

**Luxembourg: Detailed Assessment of Observance of Standards and Codes—
FATF Recommendations for Anti-Money Laundering and
Combating the Financing of Terrorism**

This detailed assessment of observance of standards and codes on Luxembourg's observance of the FATF 40 recommendations for anti-money laundering and combating the financing of terrorism was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on information available at the time of its completion. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Luxembourg or the Executive Board of the IMF.

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**ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF
TERRORISM**



**Detailed Assessment of Observance of Standards and
Codes**

Luxembourg

OCTOBER 2004

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Contents	Page
Glossary.....	4
Overview.....	5
I.....	5
A. General.....	5
Information and methodology used for the assessment.....	5
General Situation of Money Laundering and Financing of Terrorism.....	5
B. Overview of Measures to Prevent Money Laundering and Terrorism	
Financing.....	7
History of money laundering control in Luxembourg.....	7
Main findings—criminal justice.....	8
Preventive measures for financial institutions.....	10
II. Detailed Assessment.....	12
A. Assessing Criminal Justice Measures and International Cooperation.....	12
B. Assessing Preventive Measures for Financial Institutions.....	32
C. Description of the Controls and Monitoring of Cash and Cross Border	
Transactions.....	54
D. Ratings of Compliance with FATF Recommendations, Summary of	
Effectiveness of AML/CFT efforts, Recommended Action Plan and	
Authorities’ Response to the Assessment.....	55
E. Authorities’ Response to the Assessment.....	76

GLOSSARY

AML/CFT	Anti-money laundering and combating the financing of terrorism
ML	Money laundering
FT	Financing of terrorism
IAE	Independent AML/CFT expert
CSSF	Commission de Surveillance du Secteur Financier
CaA	Commissariat aux Assurances
FIU	Financial Intelligence Unit
FIU-Lux	Luxembourg Financial Intelligence Unit
PSF	Professionals of the financial sector
BCCI	Bank of Commerce and Credit International
FATF	Financial Action Task Force
STR	Suspicious Transaction Report
MLA	Mutual legal assistance
LoFS 93	Law of April 05 1993 on the Financial Sector
LoIS 91	Law of 1991 on Insurance Services
ABBL	Association of Banks and Bankers in Luxembourg
IML	Institut Monétaire Luxembourgeois
BCL	Banque Centrale du Luxembourg
MoU	Memorandum of Understanding
MLAT	Mutual Legal Assistance Treaty
UCI	Unit in collective investment (scheme)
CIS	Collective investment scheme
NCCT	Noncooperative countries and territories
PEP	Politically exposed person
KYC	Know your customer
COPILAB	AML/CFT coordinating committee in Luxembourg

I. OVERVIEW

A. General

Information and methodology used for the assessment

1. A detailed assessment of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of Luxembourg was prepared by a team of assessors that included staff of the International Monetary Fund (IMF) and an expert, not under the supervision of IMF staff, who was selected from a roster of experts in the assessment of criminal law enforcement and non-prudentially regulated activities. IMF staff reviewed the relevant AML/CFT laws and regulations and supervisory and regulatory systems in place to deter money laundering (ML) and financing of terrorism (FT) among prudentially regulated financial institutions. In addition, the expert not under the supervision of IMF reviewed the capacity and implementation of criminal law enforcement systems.
2. The team consisted of Jean-François Thony and Terry Donovan of the IMF, with Michael Lauber, Head of the Liechtenstein FIU, as the Independent AML/CFT Expert (IAE) to address law enforcement issues and certain other matters beyond the scope of the work of the Fund.¹
3. In the course of the assessment, a wide range of meetings was held with the Ministries of Finance and Justice, the Commission du Surveillance du Sector Financier (CSSF), the Commission aux Assurance (CaA), the Prosecutors Office/Financial Intelligence Unit (FIU), the police, the Bankers' Association, and a number of banks and other private sector financial institutions and professionals of the financial sector (PSFs). The assessment team would like to express its appreciation for the high level of organizational support, the high standard of cooperation received and the constructive nature of the discussions.
4. The following categories of regulated financial institutions were included within the scope of the assessment: banks, financial market professionals (PSFs, including securities and funds businesses), and insurance companies.

General Situation of Money Laundering and Financing of Terrorism

5. Luxembourg's geographical location, the free movement of capital and persons in the context of EU membership, and the international standing of its financial services sector are among the factors that create the environment for attracting cross-border financial services business. From the early 1980s, the authorities have recognized that private customers often seek confidential financial services, for a wide variety of reasons, and have pursued a policy

¹ Those parts of the assessment report attributable to the work of the independent AML/CFT expert are shown in italics.

to attract international financial services business to Luxembourg, based at least in part on the existence of strong bank secrecy laws. While these laws do not stand in the way of disclosure by financial institutions of client details to the appropriate authorities in the case of suspected money laundering or other financial crime, tax offences are not within the definition of crime for these purposes, except when committed within the framework of a criminal organization. Neighboring countries consider that they lose substantial amounts of tax revenue as a result of funds being transferred by their residents to Luxembourg financial institutions, often to branches of their own banks.

