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CONFERENCE OF THE PARTIES

Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (CETS No. 198)

Interpretative Note on Article 10 of the Convention

Directorate General Human Rights and Rule of Law – DGI

INTRODUCTION

1. At its 13th meeting, held in Strasbourg from 17 to 18 November 2021, the Conference of the Parties to the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (COP to CETS n° 198) invited the Bureau to consider interpretative issues related to certain aspects of Article 10 of the Convention, specifically related to the function of corporate compliance programmes in the context of corporate liability. At the same plenary meeting, the Conference adopted the Thematic Monitoring Report on States Parties implementation of Article 10. A number of findings/analysis of this report have informed this Interpretative Note. This Interpretative Note was discussed and adopted at the COP Plenary meeting on 16 November 2022.

INTERNATIONAL INSTRUMENTS ON CORPORATE LIABILITY

2. A range of international instruments contain provisions related to corporate liability. The United Nations Convention against Transnational Organised Crime (UNTOC, 2000) was the first UN instrument to establish international norms on corporate liability of legal entities for a range of offences related to organised crime, corruption and money laundering. The United Nations Convention against Corruption (UNCAC, 2005) followed suit by broadening the spectrum of applicable corruption offences, and the respective scope of corporate liability, including with regard to money laundering. Both the UNTOC and the UNCAC thus affirm the applicability of the same corporate liability mechanism to various offences.

3. Such broad applicability was not yet present in the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which established corporate liability solely for the offence of bribery of a foreign public official, even though the same Convention contained requirements for the criminalisation of money laundering, without a link to corporate liability for this offence. However, this gap is an outlier among modern conventions, including Council of Europe instruments analysed below, which confirm the principle of multi-varied applicability of corporate liability to different offences.

4. It should be noted, however, that the UNTOC, UNCAC and the OECD Convention do not elaborate on the concept of corporate liability, other than stating that such liability is triggered for the involvement of a legal entity in the commission of the respective offence. The Council of Europe Conventions go further than their UN and OECD counterparts in defining the scope of corporate liability.

COUNCIL OF EUROPE CONVENTIONS

5. The Council of Europe Conventions ETS 173 (Criminal Law Convention of Corruption, 1999) and CETS 198 remain the most elaborate international instruments with regard to the concept of corporate liability, and the circumstances when such liability should be triggered. As such, this definition of corporate liability forms the basis of the international legal consensus on this matter, and has also permeated international business practice. It is also replicated in European Union Directives 2018/1673 and (EU) 2017/541.

6. The respective Articles of ETS 173 (Article 18) and CETS 198 (Article 10) contain similar wording, once again confirming the multi-varied applicability of the same norms of corporate liability to different offences. The requirements of Article 10 establish two levels of circumstances, triggering corporate liability:

- When the offence was committed by a natural person in the position of authority, control or legal representation, including in circumstances when such persons were acting as an accessory or instigator of the criminal conduct (Article 10.1);
- When any other natural person under the authority of the legal person committed the offense, that was made possible due to lack of supervision or control by the management of the legal person (Article 10.2).

7. In both cases criminal liability is triggered, when the offense is committed for the benefit of the legal person. While under paragraph 10.1 the association between the legal person and the actions of its owner, manager or representative is relatively straightforward, the provisions of paragraph 10.2 have raised uncertainties during discussions in the Conference of the Parties to CETS 198. They are thus the key subject of this Interpretative Note, which specifically focuses on cases where a legal person may be held liable for offences committed as a consequence of lack of supervision or control.

Assessed criteria

PARAGRAPH 2 (CORPORATE LIABILITY IN CASE OF LACK OF SUPERVISION OR CONTROL)

Apart from the cases already provided for in paragraph 1, each Party shall take the necessary measures to ensure that a legal person can be held liable where the lack of supervision or control by a natural person referred to in paragraph 1 has made possible the commission of the criminal offences mentioned in paragraph 1 for the benefit of that legal person by a natural person under its authority.

8. The key notions in this paragraph, which require interpretation, relate to “supervision or control”, namely the circumstances, scope and parameters when such supervision or control should be applied, and the forms it may take. In accordance with the language of the requirement and established international practice, “supervision and control” by the owners and management of a legal entity should be in place and should be capable to contribute to the prevention of offences. The effectiveness and capability of such “supervision and control” may be increased, if it is implemented in the form of systemic top-down measures within the legal entity. Such systemic measures, when they are transferred into permanent processes, procedures and practices of the legal entity, are often referred to in international legislation, standards and business practice as “internal controls” (also alternatively labelled as “compliance programmes”). Internal controls serve as a means for the managers or owners (through a board of directors) of the legal entity to ensure comprehensive “supervision and control” of its activities.

9. The lack of internal controls in a legal entity, which is the subject of a criminal, administrative or civil proceeding, may be considered by a court to be a clear demonstration of absence of supervision and control on the part of owners or managers of the entity. At the same time, the *practical implementation* of internal controls and their *actual effectiveness* in preventing misconduct should be the main focus of the liability proceedings, rather than the fact of their formal existence.

