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FI	Financial Institution
FIU	Financial Intelligence Unit
FOF	Foreign-Owned Firm
FSI	Financial Secrecy Index
GDP	Gross Domestic Product
IBFD	International Bureau of Fiscal Documentation
ICT	Information and Communication Technology
IDAITM	Implementing Decree on the Assistance in International Tax Matters
IFC	International Finance Corporation
IMF	International Monetary Fund
INCSR	International Narcotics Control Strategy Report
IT	Information Technology
KFSI	Key Financial Secrecy Indicator
LE/LA	Legal entities and arrangements
LO	Legal owner(ship)
MiFID	Markets in financial instruments directive
ML/TF	Money laundering and terrorist financing
MNC	Multinational Corporation
MNE	Multinational Enterprise
MS	Member States
NGO	Non-governmental Organization

OECD	Organisation for Economic Cooperation and Development
OFC	Offshore Financial Centres
OLAF	European Anti-Fraud Office
ORBIS	Database of company and entity information
PIF	Protection of the financial interest by means of criminal law - Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law
SAR	Special administrative region
SPE	Special purpose entities
SRB	Single Resolution Board
TFEU	Treaty on the Functioning of the European Union
TRACK	The automated information system of the Scrutiny, Integrity and Screening Agency
UBO	Ultimate Beneficial Ownership
US	United States
VAT	Value Added Tax

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EXECUTIVE SUMMARY

Background

This study has the following goals: first, to give an overview of how to identify high-risk jurisdictions. Second, it discusses possibilities to reduce money laundering through letterbox/shell companies. Finally, it analyses whether regulations would be more effective than directives for AML policy, and the possibilities that exist for a European executive.

Aim

Identifying high-risk jurisdictions for money laundering is key to enable obliged entities to carry out appropriate customer due diligence and identify when enhanced checks are needed. The Financial Action Task Force (FATF) blacklists are one way to do so, but there are other options. The EU methodology for identifying high-risk countries builds on the work of the FATF but paying particular attention to criteria that is important in EU legislation. The possibility to identify potentially high-risk countries (“grey list”), the way the FATF does, might inflict with the current legal framework as the AML Directive provides that countries be listed once strategic deficiencies are identified. This can only be the case after countries have been assessed. To declare countries as potentially risky might – according to the European Commission¹ – pose a problem.

a) Blacklists

Nevertheless, for a good preventive anti-money laundering policy, a good alert system is necessary. This study compares diverse lists, indices and rankings of high-risk jurisdictions and their diverse outcomes. One problem of blacklists that involve economic sanctions is that they tend to become empty very soon, while money laundering scandals persist. This “blacklist emptying paradox”² holds for the FATF, OECD and IMF blacklists. It is explained by the strategic behaviour of countries to either not to be put on the list in the first place or to be removed from it as soon as possible.

Official blacklists from government related institutions also suffer from diplomatic biases. In the OECD list of harmful tax practices, only small islands were listed while no OECD country was included. The United States never appear on the FATF blacklists, the 2019 EU blacklist of money laundering contained 23 jurisdictions³ and was rejected due to diplomatic protests from its own member states for having listed Saudi Arabia and from the US Treasury for having listed four US territories - Puerto Rico, Guam, American Samoa and the US Virgin Islands.⁴ The latest EU list of non-cooperative jurisdictions for tax purposes published in February 2020 contains only 12 jurisdictions.⁵

In order to improve upon the existing black and grey lists, I suggest the following:

- Critically reflect on the wide use of blacklisting. Although it is a very powerful instrument to induce behavioural change, naming and shaming can have unwanted economic, political and social side effects. Most importantly, it risks producing compliance on paper, rather than true compliance.

¹ Follow up to the European Parliament non-legislative resolution on the state of implementation of the Union’s anti-money laundering legislation, 2019/2820(RSP) / B9-0045/2019 / P9_TA-PROV(2019)0022 Ref. Ares(2019)7637850 - 12 December 2019.

² Ferwerda, Joras, Deleanu, Ioana S. and Unger, Brigitte (2019) Strategies to avoid blacklisting: The case of statistics on money laundering, PlosONE, 26 June 2019, <https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0218532>.

³ Afghanistan, American Samoa, Bahamas, Botswana, Democratic People’s Republic of Korea, Ethiopia, Ghana, Guam, Iran, Iraq, Libya, Nigeria, Pakistan, Panama, Puerto Rico, Samoa, Saudi Arabia, Sri Lanka, Syria, Trinidad and Tobago, Tunisia, US Virgin Islands, Yemen.

⁴ Financial Times, “US attacks EU money laundering blacklist”, <https://www.ft.com/content/dba2c2ca-2f84-11e9-ba00-0251022932c8>.

⁵ American Samoa, Cayman Islands, Fiji, Guam, Oman, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands, Vanuatu, Seychelles.

- Blacklists often end up as “small island lists” which do not touch upon the bigger problems caused by wealthy countries. They are considered unfair and lack legitimacy.⁶
- Some blacklisting has had countereffects. Unger and Rawlings called this the “Seychelles effect”⁷ where after having been blacklisted, money laundering business boomed as launderers discovered this attractive place for their deeds.
- The EU should make more use of white lists. Listing countries with a good functioning AML system and with best practices. This allows for a learning effect and incentivises true compliance.
- Nevertheless, high-risk countries have to be identified. This should be left to financially and diplomatically independent NGOs that have transparent sponsoring and are not diplomatically dependent on those they evaluate.
- Make the methodology, aims and outcome of the rankings transparent, publicly available, and updated regularly (e.g. annually or twice a year).

b) Letterbox companies

Defining and distinguishing harmless *shell* from harmful *letterbox* companies is difficult, since big companies can use shell companies with substance, say five directors, which compared to their turnover is negligible, but in practice it would still be “empty”.

None of the existing indicators to measure shell companies are very reliable by themselves, as they are only proxies for a phenomenon that is by design difficult to observe. However, comparing previous research on this topic, a pattern emerges of EU Member States with an unusually large number of foreign-owned firms and asymmetric or over proportionately large FDI stocks. For those jurisdictions, shell companies are more likely to be or become problematic. Hence, it is important to pay attention to these countries when analysing or implementing new measures on tax avoidance and money laundering.

- The focus on letterbox companies – due to striking findings in the media – is only attractive at first sight. Looking carefully, it seems almost impossible to identify them properly.
- It seems more promising to improve and harmonise ownership registers since letterbox or shell companies cannot be measured directly, because there are many ways of circumventing substance rules.
- Both, legal and beneficial ownership registers of companies should be easily available, and regularly updated. Including that of trusts, foundations and partnerships. This way the beneficial, and hopefully the ultimate beneficial, owners of a company can be traced to distinguish real from paper business and criminal activities.
- Data verification is crucial for registries to be effective and can be facilitated by a range of tools and methods. Knobel (2019) suggests basic cross-checks for data validity with other government databases, when new companies are registered, as well as plausibility checks on the data provided (e.g. if addresses actually exist). Registrations should not be allowed for owners whose data cannot

⁶ See e.g. the criticism of the OECD 2000 list on harmful tax practices in the EU Horizon 2020 COFFERS project under <http://coffers.eu/>.

⁷ Unger, B. and Rawlings, G., Competing for criminal money, in *Global Business and Economics Review*, Vol. 10, No. 3, 2008.

be reliably verified. Compliance with tax return and financial statement requirements should be evaluated both in form and content on regular basis.⁸

- If background data on the owners, employees, the company structure, its presence online and in social media or financial transactions were analysed to detect irregularities or similarities to known previous schemes, one could have more sophisticated analytic methods that allow for “pattern-finding and red-flagging”. Several ratios, similar to profitability ratios in Table 5, could also point to illegitimate activities. This would bring suspicious activities to the attention of authorities for further investigation rather than being a reliable and unambiguous verdict.⁹
- An encompassing legal analysis of EU Member States (and other countries’) measures to fight letterbox companies could be done using data of the International Bureau of Fiscal Documentation (IBFD).¹⁰ They include the Anti-Tax Avoidance Directives I and II (ATAD) of 2016 and 2017, which implement many of the OECD BEPS commitments and are largely in force as of 2019,¹¹ or the DAC6 Directive in June 2018, which establishes a reporting requirement for cross-border tax arrangements if they involve at least one EU Member State.¹²
- To build up such a legal database on how to implement letterbox relevant legal changes in each EU Member State is time consuming, but once established, it can easily be updated. For this the EU would need either a European Intelligence Centre on Taxes as part of the Commission or working for the Commission, as has been suggested by the Tax Justice Network. This centre could also update the AML tool of comparing all tax and money laundering laws in the EU Member States¹³ and it could be used to cross-check entries in beneficial ownership registers. It could also analyse shifts in financial and money laundering transactions due to the corona crisis. It should consist of a highly ICT trained staff and could compensate lacks of this in the Member States.

c) Legal instruments: regulations versus directives

EU anti-money laundering policy was mainly done through directives, which have to be transposed/implemented by the Member States, some of which were delayed by up to three years in doing so. Though the Fourth AML Directive had less delays, they are still substantial. Contrary to directives, regulations are the same for all Member States and all national law related to them has to be adjusted.

While regulations are better for harmonisation, they might lead to even longer delays, compliance only in the books, and resistance. There is a tradeoff between harmonised policy through regulation and the flexibility needed for anti-money laundering policy to be effective through directives. Regulations should, therefore, be used only when establishing a new EU body, or when harmonisation has to be reached fast. Need for harmonisation was identified in the definition of predicate crimes for money laundering, in fines, in procedures of prosecution, in a number of auditing and administrative staff for tax evasion and money laundering execution.

⁸ Knobel, A. (2019). Beneficial ownership verification: Ensuring the truthfulness and accuracy of registered ownership information. Tax Justice Network. Retrieved at https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification_Tax-Justice-Network_Jan-2019.pdf.

⁹ Ibid.

¹⁰ International Bureau of Fiscal Documentation (IBFD). Tax Portal. Accessible at <https://research.ibfd.org>.

¹¹ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p. 1–14. Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, OJ L 144, 7.6.2017, pp. 1–11.

¹² Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, ST/7160/2018/INIT, OJ L 139, 5.6.2018, pp. 1–13.

¹³ See <http://coffers.eu/>.

d) A European executive: a European public prosecutor, supervision, police, FIU

The model chosen for the European Public Prosecutor's Office (EPPO) to act like a "chameleon" together with national public prosecutors, is cost effective. The EPPO is only responsible for financial crimes against the EU budget. This makes its agenda quite small. But extensions in the future are possible. The need for a European supervisory body seems more urgent than an EU FIU or EU police. The European supervisor should be an autonomous body, sufficiently staffed, and have direct powers of sanctioning. Supervision should concern all financial institutions. Non-financial institutions should be excluded, since they are too diverse.

The study suggests a European intelligence unit for several reasons: after corona, online crime will increase. So will tax evasion. Countries will lack means to equip the executive with expensive ICT specialists. The executive in the Member States is not sufficiently trained to deal with internet crimes. There should be a European intelligence unit within the European Commission or connected to it, that provides Intelligence service for the whole EU. This unit could also monitor the adequacy of information in the legal and beneficial ownership registers. Furthermore, this unit could keep track of changes in EU Member States' laws regarding money laundering and tax evasion and update the AML tool presented by the EU COFFERS project.

1. ANTI-MONEY LAUNDERING INDICATORS

KEY FINDINGS

AML high-risk countries can be identified through diverse rankings: the list of the Financial Action Task Force, FATF, the EU list of non-cooperative countries for money laundering in 2019 and the EU list of non-cooperative countries for tax purposes in 2020, the BAML, FSI, and many others. All assess a different number of countries and rank countries differently according to the risk they pose for money laundering in general or for tax purposes in particular.

Blacklists suffer from the “emptying blacklist paradox”, they all tend to become empty over time and are heavily biased. Blacklists, rankings, and indices should be created by a neutral organisation of high ethical standard. They should be transparent, publicly available and renewed periodically. With tax crime becoming a predicate crime for money laundering, tax haven lists and money laundering lists will eventually merge.

Anti-money laundering (AML) high-risk countries can be identified and listed through diverse indicators, rankings and blacklists. In the following, I first show the history of FATF blacklists and the “emptying blacklist paradox”. I then identify and present the most important classifications and finally discuss the pros and cons of blacklists.

1.1. The history of money laundering blacklisting

High-risk jurisdictions can be identified through various indicators which point at lax anti-money laundering regulation and/or lax anti-money laundering practice.

The most prominent blacklist is the FATF blacklist. The Financial Action Task Force is considered “the global money laundering and terrorist financing watchdog”.¹⁴ The list of high-risk and non-cooperative jurisdictions that they compile is based on the implementation of the FATF recommendations that virtually all countries of the world have accepted by 2020.¹⁵ Jurisdictions are considered high-risk if they suffer from significant limitations in their fight against money laundering and terrorist financing.

Ferwerda, Deleanu and Unger (2019) argue that the FATF blacklists are doomed to fail, because they repeatedly tend to become empty – due to what the authors call “the emptying blacklist paradox”.¹⁶

Indeed, as the history of FATF blacklists shows, they have to be renewed every couple of years. The first FATF blacklist (first graph in Figure 1 with blacklisted countries in red officially known as the list of Non-Cooperative Countries and Territories) was issued in 2000 with a total of 15 countries, mainly small islands in the Caribbean and the Pacific, and 19 countries in 2001. Since then, their numbers have declined steadily until Myanmar was the only country left and was removed in October 2006 (second graph in Figure 1 with only Myanmar in red). In 2009, a “grey list” replaced the blacklist. Initially, it distinguished four groups of non-compliant countries, ranging from highly non-compliant to little non-compliant. In 2013, it was replaced by a simplified version with only two groups of non-compliant/non-

¹⁴ See Financial Action Task Force, <https://www.fatf-gafi.org/about/>.

¹⁵ Financial Action Task Force, “High-Risk Jurisdictions subject to a Call for Action – 21 February 2020”, <https://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/call-for-action-february-2020.html>.

¹⁶ Ferwerda, Joras, Deleanu, Ioana S., and Unger, Brigitte (2019) Strategies to avoid blacklisting: The case of statistics on money laundering, PlosONE June 26, 2019 <https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0218532>.

cooperative jurisdictions. But the FATF soon saw the new lists empty again. The 2011 FATF list consisted of only 10 countries, down from 28, in 2010.¹⁷ The 2015 FATF list mentioned only 5 countries: Iran, North Korea, Algeria, Ecuador and Myanmar while in 2018, the FATF only mentions North Korea and Iran. At the same time, however, we have seen the largest leaks on offshores, shell companies and money laundering schemes (e.g. Swiss Leaks, Luxembourg Leaks, Panama papers), therewith supporting the critics of the efficiency of the black/grey lists of the FATF.

Figure 1: The emptying blacklist paradox -FATF blacklist 2000 and 2006



Source: Ferwerda, Deleanu and Unger (2019).¹⁸

The authors explain this emptying of the blacklist by the enormous pressure the FATF puts on countries through economic sanctions in case of non-compliance. Governments squeezed between national needs to have lax AML regulation (e.g. low costs for reporting of banks) and international pressure of fulfilling FATF standards will find creative ways to get off the blacklist by fulfilling standards on paper or using diplomacy to get removed from the list. Ferwerda et al. (2019) show the example of how in a non-harmonised EU, legal tricks with statistics can be used to fulfil reporting requirements. Still there are certainly many more creative ways to comply on paper.

1.2. Blacklists, ranking and indices

At the moment, the FATF compiles a list known as the “grey list” that – next to identifying high-risk jurisdictions (North Korea and Iran) – catalogues jurisdictions that are actively working to address their anti-money laundering regimes within agreed timeframes and are therefore kept under increased monitoring.¹⁹ In February 2020, these countries were Albania, the Bahamas, Barbados, Botswana, Cambodia, Ghana, Iceland, Jamaica, Mauritius, Mongolia, Myanmar, Nicaragua, Pakistan, Panama, Syria, Uganda, Yemen and Zimbabwe. Albania is the only European country among them.

The INCSR US State Department also publishes a list of “major money laundering jurisdictions”. The last one of March 2020²⁰ is long and includes five EU Member States (Belgium, Cyprus, Italy, the

¹⁷ Angola, Antigua and Barbuda, Azerbaijan, Ecuador, Greece, Indonesia, Morocco, Nepal, Nigeria, Pakistan, Paraguay, Qatar, Sao Tomé and Príncipe, Sudan, Thailand, Trinidad and Tobago, Turkmenistan, Ukraine and Yemen were removed while Cuba was placed on the list.

¹⁸ Ferwerda, Joras, Deleanu, Ioana S. and Unger, Brigitte (2019) Strategies to avoid blacklisting: The case of statistics on money laundering, PlosONE June 26, 2019 <https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0218532>.

¹⁹ Financial Action Task Force, “Jurisdictions under Increased Monitoring – 21 February 2020”, <https://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-february-2020.html>.

²⁰ US Department of State, “2020 INCSR–Volume II: Money Laundering and Financial Crimes (As submitted to Congress)”, <https://www.state.gov/2020-incsr-volume-ii-money-laundering-and-financial-crimes-as-submitted-to-congress/>.

Netherlands, and Spain), the United Kingdom, and the United States itself. In total, there are 82 countries listed.²¹ The evaluation focusses on drug-related money, includes FATF standards, but also vulnerabilities due to specific trade patterns (e.g. diamond trade in Belgium). The ranking of the INCSR is used for one of the risk scores of the 15 components in the Basel Money Laundering Indicator BAML. ²² The Tax Justice Network stopped using INCSR data for their Financial Secrecy Index, indicator KFSI 1 bank secrecy, in 2016.

The EU's dirty money blacklist in 2019 largely followed the FATF blacklist, but included 11 additional jurisdictions, in particular Saudi Arabia, Panama, Nigeria and four US territories. The list was rejected by 27 out of 28 EU Member States. Especially the inclusion of Saudi Arabia – a major trading partner of some of the EU countries, especially France and the United Kingdom – was debated.²³

On 19 September 2019, the European Parliament adopted a resolution urging the European Commission to proceed with its list and suggesting that there could be an additional “grey list” of potentially high-risk third countries. This could be compiled on a similar basis to the EU's approach to listing non-cooperative jurisdictions for tax purposes.²⁴

The EU blacklist for tax purposes uses criteria based on the international tax standards to continuously monitor and list or de-list countries. This list is based on criteria of transparency, fair competition and the level of implementation of the BEPS minimum standards.²⁵

Since, with the Fourth Anti-Money Laundering Directive of 2015, tax crime became a predicated crime for money laundering, the topics of money laundering, tax evasion and grey zones between tax evasion and tax avoidance started to merge. This is why I also added lists of tax havens into the money laundering lists.

Two more blacklists were identified: the OECD List of Uncooperative Tax Havens and the IMF Offshore Financial Centres, both established in 2000. The OECD List of Uncooperative Tax Havens was created as a part of a report that identified jurisdictions that had not implemented the OECD's standards of transparency and exchange of information. The OECD list was heavily criticised, in particular, because no single OECD country was on this list. But it started an important debate on tax avoidance and evasion and it also nicely shows the “emptying blacklist paradox” mentioned in the previous section:

The OECD List of Uncooperative Tax Havens of 2000 identified jurisdictions that had not implemented the OECD's standards of transparency and exchange of information. Until 2002, 35 jurisdictions had

²¹ Afghanistan, Albania, Algeria, Antigua and Barbuda, Argentina, Armenia, Aruba, Azerbaijan, Bahamas, Barbados, Belgium, Belize, Benin, Bolivia, Bosnia and Herzegovina, Brazil, British Virgin Islands, Burma (=Myanmar), Cabo Verde, Canada, Cayman Islands, China, Colombia, Costa Rica, Cuba, Curacao, Cyprus, Dominica, Dominican Republic, Ecuador, El Salvador, Georgia, Ghana, Guatemala, Guyana, Haiti, Honduras, Hong Kong, India, Indonesia, Iran, Italy, Jamaica, Kazakhstan, Kenya, Kyrgyz Republic, Laos, Liberia, Macau, Malaysia, Mexico, Morocco, Mozambique, Netherlands, Nicaragua, Nigeria, Pakistan, Panama, Paraguay, Peru, Philippines, Russia, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Senegal, Sint Maarten, Spain, Suriname, Tajikistan, Tanzania, Thailand, Trinidad and Tobago, Turkey, Turkmenistan, Ukraine, United Arab Emirates, United Kingdom, United States, Uzbekistan, Venezuela, and Vietnam, <https://www.knowyourcountry.com/news-updates>.