6. Discretion was and is one of the key factors in the success of financial services in Luxembourg, attracting legitimate business persons and, on occasion, also less scrupulous individuals. While the scope for development of retail banking in the Grand Duchy is relatively limited, Luxembourg has built up a substantial business in private banking, and is the second largest provider of funds management services in the world (after the United States), and the largest provider to non-resident investors. This brings with it inherent risks of money laundering and terrorist financing that demand the implementation of the strongest level of controls. Historical evidence suggests that these controls have not always been applied evenly across the financial system. Cases such as Jurado-Garcia (involving the drug-trafficking proceeds of the Colombian Cali cartel) and the BCCI collapse illustrate the vulnerabilities.

7. While it is difficult to assess with certainty the quality of day-to-day implementation, particularly in the areas of private banking and funds management, the strong AML/CFT control environment applied to Luxembourg financial institutions limits the scope for its system to be used for the initial placement of the proceeds of crime, although the mission was informed that large deposits of cash still sometimes occur. The main vulnerability is likely to arise at the subsequent layering stage, with the transfer from abroad of funds which have already been successfully introduced into the financial system. While Luxembourg is not without domestic crime, the main risks of money laundering arise therefore from crimes committed abroad, with the proceeds blended with legitimate funds in the Luxembourg system. At this point in the process, laundered money is much more difficult to detect. In Luxembourg, the availability of a variety of corporate structures (and of the service providers to create and manage them) that can be used to disguise the true identity of the beneficial owners of the underlying assets, creates a particular vulnerability. The authorities have put in place controls broadly in line with the international standard.

8. Luxembourg was the subject of a FATF second round mutual evaluation in 1998–99. The report, while broadly positive, indicated that the effectiveness of implementation was difficult to assess, particularly having regard to the low level of STR reporting. It called for a strengthening of AML structures and an improvement in financial analysis conducted by the FIU. Luxembourg has taken a number of steps to address these recommendations.

B. Overview of Measures to Prevent Money Laundering and Terrorism Financing

History of money laundering control in Luxembourg

9. The criminalization of money laundering in Luxembourg appeared for the first time in the legal framework of Luxembourg by the law of July 7, 1989 which set out the offence of the laundering of drug trafficking proceeds. The law provided also that those who facilitated the laundering knowingly or by violation of their “professional obligations”² could be found guilty of the offence, which was one of the most stringent provisions against money laundering in Europe.

10. In 1993, Luxembourg provided its financial industry with a new and comprehensive legal framework by the law of April 5, 1993 on the Financial Sector (LoFS 93), which established the foundations of the obligations of financial institutions to prevent the abuse of the financial system for the purpose of laundering criminal proceeds: duty to identify customers, to keep record of transactions, to report suspicious transactions, etc. In March 1998, the requirements were extended to a number of other financial businesses under the denomination of “professionals of the Financial Sector” such as asset management companies, financial advisors, brokers, market makers, currency exchange dealers, etc.

11. In August of the same year, the scope of the money laundering offence was extended over the sole offence of drug trafficking to cover in particular offences in relation with organized criminal groups, and on December 23, the Supervisory Commission of the Financial Sector (Commission de Surveillance du Secteur Financier, CSSF) was established as the supervisory authority for financial institutions and related businesses. Domiciliation services providers were regulated by a law of May 31, 1999 and added to the list of those who were subject to AML preventive measures.

12. In 2000 and 2001, two laws, respectively, on mutual legal assistance and on extradition completed the framework for international cooperation in accordance with the treaties to which Luxembourg had become party. Two other laws were adopted in August 2003 to complement the legal framework: one the Financial Sector, which added a number of other financial services-related professions in the list of regulated entities (including financial IT services and company services providers) and one on terrorism and financing of terrorism which added the terrorism-related offences to the list of predicate offences of money laundering.

13. During the time of the mission, authorities were discussing a draft law (referred to in the text as draft law N^o. 5165) aiming at bringing the legal framework up to the standards edicted in particular by the European Directive 2001/97/EC of December 7, 2001. Among

² Obligations arising under the set of laws and regulations that apply to a particular profession.

other things, the draft law was intended to extend the scope of predicate offences including to the financing of terrorism, extending the reach of the law to new businesses and professions, clarifying the role and function of the FIU, and the scope of the prevention measures applicable to the institutions subject to the law. On many accounts, this draft law would be a marked improvement to the legal framework in place. However, under the pressure of the lobbies of the financial and the legal professions, the draft law was substantially amended since the mission and adopted in first reading on May 19, 2004. It is expected to be discussed in second reading during the next session of the Parliament. If the law as adopted in first reading were enacted and implemented in its current form, the AML/CFT framework would be likely to fall short in some important respects of the requirements of the revised FATF recommendations, bearing in mind the published comments of the Legal Commission of the Parliament, which would be expected to influence implementation by the authorities and the financial sector. Among areas of concern are the proposed limitation of the scope of predicate offences, of the “know your customer” procedures,³ and of the powers of the FIU. Unless the necessary adaptations are made to the present law, before it is adopted in second reading, the authorities may have to make some further amendments in the near future to align the legal framework to the international requirements.

14. Since the law was not in force at the time of the mission, its provisions are not assessed as part of the evaluation, but only referred to when the draft law was to change some elements of the existing legal framework. The references to the draft law N^o. 5165 relate to the text as it stood at the time of the mission and not as it was later amended.

Main findings—criminal justice

15. Luxembourg’s criminal justice legal and institutional framework provides a solid foundation for the fight against money laundering and financing of terrorism.

