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PROJECT AGAINST ECONOMIC CRIME IN KOSOVO* (PECK)

TECHNICAL PAPER:

Expert Opinion on the Law No.03/L-196 "On the Prevention of Money laundering and Terrorist Financing" and Draft Law on Amending and Supplementing Law No.03/L-196 "On the Prevention of Money laundering and Terrorist Financing"

Prepared by the PECK Project team with input from experts:
Mr Nicolas Burbidge
Mr Jens Madsen

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***** This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ opinion on the Kosovo Declaration of Independence.

For all further information please contact:

PECK Project Team
Action against Crime Department
Information Society and Action against Crime Directorate
Directorate General for Human Rights and Rule of Law of the Council of Europe
F-67075 Strasbourg Cedex FRANCE
Tel: +33 390 21 55 99 / Fax +33 390 21 56 50
Email: contact.econcrime@coe.int
Internet: www.coe.int/corruption

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Introduction

This expert opinion is provided by the Joint European Union and Council of Europe Project against Economic Crime in Kosovo based on a request of the Ministry of Finance of Kosovo to review the Draft Law on Amending and Supplementing Law No.03/L-196 "On the Prevention of Money laundering and Terrorist Financing" (hereafter – the Draft Law).

In addition to the Draft Law this review also considered the current version of the Law No.03/L-196 "On the Prevention of Money Laundering and Terrorist Financing", which is currently in force (hereafter – the AML/CFT Law).

This expert opinion in the form of a technical paper has been prepared independent of the assessment process currently underway under the PECK Project in Kosovo to evaluate the anti-money laundering regime in its compliance with international AML/CFT standards. The technical paper does in no way prejudge or bind by any manner the abovementioned assessment to share or utilize the opinions or conclusions laid out below.

The PECK Project Team expresses its sincere gratitude to experts Mr Nicolas Burbidge (Canada) and Mr Jens Madsen (Denmark) for their expertise and contributions in preparation of this paper.

Methodology

The methodological approach used in the course of the review of the AML/CFT Law and Draft Law includes the following international standards as the main reference criteria for analysis:

- The Financial Action Task Force 40 Recommendations (2012) on Combating Money Laundering and the Financing of Terrorism & Proliferation;
- The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism;
- Council Decision 2000/642/RIA of 17/10 2000 on the Exchange of Information between the FIU's of the Member States;
- EU Directive 2007/64/EC of 13/11 2007 on Payment Services in the Internal Market;
- EU Directive 2005/60/EC of 26/10 2005 on the Prevention of the Financial System for the Purpose of Money Laundering and Terrorist Financing;
- EU Regulation 1889/2005 of 26/10 2005 on Controls of Cash entering or leaving the Community;
- EU Regulation 1781/2006 of 15/11 2006 on information of the payer accompanying transfers of funds;
- The Egmont Group Statement of Purpose;
- The Egmont Group Principles for Information Exchange between FIU's;
- The Egmont Group definition of a Financial Intelligence Unit.

At the same time given the desk-based nature and limited scope of this exercise, various aspects of the abovementioned standards cannot be adequately considered in terms of their application in the AML/CFT Law of Kosovo and the respective Draft Law.

The aim of this analysis has several goals:

- Identify areas of the (draft) legislation where changes need to be introduced in order to adequately implement international requirements and propose recommendations;
- Identify inconsistencies in the legislation, which could impede the effective functioning of various components of the AML/CFT regime and propose recommendations;
- Recommend a proper distribution of provisions between primary (AML/CFT Law) and secondary legislation.

The form of the analysis will include an outline of general areas of concern pertaining to the AML/CFT Law and regulatory framework, which fall outside or cannot be resolved within the framework of this drafting exercise. This is followed an Article by Article commentary which covers both the current Law and Draft Law with the proper references; where possible appropriate draft legislative amendments (highlighted in this paper in *italics*) are proposed.

General areas of concern

1. *National risk assessment*. The new international AML/CFT standards, specifically the 40 FATF Recommendations (2012) institute a specific obligation for jurisdictions to conduct a national risk assessment, comprising *inter alia* a risk assessment at the sectoral level, as well as at the level of individual financial institutions. While the framework for NRA does not need to be entirely regulated by the AML/CFT Law, some components of it, such as those imposing obligations on financial institutions to conduct individual risk assessments would normally be contained in the AML/CFT Law. This review does not propose draft language to this effect, absent the overall knowledge of plans or steps that Kosovo is taking to institute an overarching National Risk Assessment framework.