²² Basel Institute on Governance, “Basel AML Index 2019 A country ranking and review of money laundering and terrorist financing risks around the world”, <https://www.baselgovernance.org/sites/default/files/2019-08/Basel%20AML%20Index%202019.pdf>.

²³ de Haldevang, M., “The EU is launching a new money-laundering blacklist, after its last one was nixed for naming Saudi Arabia”, 22 August 2019, <https://qz.com/1692089/the-eu-is-set-to-relaunch-a-money-laundering-blacklist/>.

²⁴ International Bar Association, “Corruption: EU revives blacklist proposal to tackle money laundering”, <https://www.ibanet.org/Article/NewDetail.aspx?ArticleUid=02953d00-cdca-4798-85ae-4a4b4878158c>, retrieved 29.3.2020.

²⁵ European Council, “Taxation: EU list of non-cooperative jurisdictions”, <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/>.

already made formal commitment to implement these standards, leaving only 7 jurisdictions on the list.²⁶ By May 2009, the remaining jurisdictions had all been de-listed as uncooperative tax havens.²⁷

In a paper that aimed at providing background information on the business of Offshore Financial Centres (OFCs), the IMF quotes the Financial Stability Forum which created a list of 42 jurisdictions that were considered to have significant offshore activities. These jurisdictions were split into three groups: Group I which included jurisdictions considered cooperative and with good quality of supervision; Group II which was seen as having procedures for supervision and cooperation in place but were performing below standard; and lastly, Group III which included jurisdiction with low quality of supervision or that were deemed non-cooperative and with little interest in adhering to international standards.²⁸ This list was discontinued in 2008.

Table 1: Overview of sources and classifications

Classification	Year	Details	Total no.
Blacklists			
EU	2020	EU List of non-cooperative jurisdictions for tax purposes ²⁹ Transparency, Fair Tax Competition, BEPS Implementation	12
FATF	2020	Financial Action Task Force High-risk and non-cooperative jurisdictions ³⁰ Money laundering and terrorist financing techniques	20
INCSR	2020	United States Department of State, International Narcotics Control Strategy Report, Volume II ³¹ The INCSR is focused on narcotics-related money laundering and monitors the adoption of laws and regulations to prevent it. As a result, they identify “major money laundering countries”.	82

²⁶ Later removed by 2003: The Republic of Nauru and The Republic of Vanuatu; removed by 2007: Liberia and The Republic of the Marshall Islands; removed by 2009: Andorra, Principality of Liechtenstein and the Principality of Monaco.

²⁷ OECD, “List of Unco-operative Tax Havens”, <https://www.oecd.org/countries/monaco/list-of-unco-operative-tax-havens.htm>.

²⁸ IMF, “Basic Facts on OFCs Considered by the Financial Stability Forum”, <https://www.imf.org/external/np/mae/oshore/2000/eng/back.htm#table2>.

²⁹ EU list of non-cooperative jurisdictions, Council conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes 2020/C 64/03, ST/6129/2020/INIT, OJ C 64, 27.2.2020, pp. 8–14.

³⁰ FATF, High-Risk Jurisdictions subject to a Call for Action, 21 February 2020. Retrieved at <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/call-for-action-february-2020.html>. FATF, Jurisdictions under Increased Monitoring, 21 February 2020. Retrieved at <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-february-2020.html>.

³¹ United States Department of State, Bureau of International Narcotics and Law Enforcement Affairs, International Narcotics Control Strategy Report, Volume II, Money Laundering. March 2020. <https://www.state.gov/wp-content/uploads/2020/03/Tab-2-INCSR-Vol-2-508.pdf>.

Classification	Year	Details	Total no.
OECD	2000	OECD List of Uncooperative Tax Havens ³² All countries were subsequently removed, the list however is still considered a benchmark and used for comparison purposes.	35
IMF	2000	IMF Offshore Financial Centers (discontinued 2008) ³³ A: Low quality of supervision and/or non-cooperative B: Actual performance below international standards C: Jurisdictions generally viewed as cooperative	42
Rankings and Indices			
BAMLI	2019	Basel Institute on Governance, Anti-Money Laundering Index ³⁴ Independent annual ranking, assessing money laundering and terrorist financing risks Criteria: Quality of AML framework, legal and political risks, financial and public transparency, corruption and bribery,	125
FSI	2020	Tax Justice Network, Financial Secrecy Index ³⁵ Aggregates 20 indicators on financial secrecy in the dimensions: ownership registration, legal entity transparency, integrity of tax & financial regulation and international standards & cooperation	133
CTHI	2019	Tax Justice Network, Corporate Tax Haven Index ³⁶ Most important tax havens for MNCs, ranked by their extent and aggressiveness in contributing to corporate tax avoidance	64
Oxfam	2016	Policy Brief, Tax Battles: The dangerous global race to the bottom on corporate tax ³⁷ Semi-quantitative assessment of the most problematic tax havens, based on tax rates, tax planning indicators, regulatory framework and commitment to international efforts.	15
Academic Research			

³² OECD, List of Uncooperative Tax Havens, <http://www.oecd.org/countries/monaco/list-of-unco-operative-tax-havens.htm>.

³³ Offshore Financial Centers, IMF Background Paper, Prepared by the Monetary and Exchange Affairs Department, 23 June 2000. Retrieved at <https://www.imf.org/external/np/mae/oshore/2000/eng/back.htm>.

³⁴ Basel Institute on Governance, AML Index 2019. Retrieved at <https://www.baselgovernance.org/basel-aml-index/public-ranking>.

³⁵ Tax Justice Network, Financial Secrecy Index (FSI) 2020. Retrieved at <https://fsi.taxjustice.net/en/introduction/fsi-results>.

³⁶ Tax Justice Network, Corporate Tax Haven Index (CTHI) 2019. Retrieved at <https://www.corporatetaxhavenindex.org/introduction/cthi-2019-results>.

³⁷ Berkhout, E. (2016). Tax Battles: The dangerous global race to the bottom on corporate tax. Oxfam Policy Brief. Retrieved at <https://oxfamilibrary.openrepository.com/handle/10546/620159>.

Classification	Year	Details	Total no.
Hines	2010	“Treasure Islands” ³⁸ Updated version of Hines first coherent academic tax haven list.	52
Cobham and Jansky	2019	Measuring misalignment: The location of US multinationals’ economic activity versus the location of their profits ³⁹ The authors identify ten “profit-haven” low-tax jurisdictions, which capture a big share of internationally shifted profits. Data: Surveys on international operations of US enterprises	10
Fichtner	2015	The Offshore-Intensity Ratio: Identifying the Strongest Magnets for Foreign Capital ⁴⁰ Quantitative approach, comparing the ratio of external capital with a country’s GDP, indicates the strength in attracting capital Data: Bank of International Settlements (BIS), external deposits of reporting banks for each country and all sectors	40
Garcia-Bernardo et al.	2017	Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network ⁴¹ Distinguish and rank conduit (C) and sink (S) offshore financial centers, which serve as intermediary nodes (C) or tax havens (S). Data: ORBIS database, Global corporate ownership relations	5 Conduit, 24 Sinks
Tørsløv et al.	2018	Tørsløv, Wier & Zucman, The missing profits of nations ⁴² Indicate countries that receive the most of internationally shifted profits and compare it to a benchmark model. Data: foreign affiliates statistics, capital shares and profitability	11

Source: Prepared by the author.

As shown in Table 1, next to the blacklists mentioned above, four main rankings and indices were identified to point at high-risk jurisdictions. The first one being the Basel Anti-Money Laundering Index (BAMLI) published since 2012 by the Basel Institute on Governance, an NGO located in Switzerland. This index gives scores to countries based on an independent annual assessment of the risk of money laundering. This is based on five domains: the quality of the countries’ AML framework, the occurrence of bribery or corruption, financial transparency and standards, public transparency and accountability

³⁸ Hines Jr, J. R. (2010). Treasure islands. *Journal of Economic Perspectives*, 24(4), pp. 103-126.

³⁹ Cobham, A., & Janský, P. (2019). Measuring misalignment: The location of US multinationals’ economic activity versus the location of their profits. *Development Policy Review*, 37(1), pp. 91-110.

⁴⁰ Fichtner, J. (2015). The offshore-intensity ratio: identifying the strongest magnets for Foreign Capital. CIYPERC Working Paper, Series 2015/02.

⁴¹ Garcia-Bernardo, J., Fichtner, J., Takes, F. W., & Heemskerk, E. M. (2017). Uncovering offshore financial centers: Conduits and sinks in the global corporate ownership network. *Scientific Reports*, 7(1), pp. 1-10.

⁴² Tørsløv, T. R., Wier, L. S., & Zucman, G. (2018). *The missing profits of nations* (No. w24701). National Bureau of Economic Research.

as well as legal and political risks.⁴³ The BAML provides risk scores based on data from 15 publicly available sources such as the Financial Action Task Force (FATF), Transparency International, the World Bank, INCSR, and the World Economic Forum. The Public Edition of the Basel AML Index 2019 covers 125 countries with sufficient data to calculate a reliable ML/TF risk score.

The Financial Secrecy Index (FSI) is a quantitative assessment of the secrecy and the weight that the jurisdiction has on the global trade of financial services. Made by the Tax Justice Network, an independent international network, launched in 2003, founded in the United Kingdom. The Financial Secrecy Index includes 20 indicators such as trust and foundations register, recorded company ownership, and if relevant trade or investment statistics are made available.⁴⁴ It includes an anti-money laundering indicator that measures to what extent the jurisdiction's AML regime meets the FATF recommendations.⁴⁵

The third identified index is the Corporate Tax Haven Index (CTHI), also compiled by the Tax Justice Network for the EU Horizon 2020 project COFFERS.⁴⁶ This index rates the most important tax havens according to how much the jurisdiction helps the world's multinational companies escape paying taxes and the erosion it creates to other countries' tax revenue. The twenty indicators that are used as criteria can be grouped into five categories:⁴⁷

- lowest tax rate offered to multinationals in that jurisdiction,
- loopholes and gaps allowing for exclusions from corporate taxes,
- the level of transparency of the jurisdiction,
- anti-avoidance or defensive measures put in place by the jurisdiction to compel multinational enterprises to pay taxes, and
- Double Tax Treaty Aggressiveness based on how the jurisdiction uses tax treaties to lower taxes.

Though unpaid taxes by companies often consist of exploiting legal loopholes in international tax law, criminal organisations use similar channels as legal organisations. A lack of transparency attracts money launderers as well.

Lastly, Oxfam's semi-quantitative assessment of jurisdictions, published in "Tax Battles: the dangerous global race to the bottom on corporate tax" was included. This assessment ranked the most problematic tax havens based on criteria such as the jurisdiction's relative role as a corporate tax haven, and lack of commitment to international efforts against tax avoidance.⁴⁸ Here again, the major concern is to identify tax avoidance, but criminals might use similar arrangements.

1.3. The link between money laundering and unpaid taxes

In 2012, the FATF (Financial Action Tax Force) amended its recommendations and included tax evasion as a designated offense for money laundering. Following the direction of the FATF in 2015, the European Parliament passed the Directive (EU) 2015/849 – otherwise known as the Fourth Anti-Money Laundering Directive – and incorporated this principle by adding tax crimes as a predicate crime for

⁴³ Basel AML Index: <https://www.baselgovernance.org/basel-aml-index>.

⁴⁴ Financial Secrecy Index, "Methods and concepts", <https://fsi.taxjustice.net/en/introduction/method-and-concepts>.

⁴⁵ Indicator KFSI 17 <https://fsi.taxjustice.net/PDF/17-Anti-Money-Laundering.pdf>.

⁴⁶ Combatting Fiscal Fraud and Empowering Regulators (COFFERS), EU Horizon 2020 project under the lead of Brigitte Unger, Utrecht University. See <http://coffers.eu/>.

⁴⁷ Corporate Tax Haven Index 2019, <https://www.corporatetaxhavenindex.org/methodology>.

⁴⁸ OXFAM, "How Oxfam identified the world's worst corporate tax havens", https://oi-files-d8-prod.s3.eu-west-2.amazonaws.com/s3fs-public/file_attachments/tb-race-to-bottom-methodology-note-121216-en.pdf.

money laundering. However, the Fourth AMLD did not offer a harmonised definition of tax crimes; hence it was left up to each Member State to incorporate this principle, as they saw fit, in their national law. In 2016, the Chairman of the Committee on Money laundering, tax avoidance and tax evasion requested information on every Member States' capabilities to fight tax crimes. The European Parliament started to collect definitions of tax crime and money laundering from the Member States in 2016, but the list stayed incomplete. The link between money laundering, tax evasion and tax avoidance has been studied further in the EU Horizon 2020 project COFFERS. We completed missing entries by looking for the relevant laws in the official gazette or legal database of each EU Member State. We emailed every countries' ministry of finance and asked to verify it.

The project developed an AML tool⁴⁹ which updated for all EU Member States what tax crime is (national definition and translation), which threshold for criminalisation exists, and what the minimum threshold for criminal liability is. It also shows punishments and fines, whether CEOs can be liable for money laundering, and whether tax crimes qualify for money laundering. The establishment of this tool took two years' time and several lawyers working on it.

Now, this tool would only need a regular update by the Member States, once they make changes to their laws. If a person/institution could take care of the update of this table, this would require little work and the EU would have a living tool so that everybody can look up tax crime and money laundering relevant issues in all Member States. A European Tax Intelligence Centre hosted or acted by the European Commission, as suggested by the Tax Justice Network, could do this.

Next to law in the books, the project also compared law in practice among the 27 Member States plus the United Kingdom. A survey among public prosecutors of all EU Member States reveals that law in practice still varies considerably. The same tax case can and will be prosecuted as money laundering in one country, while it will not be prosecuted in another country (see further under section 3).

Since money launderers and tax evaders both use offshore centres to hide their identity and business, it was only a matter of time that the two fields – tax evasion and money laundering – would merge. A lack of transparency, for whatever reason, promotes not only the use of legal escapes from taxation, but also opens doors for criminal abuse (see also next chapter on shell companies).

1.4. Overview of blacklists, rankings and indices for the EU-27 countries

Table 2 presents an overview of all blacklists, rankings and indices for the EU-27 countries and a selection of other relevant jurisdictions.⁵⁰ Luxembourg is ranked first as the jurisdiction that in general performs worst in the previously identified blacklists, rankings and indices. The Netherlands follows in third after Switzerland. It is interesting to note that although these three countries overall perform badly, none is included in the blacklists discussed above (except the one of the US State Department which includes 82 countries). In fact, among the top 15 worst ranked jurisdictions, one third are members of the EU (Luxembourg, the Netherlands, Cyprus, Ireland and Malta), yet once again none of these EU Member States are listed in the EU and FATF blacklists.

Table 2 shows all the rankings from the sources indicated in Table 1 for the EU-27 and selected additional European and international countries, including some of the jurisdictions often classified as tax havens (e.g. British Virgin Islands, Cayman Islands, Bermuda or the Bahamas). An "X" indicates that a country is listed on a blacklist or has been identified by a paper without being ranked. The letters in the IMF ranking refer to A being high risk (Group III with low quality of supervision and or non-

⁴⁹ See <http://coffers.eu/>.

⁵⁰ Included: Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Jersey, Hong Kong, Panama, Singapore, Switzerland, Turkey, United Kingdom, United States.

cooperative behaviour), B to Group II which was seen as having procedures for supervision and cooperation in place but were performing below standard and C to Group I which included jurisdictions considered cooperative and with good quality of supervision. The Column of Garcia and Bernardo refers to C as Conduit and S as Sink country. C1 classifies the Netherlands as the top conduit country, where money is flowing through. S1 classifies the Virgin Islands as top sink country, where money is being parked.

The numbers indicate ranking positions within all countries assessed in the underlying studies (not all countries are included in the tables in this report). The first line provides the total number of countries ranked by the studies, which varies widely between 10 (Cobham and Jansky) and 133 (Financial Secrecy Index). The colour codes range from red (most problematic) to green (least problematic).

Table 2: Blacklists, rankings and indices for EU-27 and selected other jurisdictions

Country	Blacklists					Rankings and Indices				Academic Research				
	EU	FATF	INCSR	OECD	IMF	BAMLI	FSI Rank	CTHI Rank	Oxfam	Hines	Cobham	Fichtner	Garcia-Bernardo	Tørsløv
<i>Total ranked or listed</i>	12	20	82	35	42	125	133	64	15	52	10	40	C:5, S:24	11
Luxembourg					A	85	6	6	7	x	3	6	S 12	6
Switzerland					A	78	3	5	4	x	5	18	C 3	4
Netherlands			x			82	8	4	3		1	16	C 1	5
Hong Kong			x		A	69	4	10	9	x	9	15	S 23	8
Panama	x	x	x	X	C	34	15	26		x		21		
Cayman Islands	x		x		C		1	3	2	x		1	S 5	
Singapore					A	95	5	8	5	x	7	19	C 4	3
Virgin Islands, British			x	X	C		9	1	15	x		2	S 1	
Cyprus			x		C	74	27	18	10	x		11	S 14	
Jersey				X	A		16	7	12	x		5	S 3	
Ireland					A	97	29	11	6	x	2	14	C 5	1
Bermuda					B		40	2	1	x	4	4	S 4	9
Bahamas		x	x	X	C		22	9	11	x		9	S 16	
United States			x			72	2	25				37		
Malta					B	113	18	23		x			S10	11
Germany						99	14	24				28		
Italy			x			75	41	30				38		
Austria						92	36	33				26		
France						108	33	22				25		
Belgium			x			103	50	16				22		10
Turkey			x			33	55							
Hungary						80	75	20				32		
United Kingdom			x			106	12						C 2	
Romania						87	56	43						
Spain			x			100	66	27				34		
Latvia						81	65	41						
Sweden						121	64	29				23		
Czech Republic						105	67	31						
Poland						102	59	53						
Portugal						107	76	49				31		
Finland						124	87	34				24		
Denmark						111	97	36			10	27		
Croatia						115	93	48						
Greece						96	103	61						
Slovakia						109	104	47						
Lithuania						119	105	52						
Bulgaria						120	115	45						
Estonia						125	121	39						
Slovenia						117	128	55						

Source: Prepared by the author, for data sources please refer to the detailed sources listed in Table 1. Red indicates high risk.

Table 2 shows the rankings for a larger number of countries, including Asian hubs and Panama. EU countries have been marked bold on this list. As can be seen, Luxembourg figures prominently on top of the EU countries as high-risk country. It belongs to Group III of the IMF list, is no. 85 out of 125 countries on the Basel Money Laundering Index, no. 6 out of 133 on the FSI, and no. 7 out of 15 on the Oxfam list. Table 3 shows the same information for EU countries only.