16. Luxembourg is a party to the main international instruments addressing money laundering and financing of terrorism except for the Palermo convention. Criminal laws are

³ The amendments to the provisions on customer identification illustrate the downgrading of the AML/CFT requirements proposed in the new law, when compared to the earlier draft provided at the time of the mission. While the initial draft specified that “professionals are required to collect any other information [on their clients] in order to reduce the risk to be abused for the purpose of money laundering,” this requirement has been removed from the text. Moreover, the Report of the Legal Commission of the Parliament added that “it would be useless and impractical to define the identification requirements further than, for a physical person, the identification elements deriving from an identity document, and for a legal person, the official registration document.” This implies that, for legal persons, financial institutions would not be required to check the beneficial ownership of the company, except in the cases of doubt as specified in paragraph (3) of the relevant article.

in line with international obligations, with the important exception of the criminalization of money laundering, where the scope of the offence is too limited to comply with existing standards regarding money laundering-related predicate offences. Crimes such as fraud, embezzlement, and armed robbery do not currently constitute predicate offences for the purposes of the money laundering law.

17. The effectiveness of confiscation laws in money laundering matters is difficult to assess, given the low rate of prosecutions for money laundering and financing of terrorism offences. However, the scope of confiscation is quite broad and its application should not be a problem. To enhance the effectiveness of confiscation measures, Luxembourg could consider alleviating the burden of proof of the origin of the seized assets, as suggested by the Vienna, the Strasbourg, and the Palermo Conventions.

18. With regard to the freezing of assets on the basis of the UN Resolutions, Luxembourg has actively implemented its obligations to search and freeze assets of the persons considered to provide support to terrorist organizations, by issuing circulars to financial institutions. However, today, less than half a dozen accounts have been identified as being related to a person or entity on the list. While the EC regulations provide an adequate legal basis for freezing the assets, the specific nature of these measures, taken outside the framework of a criminal investigation or prosecution, and outside the scope of the exercise of FIU functions, would require the enactment of specific provisions to empower authorities to give full and immediate effect to these obligations.

19. The Financial Intelligence Unit in Luxembourg is one of the judicial model, i.e., under the supervision and operation of a judicial authority, namely the Prosecutor's office. It benefits from a ten-year old experience in receiving suspicious transaction reports (STRs), and its authority is recognized and unchallenged. Its staff is very committed and maintains close relations with the financial sector. However, it lacks a clear and transparent legal framework to operate, and sufficient means and IT equipment to face the continuous rise in STRs and to fulfill a real analysis function. Financing of terrorism should be added to money laundering as the offences for which suspicion should be disclosed.

20. The FIU and law enforcement and prosecution authorities being the same, many of the comments made as to the FIU could be replicated in relation to the effectiveness of the prosecution authorities. The specialized police authorities and the prosecutor's office are taking great benefit of the fact that they are combined with the FIU, for a maximum efficiency in prosecutions. However, the number of prosecution is very low, due to the established policy of simply forwarding to foreign central authorities all cases and suspicions of money laundering which relate to persons or funds originating from abroad. The authorities in Luxembourg expect that the foreign central authorities will investigate and pursue the matter, while they themselves consider the matter closed. With regards to proactive investigative techniques, these are limited to wire tapping and other related measures.

21. Given the amount of assets managed or deposited in Luxembourg by foreigners, the number of requests for mutual legal assistance is very important in Luxembourg. The

overload of foreign requests and the previously existing procedures often resulted in the past in undue delays and Luxembourg was sometimes criticized by neighboring countries for its low and slow response to their requests. The law of August 08, 2000 has provided for a simpler procedural framework and is praised for its efficiency although petitions opposing the giving of assistance may still be filed on a case-by-case basis. Since its adoption, the number of petitions against measures executed in response to an MLA request, which were filed before for the main purpose of delaying the process, has dropped significantly to a dozen per year. The law is clear and simple, even though the conditions for granting the request and the possibilities for refusal are extensive. The adoption of a law on extradition on June 20, 2001 has completed Luxembourg's now comprehensive framework for international cooperation. Luxembourg is a party to the international instruments designed to enhance judicial cooperation in criminal matters, apart from the Palermo convention.

Preventive measures for financial institutions

22. Luxembourg has a well developed supervisory framework that encompasses AML/CFT preventive measures broadly in line with international standards. The CSSF is the competent authority for banks, funds management, and a range of financial sector professionals. As noted, the LoFS 93 has provided the main basis for AML/CFT preventive measures. The law has been supplemented by 60 circulars issued by the CSSF (and its predecessors) that, although they do not in themselves have direct force of law, provide useful guidance to financial professionals on implementing provisions of the AML/CFT legislation.

23. There is a culture of strong bank secrecy in Luxembourg, but there are mechanisms to permit access to information needed by foreign and national authorities responsible for financial sector supervision. Some issues have arisen regarding the provision of information by supervised institutions to the FIU and Prosecutor's Office, which led the CSSF to issue a circular in 2001 reminding banks to cooperate and "refrain from systematically objecting on the grounds of bank secrecy." The authorities indicate that cooperation has since improved.

24. Anonymous accounts are prohibited in Luxembourg. Customer identification procedures are mandated by law for customers, without distinction between natural and legal persons. CSSF Circulars provide detailed guidance. Banks interviewed in the course of the mission indicated that numbered accounts are used extensively in Luxembourg, particularly in the private banking area. The authorities and banks indicated that they are not treated any differently to nominative accounts as regards customer identification, except that access to the information is confined to those needing to know.