2. *Criminalization framework.* The repressive side of AML/CFT measures deals with the criminalization of money laundering and terrorist financing. In most countries these offences are to be found in the Criminal Code. The preventive side deals with all the measures concerning the designated parties, including record keeping, reporting of STR's etc. In the case of Kosovo the criminal offence of money laundering is defined in the preventive law. Kosovo should consider whether this is the most logical way of regulating this issue. If Kosovo decides maintains the money laundering offence in the preventive law the same should be done for the offence of financing of terrorism. The definition of the latter offence is not to be found in the AML/CFT Law. The same applies to the UN sanction regimes on terrorism and financing of terrorism as well as on financing of proliferation of weapons of mass destruction, which is absent from the Law.

3. *Sanctions for non-compliance.* The Law does not set out a comprehensive framework with effective, proportionate and dissuasive sanctions for non-compliance. There are several provisions (e.g. as contained in Article 31), however these address only a few aspects of the regulatory framework and in no way do they allow for the construction of an effective supervisory regime of obliged institutions. The power to apply such sanctions must be available to a designated authority(ies). This authority must have a wide range of sanctioning tools available for use in case non-compliance with various provisions of the Law is detected. In case such powers are available to a certain authority pursuant to another legislative act, this should be referred to in the AML/CFT Law. An overlap in sanctioning powers (similarly as with supervisory powers) should also be avoided.

4. *International cooperation.* The provisions regulating international cooperation in the AML/CFT Law need significant consideration and revision, *in lieu* of the new standards in the areas of mutual legal assistance, as well as direct cooperation between international counterparts (i.e. police, supervisors, etc.) as well as non-counterparts (so-called 'diagonal' cooperation). This, however needs to be considered with regard to other existing legislation regulating MLA and non-MLA mechanisms to exclude the occurrence of possible legislative inconsistencies.

AML Law No.03/L-196 Ref. Article	Draft Law Ref. Article	Analysis and commentary
Art 2, subpara 1.2	Art. 1, subpara 1	**Definition of "beneficial owner"** The Draft Law proposes a change to the definition of beneficial owner, however in doing so the concept of the owner controlling the account appears to have been dropped. It is recommend to retain the concept as in the current version of the Law.
Art.2, subpara 1.9	Art. 1, Subpara 2	**Definition of "client"** Article 2 of the Law contains a definition of "client" which lists various types of entities that could have clients. However, elsewhere, the Law already defines "reporting parties". In order to ensure that all clients of all reporting parties are caught under the Law, it is proposed that the definition of "client" be amended as set out below: *"Client: any person that conducts, or attempts to conduct, a transaction with or use the services of a Reporting Subject as defined in Article 16, and shall include any owner or beneficiary or other person or entity on whose behalf the transaction is conducted or the services are received."*
Art. 2, subpara 1.26	Art. 1, subpara 3	**Definition of "PEP"** The Draft Law provides a definition of "PEP". There are no sub-definitions of foreign or domestic PEPs. In addition, there is no definition or other guidance on "public functions" or "immediate family members". One approach would be to insert these definitions into the legislation; however, given that other parts of the Law seem to give Government the authority to issue regulations it is therefore recommend that this be the approach here. The following draft language should be added, which would give the Minister of Finance the authority to define the scope of application of the definition: *"2.1.41 politically exposed persons means natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons. The FIU with consultation with the Minister of Finance may issue a sub-legal act to define the prominent public functions and the immediate family members of such persons".*
Art. 2, subpara 1.35		**Definition of STR:** Article 2 contains a definition of suspicious transactions. It does not appear to include the concept of "attempted" transactions. The recommendation is that the Draft Law be amended to capture the concept of attempted transactions by modifying subparagraph 2.1.35 as below: *"Suspicious Act or Transaction – an act or transaction, or an attempted act or transaction, that generates a reasonable suspicion that the property involved in the act or transaction, or the attempted act or transaction, is proceeds of crime and shall be interpreted in line with any guidance issued by the FIU on suspicious acts or transactions;".*
Art. 4, 7		**Undue influence on the FIU:** Kosovo could choose to be more explicit regarding the fact that undue influence and