Examples from Thematic Monitoring Review of Article 10.2

10. A number of national regimes have established requirements for legal persons in accordance with paragraph 10.2. The two specific cases noted in the Thematic Monitoring Review, which refer to compliance programmes are those of **Italy** and **Spain**. In both cases a

compliance programme may be considered by a court as an alleviating circumstance in case of criminal activity conducted by the legal entity.

Italy

"Italy has also introduced liability "exemptions" in Art. 6 of the Legislative decree. This instrument enables a legal person to avoid liability in case it had adopted and effectively applied a compliance program aimed at preventing the type of offence which an individual has nevertheless committed by fraudulently circumventing the compliance program. In order to be exempted from a liability, the entity is also required to have allocated the task of ensuring the implementation and observation of the program's application to a unit with autonomous powers of initiative and control. Furthermore, the afore-mentioned Article 6 lists the minimum requirements of the criminal compliance programme which include identification of the risk, methods for managing financial resources, obligation of notification on the functioning of the compliance model, disciplinary measures in case of non-compliance and whistle-blower programme. The "compliance model" requires periodic verification and possible modification in case of significant violations. In case there are suspicions/investigations against legal entity for an offence committed by its side, the application of a compliance programme will not automatically release a legal entity from its liability since the court is free to assess evidence and decide on each case. In view of this, the provisions of Article 6 of the Legislative degree do not limit the scope of the requirements of the Convention."

Spain

"The 2015 reform of the corporate criminal liability in Spain introduced a criminal liability "exemption". Art. 31 bis (2) - (5) of the Criminal Code provides for a possibility for the legal persons to benefit from "defence", if they are able to prove they had in place and had effectively implemented, before an offence was committed, an organizational and management model, which would be adequate to prevent criminal offences or reduce significantly the risk of such offences being committed. This provision lists the minimum requirements of a corporate criminal compliance program, which includes risk analysis of potential vulnerable spheres of activities, models for adequate management of financial assets, an obligation of notifying on possible risks and cases of non-compliance, a disciplinary measures in case of non-compliance and periodic audits. The "compliance model" has to be adequately monitored independently by a management body, with sufficient controlling authority or directly by management bodies in case of a small size legal persons (Art. 31 bis (2) and (3)). In those cases, in which only partial evidence of compliance with the afore-mentioned requirements is met, the exemption of the liability would not be possible. The undertaken measures might be considered as factor to reduce the penalty (Art. 31 bis (2) 4.) The implementation of a non-mandatory compliance "model" does not exempt the legal person from liability, but rather allows the courts to take into account the legal person's efforts to prevent criminal offences from occurring. Therefore, the new provisions do not affect the compliance of Art. 31 bis of the Criminal Code with the requirements of the Convention."

11. In both cases the compliance programme has a universal purpose of preventing various types of criminal offences, including money laundering. It would also be applicable to, for example, anti-corruption offences, which were historically one of the main drivers for the development of broader compliance requirements for legal persons, and the respective norms for corporate liability, including in Italy and Spain. Anti-corruption compliance norms are comprehensively articulated in the ISO 37001 Standard and continue to evolve.

ISSUE: What measures are needed to implement <u>effective</u> supervision and control in a legal entity?

12. This Interpretative Note does not seek to establish an exhaustive list of measures to be implemented by a legal entity in demonstrating effective supervision and control. The nature of internal control measures will vary depending on the type of legal entity, the nature of its business profile and the profile of its business counterparts, its size and geographic scope of business activities.

13. In general terms, internal controls may include main pillars, such as the following, depending also on the size of the legal entity:

a) The *commitment of senior management* to a comprehensive internal controls policy adopted at the high-level by the management, including the designation of a senior executive responsible for the internal control function and the sufficient staffing and resource allocation toward this function.

b) *An internal control policy* could be developed describing the goal of the internal control programme, its main components, the roles of the staff involved and impacted by this policy. It could clearly articulate behavioral guidelines and prohibitions, as well as the record-keeping policy for the organization. The internal controls should be attuned and in line with the legislative framework of the jurisdiction of registration and operation of the company.

c) *Risk assessment* is now widely considered to be an essential component in constructing any effective internal control system. Risk may be defined as the probability of corporate offences being committed by managers, staff under their supervision and the entity itself. It involves determining what are the threats (or hazards) that the company faces, i.e. the types of offences which may occur and the types of actors that may be involved; as well as any systemic vulnerabilities in its control mechanisms (to be rectified upon identification). Risk assessments would normally take into consideration the business profile, counterparts, geography and other factors related to the operations of the business entity.

d) *Employee screening and training* is a major component of internal controls, especially for key functions (executive and financial decision making, management of external commercial relations and subcontractors, etc.).