25. The identification of beneficial owners is a requirement of LoFS 93. Financial professionals interviewed identified difficulties in practice in some cases in identifying the ultimate beneficial owner, and indicated that, in the absence of this information, they would not proceed with the business relationship. There is no legal requirement to include originator information in wire transfers. However, banks interviewed indicated that their internal procedures address this issue in line with international standards.

26. Most business of banks and other financial professionals in Luxembourg relates to nonresidents. This business is subject to the same controls for AML/CFT purposes as resident business, but there is no requirement for enhanced due diligence for nonresident business to accord with the international standard. Neither is there any specific guidance relating to the use of corporate vehicles, which are particularly important in Luxembourg. Customer due diligence procedures carried out by a regulated entity in Luxembourg or in a range of other countries are accepted for their purposes by Luxembourg financial services entities. While consistent with the exemption available under the relevant EU Directives and international standards, the scale of the application of this exemption in Luxembourg could create reputational risks, particularly in cases of complicated or obscure ownership structures.

27. Records of customer identification and transactions must be maintained for at least five years, in line with the international standard.

28. Legal provisions on reporting of STRs are largely in line with the standard. It is difficult to assess whether financial professionals are prepared to fully accept their obligations, and the views expressed by the Banking Association point to a reluctance to do so, based at least in part on a concern of potential self-incrimination as a result of reporting.

29. Banks must establish adequate internal control procedures for AML/CFT under LoFS 93, and CSSF requires banks to submit to it a copy of the procedures manual on an updated basis. CSSF carries out a regular program of on-site inspections of banks, including coverage of AML/CFT. These inspections are detailed and have identified significant weaknesses in procedure and implementation, for which remedial action has been required.

30. The legal framework for the insurance sector is based on the Law of 1991 on Insurance Services (LoIS 91), with the implementation of AML/CFT measures currently limited to life insurance products. The competent authority is the Commissariat aux Assurances (CaA). Customer identification requirements are similar to those for banks, albeit with exemptions for low-value business. Life assurance business on behalf of non-residents is a very significant component of the Luxembourg financial services market. It is among the range of products offered for investment purposes to attract the business of medium to high net worth individuals, alongside private banking, funds products, corporate structures, etc. As such, it is similarly vulnerable to abuse by money launderers, particularly at the layering and subsequent stages of the ML process. Typology information published by the FIU, and analyzed independently by the CaA, points to a range of possible abuses of these products, based on the 180 or so STRs filed by the insurance sector to date. Discussions during the mission confirmed a keen awareness of the risks and the existence of a range of controls. The quality of customer due diligence is critical to protecting the system and cannot be assessed directly by the mission. The CaA conducts onsite inspections of life companies, on a 3-4 year cycle, and includes coverage of AML/CFT measures.

II. DETAILED ASSESSMENT

31. The following detailed assessment was conducted using the October 11, 2002 version of *Methodology for assessing compliance with the AML/CFT international standard, i.e., criteria issued by the Financial Action Task Force (FATF) 40+8 Recommendations* (the Methodology).⁴

A. Assessing Criminal Justice Measures and International Cooperation

Table 1: Detailed Assessment of Criminal Justice Measures and International Cooperation

I—Criminalization of ML and FT (compliance with criteria 1-6)
Description
<p><i>1. Ratification of conventions</i></p> <p>Luxembourg ratified the 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances by the law of 17 March 1992 (Mémorial A – Nr 15 of March 26, 1992). The convention has been fully implemented, in particular through legislative amendments to the law of 19 February 1973 on Narcotic Drugs, made by the law of 17 March 1992.</p> <p>The UN International Convention for the Suppression of the Financing of Terrorism 1999 has been ratified by the law of 12 August 2003, which also adapted the legislative framework to implement its provisions, in particular through the addition of a new section III-1 on Terrorism in the Penal Code (Art. 135-1 to 135-8 of the Penal Code) criminalizing the financing of terrorism.</p> <p>Luxembourg has signed but not ratified the UN Convention Against Transnational Organized Crime 2000 (Palermo Convention). Authorities are of the view though that Luxembourg is fully compliant with the provisions of the Convention, the law of 11 August 1998 having incriminated specifically criminal organizations through the addition of articles 324bis and 324ter in the Penal Code. All crimes committed by an organized crime group are considered as predicate offences of money laundering.</p> <p>Luxembourg is a party to the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime since its ratification by the law of 14 June 2001. This convention is fully implemented, but the definition of the money laundering offence is not extended to all crimes as provided for by the Strasbourg Convention. Luxembourg applied Article 6, para. 4. of the Convention which provides that parties which do not conform with the “all crimes” approach may make a declaration that the offence extends only to predicate offences or categories of such offences specified in such declaration.</p> <p>The UN resolutions on financing of terrorism are being implemented. The Prosecutor’s Office, as well as the Commission de Surveillance du Secteur Financier (CSSF) issue circulars to the financial sector on a regular basis, notifying regulated professionals in relation to the new names of suspected terrorists, with a view to freezing their assets.</p> <p><i>2. Criminalization of money laundering</i></p> <p>The laundering of the proceeds of drug trafficking is criminalized by art. 8.1 of the law on Narcotic Drugs of</p>

⁴ The 1996 FATF 40 Recommendations were used.