Table 3: Blacklists, rankings and indices for EU-27 (same as Table 2, but for EU countries only)

Country	Blacklists		Rankings and Indices				Academic Research				
	INCSR 2020	IMF 2000	BAML	FSI Rank	CTHI Rank	Oxfam	Hines	Cobham	Fichtner	Garcia-Bernardo	Tørsløv
<i>Total ranked or listed</i>	82	42	125	133	64	15	52	10	40	C:5, S:24	11
Luxembourg		A	85	6	6	7	x	3	6	S 12	6
Netherlands	x		82	8	4	3		1	16	C 1	5
Cyprus	x	C	74	27	18	10	x		11	S 14	
Ireland		A	97	29	11	6	x	2	14	C 5	1
Malta		B	113	18	23		x			S10	11
Germany			99	14	24				28		
Italy	x		75	41	30				38		
Austria			92	36	33				26		
France			108	33	22				25		
Belgium	x		103	50	16				22		10
Hungary			80	75	20				32		
Romania			87	56	43						
Spain	x		100	66	27				34		
Latvia			81	65	41						
Sweden			121	64	29				23		
Czech Republic			105	67	31						
Poland			102	59	53						
Portugal			107	76	49				31		
Finland			124	87	34				24		
Denmark			111	97	36			10	27		
Croatia			115	93	48						
Greece			96	103	61						
Slovakia			109	104	47						
Lithuania			119	105	52						
Bulgaria			120	115	45						
Estonia			125	121	39						
Slovenia			117	128	55						

Sources: Prepared by the author, for data sources please refer to the detailed sources listed in Table 1. Red indicates high risk.

Table 4 shows the country positions within the group of the EU-27 (relative rankings). A “3” in the latter table therefore indicates the third most problematic country among the EU-27. As can be seen from this table, Luxembourg takes the lead among high-risk countries within the EU. This is more due to its

being top in financial secrecy (the FSI rank no. 6 out of 133 countries puts it on the first spot among the EU Member States).

Table 4 displays Luxembourg, the Netherlands, Cyprus, Ireland and Malta as the highest-risk jurisdictions in the EU. The reason being not necessarily drugs and corruption money, but tax evasion and avoidance money which goes to these countries due to their financial secrecy and/or special tax policy.

What is noticeable, when one compares the rankings with the blacklists, is that most countries of the traditional blacklists do not appear on the rankings. Iran, North Korea, Afghanistan are not mentioned among the 133 countries ranked in the FSI. Blacklisted countries usually do not attract the large bunch of the international criminal transactions.

Table 4: Blacklists, rankings and indices for EU-27 (relative ranks among EU member states)

Country	Blacklists		Rankings and Indices				Academic Research				
	INCSR 2020	IMF 2000	BAMLI	FSI Rank	CTHI Rank	Oxfam	Hines	Cobham	Fichtner	Garcia-Bernardo	Zucman
<i>Total ranked or listed</i>	82	42	125	133	64	15	52	10	40	C:5, S:24	11
Luxembourg		A	6	1	2	3	x	3	1	S2	3
Netherlands	x		5	2	1	1		1	4	C1	2
Cyprus	x	C	1	5	5	4	x		2	S3	
Ireland		A	10	6	3	2	x	2	3	C2	1
Malta		B	20	4	8		x			S1	4
Germany			11	3	9				11		
Italy	x		2	9	12				15		
Austria			8	8	14				9		
France			17	7	7				8		
Belgium	x		14	10	4				5		5
Hungary			3	17	6				13		
Romania			7	11	19						
Spain	x		12	15	10				14		
Latvia			4	14	18						
Sweden			25	13	11				6		
Czech Republic			15	16	13						
Poland			13	12	25						
Portugal			16	18	23				12		
Finland			26	19	15				7		
Denmark			19	21	16			4	10		
Croatia			21	20	22						
Greece			9	22	27						
Slovakia			18	23	21						
Lithuania			23	24	24						
Bulgaria			24	25	20						
Estonia			27	26	17						
Slovenia			22	27	26						

Sources: Prepared by the author, for data sources please refer to the detailed sources listed in Table 1. Red indicates high risk.

1.5. Suggestions for identifying high-risk jurisdictions

- Ranking of high-risk countries must be done by a neutral institution. Institutions linked to governments or intergovernmental institutions are diplomatically bound and financially dependent on their governments. The fact that no OECD country was on the OECD list of harmful tax competition, or that Saudi Arabia had to be removed from the EU list of non-cooperative countries shows that diplomatic concerns and political and economic interests conflict with the neutrality of the ranking. The designated neutral institution should be financially independent and fulfil ethical requirements.
- The existing lists, rankings and indices all point at different problems, money laundering, money flowing through, or non-transparencies for tax reasons and they compare different numbers and sets of countries. Subcomponents of one ranking, like the BAMLII or the FSI could be used to differentiate between pure money laundering, drugs and corruption risks and between financial risks due to secrecy and lack of transparency.
- It is noticeable that the top blacklisted countries – the enemies of the United States, Iran and North Korea – do not appear top in any of the rankings. The study here concentrated on money laundering. Risks of terrorist financing should be evaluated separately since they follow a very different pattern.
- It should be noticed that qua volume, the largest money laundering risks come from wealthy countries with good financial infrastructure, and not from poor countries. Europe must, therefore, also look at its own high-risk jurisdictions.
- There should be an ex post evaluation of rankings in order to fine-tune further evaluations.
- Money laundering combat needs true compliance of many actors. Blacklists, when implying economic sanctions, will lead to strategic counteractions. This can lead to paper compliance only. White lists, positive examples, and benchmarking might be more effective in changing behaviour. The next section on shell companies shows one example of such a white list for ultimate beneficial ownership registers.

2. SHELL COMPANIES

KEY FINDINGS

The definition of letterbox or shell companies is unclear. “Anonymous shell companies”, which mainly disguise their beneficial owner, “letterbox or mailbox companies”, which are mostly used to circumvent regulations in the country where the actual operations take place, and “special purpose entities” (SPEs), which facilitate tax avoidance by bundling foreign assets and liabilities in favourable jurisdictions with little to no physical presence and real economic activity are empirically difficult to distinguish. “Empty” firms can be defined as companies without personal but also companies with several directors can be used to disguise economic inactivity in a country.

Empirical estimates of special purpose entities, shell companies, foreign owned firms, phantom foreign direct investments, etc. show that countries rank quite differently on these diverse indicators.

A different and more promising approach is to identify the ultimate beneficial owner of each company or other vehicle. Once, the ultimate beneficial owner of a company, foreign or domestic trust, foundation, or partnership can be traced, there is transparency about the origins of the company and its owner. For a good register, both the legal and the beneficial owner should be made transparent, otherwise criminals can hide because of different types of registers used in countries.

By today all EU Member States have a beneficial ownership register. However, there are still many deficiencies. First, both legal and beneficial owners should be registered. Second, not only companies, but also foundations, partnerships, domestic and foreign trusts should be registered. The threshold of a 25% share in order to have to register in most countries is very high. Data entries are not sufficiently verified, updated or made accessible online and at low costs.

2.1. Definition and problem

There is no universal definition of letterbox companies or shell corporations, which is accepted and adopted internationally. The lack of a specific concept complicates the fight against the often harmful practices connected to these entities.

In the OECD Glossary of Tax Terms one finds the following definitions:

- Shell company: “A company set up by fraudulent operators as a front to conceal tax evasion schemes.”⁵¹
- Letterbox-company: “A paper company, shell company or money box company, i.e. a company which has compiled only with the bare essentials for organisation and registration in a particular country. The actual commercial activities are carried out in another country.”⁵²

⁵¹ OECD Glossary of Tax Terms. Retrieved at <https://www.oecd.org/ctp/glossaryoftaxterms.htm>.

⁵² Ibid.

If interpreted rightly, this means that the OECD sees shell companies as always fraudulent, while letter box companies can be fraudulent (shell companies) or simply do their commercial activities in another country, which reads more neutral than the first definition.

A recent study of the European Parliament Research Service notes the broad and varying use of the term “shell” and finds different definitions in different contexts. According to Kiendl and Thirion (2018), the term mostly refers to three types of entities: “anonymous shell companies”, which mainly disguise their beneficial owner, “letterbox companies” or “mailbox companies”, which are mostly used to circumvent regulations in the country where the actual operations take place, and “special purpose entities” (SPEs) which facilitate tax avoidance by bundling foreign assets and liabilities in favourable jurisdictions with little to no physical presence and real economic activity.⁵³

The use of a shell corporation can have legitimate purposes, e.g. facilitating mergers and acquisitions or disguising the identity of a well-known company or individual to avoid paying mark-ups on market prices. They are not dangerous or illegitimate per se, but in combination with lacking transparency, inconsistent regulation and illicit intent, they can facilitate a range of undesirable behaviour.

Problems include the lack of scrutiny and control by tax authorities, which are unable to trace ownership chains and therefore cannot enforce taxation rules. By combining entities in different jurisdictions, corporations and individuals can exploit taxation loopholes or circumvent national standards by creating carefully designed constructs of firms that change the regulatory framework to their economic benefit.⁵⁴

2.2. Estimating the size of the problem

How many letterbox companies are there? How many transactions and which value of transactions are flowing through them? And how much of this volume is related to crime and tax crime, and how much is legal due to loopholes in the law or economic necessity of hiding from business competitors?

Data availability is somewhat limited and mostly unreliable. Therefore, most estimates and cross-country comparisons employ proxy indicators or qualitative assessments of the regulatory frameworks.

2.2.1. Firm-level data

When assessing the number of shell and “non-shell” corporations, it is very difficult to draw a distinction based on the limited data available. Even with regularly updated open-access registers, one has to define clear criteria to identify (harmful) shell corporations, which fundamentally impact the results and create opportunities for politically motivated influence on the problem definition.

Potential starting points for quantitative analysis include:

- the total number of (foreign-owned) firms relative to GDP or population of a country, and
- the number of companies without any employees relative to a country’s GDP.

These approaches are, however, limited as illicit activity does not necessarily involve shell corporations and some entities, which would be classified as shells are serving legitimate purposes or might not be used at all.

⁵³ Kiendl Krišto, I., & Thirion, E. (2018). An overview of shell companies in the European Union. Study, European Parliamentary Research Service. Retrieved at https://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell_companies_in_the_EU.pdf.

⁵⁴ For a detailed assessment of risks and consequences of shell companies in the EU context see also part 3.1 in Kiendl Krišto, I., & Thirion, E. (2018). An overview of shell companies in the European Union. Study, European Parliamentary Research Service. Retrieved at https://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell_companies_in_the_EU.pdf.

Loretz et al. (2017) present such statistics in their Working Paper on “Aggressive Tax Planning Indicators”.⁵⁵ Table 5 shows both the share of foreign-owned firms (FOF) among all firms for each country and the share of profits that arise in those foreign-owned firms in relation to total corporate profits in a country. Particularly high disparities indicate that a substantial share of profits in a country stems from rather few foreign-owned firms, which are potentially taxed in more favourable jurisdictions. With 28.9% and 24.7% of FOF, Luxembourg and Estonia are by far the two countries with the most foreign-owned firms. However, there are other countries, where the disparities between the number of firms and their share of profits is much bigger. In Ireland, 2.3% of firms are foreign-owned, but accrue for 73.6% of all corporate profits. In the Netherlands, 1.2% of firms are producing 29.4% of profits and in Belgium, 0.2 of firms have 26.2% of all profits. Other jurisdictions with notable disparities are Spain, Italy, Greece, Slovakia, Malta and Portugal.

Tørsløv et al. (2018) assess the profitability of enterprises by calculating the ratio of pre-tax corporate profits to expenditures on salaries.⁵⁶ A higher ratio in the foreign-controlled sector indicates higher profits on less employees which – in extreme cases – might indicate a lack of physical presence and economic substance. The third column in Table 5 shows the profitability ratios of foreign-owned firms (FOF) in relation to local businesses (own calculations based on the raw data available in the online annex). A value of 929, as in the case of the British Virgin Islands, states that foreign-owned firms on average have the 929-fold amount of profits per salary expense than the local companies. It becomes apparent, that for some EU Member States, local firms are more profitable, but this is not the case for the majority. Ratios average at 36.7 and increase up to 78.6 (the Bahamas), 82.2 (Cayman Islands) and 929.3 (in the case of the British Virgin Islands). With 24.4, the Maltese ratio is the biggest among the EU-27. The macro data therefore shows a clear trace for a reallocation of profits to low-tax countries by the means of (likely shell) companies.

2.2.2. FDI data

Other approaches for identifying the role of shell corporations rely on FDI data. If a country experiences a high inflow (investment by a foreigner in a domestic business) and high outflow (investment of a resident in a foreign business) of FDI, it is likely that the majority of these investments do not correspond to actual economic activity in the country. Instead the funds are only rerouted (e.g. through shell companies) to another more favourable jurisdiction. For many countries, these FDI flows exceed the national GDP by many times, becoming a sensitive amount of transactions. They are included in the capital balance of a country under FDI even though the money only passed through the country on paper.

Loretz et al. (2017) calculate the ratio of FDI flows to GDP for the EU-27, which can be found in columns six and seven of Table 5.⁵⁷ For Hungary, Ireland, the Netherlands, Malta and Luxembourg, both inward and outward FDI exceeds the country’s respective GDP. In the case of Luxembourg, inward investment is 58 times and outward investment 67 times higher than the national GDP.

The authors compare these flows to a gravity model of FDI stock, which indicates the expected flows given the actual economic activity in the countries. Column eight in Table 5 indicates how the observed values relate to the results of the gravity model and show a similar pattern as the ratios as percentage

⁵⁵ Loretz, S., Sellner, R., Brandl, M. B., Arachi, G., Bucci, V., van’t Riet, M., & Aouragh, A. (2017). Aggressive tax planning indicators; Final Report. *Taxation Papers*, 71. Retrieved at https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp.pdf.

⁵⁶ Tørsløv, T. R., Wier, L. S., & Zucman, G. (2018). *The missing profits of nations* (No. w24701). National Bureau of Economic Research. Retrieved at <https://www.nber.org/papers/w24701.pdf>.

⁵⁷ Loretz, S., Sellner, R., Brandl, M. B., Arachi, G., Bucci, V., van’t Riet, M., & Aouragh, A. (2017). Aggressive tax planning indicators; Final Report. *Taxation Papers*, 71, p. 69. Retrieved at https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp.pdf.

of GDP with even more pronounced results for the countries mentioned above (except for the Netherlands). Some other EU-27 members experience FDI flows that are much lower than expected with only one third of the predicted values, as in the cases of Greece, Slovenia or Slovakia.

The authors conclude: “Very large parts of this [sic] FDI stocks appear to be held in SPEs [...]. The very high level of both inward and outward FDI stocks are a clear indication of the attractiveness of Cyprus, Luxembourg, Malta and the Netherlands for holding companies, which themselves are foreign-owned.”⁵⁸

In a similar vein, Vellutini et al. (2019) employ an identification approach that is based on the distinction between so-called “Type I” and “Type II” international financial centres.⁵⁹ Whereas the former are wealth-receiving and can be identified by a high ratio of incoming foreign deposits to GDP, the latter provide shell companies for profit shifting and are therefore identified by an overproportionally high ratio of outgoing deposits to GDP. Wealth is reallocated from Type II jurisdictions to other countries, which is therefore artificially inflating FDI statistics.

Based on bilateral data on cross-border non-bank deposits by the Bank of International Settlements, the authors computed deposit ratios for both types of financial centres. The most recent values for 2016 are included in column nine of Table 5. It is predominantly non-EU member states with the biggest ratios, led by the Cayman Islands (2339%), Bermuda (672%) and Jersey (672%), but Austria is also on the fourth rank of the countries included in the analysis (185%).

Similar to Loretz et al. (2017), the results are again compared to a null model, which leads to the weights in column ten. According to the authors, they indicate the share of the deposits that cannot be explained by actual economic activity. In the case of the Cayman Islands, Bermuda, Jersey and Austria, normal economic activity explains less than 5% of the observed outgoing deposits. This calculation is based on the assumption, that countries with an outgoing deposit share blow their GDP share, but do not provide any shell companies. Those countries have a weight of zero and are therefore not shown in the table.

In line with the previous findings, a recent IMF study found that few small economies facilitate an overproportionate share of global FDI given the size of their real economies. The jurisdictions with the biggest discrepancy between FDI positions and local GDP include many with favourable tax regimes for multinational companies.⁶⁰ “The Netherlands, Luxembourg, Hong Kong SAR, Switzerland, Singapore, Ireland, Bermuda, the British Virgin Islands and the Cayman Islands jointly host more than 40% of global FDI although their combined share of global GDP is only around 3%.”⁶¹

The new contribution of Damgaard et al. (2019) is the distinction of legitimate FDI, where an investor has a substantial active business in another country, from phantom FDI for tax planning or money laundering purposes, which involves shell companies without real economic activity.⁶² They define phantom FDIs as opposed to real FDIs as follows: “The OECD FDI Statistics include additional information on FDI positions for a smaller group of OECD economies. First, 30 economies specify how much inward FDI is into SPEs and how much is into other entities (non-SPEs). The statistical manuals describe an SPE as a formally registered legal entity subject to national law that satisfies several criteria:

⁵⁸ Loretz, S., Sellner, R., Brandl, M. B., Arachi, G., Bucci, V., van't Riet, M., & Aouragh, A. (2017). Aggressive tax planning indicators; Final Report. *Taxation Papers*, 71. Retrieved at https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp.pdf.

⁵⁹ Vellutini, C., Casamatta, G., Bousquet, L., Poniatowski, G., Zavatta, R. & Śmietanka, A. (2019). Estimating International Tax Evasion by Individuals. *Taxation Papers*, 76. Retrieved at https://ec.europa.eu/taxation_customs/sites/taxation/files/2019-taxation-papers-76.pdf.

⁶⁰ Damgaard, J., Elkjaer, T., & Johannesen, N. (2019). *What Is Real and What Is Not in the Global FDI Network?*. International Monetary Fund. Retrieved at <https://www.imf.org/en/Publications/WP/Issues/2019/12/11/what-is-real-and-what-is-not-in-the-global-fdi-network>.

⁶¹ Ibid, p. 1.

⁶² Ibid.

it has few or no employees; it has little or no production in the host economy; it has little or no physical presence; its ultimate owners are foreign residents; its assets and liabilities are mostly vis-a-vis non-residents; and its core business consists of group financing or holding activities (OECD, 2008). FDI into SPEs falls within the standard definition of FDI and is generally included in the FDI reported to CDIS. However, since it has no real economic significance for the host economy, we label it phantom FDI as opposed to foreign investment into non-SPEs, which we label real FDI. This decomposition yields a conservative estimate of phantom FDI as foreign-owned corporations with mixed activities, e.g. production to the local market and passive shareholdings in foreign subsidiaries, are classified as non-SPEs, implying that all the foreign investment they embody is classified as real FDI.”⁶³

By combining CDIS data (IMF Coordinated Direct Investment Survey) on FDI positions and OECD data on investment into Special Purpose Entities (SPEs), the authors decompose total FDI for countries with full data availability and estimate the composition for the remaining ones.

Of 40 trillion US dollars of total FDI in 2017, the authors identify 15 trillion US dollars as phantom FDI, which does not correspond to real economic activity. For every country, the share of phantom investment in inward and outward FDI (investment from a foreign SPE versus investment in a foreign SPE) is calculated and can be found in the fourth and fifth columns of Table 5. These results are considered to indicate the exposure of a country to shell-based tax avoidance opportunities.