e) *Third parties and business counterparts* may be evaluated and screened based on their potential susceptibility to risk of criminal conduct, which should be strictly managed through contractual clauses, and when necessary application of targeted screenings or controls to such parties.

f) *Controls and audit*, could be attuned to potential risks of criminal conduct and scenarios, and should be well-resourced. An internal or independent audit including with regard to the compliance function itself should be periodically undertaken.

g) *Whistle-blowing, internal investigations and conflict of interest resolution* comprise the enforcement element of a compliance system. Specific procedures and mechanisms for internal whistleblowing should be established. Investigation procedures with regard to whistleblower reports should be prescribed. A well-scaled disciplinary policy for identified breaches should be applied. A special channel of reporting criminal misconduct to law

enforcement authorities may be set up, as may be necessary in accordance with national legislation.

14. In terms of *scope* the compliance programme may be applied to prevent various types of offences, at a minimum those required by international and national legislation, in particular money laundering, terrorism financing and corruption offences.

15. *Outsourcing* of internal controls components is not encouraged, and in any case may only apply to certain isolated elements, such as employee screening, audit and checks of third parties and business counterparts. Overall "supervision and control" responsibility of senior managers/owners should remain and be effectively applied regarding all components of the internal control programme, including for the outsourced elements.

ISSUE: What is the link between Article 10 provisions and AML/CFT requirements for so-called "obliged entities"?

16. For purposes of regulatory clarity, it is important to explain how the provisions of Article 10 and its concept of "supervision and control" interrelates with the internal control requirements applied to so-called "obliged entities" subject to anti-money laundering and combating the financing of terrorism (AML/CFT) legislation.

17. Obliged entities should be subject to the provisions of Article 10, like all other legal entities. By virtue of domestic AML/CFT legislation, obliged entities are required to implement AML/CFT internal controls and compliance programmes, which have as one distinct purpose the monitoring of clients' activities and the reporting of suspicious transactions. The FATF Recommendations requires obliged entities to have employee screening procedures and an internal audit function to test AML/CFT controls, however this is not tailored to prevent of criminal conduct within and by the obliged entity in the sense of Article 10. Key internal control elements in the spirit of Article 10 (e.g. such as an internal or external whistle-blower programme) are currently not present in the FATF Recommendations.

18. Indirectly, the existence of effective AML/CFT internal controls or lack thereof has served as a factor in cases where the obliged entity itself is levelled with charges of corporate misconduct. For example, recent large-scale prosecutions against financial institutions built their case proving corporate criminal misconduct (e.g. facilitation of money laundering and tax evasion) largely based on findings of dysfunctional internal AML/CFT controls, and proven purposeful negligence (in some cases even resistance) by corporate managers to fix these controls.

19. In sum, specialised AML/CFT controls may and should assist a legal entity in identifying corporate misconduct, however these would not be sufficient to demonstrate effective "supervision and control" for purposes of exemption from corporate liability in the spirit of Article 10. Additional effective controls specifically related to the prevention of corporate misconduct would be necessary to achieve an exemption.

ISSUE: How to implement a "compliance defence" in the judicial process?

20. The formal existence of internal controls in a legal entity should never serve as a guarantee of exemption from liability. However, national legislation should foresee the possibility of *conditional* exemption of a legal entity from liability in case it is able to demonstrate all components of an *effective* compliance programme. These components should be prescribed in national legislation or guidance issued by competent authorities, and subsequently considered as

a benchmark by a prosecutor and the court. An independent expert evaluator may be engaged by prosecution in order to assess the compliance programme of the legal entity and, if necessary, present the findings in court.

21. In case a legal entity is found to have insufficient compliance controls, the court may instruct the legal entity to improve compliance as a correctional measure, in addition to other measures. Equally, an out-of-court conditional settlement may be negotiated. In some jurisdictions this is referred to as a deferred prosecution agreement (DPA), whereby the legal entity commits to create or improve its compliance controls under the supervision of a specialised monitor appointed by a judicial authority. If all conditions of the monitor are met, the criminal proceedings will come to an end. If the legal entity fails to make the necessary improvements the case is taken to court. The possibility for applying DPAs may be envisaged in the respective criminal procedure legislation, or its administrative analogues, where corporate liability is implemented through administrative means.

22. Internal control requirements may be implemented with due regard to the size of the corporate entity and proportionality of misconduct. As in the example of the French law No. 2016-1691 of 9 December 2016 “On transparency, the fight against corruption and modernisation of economic life”, an applicability threshold is prescribed in terms of size of the entities by financial turnover and workforce. Only entities above the threshold are subject to strict compliance requirements.

23. At the same time, applying a certain set of internal control and compliance requirements to legal entities may ease the procedural burden on authorities when applying sanctions, in particular with regard to so-called shell companies operating without a specific economic purpose and often used as a tool for money laundering. The absence of proper compliance controls in such entities may be used by court to decide on their appropriate sanctioning.