February 19, 1973 as amended. Until the law of 11 August 1998, the offence of money laundering was limited to the laundering of the proceeds of drug trafficking. This law has included a new provision in the Penal Code under art. 506-1, to criminalize the laundering of proceeds derived from a number of other crimes. This offence is punished by penalties of a maximum of 5 years imprisonment and EUR 1,250,000. Under art. 506-5, the maximum penalty is brought to 20 years imprisonment when it is done as part of the participation in an organized crime group. The money laundering offence is constituted even when the predicate offence has been committed abroad, according to art. 506-3 of the Penal Code, and art. 8-1 4) of the law on narcotic drugs.

Luxembourg has chosen a list approach for defining the scope of predicate offences. This list covers a very limited number of offences, namely:

- terrorism, participation in a terrorist group, financing of terrorism
- crimes committed as part of the participation in an organized criminal group
- abduction of a minor
- prostitution and procurement
- corruption
- violation of the legislation on weapons

This list excludes a number of serious profit-making crimes (fraud, embezzlement, armed robbery, etc.) and is not therefore compliant with existing standards, in particular FATF Recommendation 4 requiring the inclusion of all serious offences within the scope of the money laundering predicate offences.

The authorities have prepared a draft bill no. 5165 which would correct this loophole by enlarging the scope of predicate offences to the following ones, in addition to the existing ones:

- all offences defined as a “crime” under Luxembourg law (the most serious offences)
- fraud and embezzlement
- corruption of foreign public officials, corruption, unlawful shareholding, corruption of judges, and threatening.
- misappropriation of corporate funds

“Self laundering” as spelled out in criterion 2.1, is punishable under Luxembourg law, following an amendment to the original definition of money laundering which was included in the law of 12 August 1998, which extends the offence of money laundering to the case where “the author of the offence of money laundering is also the author or the accomplice of the predicate offence”.

As required in criterion 2.2, there is no requirement under the Luxembourg law that a conviction for the predicate offence be ordered to allow for the prosecution of money laundering offences.

Proceeds of crime include direct or indirect proceeds.

3. Financing of terrorism

Under article 135-5 of the Penal Code, the offence of financing of terrorism is defined as “providing or collecting by any means, directly or indirectly, unlawfully and intentionally, funds, assets, or properties of any nature, with a view to utilize them or knowing that they will be utilized, partly or in whole, for the purpose of perpetrating one of the offences [of terrorism], even if they have not actually been used to perpetrate one of these acts.”

⁵ Which seems to be a theoretical case, since almost all cases of terrorism are done within the framework of a terrorist organization.

This definition, as well as the definition of terrorism, are in accordance with the 1999 Convention on the suppression of financing of terrorism. Luxembourg is in the process of ratifying all of the 11 other UN Conventions on terrorism. Prosecution of financing of terrorism offences is possible when terrorist organizations are located in another jurisdiction or when the terrorist acts take place in another jurisdiction (art. 135-4 (5)). It does not extend to the case of terrorists not belonging to a terrorist organization⁵.

4. Intentional element of the offence (mens rea). Penal liability of legal Entities

The definition of the money laundering offence under art. 506-1 of the Penal Code and 8-1 of the Law on Narcotic Drugs requires that the offence be committed “knowingly”. There is no provision to ease the burden of proof as suggested by Article 6(3)(a) of the Strasbourg convention, which extends to those who “ought to have assumed that the property was proceeds”, or as included in the law of other countries, to those who “might reasonably have suspected” (Netherlands) or had “reason to assume” (Switzerland) that the assets were derived from one of the predicate offence. The language of this offence, as it derives from the amendment of Law of 11 August 1998, is laxer in comparison to its previous language (law of 1989), under which the persons who had facilitated the offence of money laundering “by violations of their professional obligations” could be prosecuted, which alleviated the burden of proof of the mental element of the offence. In this drafting language, the prosecution had only to prove that the person had knowingly violated his professional obligations to allow for his conviction. Furthermore, conviction can be based on objective factual circumstances, according to the general principles of continental law.

Legal entities are not punishable under the penal code. A draft law is being considered to include them as punishable persons.. However, it is possible for a court, in case of companies or non-profit associations or foundations which are in breach of criminal law or statutory laws, to order the termination and liquidation of the entity. (art. 203 of the law of 10 August 1915 on commercial companies, art. 18, 40 and 41 of the law of 21 April 1928 on non-profit associations and foundations). Such decisions are taken routinely, in particular in cases of failure to comply with company law requirements, but it has never been applied for cases of money laundering or financing of terrorism, according to the authorities.

5. Effective, proportionate and dissuasive criminal, civil or administrative sanctions

Money laundering is punishable by sanction up to a maximum of 5 years imprisonment and/or a fine of EUR 1,250 to EUR 1,250,000 (art. 506-1 Penal Code and art. 8,1 Law of 19 February 1973). The offence of financing of terrorism is punished by the same sanctions as the terrorist acts themselves, i.e. 15 to 20 years imprisonment; or life imprisonment if the terrorist act has led to the death of one or several persons (art. 135-2 Penal Code). In the case of participation in a terrorist group or in its licit activities when they contribute to the objectives of the group, the maximum is 8 years imprisonment and/or a fine of EUR 2,500 to EUR 12,500 (art. 135-4 Penal Code). The participation to the decision-making process of a terrorist group is punished by 5 to 10 years imprisonment and/or a fine of EUR 12,500 to EUR 25,000, and the direction or management of a terrorist group by 10 to 15 years imprisonment and/or a fine of EUR 25,000 to EUR 50,000 (art. 135-4 Penal Code).