Table 5 shows an overview of the different indicators and proxies introduced in this section 2.2.2. To give an example: the third row provides estimates from the different publications for Luxembourg, indicating that 28.9% of firms in Luxembourg are foreign-owned and 50.4% of profits are created in those (Loretz et al., 2017). The profitability of foreign-owned firms (relative to the expenses for salaries) is 11.5 times higher than the profitability of local firms (Tørsløv et al., 2018). 38% of inward FDI into Luxembourg and 32% of outward FDI from Luxembourg can be attributed to Special Purpose Entities, which are often linked to money laundering and other illicit actions (Damgaard et al., 2019). The following columns indicate that inward FDI amounts to 5767% of the Luxembourgish GDP and outward FDI to 6749% of GDP. Compared to a gravity model based on real economic activity, this exceeds the expected values by 526 times (Loretz et al., 2017). Vellutini et al. (2019) calculate a 70% ratio of outward going deposits to GDP, and also compare this estimate to a null model, finding that 91% of those flows cannot be explained by actual economic activity. The FSI score for transparency of 50 indicates on a scale from 0 (no secrecy) to 100 (full secrecy), that Luxembourg is among the better-performing countries with regard to reporting requirements and public availability of beneficial ownership and financial information of companies (based on Financial Secrecy Index sub indicators).

The colour codes are assigned for each column separately and indicate the relative position of the countries for the respective estimate compared to the other countries. Red colours indicate the most problematic jurisdictions for each respective parameter.

⁶³ Damgaard, J., Elkjaer, T., Johannesen, N., “What Is Real and What Is Not in the Global FDI Network?”, <https://www.nielsjohannesen.net/wp-content/uploads/DEJ2019-IMF-working-paper.pdf> (pp. 6-7).

Table 5: Overview of indicators for the role of shell companies for selected jurisdictions

Country	Loretz et al.		Tørslov, profitability of FOF vs. local firms	Damgaard et al.		Loretz et al.			Vellutini et al.		FSI for company o. transparency
	Share of FOF	Share of profits in FOF		% inward FD from SPEs	% outward FDI from SPEs	Inward FD (%GDP)	Outward FDI (%GDP)	Compared to gravity model	Type IFC ratio	Weight	
Virgin Islands, Br.			929,3	40%	48%						75
Cayman Islands			82,8	7%	59%				2339%	100%	85
Luxembourg	28,9%	50,4%	11,5	38%	32%	5767%	6749%	5263%	70%	91%	50
Bermuda			41,3	26%	66%				672%	99%	75
Malta	0,6%	23,4%	24,4	12%	42%	1732%	700%	3125%	29%	79%	68
Bahamas			78,6	8%	58%				5%	18%	85
Jersey			21,3	32%	57%				355%	98%	76
Cyprus	0,7%	14,0%	5,0	33%	18%	905%	907%	2222%	35%	82%	75
Switzerland			29,0	38%	28%				2%	0%	90
United States			0,9	26%	52%						90
Panama			18,8	8%	27%				67%	90%	90
Poland	9,3%	36,5%	0,5	33%	78%	39%	5%	38%			75
Ireland	2,3%	73,6%	11,8	33%	72%	311%	319%	571%	19%	70%	38
Netherlands	1,2%	29,4%	2,8	35%	34%	535%	633%	481%	7%	35%	90
Romania	5,8%	46,2%		33%	48%	40%	1%	40%			73
Hong Kong			4,4	51%	35%				14%	60%	76
Turkey			0,4	25%	45%				12%	55%	85
Singapore			4,5	33%	30%				12%	55%	79
Hungary	3,5%	58,4%	1,0	51%	10%	161%	124%	222%	4%	3%	65
Austria	3,1%	21,9%	0,8	19%	26%	71%	84%	111%	185%	96%	73
Croatia	2,7%	29,3%		37%	17%	54%	12%	48%			68
Portugal	0,6%	21,1%	0,8	37%	26%	59%	31%	97%	5%	16%	70
Czech Republic	1,3%	41,5%	1,5	35%	27%	62%	10%	49%			58
Greece	0,2%	8,4%	0,4	36%	38%	12%	15%	29%	14%	60%	68
Belgium	0,2%	26,2%	1,7	50%	35%	102%	100%	77%			50
Lithuania	2,2%	29,2%		23%	20%	36%	6%	38%			70
Latvia	6,7%	33,6%	0,9	24%	12%	56%	5%	54%	5%	16%	68
Germany	1,2%	27,0%	0,3	38%	20%	24%	42%	40%	5%	16%	62
Finland	1,2%	22,6%	0,7	33%	30%	36%	41%	76%	5%	18%	59
Spain	0,5%	21,4%	0,6	33%	9%	47%	42%	93%	2%	0%	70
Sweden	1,8%	25,1%	1,6	30%	22%	62%	77%	130%			58
Slovakia	0,8%	32,7%	1,1	43%	24%	51%	3%	34%	4%	6%	46
Italy	0,3%	12,7%	0,3	37%	19%	19%	26%	44%	0%	0%	60
Denmark	1,8%	22,0%	0,4	23%	20%	39%	63%	75%			59
United Kingdom			0,5	33%	37%				7%	32%	40
Estonia	24,7%	41,7%	0,8	19%	20%	86%	28%	98%	4%	10%	37
Bulgaria	3,8%	34,2%		31%	12%	86%	4%	85%	5%	17%	47
France	0,8%	12,0%	1,0	35%	14%	28%	51%	47%	3%	0%	55
Slovenia	4,5%	22,2%	1,6	37%	22%	30%	14%	31%	8%	42%	30

Source: Prepared by the author, for data sources please refer to the sources indicated in the text.

Within the European Union, Luxembourg is the only country that pops up in diverse rankings as a top country regarding the role of investment flows related to SPEs or letterbox companies. Other “usual suspects” like Malta, Cyprus, Ireland or the Netherlands rank high, but not top and not on all indicators. But the rest of the rankings show, that what these studies proxy as shell or letterbox companies, or in how far they include letterbox companies in their measurement, varies a lot. Also, which role countries have (receiving flows, sending flows) varies.

To sum up the literature survey, it seems very difficult to empirically grasp what a shell company or letterbox company is, because the term is too slippery. But even if one defines it as an “empty” company – as a company without staff – the term “emptiness” becomes flexible. All shell companies/letterbox companies will have to hire at least one director. What does “empty” then mean? That those directors are paid less than 1 million Euro a year, or a modest 50 000?

Another problem is proportionality. If there are “substance requirements”, companies do not operate with proportionality. You could have an abusive shell company with five directors (and as many part-time support staff if you like) earning each €50 000. This would seem perfectly fine like doing regular business. But if this is a subsidiary of a big MNC like Apple, which is making a profit of €1 billion on paper, this is still an empty shell company.⁶⁴

Seen that there are serious complications to measure the size of letterbox companies and to identify empty shells, we opt for the alternative approach of good ownership registration. If one knows who the ultimate beneficial owner of a company is, criminals cannot hide in companies anymore and tax avoidance scheme with empty shells are being discovered.

2.2.3. Ownership registers

For a qualitative analysis of the beneficial ownership (BO) and legal ownership (LO) reporting requirements and transparency, very recent data of the Tax Justice Network are used, the 2020 Financial Secrecy Index.⁶⁵ Several of the 20 indicators that build the aggregate secrecy score, exclusively measure the requirements for registering trust and foundations (KFSI 2) and recording ownership of companies (KFSI 3) as well as public data availability and reporting duties for limited partnerships (KFSI 5) and companies (KFSI 6), including company accounts (KFSI 7).⁶⁶ The average of these four scores comprises an own company ownership transparency score (ranging from 0 – no secrecy to 100 – full secrecy), which can be found in the rightmost column in Table 5.

It is notable, that none of the countries presented fulfils all transparency requirements established by the Index. The range among the EU-27 is, however, very broad, ranging from the most transparent (Slovenia, 30) to the least transparent (the Netherlands, 90) (joined by other non-EU countries on the list).

2.2.4. Suggestions of best practices for beneficial ownership registry

Jurisdictions with BO registration laws have increased by more than had been expected.⁶⁷ By today, there are 65 jurisdictions which have a beneficial ownership register laws, out of 133 evaluated. Apart

⁶⁴ I owe this point Markus Meinzer from the Tax Justice Network.

⁶⁵ Knobel, A., Harari, M., Meinzer, M., & Palanský, M. (2020). Ownership Registration of Different Types of Legal Structures in International Comparative Perspective. State of Play of Beneficial Ownership – update 2020. Tax Justice Network Report, forthcoming April 2020 Tax Justice Network, Financial Secrecy Index 2020. Available at <https://fsi.taxjustice.net/en/>.

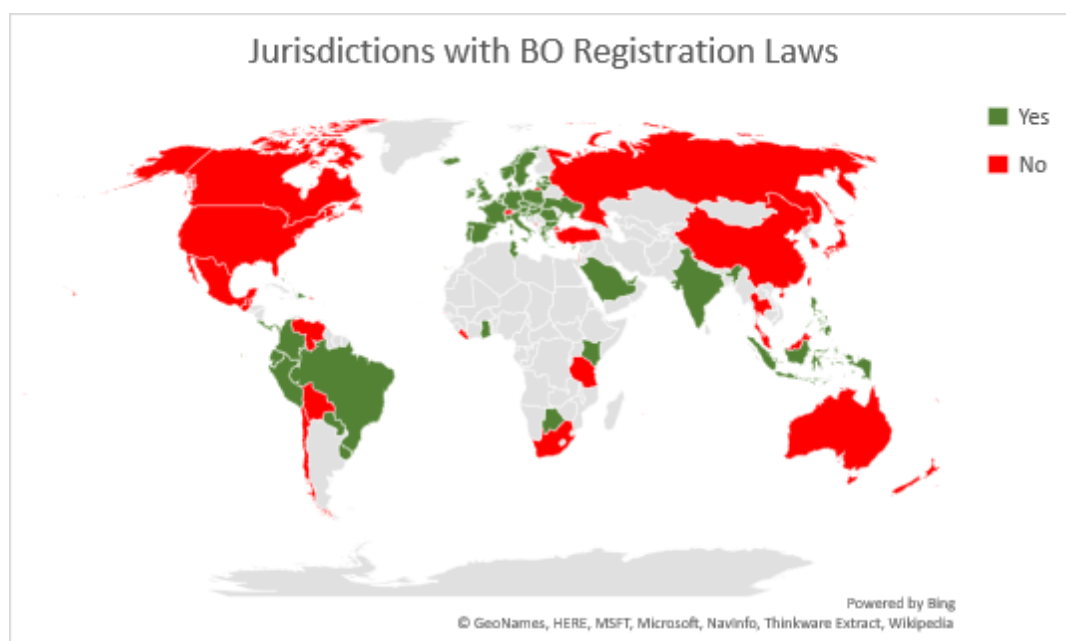
⁶⁶ For detailed information on the construction of the individual indicators, please refer to the FSI Methodology documentation, available at <https://fsi.taxjustice.net/PDF/FSI-Methodology.pdf>.

⁶⁷ Knobel, A., Harari, M., & Meinzer, M. (2018). The state of play of beneficial ownership registration: A visual overview, Tax Justice Network, <https://www.taxjustice.net/wp-content/uploads/2018/06/TJN2018-BeneficialOwnershipRegistration-StateOfPlay-FSI.pdf>.

from two EU Member States (Finland and Hungary) for which Knobel et al. (2020) found that not all types of companies have to register their beneficial owners, all European Member States require beneficial ownership registration by now.

On a world map one sees that Europe and South America are leading, while Canada, the United States, Australia, Russia and Asia are still red, indicating no registers.

Figure 2: Map of jurisdictions with Beneficial Ownership Registration Laws



Source: Knobel et al. (2020).⁶⁸

As Knobel et al. (2020) show, even more countries than predicted in this world graph, have established an ultimate beneficial ownership (UBO) by 2020, namely 69, hence more than half of the coloured countries on the map are by now green. The big areas, however, the United States, Canada, Russia and China do not have registers yet.⁶⁹

⁶⁸ Knobel, A., Harari, M., Meinzer, M., & Palanský, M. (2020). Ownership Registration of Different Types of Legal Structures in International Comparative Perspective. State of Play of Beneficial Ownership – update 2020. Tax Justice Network Report, forthcoming April 2020, Tax Justice Network, Financial Secrecy Index 2020. Available at <https://fsi.taxjustice.net/en/>.

⁶⁹ Ibid.

Table 6: Thresholds for the definition of a company's beneficial owner in BO registration laws

Companies BO registration law?	BO definition threshold?
Yes (65): Andorra, Antigua and Barbuda, Austria, Bahamas, Bahrain, Belgium, Bermuda, Botswana, Brazil, Bulgaria, Cayman Islands, Colombia, Costa Rica, Croatia, Curacao, Cyprus, Czechia, Denmark, Dominican Republic, Ecuador, Estonia, France, Germany, Ghana, Gibraltar, Greece, Guernsey, Iceland, India, Indonesia, Ireland, Isle of Man, Italy, Jersey, Kenya, Latvia, Lebanon, Liechtenstein, Lithuania, Luxembourg, Malta, Monaco, Nauru, Netherlands, North Macedonia, Norway, Panama, Paraguay, Peru, Philippines, Poland, Portugal (Madeira), Romania, San Marino, Saudi Arabia, Slovakia, Slovenia, Spain, Sweden, Trinidad and Tobago, Tunisia, Ukraine, United Kingdom, Uruguay, United Arab Emirates	At least 1 share (3): Botswana ⁷⁰ , Ecuador ⁷¹ , Saudi-Arabia ⁷²
	More than 1 share – 10% (7): Antigua and Barbuda, Bahamas, Bahrain, Colombia, India, Kenya, Peru
	10-25% (11): Latvia, Spain, Costa Rica, Dominican Republic, Lebanon, Curacao, Panama, Philippines, Tunisia, Ukraine, Uruguay
	More than 25% (44): Andorra, Austria, Belgium, Bermuda, Bulgaria, Brazil, Cayman Islands, Croatia, Cyprus, Czechia, Denmark, Estonia, France, Germany, Ghana, Gibraltar, Greece, Guernsey, Iceland, Indonesia, Ireland, Isle of Man, Italy, Jersey, Liechtenstein, Lithuania, Luxembourg, Malta, Monaco, Nauru, Netherlands, North Macedonia, Norway, Paraguay, Poland, Portugal, Romania, San Marino, Slovakia, Slovenia, Sweden, Trinidad and Tobago, United Arab Emirates, United Kingdom

Source: Knobel et al. (2020).⁷³

Most countries followed the FATF standard of asking BO registering for ownership of shares of more than 25% of the company. This standard is a very soft one and leaves quite some room for manoeuvre for companies. If five people (of a family or a clan) share a company equally, they would not have to register. This means, for criminals who plan to hide, there are still plenty of ways to escape registration.

Only few countries have stricter requirements for beneficial ownership. Already holding at least one share of a company obliges to register in Botswana, Ecuador and Saudi Arabia. In Europe, a lower threshold than the one set by the FATF is required only by Latvia and Spain (10-25%). All other EU Member States require the 25% of shares which are FATF standard.

Important for a good register is that both the legal owner (LO) and the beneficial owner (BO) are being registered. Otherwise criminals can hide their traces, especially, if some countries register the legal owner, and others the beneficial owner. In order to prevent that criminals can switch to vehicles that do not require registration, not only both the legal and the beneficial owner, but also all vehicles should be registered. For example, if banks get stricter and require companies to register their ultimate

⁷⁰ Financial Secrecy Index, "Botswana", https://fsi.taxjustice.net/database/dbr_Comments.php?Juris=BW&infoID=471&Per=20.

⁷¹ Financial Secrecy Index, "Ecuador", https://fsi.taxjustice.net/database/dbr_Comments.php?Juris=EC&infoID=474&Per=20.

⁷² Financial Secrecy Index, "Saudi Arabia", https://fsi.taxjustice.net/database/dbr_Comments.php?Juris=SA&infoID=388&Per=20.

⁷³ Knobel, A., Harari, M., Meinzer, M., & Palanský, M. (2020). Ownership Registration of Different Types of Legal Structures in International Comparative Perspective. State of Play of Beneficial Ownership – update 2020. Tax Justice Network Report, forthcoming April 2020 Tax Justice Network, Financial Secrecy Index 2020. Available at <https://fsi.taxjustice.net/en/>.

beneficial owner, criminals might like to switch to foundations or to trusts. Therefore, all vehicles, i.e. companies, partnerships, foreign and domestic trusts, and foundations should register their beneficial owner.

Furthermore, a good register should be regularly updated (at least once a year), easily available online, and at low or no costs.

The following graph done by the Tax Justice Network⁷⁴ shows which registers exist in Europe, and how good they are. The perfect register would be in the first line – online (open data) for legal and beneficial owners and for all vehicles.

As the graph shows, no EU countries fulfil these optimal benchmark criteria. Ex-EU member the United Kingdom and Denmark have open data online of beneficial ownership registers for companies, but their legal ownership register is only updated, but not online. Denmark also has beneficial owners of partnerships online. Only Belgium and Germany disclose private foundations fully and online. And in Germany, the beneficial owner of foreign trusts with local trustee is also available online. Bulgaria, Sweden, Croatia, Finland, Belgium, Czechia, Hungary, France, Ireland and Austria have the registering of foreign trusts mandatory. Countries, where foreign trusts play a major part of business, such as the Netherlands, are unfortunately still missing (the Netherlands only requires its domestic trusts to be registered).

Table 7: Best cases in ownership (BO and LO) registration of companies and partnerships in the EU

	Companies		Partnerships	
	LO	BO	LO	BO
Online (Open Data)	*	United Kingdom, Denmark	Bulgaria	Denmark
Online (free)	Bulgaria, Malta	Slovenia	Malta, Slovenia, Slovakia, Czechia, Croatia	Slovenia, Luxembourg
Online (cost)	Cyprus, Estonia, Ireland, Italy	Estonia, Ireland	Cyprus, Estonia, Italy, Germany, Finland	Estonia, Germany
Only Updated	United Kingdom, Greece, Latvia, Sweden, Slovenia, Slovakia	Bulgaria, Greece, Italy, Malta, Sweden, Slovakia, Belgium, France, Lithuania, Romania	Hungary, United Kingdom, France, Luxembourg, Romania, Austria, Spain, Latvia, Greece, Lithuania, Poland, Portugal, Sweden	France, Romania, Austria, Czechia, Spain, Latvia, Greece, Malta, Lithuania, Poland, Portugal, Croatia, Belgium, Netherlands, Slovakia, Bulgaria, Sweden

Source: Knobel et al. (2020).⁷⁵

⁷⁴ Knobel, A., Harari, M., Meinzer, M., & Palanský, M. (2020). Ownership Registration of Different Types of Legal Structures in International Comparative Perspective. State of Play of Beneficial Ownership – update 2020. Tax Justice Network Report, forthcoming April 2020, Tax Justice Network, Financial Secrecy Index 2020. Available at <https://fsi.taxijustice.net/en/>.

⁷⁵ Ibid.

Table 8: Best cases in ownership registration of trusts and foundations in the EU

	Private Foundations		Trusts Domestic Law		Trusts Foreign law with local trustee
Online	Partial disclosure: Denmark, Netherlands, Estonia, Austria Full disclosure: Belgium, Germany	Private foundations not available: Ireland, Hungary, United Kingdom, Cyprus, France, Luxembourg, Romania, Finland, Italy, Czechia, Spain, Latvia, Greece, Lithuania, Poland, Portugal, Croatia, Slovenia, Slovakia	✘	Domestic law trusts cannot be created: Finland, Italy, Estonia, Spain, Latvia, Greece, Lithuania, Poland, Portugal, Croatia, Slovenia, Belgium, Denmark, Netherlands, Slovakia, Bulgaria, Sweden	Germany
Only mandatory registration	Bulgaria, Sweden, Malta	Not Applicable	Czechia, Hungary, France, Cyprus, Romania	Not Applicable	Bulgaria, Sweden, Croatia, Finland, Belgium, Czechia, Hungary, France, Ireland, Austria

Source: Knobel et al. (2020).⁷⁶

2.3. Suggestions to combat letterbox companies

To sum up, none of the indicators to measure shell companies are very reliable by themselves, as they are only proxies for a phenomenon that is by design difficult to observe. However, comparing previous research on this topic, a pattern emerges of EU Member States with a particularly large number of foreign-owned firms and asymmetric or over proportionately large FDI stocks. For those jurisdictions, shell companies are more likely to be or become problematic in the future. It is therefore important to pay particular attention to these countries when analysing tax avoidance and money laundering or when deciding and implementing new measures.