		interference, as well as any type of political pressure on the FIU should not be allowed. It should also be noted that Article 7 makes it clear that the Board has no right to interfere into on-going cases which the FIU is dealing with. This provision supplements the wording of Article 4 on the independent nature of the FIU. Still, however, there should be an explicit recognition of the importance of the FIU being independent from political, government or industry pressure and influence.
Art. 5-13		**Regulating the activities, powers and status of the FIU:** The level of detail in Articles 5-13 when it comes to describing the internal structures of the FIU, including the split of competences between the Board and the Director of the FIU, is extremely high. The very high level of detail in this regard could risk taking away the attention from the more important and substantive provisions. In this case such internal matters could well be regulated through secondary legislation which would also be an approximation to the normal EU/European way of regulating such issues.
Art. 11, subpara 7		**Mandate for the Head of the FIU:** The mandate given in Article 11, par. 7, to the Head of the FIU is very short (three years). In order to secure real independence the mandate should be longer. The duration should be 5-6 years, which is normal practice in many European countries.
Art. 14, subpara 1.1		**Types of analysis conducted by the FIU:** The FIU should be able to conduct both operational and strategic analysis. The AML/CFT Law does not differentiate between operational and strategic analysis. It will depend on the FIU practice whether Kosovo really does implement both requirements. However in this case it could be considered by the Kosovo legislators to emphasize that both operational and strategic analysis are covered.
Art. 15, subpara 1		**Types of information subject to disclosure by the FIU:** Subpara 1 of Article 15 currently allows for dissemination of information resulting from operational analysis conducted by the FIU. The current wording would seem to preclude the possibility of disclosure of any information as a result of strategic (macroanalysis), carried out by the FIU – i.e. typologies. Such disclosure should be made possible. Additionally in terms of international cooperation it should be made explicit that the FIU is able to exchange internationally <u>all</u> information required to be accessible or obtainable directly or indirectly by the FIU (not solely the list under subpara 1 of Article 15).
Art. 15, subpara 2		**Modes of dissemination by the FIU:** The current wording of the Law does not specify the mode of dissemination of information - i.e. spontaneously (at its own initiative) or upon request (i.e. from law enforcement authorities). This should be made explicit in the Law to make sure both modes of dissemination are available.
Art. 17	Art. 4	**Identification of the beneficial owner:** The Draft Law includes language which makes the identification of the beneficial owner a requirement where applicable; however it is not clear when the requirement would be applicable. The new FATF standard now allows for a risk- based approach, so if this is intended there needs to be a clear link to the risk assessment process and Article 21, which

		regulates enhanced measures. Otherwise, without these frameworks in place, the phrase "where applicable" should be dropped.
Art. 17 (subpara 1), 21	Art. 4, 7	**CDD and the risk based approach:** The current function of subpara 1 of Article 17 is to define "customer due diligence" which consists of 4 elements: the identification of the customer; identifying the beneficial owner and taking "risk based" measures to verify their identity; obtaining information about the business relationship; and ongoing monitoring. Because this subparagraph is drafted as a definition, it does not appear to create a separate legal obligation. Although "customer due diligence" is mentioned in several other places in the text of the Law, it is not clear that there is a clear and binding legal obligation on the part of reporting parties to do the CDD elements as defined. I therefore it is recommended that the existing elements of subpara 1 be transformed into separate enforceable elements shown below. The other problematic issue of subpara 1 is that the references to "risk- based" do not appear to be defined anywhere in the Law. There are also other references to the risk-based approach elsewhere which are worded with slight variations. It seems that what is missing is an obligation for reporting parties to assess the risk of ML and TF, and the related obligation to impose enhanced measures where they consider the risks to be higher, or elevated. These enhanced measures would be specifically referred to as shown in the drafting and would apply when a higher risk is detected. Additionally, some of the provisions under subpara 1 of Article 17 are duplicated in other parts of the Article. Therefore it is recommend that subpara 1 be repealed. The following subparagraphs should placed in Article 17 instead: *1. "All reporting subjects shall determine, on an ongoing basis, the risk of money laundering and terrorist financing presented by their customers and any other persons to whom they provide financial services. Where reporting subjects determine that the risk of ML and TF is elevated, they shall take the measures set out in subparagraph 1 of Article 21, in addition to the measures set out in this Article."* *2. "All reporting subjects shall identify the beneficial owner and/or the natural person or persons who directly or indirectly control 20% or more of a legal person. Where reporting entities consider that the risk of ML or TF is high, they shall take reasonable measures to verify his or her identity so that the institution or person covered by this law is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts and similar legal arrangements, taking risk-based and adequate measures to understand the ownership and control structure of the customer;"* *3. "All reporting entities shall obtain information on the purpose and intended nature of the business relationship, and monitor the business relationship, including scrutiny of transactions made throughout the course of the relationship to ensure that the transactions being conducted are consistent with the reporting entity's or person's knowledge of the customer. The competent regulator may issue binding instructions in connection therewith."* The first provision proposed would include the creation of a new obligation to apply a risk analysis to account relationships and apply enhanced measures to them. The following text should thus replace subpara 1 of Article 21, in terms of application of enhanced measures:

		'When the reporting subjects determine, in accordance with paragraph 1 of Article 17, that the risk of ML or TF is elevated, they shall take reasonable measures to keep up to date the information collected pursuant to Article 17, and apply reasonably enhanced measures to monitor the business and risk profile, including the source of funds, and ensure that records and other information held are kept up to date. The competent regulator may issue binding instructions in connection therewith." This texts also removes the self-evident references in subpara 1, Article 21 to paragraphs 2,4 and 5 of the same Article.
Art. 18, subpara 1	Art. 5, subpara 1	**CDD and anonymous accounts:** It is recommended to strengthen the drafting in 18.1 (as below) to create a legal obligation for financial institutions to apply the CDD measures to customers holding anonymous accounts. *"Banks, credit and financial institutions are prohibited from keeping anonymous accounts or anonymous passbooks. Banks and financial institutions shall apply the measures set out in this Act to customers and their accounts who are anonymous, and such accounts may not be used to process transactions until the owners and beneficiaries of existing anonymous accounts or anonymous passbooks are made the subject such measures as soon as possible."*
Art. 21, subpara 5		**Enhanced CDD on politically exposed persons:** There is an issue in Article 21 paragraph 21.5 regarding PEPs: notably the FATF standards which now differ on foreign *versus* domestic PEPs. Under the new FATF standards, countries are obligated to apply appropriate risk management systems to determine if they have foreign PEPS, but need only apply reasonable (i.e. risk-based) measures to determine if they have domestic PEPs. The present Law contains several issues which Kosovo needs to deal with arising from this: • As drafted, the Law currently does not apply to any PEPs, domestic or foreign, resident in Kosovo. This is clearly not in accordance with the FATF standards; and • the issue of domestic PEPs is not addressed. • Paragraph 21.5.1 applies risk- based measures to PEPs, including foreign PEPs. As noted above, the FATF standards do not allow a risk based approach in the case of foreign PEPs. • The present Law requires reporting subjects to obtain the approval of the "Director General" or his designate before starting a relationship with a PEP. It is not clear what this position is referring to. • Therefore, changes to Articles 2 and 21 as outlined below are proposed to rectify these issues. These create new definitions of domestic and foreign PEPs, and the different measures to be taken with respect to each. *"Reporting subjects shall take reasonable measures to determine if their clients are domestic politically exposed persons, and if such determination results in a client being determined to be a domestic PEP then reporting subjects shall take the measures set out in Article 19 paragraph 1 in respect of such clients:* *Reporting Subjects shall ensure they determine whether their clients are foreign politically exposed persons, and if such determination results in a client being determined to be a foreign PEP then reporting subjects shall take the following measures:* *(i) Obtain the approval of a senior officer of the reporting subject;*