6. Adequate legal means and resources for the implementation of AML/CFT laws

The criminal justice system appears adequately equipped and resourced to enforce AML/CFT laws, bearing in mind that only a small number of the cases uncovered in Luxembourg are actually prosecuted in the country, the majority of them being investigated on behalf of foreign authorities or referred for action to foreign authorities where the predicate offence or the other elements of the money laundering offence have been committed abroad.

Analysis of Effectiveness

Luxembourg is a party to the international instruments addressing money laundering and financing of terrorism except for the Palermo convention. Criminal laws are in line with its international obligations, with the important exception of the criminalization of money laundering, which refers to a too narrow list of predicate offences compared to the international standards, except for offences committed in the framework of criminal

organizations.

With regard to the ratification of the Palermo Convention, the authorities consider that since all its provisions have been implemented, the need to ratify it is not urgent and there is no prospect of the convention being ratified in the near future. However, by not being a party to the Convention, Luxembourg cannot take advantage (and offer the benefit to other countries) of the other specific provisions of the convention, and in particular of the mutual legal assistance and extradition provisions, which provide extended possibilities of international cooperation in organized crime matters.

The list of predicate offences is far too narrow. A large number of profit-making crimes are excluded from the list, except when they are committed as part of the activity of an organized crime group. Draft bill no. 5165 was intended to correct this flaw. However, while this new law would improve the scope of predicate offences, it is important to point out that it still does not meet the new requirements instituted by the FATF in revised Recommendation 1 for those countries which choose to adopt the list approach. Since Luxembourg, as a FATF member State, has committed itself to implement the revised recommendations, Luxembourg should consider taking advantage of the modification of the law to extend the scope of predicate offences at least to those designated in the new recommendations.

In relation to the self-laundering issue, the mission notes that despite the inclusion of self-laundering by a later amendment, the original definition of money laundering, which was worded to exclude self-laundering (ceux qui auront facilité... ceux qui ont apporté leur concours...) has not been modified, which may lead to interpretation difficulties.

Figures of prosecutions for AML/CFT cases in the country are very low. Only four prosecutions for money laundering have been carried out since the adoption of the first money laundering drug-related offence, three of them having successfully resulted in a conviction. Three to five other cases are still being investigated by an Examining Judge, but concern domestic laundering without cross-border implications. Like in every country, the main problem encountered has been the difficulty of providing evidence of the origin of funds. However, there is no prospect to introduce in the law any legal means to alleviate the burden of proof, as was done in neighboring countries. The difficulties in taking prosecutions may also result from the “list approach” chosen by Luxembourg for the predicate offences rather than an “all crimes” approach. The prosecutor has not only to provide evidence of the existence of a predicate criminal offence, but also to prove that this offence is one of those listed, and not any other one. According to the authorities, the fact that most laundering schemes uncovered had an origin in another country means that prosecutions are not taken in Luxembourg. Either the evidence was sent abroad by the Luxembourg authorities or the investigation was carried out in Luxembourg on the basis of a mutual legal assistance request from abroad. In either case, the offenders are prosecuted elsewhere.

While the law allows for prosecution of AML/CFT cases as long as some of its elements have been perpetrated in Luxembourg, even when the predicate offence has been committed abroad, there seems to be a deliberate policy of prosecuting authorities to hand over systematically to foreign authorities money laundering cases uncovered as a result of an STR or any other investigation when it appears that, at some point, the case has a foreign connection or the funds originated from elsewhere. The authorities justify this approach for reasons of efficiency. Evidentiary material and the offenders are abroad, and prosecuting in Luxembourg would mean a complicated international cooperation procedure, including extradition of offenders, which is particularly difficult with neighboring countries which do not extradite their nationals⁶.

The offence of financing of terrorism has been integrated in the legal framework of Luxembourg by a law of 2003, and it is too early to determine its actual effectiveness. However, it was drafted in a way which should

⁶ One interlocutor suggested also, to explain the low rate of prosecutions in Luxembourg, that such prosecutions could affect the reputation of the country.