Since letterbox or shell companies cannot be measured directly, and since there are many ways of circumventing substance rules, it seems more promising to improve and harmonise ownership registers. Both, legal and beneficial ownership should be easily available, and regularly updated. Trusts, foundations and partnership should also be registered. Like this, the beneficial owner, and hopefully

⁷⁶ Knobel, A., Harari, M., Meinzer, M., & Palanský, M. (2020). Ownership Registration of Different Types of Legal Structures in International Comparative Perspective. State of Play of Beneficial Ownership – update 2020. Tax Justice Network Report, forthcoming April 2020, Tax Justice Network, Financial Secrecy Index 2020. Available at <https://fsi.taxjustice.net/en/>.

once the ultimate beneficial owner of a company can be traced, and one can distinguish real business from paper business and criminal activities.

2.3.1. Approaches taken so far to identify and combat letterbox companies

So far, several legislative measures have been taken at the national, European and international levels. Approaches vary between general transparency measures and defining criteria to distinguish harmful from legitimate or inactive shell companies.

a. Distinguishing harmful and legitimate shells seems impossible

This approach, although very intuitive and straightforward, is often not feasible or fails an international consensus. German Minister of Finance, Wolfgang Schäuble, formulated such a proposal in the aftermath of the Panama Papers. In order to fight tax avoidance and money laundering more effectively, he introduced a Ten-Point-Plan, including a call for more transparency: "We need full transparency. The OECD should develop criteria to identify inactive and shell companies. We have to be able to distinguish harmless empty shells from so-called letterbox companies."⁷⁷ The problem is, as our previous literature survey showed, that one cannot distinguish the good from the bad ones, the harmful letterbox companies from the harmless empty companies.

Empirically, it seems almost impossible to find out about "empty" firms. If "empty firms" are defined as companies with zero or few employees, the data is not available. The number of staff may only be included in public data if one has full financial statements published for all companies - but many companies are exempt from this. From many types of companies, only balance sheets are required. (see indicator 7 of the Financial Secrecy Index⁷⁸).

Given the lengthy and often unsuccessful attempts to define international criteria for tax havens or harmonise blacklists across countries,⁷⁹ it seems unlikely that an international or OECD consensus could be found for such a distinction between harmful and harmless companies.

- Existing approaches to prevent the abuse of shells are often easy to circumvent. If substance requirements are defined by a fixed amount of staff or salaries without any proportionality to the rest of the corporation, it gets disproportionately easier for big MNEs to fulfil these requirements as they are negligible in relation to the potential tax savings.

Another point is proportionality: by defining "substance requirements", which become very fashionable by suspected corporate tax havens (e.g. the Netherlands) to escape anti-avoidance rules, they do not operate with proportionality. So you can have an abusive shell company with 5 directors (and as many part-time support staff as you like), earning each €50 000: but if this is a subsidiary of Amazon which is making on paper a profit of €1 billion, or if it is the money laundering hub for a professional launderer's network servicing organised crime, with annual turnovers of tens of millions of Euros: it would not appear as an empty shell company, yet it serves to enable illegal activities.

This is further complicated by the nature of harmful shells that try to exploit existing regulations to their advantage and disguise their purpose, which makes investigations even more difficult. Broad and

⁷⁷ Steuerbetrug, trickreiche Steuervermeidung und Geldwäsche konsequent bekämpfen. Zehn nächste Schritte für ein faires internationales Steuersystem und ein effektiveres Vorgehen gegen Geldwäsche, Tagesschau, 10.04.2016, <https://www.tagesschau.de/schauble-313.pdf> (author's translation).

⁷⁸ Financial Secrecy Index 2020, "Key Financial Secrecy Indicator 7: Public Company Accounts", <https://fsi.taxjustice.net/PDF/7-Public-Company-Accounts.pdf>.

⁷⁹ For an overview see Meinzer, M. (2016). Towards a Common Yardstick to Identify Tax Havens and to Facilitate Reform. In T. Rixen & P. Dietsch (Eds.), *Global Tax Governance – What is Wrong with it, and How to Fix it* (pp. 255–288). Colchester: ECPR Press.

detailed transparency measures are therefore a more fundamental requirement that needs to be established first.

Finally, it does not follow that the practices of “non-shell” companies under any definition are unproblematic and not involved in any illicit flows.

b. Explore general transparency measures more

- Many recent efforts are aimed at increasing transparency in general. The Financial Secrecy Index (see table above) includes information on beneficial and legal ownership registers and publication of financial standards. It finds major deficits for most EU countries with only limited information being collected, accessible online for free and/or in an open data format, and updated on a regular basis. Furthermore, many firms are covered by exemptions, which further narrows the scope of available data.
- The collection of beneficial ownership data is crucial for effective taxation and accountability. The abuse of shell companies would therefore be more likely to be detected, which changes the benefit-risk assessment of the parties involved and could therefore reduce harmful practices in the long run.
- The Financial Action Task Force (FATF) recently published a best practice report on ownership verification, promoting a “multi-pronged approach” by combining existing sources of information (other authorities and registries, i.e. property or tax) with company registries and self-reporting duties companies to hold up-to-date information on their owners.⁸⁰
- Data verification is crucial for the registries to be effective and can be facilitated by a range of tools and methods. Knobel (2019) suggests basic cross-checks for data validity with other government databases, when new companies are registered, as well as plausibility checks on the data provided (e.g. if addresses actually exist). Registrations should not be allowed for owners whose data cannot be reliably verified. On a regular basis, compliance with tax return and financial statement requirements should be evaluated both in form and content.⁸¹
- More sophisticated analytic methods then allow for “pattern-finding and red-flagging” if background data on the owners, employees, the company structure, its presence online and in social media or financial transactions are analysed to detect irregularities or similarities to known previous schemes. Several ratios, similar to the profitability ratios in Table 5, could also point to illegitimate activities. This would rather bring suspicious activities to the attention of authorities for further investigation than being a reliable and unambiguous verdict.⁸²

c. Improve ultimate beneficial ownership registers

As has been mentioned before, both legal and beneficial ownership registers should exist. Online, easily accessible and at no or low costs. For all vehicles, companies, foundations, partnerships, domestic and foreign trusts.

To sum up, there are still noticeable differences and deficiencies among EU Member States efforts with regards to harmful shell companies that facilitate anonymous transfers and aggressive tax planning.

⁸⁰ FATF (2019). Best Practices on Beneficial Ownership for Legal Persons. FATF, Paris. Retrieved at <https://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf>.

⁸¹ Knobel, A. (2019). Beneficial ownership verification: Ensuring the truthfulness and accuracy of registered ownership information. Tax Justice Network. Retrieved at https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification_Tax-Justice-Network_Jan-2019.pdf.

⁸² Ibid.

- Observing, collecting data and analysing the activities of such entities is complicated by their very nature and preferred use. It is, however, an essential prerequisite to place them under scrutiny and establish comprehensive and detailed public company registries in order to constrain the scope for harmful practices. The Financial Action Task Force presents best practices that can serve as a starting point for both national and supranational measures on beneficial ownership.⁸³
- The verification of beneficial ownership data, if collected in the first place, is crucial and combined with background information on companies, it has an untapped potential for identifying irregularities and potential undesired behaviour. Andres Knobel of the Tax Justice Network describes detailed possibilities for ownership verification⁸⁴ and the indicators of the Financial Secrecy Index can give a first impression of the status-quo in the EU-27 and beyond.⁸⁵

d. Show country examples of best practices regarding legal ownership

Many countries have taken action in recent years, with transparency gaining importance after the financial crisis and due to public scrutiny after leaks such as the Panama or Paradise Papers.

The FATF Best Practices Paper notes several countries that already implemented some of the measures introduced above, including a comprehensive publicly accessible database, external verification of register information or automatic flagging of suspicious patterns.⁸⁶

Austria:

- “Where an obliged entity determines during the application of its due diligence obligations towards customers that a different beneficial owner has been entered as beneficial owner than was determined, and is convinced that the entry is incorrect or incomplete, then the obliged entity may electronically report this case to the BO Registry Authority by setting a remark – a “red flag” – for the respective legal entity. The same applies to all competent authorities.”⁸⁷
- “Through an automated alignment with other registers, it is ensured that beneficial owners and legal entities can only be reported if their data is also contained in other public registers. If, for example, a person with a main residence address in Austria is entered as a beneficial owner, there is a real time check with the Central Residence Register in the background if the entered person has a valid main residence in Austria.”⁸⁸

Belgium:

- “In Belgium, a centralised beneficial ownership register (UBO Register) has been implemented for both legal entities and arrangements (LE/LA). It is developed, managed and controlled by the Treasury administration of the Federal Public Service Finance and is separate from the Commerce registry managed by the Federal Public Service Economy. The UBO register is an online and fully digitalised platform through which all LE/LA can submit and update their UBO information and that can directly be accessed by competent authorities, obliged entities and members of the general

⁸³ FATF (2019). Best Practices on Beneficial Ownership for Legal Persons. FATF, Paris. Retrieved at <http://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf>.

⁸⁴ Knobel, A. (2019). Beneficial ownership verification: Ensuring the truthfulness and accuracy of registered ownership information. Tax Justice Network. Retrieved at <https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification-Tax-Justice-Network-Jan-2019.pdf>.

⁸⁵ Tax Justice Network, Financial Secrecy Index 2020. Available at <https://fsi.taxjustice.net/en/>.

⁸⁶ FATF (2019). Best Practices on Beneficial Ownership for Legal Persons. FATF, Paris. Retrieved at <http://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf>.

⁸⁷ Ibid, pp. 45f.

⁸⁸ Ibid, p. 57.

public. An additional condition of demonstrating a legitimate interest applicable to access the UBO information of certain LA."⁸⁹

Denmark:

- "Denmark operates with an official online company registry called the Central Business Register (CVR). The CVR contains and publishes free of charge information on legal entities registered according to both company law and tax law. To secure data quality, several automatic control mechanisms have been incorporated in the Business Register. They are intended to avoid mistakes during the registration process and facilitate the implementation of targeted control. The CVR automatically checks information that is filed (which must be done electronically), and will crosscheck this information with various governmental registers, the CPR number - Civil registration number/CVR number - Unique identification number for legal entities and other details such as address (Danish Address Register - DAR) and dates. Furthermore, business rules are set up in the system to avoid impossible situations ex. registration of a deceased person, and as the Business Register entails information about legal entities, certain information about the entity is prefilled in order to ease the registration and to avoid mistakes. These automated checks are then followed by more detailed manual checks in suspicious cases. The system is also designed to use large datasets and with machine learning to better identify potential risks."⁹⁰
- "The IT-system (CVR) is under an ongoing development and most recent developments is using machine learning to check enclosed documents signatures and read if certain documents entail demanded text and conclusions. The DBA can perform checks to verify the registrations. In these cases, DBA can ask for documentation for the registrations. If the company cannot provide this, or the incorrect registrations are not rectified, DBA can enforce a forced winding up."⁹¹

Ireland:

- "Data interfaces have been established between the Companies Registration Office (CRO) and Revenue, as the two key data repositories of corporate information in Ireland. Such interfaces allow the authorities to conduct ongoing red-flag monitoring and some verification of the information held. For example, Ireland has assessed that higher ML/TF and tax evasion risks attach to entities which, although incorporated through CRO, fail to engage with Revenue. The interface between CRO and the Revenue combats risks associated with 'non-engaged' entities and enquiry letters are generated."⁹²

Netherlands:

- "The automated information system TRACK of the Scrutiny, Integrity and Screening Agency (part of the Ministry of Justice and Security) continuously monitors the integrity of legal persons, including its directors and affiliated persons or legal persons. The system was introduced in January 2011. The Scrutiny, Integrity and Screening Agency performs risks analysis by automatically scanning several closed and public sources on a daily basis, to look for any relevant financial or criminal records of directors, and the (legal) persons in their immediate surroundings. Data includes the Company Registry, Citizens Registry of the municipalities and the Central Insolvency Registry, as well as other public sources. In addition, data is obtained from the tax authorities, the Judicial Information Service, and the National Police Services Agency. If the computer system reveals a

⁸⁹ Ibid, p. 46.

⁹⁰ Ibid, p. 48.

⁹¹ Ibid, p. 57.

⁹² Ibid, p. 50.

heightened risk, either immediately upon registration or later on, during the life span of the legal person, this dedicated Agency will carry out a more in-depth analysis.”⁹³

- “There is a general obligation for all foreign incorporated companies with an office in the Netherlands, or who provide employment in the Netherlands, to register basic company information in the company register of the Dutch Chamber of Commerce. FIs and DNFBPs are obliged to perform enhanced CDD if the country of residence of the customer is declared a high-risk country by the European Commission.”⁹⁴

Some further regulatory changes in EU Member States involving shell corporations include:

- Latvia: The country prohibited cooperation with shell companies in 2018. Banks, intermediaries and investment managers were prohibited to have any relationships or transactions with shell companies.⁹⁵

e. Make a legal analysis of measures taken regarding implementation of EU Directives

It is also worth exploring the national implementation of the relevant EU regulations regarding letter box companies. They include the Anti-Tax Avoidance Directives I & II (ATAD) of 2016 and 2017, which implement many of the OECD BEPS commitments and are largely in force as of 2019,⁹⁶ or the “DAC6” Directive in June 2018, which establishes a reporting requirement for cross-border tax arrangements if they involve at least one EU Member State.⁹⁷

Based on data of the International Bureau of Fiscal Documentation (IBFD),⁹⁸ the EU-27 can be compared systematically regarding their legal system and specifically the implementation of EU regulations. This would, however, require an extensive report in itself, which would offer a comprehensive legal analysis of the status quo in the EU Member States.

To give an example, which then could be expanded to all EU Member States:

- The Netherlands: Starting 2014, the new article 3a of the Implementing Decree on the Assistance in International Tax Matters (Uitvoeringsbesluit internationale bijstandsverlening bij de heffing van belastingen) (IDAITM) came into effect. It establishes new substance requirements for holding companies to prevent the exploitation of the Dutch treaty network by entities with no physical presence. The article details requirements and necessary steps if not all information is provided.⁹⁹
- In detail, the requirements for proving a real presence in the Netherlands are:
 - “that at least half of the statutory board members with decision-making powers must reside in the Netherlands;
 - these board members possess the required knowledge to, in short, execute their tasks;
 - the presence of qualified staff to execute and register the taxpayers' activities;
 - the decisions by the board are taken in the Netherlands;

⁹³ Ibid, p. 50.

⁹⁴ Ibid, p. 54.

⁹⁵ Kiendl Krišto, I., & Thirion, E. (2018). An overview of shell companies in the European Union. Study, European Parliamentary Research Service. Retrieved at https://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell_companies_in_the_EU.pdf.

⁹⁶ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p. 1–14. Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, OJ L 144, 7.6.2017, pp. 1–11.

⁹⁷ Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, ST/7160/2018/INIT, OJ L 139, 5.6.2018, pp. 1–13.

⁹⁸ International Bureau of Fiscal Documentation (IBFD). Tax Portal. Accessible at <https://research.ibfd.org/#/>.

⁹⁹ Schellekens, M. (2014). Netherlands, New substance requirements in effect. IBFD Tax Portal.

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- the most important bank accounts are held in the Netherlands;
 - the accounting records are kept in the Netherlands;
 - the address of the taxpayer is in the Netherlands;
 - the taxpayer is, to his knowledge, not a tax resident of another country;
 - the taxpayer runs a real risk as regards the loans or royalty/rental/lease agreements [...];
and
 - the taxpayer has an amount of equity commensurate with the real risk he runs.”¹⁰⁰
- Belgium: In December 2019, the Belgian Parliament adopted a draft bill, implementing the DAC6 Directive (2018/822 of 25 May 2018) on cross-border tax information exchange. It closely follows the directive in many regards, but does not include domestic arrangements, unlikely the implementations in many other Member States. It, furthermore, establishes penalties for late reporting or failure to report. The bill is expected to apply from 1 July 2020.¹⁰¹

2.3.2. Further research needed

To sum up, there are still noticeable differences and deficiencies among EU Member States efforts with regards to harmful shell companies that facilitate anonymous transfers and aggressive tax planning, which require more knowledge.

Further research should explore the behaviour of international corporate structures more detailed and identify the role of individual jurisdictions. Combining different government databases and furthering big data analysis can deliver first reference points for fighting harmful practices involving shell companies.

¹⁰⁰ Schellekens, M. (2014). Netherlands, New substance requirements in effect. IBFD Tax Portal.

¹⁰¹ Mortier, F. (2019). Belgium, European Union, Bill implementing EU Directive on exchange of information relating to reportable cross-border arrangements (DAC 6) – adopted by federal parliament. IBFD Tax Portal.

3. EU ANTI-MONEY LAUNDERING LEGISLATION

KEY FINDINGS

Anti-money laundering policy in Europe happens mainly through directives, which are hard law, but leave the implementation (transposition) up to the Member States. In this sense, it is similar to the soft law approach of the Financial Action Task Force, which leaves certain room for manoeuvre in the implementation of its recommendations (AML standards) to countries. From the perspective of level-playing-field and harmonisation in Europe, it seems that EU regulations are a more powerful instrument. Regulations are directly applicable in national legal orders and, hence, do not require national implementing measures. Member States must ensure that regulations are correctly applied.

In favour of regulations speaks that they would guarantee harmonisation within EU Member States (provided that the regulations do not include too many Member States options). In favour of directives speaks that they allow for more flexibility. A too rigid policy, that relies only on EU regulation risks to create policy and procedural delays and non-compliance or compliance in the books only. However, after thirty years of AML Directives, one has to doubt whether directives can bring sufficient harmonisation in important AML policy fields.

Harmonisation is needed especially regarding information exchange, reporting of suspicious transactions, cooperation possibilities, fines, definition of predicate offences of money laundering, prosecution and conviction of launderers. They are important for setting up new bodies, such as a European Public Prosecutor, a European Supervision or a European Intelligence Centre. Agreements among Member States for regulations could be more difficult than for directives.

According to Article 288 of the Treaty on the Functioning of the European Union, EU institutions can exercise their competences through regulations, directives, decisions, recommendations and opinions:

“A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. A decision shall be binding in its entirety upon those to whom it is addressed. Recommendations and opinions shall have no binding force.”¹⁰²

Regulations are one of the most powerful forms of EU law. Regulations are directly applicable in national legal orders and, hence, do not require national implementing measures. Member States must ensure that regulations are correctly applied. As a consequence, they override all national laws dealing with the same subject matter and subsequent national legislation must be consistent with and made in the light of the regulation. Directives, to the contrary, have to be transposed into national laws.

EU anti-money laundering legislation is so far mainly based on directives– hence leaving considerable room for manoeuvre to the Member States in implementing them and transposing them into national law.

¹⁰² Treaty on the Functioning of the European Union (Consolidated version), Article 288, OJ C 326, 26.10.2012, pp. 47–390.

The First AML Directive, EU Council Directive 91/308/EEC of 10 June 1991 on the prevention of the use of the financial system for the purpose of money laundering defined ML in terms of drug offences and imposed obligations solely on the financial sector.

The Second AML Directive, Directive 2001/97/EC of the European Parliament and of the Council extended the scope of Directive 91/308/EEC both in terms of the crimes covered and in terms of the range of professions and activities covered – auditors, accountants, tax advisors, real estate agents, dealers in high values, casinos, notaries and lawyers.

The Third AML Directive, Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (2005) included terrorist financing.