		(ii) Take adequate measures to establish the origin of the assets and funds used in the relationship or transaction; and *(iii) Ensure continuous and strengthened monitoring of the account and the relationship."*
Art. 21	Art 7, subpara 3	**STR reporting obligations for DNFBPs:** The Draft Law amending Article 21 contains text aimed at creating STR reporting obligations for new DNFBPs. The drafters should move this new text to separate STR reporting articles in the same way as is done for other DNFBPs in Articles 24, 25 and 26. The reason is that reporting STRs is a separate topic which should not be included in Article 21, which addresses enhanced due diligence.
Art. 25, 26,	Art. 8, subpara 4, Art. 9, subpara 2, Art. 11, subpara 1	**Parallel STR reporting and "tipping off":** It is not clear why Kosovo authorities are proposing a legislative change to require banks to report suspicious transactions to the CBK in addition to the FIU. This is not in accordance with FATF standards, which hold that the FIU is the only entity that should receive suspicious transaction reports. Their dissemination to other bodies increases the chances of information being "tipped off". It is recommended that this change be dropped. A similar comment applies to the text of Article 11 in the Draft Law, which introduces a new subpara 9 into Article 25 of the AML/CFT Law. The underlined text below is a concern because it appears to give other agencies outside the FIU access to STRs filed by political parties. The recommendation is that this text be dropped. "Directors, officers, employees and agents of Political Parties and registered Candidates who make or transmit reports pursuant to the present article shall not provide the report, or communicate any information contained in the report or regarding the report, to any person or entity, including any person or entity involved in the transaction which is the subject of the report, other than the FIU, or Office of registering Political Parties, unless authorized in writing by the FIU, a Prosecutor, or a Court."
Art. 29		**Cross-border movement of currency and BNI:** The offence of failure to declare/false declaration should not be called a "minor" offence, which may be misleading.
Art. 29, subpara 3		**Reporting to FIU on false declarations of cross-border movement of currency and BNI:** In Article 29 (subpara 3 or otherwise) it should be mentioned that the FIU should be notified of false declarations or disclosures.
Art. 29, subpara 14		**Cross-border movement of currency and BNI (factual reference error):** In Article 29, subpara 14 there is a reference to subpara 3 which is incorrect and should be amended, apparently to reference subpara 12 of the same Article.
Art. 30	Art. 14, 19A	**Overlapping supervisory responsibilities:** Proposed amendments under Articles 14 and 19A of the Draft Law create overlapping supervisory responsibilities for the FIU and the CBK in relation to a range of institutions. This should not be the case, as it would create confusion, gaps and decrease in effectiveness. There are two options:

		• The CBK and other sectoral supervisors are responsible for AML/CFT supervision of entities that fall under their general supervisory purview. The FIU in this cases supervises only those entities that do not have a sectoral supervisor; • The FIU is the sole supervisor for all reporting entities for AML/CFT purposes. Kosovo is recommended to take the 1st option, given capacity constraints that small FIUs have and subsequent problems which arise if they obtain additional supervisory responsibilities.
Art. 31 subpara 2		**Criminalization of money laundering:** The concept of "property" use in the wording of the offence is too narrow and may significantly limit its application. Instead the concept of "proceeds" should be used. The wording is also confusing to include into the definition of money laundering the issue of "covert measures". This seems to be a limiting measure and should not be mentioned.
Art. 34		**Criminal liability of legal persons:** Article 34 is a provision on "Criminal Liability of Legal Persons". This article should state explicitly in what way the legal entity itself can be sanctioned, not solely its management.

Conclusions and way forward

The review of the Draft Law on Amending and Supplementing Law No.03/L-196 "On the Prevention of Money laundering and Terrorist Financing" as well as the Law No.03/L-196 itself has resulted in the identification of a range of general areas of concern, as well as a number of specific issues requiring amendments. In addition, quite a few recommendations have been made with regard to harmonizing the distribution of norms between primary (the AML/CFT Law) and secondary legislation.

It is therefore possible to conclude that further systemic adjustment of the legislation, including the AML/CFT Law will be recommended following the comprehensive assessment of the Kosovo AML/CFT regime, as envisaged under the PECK Project. Kosovo authorities are recommended to take these factors into account in planning and undertaking a process to revise their AML/CFT legislation.

List of Annexes

Annex I: Draft Law on Amending and Supplementing Law No.03/L-196 "On the Prevention of Money laundering and Terrorist Financing"

Annex II: Law No.03/L-196 "On the Prevention of Money laundering and Terrorist Financing"