facilitate its effective implementation.
Recommendations and Comments
Implications for compliance with FATF Recommendations 1, 4, 5, SR I, SR II
FATF 4: Money Laundering does not extend to all serious crimes
II—Confiscation of proceeds of crime or property used to finance terrorism (compliance with criteria 7-16)
Description
<p>Luxembourg should ratify the Palermo convention.</p> <p>A law should widen the scope of predicate offences to all profit-making crimes, and at least to all offences included in the FATF list included in the glossary annexed to the revised recommendations, since this will become the standard for countries which choose the “list approach”.</p> <p>With regard to the burden of proof both of the knowledge element of the offence, and of the origin of the funds, Luxembourg should consider introducing some legal provisions which would ease the provision of evidence, while maintaining as a principle that the prosecution bear the onus of proof. Legislation of a number of countries within Europe provide a range of options as to ways and means to achieve efficiency in prosecution in the respect of general principles of law such as the presumption of innocence.</p> <p>It is suggested that criminal policies give more emphasis to local prosecution of offences even when some elements have been committed abroad, as it will give some visibility to the willingness of the authorities to deter the financing of terrorism as well as the laundering in Luxembourg of criminal assets from abroad.</p>
7. Confiscation of proceeds
<p>Luxembourg confiscation law⁷ is quite broad.</p> <p>There are three legal bases for confiscation, one under article 31 (1) which applies to all crimes, one under article 8-2 of the law on narcotic drugs, and one under article 32-1 which applies more specifically to money laundering-related offences.</p> <p>Art. 31 (1) of the Penal Code allows for the confiscation of instrumentalities, of assets which are the object of the offence, and of proceeds and assets acquired with those proceeds. Confiscation in the case of a financing of terrorism offence would be done on the basis of this provision, since art. 32-1 does not apply to financing of terrorism.⁸</p> <p>Art. 32-1, in money laundering-related cases, allows for the confiscation of all assets of any nature which are the object or the direct or indirect proceeds of the offence, and of assets which have substituted for the proceeds. Confiscation of such assets can be ordered even in the case of acquittal, and even if they are not the property of the author of the offence. Assets confiscated can be restituted to the victim of the offence, or given in compensation of lost assets of an equivalent value. Confiscation extends to the assets of the convicted person which are of an equivalent value of the proceeds (art. 32-2 (3) of the Penal Code).</p> <p>Art. 8-2 of the 1973 law on narcotic drugs provides, in addition to the general case of confiscation, for the</p>

⁷ Article 31, 32, 32-1 of the Penal Code, 8-2 and 18 of the law on Narcotic Drugs

⁸ except when financing of terrorism is the predicate offence of money laundering

confiscation of assets which have been acquired with the proceeds of drug trafficking, or assets with a value equivalent to those assets. The confiscation of instrumentalities such as airplanes, cars, machines, instruments which have been used for the commission of the offence can be confiscated even though they do not belong to the offender.

Confiscation of assets in relation to financing of terrorism offences would fall under art. 31 (1) of the Penal Code.

The seizure of assets subject to confiscation can be carried out by a Police Officer immediately after the commission of the offence, or by an investigating judge during the pre-trial phase. When the prosecution is made on the basis of a suspicious transaction report, the Prosecutor can, in the framework of the powers of the FIU, freeze bank accounts and transactions.

There is no civil forfeiture system in Luxembourg, and no possibility to carry out the confiscation of assets of organizations found to be primarily criminal in nature.

8. Adequate powers to identify and trace proceeds

The Criminal Investigations Code provides a wide array of powers for the police, the Prosecutor and the examining Judge to carry out investigations to identify and trace proceeds of crime. In addition, the law on the Financial Sector requires financial institutions and professionals of the financial sector to cooperate with the authorities responsible for the fight against money laundering, by responding comprehensively to all requests for information, and providing on their own initiative, information on suspicious transactions. However, there is no legal provision allowing an investigator to place a bank account under surveillance.

9. Protection of bona fide parties

Although the legislation allows for the confiscation of assets even when they do not belong to the offender, article 32-1 opens the right for third parties to challenge the confiscation when they claim to have a right to it. Such claim can be filed up to two years after the decision ordering confiscation of the assets, unless the assets have been transferred to a foreign State in accordance with an asset-sharing agreement.

10. Authority to void contract

Such possibility does not exist under Luxembourg law.

The law of March 12, 1984 created in article 391ter of the Penal Code an offence of “organizing insolvency,” which applies to those who, even before a court decision, have organized or increased the insolvency with a view to avoid the payment of any sum which would have been ordered by a court. This law serves a similar purpose as the provisions voiding contracts insofar as they aim at preventing an offender from transferring his assets to third parties to avoid the payment of liabilities or fines (“*condamnations pécuniaires*”). However, the term “*condamnation pécuniaire*” does not include confiscation.

11. Statistics on property frozen

ML and predicate offences:

In the period from 1998 to 2002 an increase in the number of frozen assets has been reported by the public prosecutor. While in 1998 there were 13 cases of freezing of assets, 21 cases were reported in 2002. However, there is, in the same period of time, a decrease in proportion of the number of cases of asset-freezing, in relation to the total number of STRs filed. In 1998 11.4% of the total of STRs resulted in a freezing order while in 2002 the percentage fell to 3.3%.

FT:

In the annual report 2001/2002 the FIU did not report a specific total number of frozen assets relating to FT, but assets of several suspected terrorists in Luxembourg have been frozen. For the moment, only one account remains frozen.

12. Training on confiscation

The respective authorities (public prosecutor, police) attended several international training seminars concerning asset forfeiture.

13. Freezing in execution of UN resolutions

The freezing of assets in accordance with the UN resolutions is implemented by EU regulations in accordance with the EC Treaty. However, the law has not conferred to an authority the legal powers to implement such legislation. To implement these resolutions, authorities use the powers of the FIU to freeze a transaction when a suspicious transaction report is filed. In effect, financial institutions and PSFs have been required by circular to declare a suspicion whenever the name of one of their customers is the same as one of the names on the UN lists published by CSSF and the Prosecutor. On receipt of the STR, the Prosecutor orders the freezing of the account.

13.1

In the annual report 2001/2002 the FIU did not report a specific total number of frozen assets relating to FT, but assets of several suspected terrorists in Luxembourg have been frozen. For the moment, only one account remains frozen.