The Fourth AML Directive, Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing emphasised “tax crimes” as predicate crime for money laundering. The Fourth AML Directive paid more attention to the matter of supervision and sanctioning than the preceding directives.

The Fifth AML Directive, Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU of 19 June 2018, focusses on enhanced powers for direct access to information and increased transparency around beneficial ownership information and trusts. It also extends the scope of obliged entities to virtual currency exchange providers. The Member States had to transpose this directive by 10 January 2020.

3.1. EU Member States’ legal framework

There are currently substantial divergences among Member States’ legal frameworks and fragmentation in the manner rules are applied cross-border.¹⁰³ This may call for a reconsideration of the effectiveness of a system based on minimum harmonisation, including by assessing whether elements of the framework might be better framed in a directly applicable regulation. The study will also show which elements would benefit from further harmonisation.

3.1.1. International soft law norms

International soft law instruments have dominated the latest legislations at the EU level and its members. In particular the Financial Action Task Force (FATF) Recommendations have had a decisive role in the evolution of the EU AML/CFT landscape, as the EU directives were meant to provide a common EU basis for their implementation. These recommendations are non-binding, but have taken a quasi-binding character because of its large membership and because some of its recommendations were reproduced in international hard instruments and UN resolutions.¹⁰⁴ Also the fact that violation of FATF recommendations can result in blacklisting of a country, which can for example mean that no US bank will transfer money from and to this country, has given substantial power to these “soft” norms.¹⁰⁵

¹⁰³ European Parliament non-legislative resolution on the state of implementation of the Union’s anti-money laundering legislation 2019/2820(RSP) / B9-0045/2019 / P9_TA-PROV(2019)0022 and M. van den Broek (2015). A legal study on the effectiveness of supervision in the European Union. Eleven International Publishing: The Hague.

¹⁰⁴ Borlini, L. S., & Montanaro, F. (2017). The Evolution of the EU Law Against Criminal Finance: The “Hardening” of FATF Standards within the EU (SSRN Scholarly Paper ID 3010099). Social Science Research Network. Retrieved at <https://papers.ssrn.com/abstract=3010099>.

¹⁰⁵ Unger, B. (2013). Money Laundering Regulation: from Al Capone to Al Qaeda, Edward Elgar Publishing.

Flexibility and openness to change, as is possible with soft law, is crucial in the anti-money laundering field where domestic laws and their enforcement have to constantly evolve to keep pace with money launderers. The FATF recommendations demonstrate that an international set of standards laid out as soft law, can nonetheless have a large impact on national law, through its implementation into binding national or even international hard law instruments.¹⁰⁶

3.1.2. EU anti-money laundering directives and harmonisation issues

While international legislation of the FATF was based on soft law, the EU basically provided a common basis to implement these international standards through directives. European anti-money laundering policy was, contrary to international soft law standards, hard law.

AML enforcement in the European Union is highly heterogeneous. Directives set out results or objectives to be achieved, but do not dictate how each Member State should reach these aims. This type of legal instrument requires transposition, meaning that it is the Member State's responsibility to implement the directive in its legal order through national implementing measures. However, when dealing with issues such as anti-money laundering, discrepancies in AML laws and enforcement – resulting in an unequal level playing field, or even into loopholes – are often quickly identified by and consequently easily exploited by money-launderers. This lack of harmonisation also creates obstacles in cross-border police and legal cooperation initiatives to tackle money laundering. In fact, Europol and Eurojust reported that incoherent definitions of what constitutes money laundering, pose a real obstacle to collaboration between Member States.¹⁰⁷

Canestri (2015) identified the following aspects lacking harmonisation:¹⁰⁸

- Confiscation procedures: some Member States apply civil confiscations (i.e. not based on convictions), other allow criminal confiscations only after a conviction, while some nations use this form of confiscation as a preventive measure before a criminal sentence has been dictated).
- Enforcement means and tools: some national officers do not have access to the same resources in order to investigate offences committed in their jurisdictions or abroad, resulting in dissimilar intensity levels of investigation between Member States.
- What is considered a money laundering crime: FATF recommendations defined 21 predicated offenses but these recommendations have not been consistently implemented into domestic criminal or tax codes. Thus, a transaction could be allowed in one of the EU Member States, while in another be considered a crime.
- Sanctions applied by different Member States:¹⁰⁹ a step towards harmonization taken already in the Fourth AML Directive was the baseline sanction for grave or repeated violations.¹¹⁰

Rosset al. (2020) find substantial differences in what is considered tax crime and money laundering in the EU Member States and which sanctions apply.¹¹¹ The authors compared tax and money laundering law in the books and law in practice in all EU Member States. For the latter, surveys with

¹⁰⁶ Ibid.

¹⁰⁷ Canestri, D. (2015). Fourth EU AML Directive: What is Missing? Section 319 PATRIOT Act and the New EU AML Directive. *European Journal of Crime, Criminal Law and Criminal Justice*, 23(3), pp. 214–240.

¹⁰⁸ Ibid.

¹⁰⁹ Kirschenbaum, J., & Véron, N. (2018). A better European Union architecture to fight money laundering. 19. Retrieved at <https://www.bruegel.org/2018/10/a-better-european-union-architecture-to-fight-money-laundering/>.

¹¹⁰ Borlini, L. S., & Montanaro, F. (2017). The Evolution of the EU Law Against Criminal Finance: The “Hardening” of FATF Standards within the EU (SSRN Scholarly Paper ID 3010099). *Social Science Research Network*. Retrieved at <https://papers.ssrn.com/abstract=3010099>.

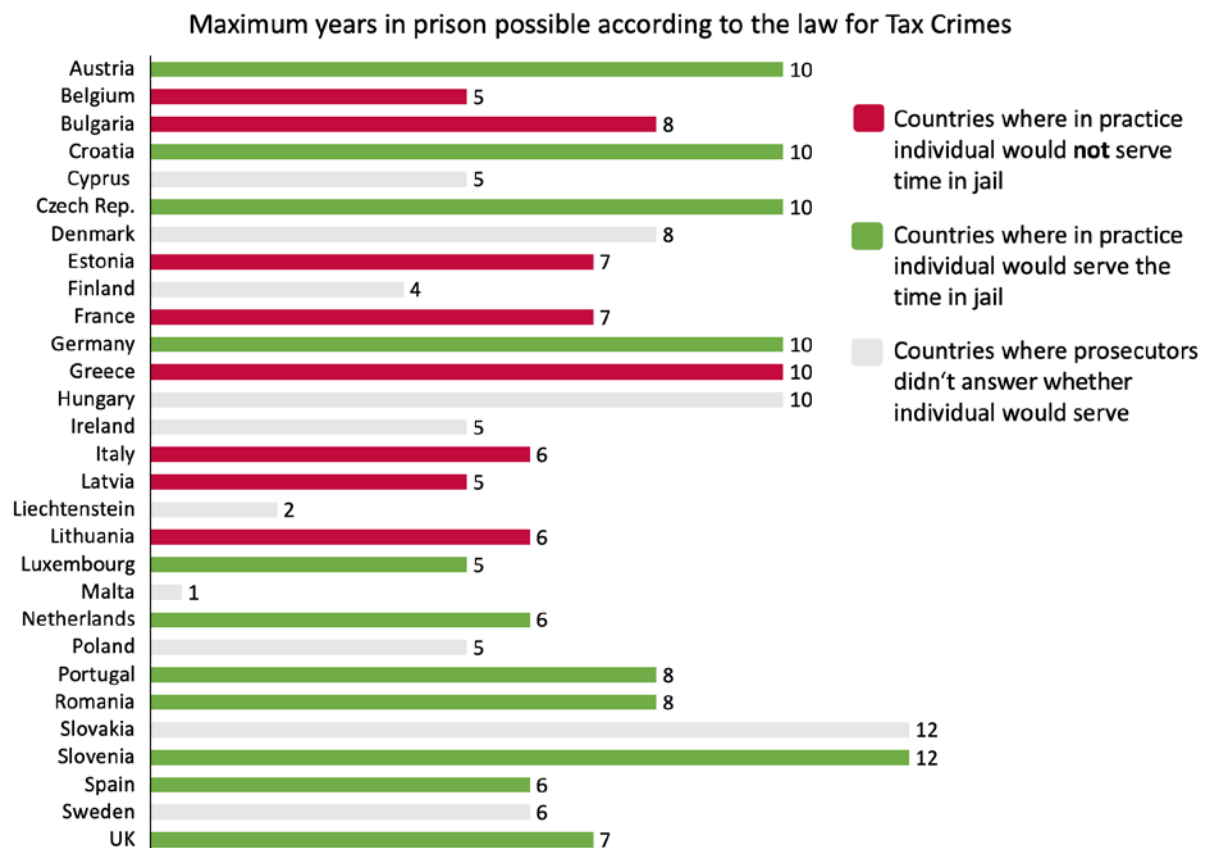
¹¹¹ Rosset, L., Unger, B., Batchelor, J., & van Koningsveld, J. (2020). Tax Crimes as a Predicate Crime for Money Laundering, Mapping of the Law in the Books and Practice across the European Union, Publication D6.8 <http://coffers.eu/>.

different cases were sent to public prosecutors of all EU Member States. The cases sent were formulated in neutral and abstract terms but resembled cases of reality. To give a simple example: if Bavarian football player Uli Hoeness (former president of the German football club FC Bayern, who had not paid more than €10 million taxes due), would have lived in another EU Member State, what would have been the maximum sentence he risked in each EU Member State? Would this be considered a tax crime and/or money laundering? And would Hoeness have to serve the sentence in jail in case he got convicted?

In 2014 Hoeness was convicted for tax evasion to three-and-a-half-year jail term in Germany. The maximum jail time he could have faced in Germany was ten years. He was released from prison on suspension after serving half of his three-and-a-half-year jail term.

As Figure 3 shows, German maximum sentences for tax evasion are ten years and hence high. Only Slovenia has an even higher maximum of twelve years in jail. Hoeness would have been better off as president of Spora Luxemburg with five years maximum jail time, or even better as president of FK Ventspils in Latvia or of Royal Antwerp FC in Belgium, where – according to the answers of the public prosecutors surveyed – individuals like him would not have had to serve the sentence in jail.

Figure 3: Maximum number of years in prison for tax crimes (in red where jail time would not have to be served)



Source: Rossel L., B. Unger, J. Batchelor, F. Vallejo (2020). AML tool <http://coffers.eu/>.

Figure 4 shows large differences between maximum sentences for tax crime and for money laundering in the Member States. There are countries with high sentences for tax crime, but low sentences for money laundering, such as Germany, Slovenia, Hungary and Croatia, and countries with low sentences

for tax crime but high sentences for money laundering (like Malta, the Netherlands, Ireland, Bulgaria, Poland, Romania, the United Kingdom) and countries where both crimes are sentenced similar (Austria, Belgium, Greece, Luxembourg).

Figure 4: Maximum sentence for tax crimes and money laundering



Source: Rossel L, B. Unger, J. Batchelor, F. Vallejo (2020) AML Tool <http://coffers.eu/>.

Hoeness could not have been prosecuted for money laundering in Germany, even after the Fourth AML Directive was in place. Only in about half of the European Member States he could also be prosecuted for money laundering, but in many he would not in practice. According to our survey, there are only six Member States where Hoeness could and would have been prosecuted and sentenced for both tax evasion and money laundering. These are Bulgaria, Croatia, the Netherlands, Portugal, Romania and Slovenia.

For tax evaders and launderers Europe still offers a variety of chances to escape prosecution and harsh punishment. There are indeed large differences in the definition of predicate crimes for money laundering and in sentencing. Also, the staff and equipment of tax administration, the number of audits, hence, the chance of being detected, varies largely.¹¹² For money launderers this can offer loopholes which they can explore. And, coming from abroad, they might choose their point of entry to Europe carefully.

¹¹² See Frederik Heitmueller, Moran Harari and Markus Meinzer, Tax Administration CapacityTJN survey on administrative capacity, <http://coffers.eu/>, <http://coffers.eu/wp-content/uploads/2019/11/D2.7-Working-Paper.pdf>.

Regulations could reduce disharmonies within EU Member States. Contrary to directives, EU regulations do not require any transposition as they are directly applicable to EU Member States and achieve more easily maximum harmonisation.

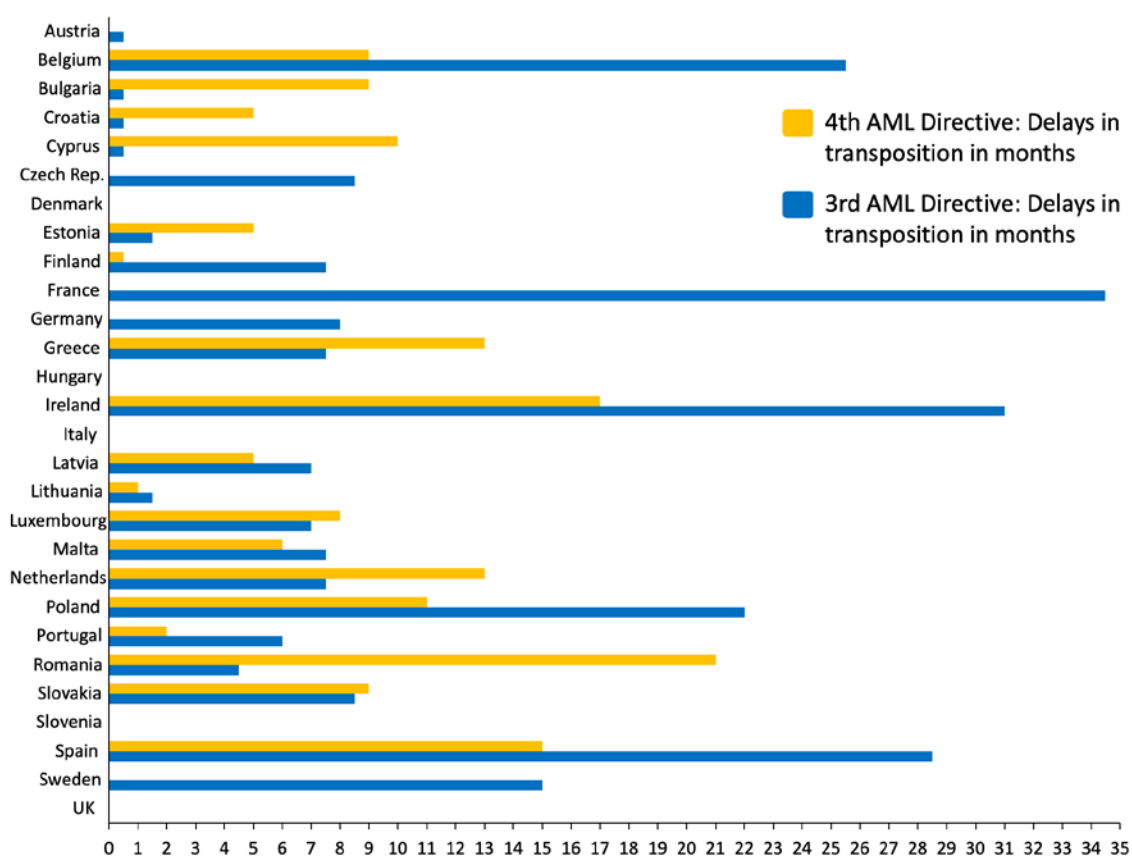
One argument mentioned against AML regulations by European Commission's Directorate-General for Migration and Home Affairs was that this might cause delays. The political process for directives already took very long. Also, directives faced large delays of implementation. If all countries have to do the same, as the regulation necessitates, this might need large adjustments in national laws. As the following Figure 3 shows, there were large delays when implementing the Third AML Directive. The implementation was due 15 December 2007. France was almost three years late. Countries gave the following reasons for delays:¹¹³

- legal difficulties (system did not fit - Ireland);
- social difficulties (opposition of legal professions - Belgium, France, Poland);
- political difficulties (Belgium had no government);
- other difficulties (France has a long parliamentary procedure);
- old Member States had statistically significantly more delay than the new Member States; and
- Member States with internal supervision (professional organisations) had statistically significantly more delay.

The implementation of the Fourth Anti Money Laundering Directive had less delays than the Third AML Directive. As Figure 3 shows, the maximum delay of implementation of the fourth directive was 21 months in Romania, 17 months in Ireland, 15 months in Spain, 13 months in the Netherlands and in Greece. The third directive had much longer delays. France exceeded the deadline by 34.5 months, Ireland by 31 months, Spain by 28.5 months and Belgium by 25.5 months.

¹¹³ Unger, B., Ferwerda, J., van den Broek, M., Deleanu, I. (2014). *The Economic and Legal Effectiveness of Anti-Money Laundering Policy*, Edward Elgar.

Figure 5: Delays in implementation of the Third and Fourth AML Directives in months



Source: Unger et al (2015) and Rossel et al (2020).¹¹⁴

Member States had to implement the Fifth AML Directive by 10 January 2020. In February 2020, the Commission sent letters of formal notice to eight Member States, Cyprus, Hungary, the Netherlands, Portugal, Romania, Slovakia, Slovenia and Spain for not having notified any implementation measures.¹¹⁵

3.1.3. Tensions of AML policy with fundamental freedoms and human rights¹¹⁶

- Problematic coexistence of the right to a fair trial and the freedom to provide service: caused by the reporting duties of lawyers (has been challenged before the Court of Justice);
- processing and exchange of personal data to be considered a “matter of public interest”; EC calls for the exchange of financial intelligence among EU FIUs and third country FIUs - without substantial assessment of the adequacy, the data goes against the EU Charter of Fundamental Rights (Court of Justice ruling);
- could jeopardise the right to legal assistance as set out in the European Convention on Human Rights and the EU Charter of Fundamental Freedoms; and
- imbalances favouring prosecution interests over defence rights.

¹¹⁴ Unger, B., Ferwerda, J., van den Broek, M., Deleanu, I. (2014) The Economic and Legal Effectiveness of Anti-Money Laundering Policy, Edward Elgar 2014 and L. Rossel, B. Unger, J. Batchelor, F. Vallejo AML Tools <http://coffers.eu/>.

¹¹⁵ European Commission, “February infringements package: key decisions”, https://ec.europa.eu/commission/presscorner/detail/en/inf_20_202.

¹¹⁶ Borlini, L. S., & Montanaro, F. (2017). The Evolution of the EU Law Against Criminal Finance: The “Hardening” of FATF Standards within the EU (SSRN Scholarly Paper ID 3010099). Social Science Research Network. Retrieved at <https://papers.ssrn.com/abstract=3010099>.

3.1.4. Arguments in favour of directives

Borlini and Montanaro (2017) argue that flexibility and openness to change is crucial in the anti-money laundering field where domestic laws and their enforcement have to constantly evolve to keep pace with money launders.¹¹⁷ For the international setting, they are favouring soft law such as the FATF recommendations, to tackle this issue. In fact, it is pointed out that international standards that were initially laid out as soft law can have a large impact on national law through its translation into binding national or even international laws.

In Europe, reasons for choosing directives in the EU could have been considerations of the principle of subsidiarity, which leaves decisions on national security up to the Member States. Policy areas such as national security, police, and the legal system are in the competence of the Member States.

Arguments in favour of AML Directives are, that while they may not lead to a complete harmonisation, they have enabled some Member States to take the rules a step further when there was a political momentum in the country. For example, the United Kingdom has made the beneficial ownership registration public even before the Fifth AML Directive was passed (and Denmark did the same though it had other caveats then). This cannot be done if there are strict identical regulations.

Also, the chances to obtain national political consensus for regulations might be far less than for the transposition of directives. This might lead either to large delays, or to compliance in the books combined with resistance in practice. A softer way to reach harmonisation is through mutual learning, benchmarking and pointing out deficiencies to the Member States.

3.2. EU anti-money laundering legislation and the United States

3.2.1. Title II of the United States Patriotic Act

US legislation is more effective as it grants extraterritorial power (long-arm approach), meaning that the United States has the power to prosecute and fine non-US banks for AML violations using US dollar even for transactions outside the United States. The United States does so by applying two main legal fictions: i) because all transactions in US dollars between non-US financial institutions are cleared in New York (through CHIPS or Federal Reserve), New York courts can consider every US dollar transaction in the world as conducted in the United States. The United States has jurisdiction over all US dollar transactions initiated and terminated abroad; ii) the funds deposited in the interbank account that a foreign bank has in a US correspondent bank are considered as equivalent to the illegal amounts abroad in an account of a foreign bank's clients. This allows the seizing of funds held in the interbank account maintained in a US bank.¹¹⁸

3.2.2. Implementing extraterritorial power in the EU AML¹¹⁹

- Borlini and Montanaro (2017) argue that the extraterritorial power has been successfully implemented in the United States and has proven the ability to prosecute and sanction any illegal activities committed by financial institutions worldwide. Additionally, in developed countries it has been welcomed by the governments and citizens, because foreign prosecution is sometimes the only way to bring kleptocrats to justice.¹²⁰

¹¹⁷ Borlini, L. S., & Montanaro, F. (2017). The Evolution of the EU Law Against Criminal Finance: The "Hardening" of FATF Standards within the EU (SSRN Scholarly Paper ID 3010099). Social Science Research Network. Retrieved at <https://papers.ssrn.com/abstract=3010099>.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ Ibid.

- Granting these prosecution powers has also proven to be an effective tool in imposing a global standard and a global ethic on financial institutions that have benefitted not only the United States but in general the global fight against money laundering. This application of AML legislation has also been profitable in terms of the fines collected.¹²¹
- Problems with implementing extraterritorial powers in the EU:
 - Contrary to the United States, where clearing of US dollar transactions occurs only in New York, the EU lacks a unique centralised clearing system. The CESR MiFID database lists 19 clearing houses in 14 different EU Member States in 2015. This makes it hard to implement the legal fictions above mentioned.
 - AML addresses every Member State of the EU but extraterritorial prosecution could only be justified for the members of the Eurozone.
 - Lack of a common political awareness among EU Member States and selfish national political interests are given priority.
 - Provision on extraterritorial would have further postponed the approval of directives, which were already hard to pass.

3.3. Suggestions for regulations

- There are two “camps” – the one is in favour of maintaining a variety in Europe. This can range from defending the French raw milk camembert, or the Sardinian cheese with living worms, casu marzu, to defending national sovereignty of its Member States regarding police, prosecution and justice. The other camp is for a stronger role of the European Union, for an effective and efficient AML system which reduces legal and practical hindrances due to a lack of harmonisation. Both camps have good arguments and reasons. Variety and freedom are values from which citizens profit, but, unfortunately, not only citizens in a democracy, but also criminals profit from variety and loopholes in the system. Which way to go further is, therefore, a political question. In the following, those areas, which would benefit most from more harmonisation, will be shown.
- More harmonisation within EU Member States is needed regarding information exchange, cooperation possibilities, fines, definition of predicate offences of money laundering, prosecution and conviction of launderers.
- Harmonisation is especially important for setting up new bodies, such as a European Public Prosecutor’s Office, a European Supervision or a European Intelligence Centre (see section 4).
- If the EU wants to establish a European supervisory body (see section 4), there should be more harmony, e.g. regarding reporting standards, to give an example. Effective supervision would be very difficult if it has to take into account the 27 Member States’ laws and regulations. Some countries report unusual transactions (like the Netherlands), others suspicious transactions, others report unusual or suspicious activities. Also, the thresholds for reporting are very different. There is also a lack of harmony regarding cash bans, which do exist in some countries, like Germany and some other EU Member States, but not in others, like the Netherlands. Also possibilities for e-ID onboarding still vary widely, just to name a few practical examples.

¹²¹ Ibid.

- A regulation might be useful for of setting up harmonised and interconnected registers of legal ownership and beneficial ownership across the EU (see section 2), or even centralised at the EU level; and for the purposes of determining data-driven cross-checking.
- A regulation for truly abolishing bearer shares across the EU (and not only phasing out the creation of new ones going forward), including the dissolution of existing bearer share companies by a certain date, would help to increase transparency.

4. EU ANTI-MONEY LAUNDERING EXECUTION

KEY FINDINGS

The European Public Prosecutor is still too young to be evaluated. Seen the pros and cons listed, it will only be a first step to either a stronger European Public Prosecution System, including broader agenda, or to intensified cooperation among national prosecutors. From the existing models available, the chosen model seems to be the best. It is cost effective. It allows the European Public Prosecutor to act as a chameleon, adapting to diverse national laws and procedures.

Since the latest money laundering scandals involving banks, voices for a European Supervisor have become stronger. There are two models: the European supervisor should only be the supervisor of national supervisors, or an autonomous European Supervisory Body with own competences, and sanction possibilities. The direct supervision model seems faster and more efficient. European supervision should be done by an autonomous independent institution, without diplomacy problems. Questions also arise as to who should be supervised. Only high-risk financial institution, all financial institutions, or also non-financial institutions. Seen the variety of non-financial institutions it seems important to restrict European supervision to financial institutions only. Seen the variety of money laundering scandals, all financial institutions should be included.

A European FIU seems more difficult and less urgent. Good cooperation among FIUs and improving exchange of information possibilities seems sufficient. A European Police still seems too far from reality. What would be needed, is a European Intelligence Centre, which can monitor Ownership Registering, can screen suspicious transactions, and can provide sufficient ICT knowledge needed during and after the COVID-19 crisis.

4.1. The EPPO

4.1.1. What is a European Public Prosecutor's Office?

The European Public Prosecutor's Office (EPPO) is an independent body of the European Union (EU) established under the Treaty of Lisbon between 22 of the 27 members of the EU following the method of enhanced cooperation, a procedure where a minimum of nine EU Member States are allowed to establish advanced integration or cooperation in an area within EU structures, but without the other members being involved. This was done under TFEU Article 86, which allows for a simplified enhanced cooperation procedure which does not require authorisation from the Council to proceed. The participating member states agreed on the legislative text to establish the EPPO. On 12 October 2017 the regulation was given final approval by the then 20 participating states.¹²²

The European Public Prosecutor's Office (EPPO) is a new Union body in charge of conducting criminal investigations and prosecutions for crimes against the EU budget.

¹²² Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO'). Official Journal of the European Union. L 283/1. 31 October 2017.

Operational in 2020, the EPPO will strengthen the Union's capacity to protect taxpayers' money. The European Union gives the following explanation:¹²³

- In 2017, the total EU budget spent was €137.4 billion, while the cost of fraud to EU budget was €467.1 million.
- The EPPO is the EU's first supranational prosecution office, it has direct powers to investigate and prosecute on the ground, in cooperation with national judiciaries and it is independent from EU and national institutions.
- It will investigate and prosecute fraud and other criminal offences affecting the EU's budget with a minimum case value of €10 000 + fraud involving EU funds (with exceptions) or €10 000 000 + cross-border VAT fraud.
- It aims to achieve more consistent and effective prosecutions policy (for crimes against EU budget), more prosecutions, more convictions, more money recovered and more money going to the people of Europe.¹²⁴
- The EPPO is (for now) only for PIF crimes, hence for crimes against the EU.¹²⁵ As of 6 July 2019, Member States need to have transposed Directive (EU) 2017/1371 on the fight against fraud to the Union's financial interests by means of criminal law into their national laws ("PIF Directive").

4.1.2. The organisation of the EPPO

The organisation of the EPPO is the following:

- There are 2 different levels, the management (or strategy) level and the operational level. The management level is the College and the daily management of the EPPO are the Chief prosecutor and 2 deputy Chiefs. The operational decisions are taken by one of the chambers, how many chambers there will be is still uncertain, but not 22. In practice a case is done by the European delegated prosecutor under supervision of a Chamber.¹²⁶

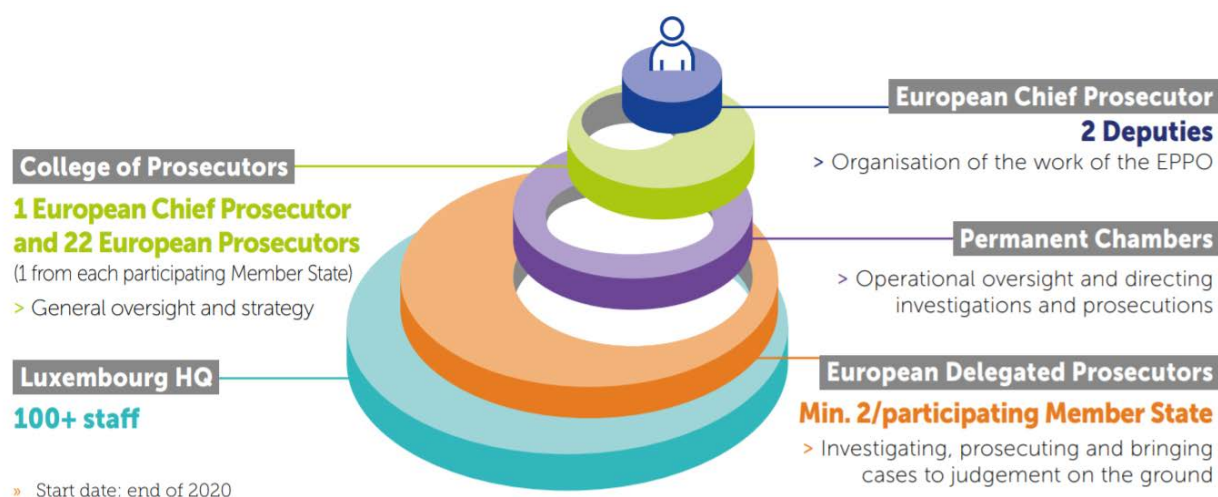
¹²³ European Union (2019). The European Public Prosecutor's Office; Protecting taxpayers against fraud and corruption. https://ec.europa.eu/info/sites/info/files/epo_factsheet_en.pdf.

¹²⁴ Interview Jean Michel Verelst, Belgian Public Prosecutor, 09.12.2019.

¹²⁵ Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law.

¹²⁶ Interview Jean Michel Verelst, Belgian Public Prosecutor, 09.12.2019.

Figure 6: The organisation of the European Public Prosecutor's Office



Source: European Commission, "The European Public Prosecutor's Office", https://ec.europa.eu/info/sites/info/files/dq_justice_eppo_infographic_a4_en_v05_lr.pdf.

4.1.3. Policy options for the establishment of an EPPO

In 2013, the European Commission, made an assessment of diverse models for a European Public Prosecutor's Office.¹²⁷

The following seven policy options have been assessed in detail:

1. Retention of the status quo;

No new action would be taken at EU level.

2. Non-regulatory actions only;

No legislative action would be taken at EU level, and no new bodies would be set up. However, national and Union-level actions to fight the relevant offences would be strengthened through non-legislative measures.

3. Strengthening of the powers of Eurojust;

This option would mean that Eurojust would be given new powers to trigger investigations throughout the Union.

4a. Creation of an EPPO entity within Eurojust;

The creation of a central EPPO entity within Eurojust, which would thus become the EPPO's holding structure as a "parent agency". In institutional terms this option would mean that Eurojust would effectively host the EPPO by providing infrastructure and support services to the EPPO entity. The EPPO entity would have exclusive power to direct the prosecution of cases affecting the EU's financial interests. Furthermore, this EPPO entity would be composed of prosecutors and investigators specialised in financial crimes, would have a limited number of own staff to

¹²⁷ Commission Staff Working Document Impact Assessment Accompanying the Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office, 2013.

autonomously carry out investigations at central level and would be organically part of Eurojust and use its support functions.

4b. Creation of a College-type EPPO;

Similar to how Eurojust is organised, the EPPO would be organised in the form of a College of national members appointed by the Member States, but with a clearer and stronger mandate for all members.¹²⁸ The EPPO College would take majority decisions as regards investigations and prosecutions of offences affecting the EU's financial interests throughout the EU. Consequently, national members would be granted more incisive powers, as they would need to be able to provide national prosecutors with binding instructions. This policy option is thus very closely linked to national judicial systems. This is the main element which sets it apart from option 4c. Furthermore, this EPPO will be directly in charge of investigation and prosecution of the relevant offences.

4c. Creation of a decentralised EPPO with a hierarchical structure;

Based on the concept of decentralisation, the EPPO would consist of an EU prosecutor's office at central level with a Chief Public Prosecutor exercising hierarchical supervision and decentralised European "Delegated" Prosecutors belonging to the national systems and therefore located in the Member States, having full prosecutorial authority under national law. The European Public (Chief) Prosecutor would have the hierarchical power of instruction over European Delegated Prosecutors, who would be a genuine part of the EPPO. The EDP would work with the national police and the EPPO would have the possibility to give instructions to the EDP.

4d. Creation of a centralised EPPO with a hierarchical structure.

This option would entail the creation of a central EPPO possessing the full legal and practical capacity required to conduct investigations and prosecutions of the relevant offences, without depending on the national prosecution and investigation services. The EPPO's investigation staff would be empowered to take the necessary investigative measures within the Member States, only referring to national judicial authorities in cases where prior judicial authorisation is required. As for options 4b and 4c, Eurojust's coordination function relating to investigation and prosecution of offences against the EU's financial interests would be transferred to the EPPO. This authority would be composed of a chief prosecutor, several prosecutors and staff at the central level, acting throughout the whole EU.

¹²⁸ It is possible that the members of the EPPO College would be identical to those of the Eurojust College.

Table 9: Assessment of different models for a European Public Prosecutor

Objectives/ costs	Policy option 1	Policy option 2	Policy option 3	Policy option 4a	Policy option 4b	Policy option 4c	Policy option 4d
Meeting the policy objectives	Low	Low	Medium	Medium	Low to Medium	High	High
Annual net benefit	No major impact	€25 million	€35 million	€50 million	€50 million	€315 million	€250 million
Cost effect- tiveness	-	Low	Medium	Medium	Medium	High	Medium
Impact on fundamental rights	-	Low	Low	Low	Medium to High	Medium to high	Medium to High
Feasibility	High	High	High	Medium	Medium	Medium to High	Medium
Impact on existing Union institutions	-	Very low	Low to Medium	Medium to High	Medium to High	Medium to high	High
Impact on legal systems of Member States	-	-	Low	Medium	Medium	Medium	High

Source: Unger (2020).

- Maintaining the status quo, taking non-regulatory actions only or improving the functioning of Eurojust have all been considered to be not effective enough in addressing the problems identified – only the options for establishing an EPPO have been assessed as providing effective and efficient action. According to the impact assessment, setting up the EPPO as a decentralised integrated European organisation, based on the national judicial systems (4c), offers the most benefits.
- All four options for establishing the EPPO are expected to bring benefits in terms of an increase in the number of prosecutions brought forward in national courts. Of these four options, only the decentralised and the centralised options are expected to bring significant benefits, with the decentralised option doubling the current number of convictions, and the centralised option reaching almost that number. In addition to an increase in recovery, the impact assessment conservatively assumes that a doubling of the number of convictions will lead to a reduction in damage of around 10%. This means that the decentralised option is expected to provide the most benefits: over 20 years these are projected to total €3 200 million. The centralised option is a close second with expected benefits of about €2 900 million over the same period. The benefits of the other options are much more limited than that.
- Regarding costs, the centralised option (4d) is the most expensive, since it requires a high number of EU staff. The costs for this option over 20 years are expected to be over €800 million, whereas the costs for the decentralised option (4c) are expected to be about €375 million.

The EPPO was established as a single, decentralised European prosecution office, thus option 4c has been chosen. According to the evaluation this was also the best solution possible. Its annual net benefit was estimated €315 million per year, hence highest, and it was considered the most cost effective variant. The EPPO was established by Regulation 2017/1939 and entered into force on 20 November 2017.

4.1.4. Pros and cons of the EPPO

Arguments in favour of the EPPO were, that crime against the EU budget is currently almost unpunished: only a minority of crimes against the financial interests of the EU are prosecuted. This has various reasons:

- The knowledge basis about the types of crimes for which the EU has introduced combatting mechanisms is unsatisfactory, thus the Member States' authorities fail to adequately recognise the true dimensions of such crimes;¹²⁹
- If the European dimension of a case is recognised, this dimension will frequently be neglected as investigators are forced or choose to streamline their investigation;¹³⁰
- The systems within which prosecutors are handling work on European cases do not necessarily prioritise European interests;¹³¹
- Differences between national laws and systems;¹³²
- The European dimension of cases makes them harder for prosecutors to work. This difficulty is at a level they perceive as hampering their work often to the point of European cases failing as such;¹³³ and
- Currently, only national authorities can investigate and prosecute fraud against the EU budget. Existing EU-bodies such as Eurojust, Europol and OLAF lack the necessary powers to carry out criminal investigations and prosecutions.

Table 9 shows the limits of the power of EU actors. As mentioned earlier, there were and are ongoing negotiations of reforms. Table 10 summarises the pro and con arguments for the EPPO, found in the literature.

¹²⁹ Wade, M. L. (2013). A European public prosecutor: potential and pitfalls. *Crime, law and social change*, 59(4), pp. 439-486.

¹³⁰ Ibid.

¹³¹ Ibid.

¹³² Ligeti, K., & Simonato, M. (2013). The European Public Prosecutor's Office: Towards a Truly European Prosecution Service? *New Journal of European Criminal Law* 4(1), pp. 7-21.

¹³³ Wade, M. L. (2013). A European public prosecutor: potential and pitfalls. *Crime, law and social change*, 59(4), pp. 439-486.

Table 10: Powers of EU actors

Limits to the power of actors at EU level	
Eurojust	The role of Eurojust is limited to support and coordination of the work of national judicial authorities. Whilst it may ask for the initiation of investigations, it cannot ensure follow-up at the Member State level, nor direct national investigations or prosecutions.
Europol	The role of Europol is limited to providing intelligence and support to national law enforcement activities. It cannot ensure follow-up to its analyses in the Member States, nor direct national investigations.
OLAF	OLAF does not have any competences with respect to criminal investigations, nor is it able to ensure follow-up to its administrative investigations at the national level.

Source: European Commission, 2013.¹³⁴

Table 11: Pros and Cons of the EPPO

Pros of the EPPO	Cons of the EPPO
The creation of an EPPO should ensure a cadre of dedicated prosecutors across Europe motivated to prosecute the European cases for which they are given competence. ¹³⁵	The EPPO only focusses on the very small EU budget. Is this sufficiently important, to recognise a European public interest in full investigation leading to comprehensive prosecution? ¹³⁶
The EPPO operating under harmonised legal rules for evidence-gathering, should overcome both the legal and practical problems currently associated with international evidence-gathering. ¹³⁷	There was no need for an EPPO because there was the possibility to increase efforts to ensure national authorities use the support institutions currently available to them at the supra-national level. ¹³⁸
There will be no problems anymore with data sharing between public prosecutors because of the legal base and regulation of EPPO. ¹³⁹	The creation of an EPPO was premature. Eurojust and Europol have ongoing reform negotiations. One cannot truly determine the necessity of any further reform until the mechanisms in place are being used properly and fully. ¹⁴⁰ This argument carries particular weight if the proposed next step is the creation of a truly supra-national criminal justice institution. ¹⁴¹
Issues of delay should also largely fall away in investigations by an EPPO. ¹⁴²	There is a significant opposition to the idea of an EPPO by practitioners. Some practitioners feel strongly that they and the national systems can

¹³⁴ Commission Staff Working Document Impact Assessment Accompanying the Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office, 2013.

¹³⁵ Wade, M. L. (2013). A European public prosecutor: potential and pitfalls. *Crime, law and social change*, 59(4), pp. 439-486.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ Hamran, L., & Szabova, E. (2013). European Public Prosecutor's Office - Cui Bono? *New Journal of European Criminal Law* 4(1), pp. 40-58.

¹³⁹ Interview Jean Michel Verelst, Belgian Public Prosecutor, 09.12.2019.

¹⁴⁰ Hamran, L., & Szabova, E. (2013). European Public Prosecutor's Office - Cui Bono? *New Journal of European Criminal Law* 4(1), pp. 40-58.

¹⁴¹ Wade, M. L. (2013). A European public prosecutor: potential and pitfalls. *Crime, law and social change*, 59(4), pp. 439-486.

¹⁴² Ibid.

	and should cope with financial crime of the EU. ¹⁴³
The EPPO is in essence the specialist service dedicated to ensuring cases of complex and large-scale fraud, etc. brought to justice. ¹⁴⁴	Practitioners increasingly interact with each other and prefer using mechanisms which leave them in charge of the process in particular in relation to transnational crimes. ¹⁴⁵
The EPPO could overcome the limits of the power of existing EU bodies. ¹⁴⁶	The EPPO will still be dependent on the will, skill and action of national public prosecutors. ¹⁴⁷ A lack of acceptance or a sense of encroachment on the side of national prosecutors would seriously undermine any potential efficacy of the EPPO. ¹⁴⁸
	Countries where wages are much lower than the European average run the risk of cooperation problems between the local public prosecutor and the European public prosecutor of this country. The EPPO public prosecutor might earn three times more than the local one, and this might demotivate cooperation for the same task, sitting next to each other in the same office. ¹⁴⁹
	There will be lots of discussion for who is taking a case and for the choice of the location of the investigation. There are rules, but quite complicated and in theory it seems not so easy to determine which country will be responsible for it. ¹⁵⁰
	Sovereignty concerns in as much as it would introduce a fully supranational judicial player to the existing framework. ¹⁵¹
	The EPPO's territory on which he or she can act is restricted to those Member States who were willing to participate in the EPPO and support the idea of creating an EPPO through enhanced cooperation. This would inevitably limit the territory on which the European public prosecutor would be able to exercise his or her powers and thus practical problems could arise. ¹⁵²

Source: Made by the author from the literature and interviews quoted.

¹⁴³ Hamran, L., & Szabova, E. (2013). European Public Prosecutor's Office - Cui Bono? *New Journal of European Criminal Law* 4(1), pp. 40-58.
¹⁴⁴ Ibid.
¹⁴⁵ Ibid.
¹⁴⁶ Commission Staff Working Document Impact Assessment Accompanying the Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office, 2013.
¹⁴⁷ Hamran, L., & Szabova, E. (2013). European Public Prosecutor's Office - Cui Bono? *New Journal of European Criminal Law* 4(1), pp. 40-58.
¹⁴⁸ Ibid.
¹⁴⁹ Eastern European Public Prosecutor who wants to stay anonymous.
¹⁵⁰ Interview Jean Michel Verelst, 09.12.2019.
¹⁵¹ Ligeti, K., & Simonato, M. (2013). The European Public Prosecutor's Office: Towards a Truly European Prosecution Service? *New Journal of European Criminal Law* 4(1), pp. 7-21.
¹⁵² Hamran, L., & Szabova, E. (2013). European Public Prosecutor's Office - Cui Bono? *New Journal of European Criminal Law* 4(1), pp. 40-58.

4.1.5. Suggestions/recommendations

The European Public Prosecutor's Office is still too young to be evaluated. Seen the pros and cons listed, it will only be a first step to either a stronger European public prosecution system, including broader agenda, or to intensified cooperation among prosecutors. From the existing models available, the chosen model seems to be the best. It is cost effective. And, as Pascal Beauvais put it very eloquently, it allows the public prosecutor to act as a chameleon:¹⁵³

"With regard to national law, the European Public Prosecutor's Office is therefore more of a "chameleon" organisation than a "Trojan horse": it is grafted onto each system by adapting to it but does not have a clearly displayed vocation for transforming it".¹⁵⁴ (own translation)

If the model of the EPPO works out, its territory will develop and its tasks will expand. It is a model that will not stand still. Eventually, the EPPO could be extended to money laundering and other financial crimes since they are related to PIF crimes.¹⁵⁵

4.2. A European supervisor

Since the latest money laundering scandals involving banks, voices for a European supervisor have become stronger. Various Member States have publicly plead for further Europeanisation of AML/CFT Supervision.¹⁵⁶ Also the Council has invited the European Commission to explore possibilities, advantages and disadvantages of conferring certain supervisory responsibilities and powers to an EU body.¹⁵⁷ The European Commission is expected to reveal its AML Action Plan in short notice, with ideas for a European AML/CFT Supervisor and its intention to turn the AMLD into a regulation, developing technical standards, and further harmonisation in specific areas.¹⁵⁸

Essentially, there are two models for further Europeanisation that are being considered: the European supervisor becomes a supervisor on national AML/CFT supervisors ("supervision on supervision" model), or the European supervisory body will obtain own competences, and sanctioning powers ("direct supervision" model). In both models, an important role remains for national AML/CFT supervisors. Direct supervision seems faster and more efficient, and would ensure more consistent and effective European AML/CFT supervision. Questions also arise as to who should be the supervised: all obliged entities (financial sector and DNFBPs) or only the financial sector? And in case of direct supervisory powers for the European supervisor: should it be directly responsible for all institutions, or only high-risk institutions? The European regulatory framework for financial institutions has to a large extent already been harmonized and typically these entities operate cross-border within the EU's internal market. It therefore seems most logical and practical to restrict a European AML/CFT supervisory framework to the financial sector at this point in time. Then, also the question pops up which EU body should be conferred with AML/CFT supervisory powers. Some call for the European

¹⁵³ Beauvais, Pascal. "Lectures analytiques guidées. Quel Modèle de Parquet ?", RCS 2018, 625. 'À l'égard des droits nationaux, le Parquet européen serait donc davantage une organisation « caméléon » que « cheval de Troie » : il se greffe à chaque système en s'adaptant à lui mais n'a pas de vocation clairement affichée de le transformer'.

¹⁵⁴ I owe this reference to Jean-Michelle Verelst.

¹⁵⁵ Interview Jean-Michel Verelst, 09.12.2019.

¹⁵⁶ Rijksoverheid, "Towards a European Supervisory Mechanism for ML/TF", <https://www.rijksoverheid.nl/documenten/kamerstukken/2019/11/08/position-paper>.

¹⁵⁷ European Council, "Money laundering: Council sets strategic priorities for further reforms", <https://www.consilium.europa.eu/en/press/press-releases/2019/12/05/money-laundering-council-sets-strategic-priorities-for-further-reforms/>.

¹⁵⁸ Communication from the Commission on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing, <https://politico.us8.list-manage.com/track/click?u=e26c1a1c392386a968d02fdbbc&id=92b7a99c6c&e=cb59e4e959>.

Banking Authority (EBA), whose mandate in relation to AML/CFT was already expanded recently, whilst others believe that a new dedicated AML/CFT body should be created.

PROS

- Kirschenbaum and Véron (2018) see the following advantages of a European supervisor:¹⁵⁹ The core problem is one of supervisory incentives and of supervisory architecture. A European wide single market and a national anti-money laundering supervision generates “national vicious circles, which tend to be self-perpetuating rather than self-correcting”.
- In theory national AML authorities in the other member states check transactions originating in the weak-link countries and should be able to spot suspicious activity. But this can be ineffective in practice, given national authorities’ capacity constraints and priorities.
- The EU faces a choice between two models. In an enhanced two-tier architecture that builds on the present situation, the ultimate responsibility for AML supervision of individual firms would remain at the national level, but an EU authority would be empowered to exercise some form of surveillance over national AML supervisors (“supervisor of supervisors”). In a unitary architecture, a European agency would have ultimate AML supervisory responsibility for firms, though this responsibility might be exercised through a network that involves national agencies and other European-level bodies. There should be an EU body with a direct AML supervisory mandate because an EU-level “supervisor of supervisors” by definition acts too late.
- Under the current system, the European Banking Authority (EBA) is the EU-level supervisor of national AML supervisors for banks. But it has not prevented or stopped large scale AML violations and even failed to impose remedial measures in the ill-starred case of Danske Bank.
- The EU AML supervisor should have the ability to impose fines and business restrictions on non-compliant firms, a tool the EBA lacks even after the recent strengthening of its AML duties.
- This central authority should be a new EU agency instead of the European Banking Authority. The EBA’s existing capacity is too small to make a difference. Also, the European AML supervisor should also cover non-bank financial firms, and even non-financial firms someday.
- This new agency should be an authoritative and independent supervisor that can judge each case’s merits without regard to diplomatic balancing acts. Independence will likely lead to more aggressive supervision, larger fines, and greater deterrence. A compact decision-making board of at most half a dozen members would be appropriate, following the precedent of the Single Resolution Board (SRB), which was established on the same EU Treaty basis.

CONS

- The alternative model of supervision on supervision as an extra layer. The idea is to put an extra layer of supervision. Proponents of this idea often also suggest that the European Banking Association should get the role, since the European Commission has already made some changes in the EBA mandate to slowly move towards a coordinating European body and strengthened its power. This would not be an enhancement of supervision of high risk institutions but rather trying to enhance national AML supervision. The European institution would be much weaker than an independent European supervisor with own sanction possibilities.

¹⁵⁹ Kirschenbaum, J., & Véron, N. (2018). A better European Union architecture to fight money laundering. Policy Contribution (19), pp. 1-28. Retrieved at <https://www.bruegel.org/2018/10/a-better-european-union-architecture-to-fight-money-laundering/>.

4.3. Suggestions

I suggest the European AML/CFT supervision to be designed for the EU's financial sector. As explained, the European regulatory framework for financial institutions has already been harmonised to a large extent, and it is typically these institutions that operate on cross-border basis. Moreover, recent money laundering scandals at banks have impacted the integrity and reputation of the European financial sector as a whole. Anti-money laundering supervision on financial institutions is designed nationally, but weaknesses in AML/CFT supervision in one Member State may have an impact on other Member States as well.

To ensure consistency and effective AML/CFT supervision throughout Europe, it is advisable to confer upon the European AML/CFT direct supervisory powers in relation to high-risk financial institutions that operate on a cross-border basis. I favour a single supervisory mechanism approach. The European supervisor with direct supervisory powers should without a doubt cooperate with the national AML supervisors of financial institutions, as they are the linking pin with law enforcement authorities, financial intelligence units (FIUs) and supervisors for non-financial institution. Also, national AML/CFT supervisors would remain responsible for AML/CFT supervision of the other financial institutions.

I am of the view that the European AML/CFT supervisor should be an authoritative and independent supervisor that can judge each case's merits without regard to diplomatic balancing acts. Without expressing a strong preference for the EBA or a newly created body to perform AML/CFT supervision, it makes sense to look at the current structure. Under the current system, the Paris-based European Banking Authority (EBA) is the European supervisory authority with a leading, coordinating and monitoring role in the fight against money laundering and terrorist financing for the entire financial sector. Yet, together with the national AML/CFT supervisors, it has not been able to prevent large money laundering scandals involving banks – like Danske Bank, ABLV Bank, ING and Pilatus Bank. The EBA was even publicly criticised for failing to take action on the Danske Bank scandal, by dropping its investigation without further action.

Should EBA be assigned as the European AML/CFT supervisory body, it is material that EBA's governance is changed to guarantee an adequate level of independence. Furthermore, the EU AML supervisor should have the ability to impose fines and business restrictions on noncompliant firms, a tool the EBA lacks even after the recent strengthening of its AML duties.¹⁶⁰

4.4. Other EU executive proposal

FIUs are operationally independent units that have been established under the EU anti-money laundering and countering the financing of terrorist framework. They aim at collecting and analysing the submitted reports from obliged entities under applicable AML programme requirements. There is only one FIU per jurisdiction, but their setups are not uniform.

FIUs can be administrative units, law enforcement bodies or the judiciary, or even stand-alone agencies of their own. They aim to support the activities of AML supervisors and law enforcement agencies. Depending on the country, the FIU may be assigned to the finance ministry, the central bank, the national police, the interior ministry, the prosecutorial service, the customs service, the justice ministry or could be a dedicated independent agency with its own governance and accountability framework.¹⁶¹

¹⁶⁰ Kirschenbaum, J., & Véron, N. (2018). A better European Union architecture to fight money laundering. 19. Retrieved at <https://www.bruegel.org/2018/10/a-better-european-union-architecture-to-fight-money-laundering/>.

¹⁶¹ Ibid.

“Latvian Finance Minister Dana Reizniece-Ozola called for ‘the creation of a financial intelligence unit at the EU level as the scope of combating money laundering and terrorism financing goes far beyond the supervision of the financial sector.’”¹⁶²

This suggestion does not seem to have strong support at the moment.

The European Commission points at the need for a stronger mechanism to coordinate and support cross-border cooperation and analysis of Financial Intelligence Units. Such a mechanism could include, as a minimum, powers to adopt legally binding standards, templates and guidelines in the area of the work of the Financial Intelligence Units. It could also include certain aspects of centralised reporting and a more central capacity building based on new IT tools to strengthen and facilitate joint analysis.¹⁶³ But the Commission does not mention a supranational FIU Institution.

Also, Kirschenbaum and Vernon (2018) see the creation of a supranational FIU more complicated and less urgent than creating a European supervisor. FIU functions of collecting, transmitting, and analysing information on suspicious transactions works. “Centralising the FIU function may be desirable in the longer term, but trying to do so now would burden and possibly cripple the urgent effort to establish an effective European AML supervisor.”¹⁶⁴

Against creation of an EU level FIU: Such a step is less urgent and more complicated than creating a central AML supervisor. The major AML lapses of the past few years in the European Union have ostensibly involved failures of AML supervision, rather than of the FIU.

Many countries are very worried of a European FIU, because it would mean that a European institution will receive all suspicious transaction information without being linked to national criminal data bases. This would be useless information then and datasets would become very big.

In the long run, there could be a European FIU, which could collaborate with the EPPO.

¹⁶² Quoted in Alexander Weber, ‘Money-Laundering Scandals Prompt EU Rethink on Policing Banks’, Bloomberg, 2 October 2018.

¹⁶³ European Parliament, https://www.europarl.europa.eu/doceo/document/PV-9-2019-09-19_DE.html.

¹⁶⁴ Kirschenbaum, J., & Véron, N. (2020). A European anti-money laundering supervisor: From vision to legislation. <https://www.bruegel.org/2018/10/a-better-european-union-architecture-to-fight-money-laundering/>.

5. AML POLICY IN THE LIGHT OF COVID-19

Criminals use more and more sophisticated online methods. New virtual currencies, like Bitcoins or Ethereum, e-gold and other e-assets, complicate the work of the executive. Now that tax crime is also a predicate crime for money laundering, an enormous amount of data has to be handled. Big data management skills are necessary. In particular, when transactions are cross-border.

The Corona crisis (COVID-19) will not only mean tremendous changes to business and the economy, but also to the way criminals behave, to the types of crime they commit and to the way, they will use the crisis for money laundering purposes.

5.1. Crime changes

As Europol has already warned,¹⁶⁵ the global pandemic of COVID-19 is not only a serious health issue, but also a cybersecurity risk. Criminals swiftly took advantage of the virus proliferation and are abusing the demand people have for information and supplies.

Criminals have used the COVID-19 crisis to carry out social engineering attacks, namely phishing emails through spam campaigns and more targeted attempts such as business email compromise (BEC). There is a long list of cyberattacks against organisations and individuals, including phishing campaigns that distribute malware via malicious links and attachments, and execute malware and ransomware attacks that aim to profit from the global health concern.

The pandemic has an impact on Darkweb operations. Certain illicit goods will become more expensive, as source materials become unavailable. Cybercriminals are likely to seek to exploit an increasing number of attack vectors as a greater number of employers adopt telework and allow connections to their organisations' systems.

Fraudsters have been very quick to adapt well-known fraud schemes to target individual citizens, businesses and public organisations. These include various types of adapted versions of telephone fraud schemes, supply scams and decontamination scams.¹⁶⁶

Drug dealers cannot sell their products on the street if there are no people. Sales on the Darkweb will increase. There might be supply shortage of drugs driving prices up. Migrant smuggling will become more difficult and expensive due to stricter border controls.

5.2. Economic and financial changes

There will also be large economic changes and financial restructuring after the crisis. Consumers get trained in online shopping and might not fall back to real shopping after the crisis. Small shops might disappear and online sales will increase. Criminals will become more present online as well. As sellers and buyers of fake goods or as a way of shifting their criminal proceeds through online expert and import business.

Gross Domestic Product will fall and unemployment will increase, maybe even mass unemployment will appear. Governments, who try to combat this with more expenditures, will be in need of money. Consumers, especially when unemployed, will be in need of loans. Criminals might exploit this situation by investing in government bonds and providing consumer loans.

As a consequence of negative forecasts, stock markets show enormous losses. Stockholders will shift their wealth into other assets. During crisis, real assets such as gold or art are popular. The art market,

¹⁶⁵ Europol (2020), Pandemic profiteering. How criminals exploit the COVID-19 crisis, March 2020.

¹⁶⁶ Ibid.

with freeports to hide wealth in an unregulated area, is a safe way to store criminal assets. Also selling art, and pumping the money into the dried out loan market, might become a way to recycle criminal money back into the legal economy. Housing markets might break in, as many companies will bankrupt and not need office space anymore. Criminals might target this market to invest their criminal proceeds. New online shops will emerge. Criminals could disguise their activities in selling and buying online goods and like this, transfer money.

Criminals will use loopholes between these shifts in financial assets. For example, in countries, where loans are difficult to get, because banks see them as too high risks (even though the government sometimes backs up 90% of the losses), criminals might use this opportunity, to bring illicit money back into the real economy. Offering liquidity when liquidity is reduced – as was done during the financial crisis – offers a window of opportunity for criminals.

The European Banking Authority already warns banks to be alert of changes and also stresses the danger of increased cybercrime.¹⁶⁷

The future will need more computer and ICT skills. The police and prosecution lack these skills. And the ICT equipment and availability of ICT experts is, due to the modest payments in the public sector, also not very high. For this, bundling the ICT competencies in a European Intelligence Centre seems important.

In order to trace new types of cross-border transactions, to establish red flags, a European Intelligence Centre should be well staffed and equipped. The needs for a European Intelligence Centre are manifold, and come from different corners:

- Tax Justice Network thinks, that the EU would need either a European Intelligence Centre on Taxes as part of the Commission or working for the Commission.
- This centre could also update the AML tool of comparing all tax and money laundering laws in the EU Member States.¹⁶⁸
- It could be used to cross-check entries in beneficial ownership registers (Tax Justice Network).
- It could also analyse shifts in financial and money laundering transactions due to the corona crises.

¹⁶⁷ EBA statement on actions to mitigate financial crime risks in the COVID-19 pandemic, 31.3.2020. https://eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20additional%20clarity%20on%20measures%20to%20mitigate%20the%20impact%20of%20COVID-19%20on%20the%20EU%20banking%20sector/Statement%20on%20actions%20to%20mitigate%20financial%20crime%20risks%20in%20the%20COVID-19%20pandemic.pdf.

¹⁶⁸ Combating Fiscal Fraud and Empowering Regulators, <http://coffers.eu/>.

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This study evaluates four measures discussed by the European Parliament, the European Commission and others, to improve anti-money laundering policy. First, identifying high-risk countries through blacklisting. Second, reducing laundering through letterbox or shell companies. Third, harmonising EU AML policies through regulations. Fourth, strengthening the European executive, e.g. through a European public prosecutor, a European FIU, a European supervisor, or a European police also in the light of COVID-19.

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