14. Power to freeze assets of suspected terrorists

Luxembourg law allows for the seizure of assets in the case of suspicion that a person has committed an offence, or that the assets have been used for the purpose of committing an offence. This extends to the offence of terrorism, even if the suspected person is not on the U.N. lists.

In addition, when a financial institution or a PSF suspects that an account is being used for the laundering of assets derived from terrorism, it discloses it to the prosecutor who can freeze the account.

15. Asset forfeiture Fund

Luxembourg has established, by the law of March 17, 1992, the “Fonds de lutte contre le trafic de stupéfiants,” which purpose is the design, the coordination and the implementation of the means to fight against drug trafficking and drug addiction. It receives the funds confiscated in application of article 8-2 of the law on narcotic drugs, which are the assets derived from drug trafficking and the laundering of the proceeds of drug trafficking. It also receives the assets confiscated in execution of a foreign decision of confiscation (article 9, law of June 14, 2001). This fund does not receive funds from assets confiscated in implementation of art. 32-1 of the Penal Code on the confiscation of money laundering proceeds.

The fund has been used to finance the contribution of Luxembourg to FIUNET, the European network of FIUs.

16. Asset-sharing agreements

Asset-sharing agreements now have a legal basis in Luxembourg following the adoption on June 14, 2001 of the law of ratification of the Strasbourg Convention.

Articles 9 and 12 of this law provide that the property of assets confiscated in execution of a foreign confiscation order is transferred to the State “unless it is otherwise agreed with the requesting State or if, in a given instance, an agreement is reached between the Luxembourg government and the Government of the requesting authority.”

Analysis of Effectiveness

The effectiveness of confiscation laws in money laundering matters is difficult to assess, given the low rate of

prosecutions for money laundering and financing of terrorism offences. However, the scope of confiscation is quite broad and its application should not be a problem. To enhance the effectiveness of confiscation measures, Luxembourg could consider alleviating the burden of proof of the origin of the seized assets, as suggested by the Vienna, Strasbourg and Palermo conventions. In such a situation, a person found guilty of an offence of money laundering or financing of terrorism has to justify the origin of the assets acquired before his conviction. The example of another European country can also be considered, which sets as an offence the fact of being unable to justify the origin of his assets, by a person who is proved to be in relation with an organized criminal group or with drug traffickers. There are a number of other examples in the legislation of European countries of such alleviation of the burden of proof.

With regards to the freezing of assets on the basis of the UN Resolutions, Luxembourg has actively implemented its obligations to search for and freeze assets of the persons considered to provide support to terrorist organizations, by issuing circulars to financial institutions. However, today, less than half a dozen accounts have been identified as being related to a person or entity on the list, and the total amount of assets which remain seized in relation to Security Council Resolutions amounts to EUR 3,500, according to the information received from the authorities. These figures, compared to the size of the financial centre, raise questions about the effectiveness of the measures taken. According to the Association of Banks and Bankers in Luxembourg (ABBL), persons or entities connected to terrorists would not choose the financial place of Luxembourg to deposit their assets. The mission has no basis on which to test this assertion. In the absence of a centralized database of bank accounts, the FIU and CSSF rely on the financial institutions to check the listed names against their own client databases, and to determine whether an account could be linked with one of the names on the list, in which case they file a suspicious transaction report (STR) with the FIU. The prosecutor then makes use of the powers under art. 40 (3) of the LoFS 93 to order the freezing of the account.

The recourse to the legal powers conferred to the Prosecutor as an FIU raises an issue, since his power to freeze a transaction is limited to cases where a financial institution has declared its suspicion. In the case of the implementation of UN resolutions, accounts have to be frozen not because a suspicion arose from the movements on the accounts or the behavior of the owner, but just because the name of this person or entity appears on a list issued by the UN Security Council. As it occurred in other countries, the use of legal powers to freeze accounts when they are not meant for this purpose could be challenged in court.

The ability to trace money laundering or financing of terrorism assets is limited by the fact that there is no central database of bank accounts held in Luxembourg. When a new person or group of persons is placed on the list, the Prosecutor contacts all banks by a circular letter to inquire about the presence of such names among the customers of the banks. Similarly, when the Police or the examining Judge, acting on their own or in execution of a mutual legal assistance request from a foreign authority, are in search of the assets held by a person suspected of an offence, they have to send a request or an order to each of the more than 170 banks to disclose whether this person appears as one of their customers.

The possibility for the public prosecutor to suspend a financial transaction is (with the exception of FT) just used in practice only if the judicial authorities get the confirmation of such demand by a mutual legal assistance request or if the FIU has enough indicators allowing it to request the opening of a domestic penal investigation.

However, the preventive aspect of the Luxembourg AML/CFT framework puts the focus more on following and monitoring suspicious financial movements than on freezing assets to interrupt the laundering chain. This focus furthermore respects the involvement of the Luxembourg financial place in the international environment and helps to avoid possible interference with ongoing investigations abroad where an early interrupting of the money flow could hinder investigative activities and successful results.

The FIU is producing a comprehensive annual report which contains the main figures to be able to measure the outcome of the AML/CFT system. However, it could be helpful to understand some significant changes in the figures by commenting on them. For example, the significant increase of the number of filed STRs by more than 50% from 2001 to 2002 was not reflected in the number of suspected persons or entities. This would indicate

<p><i>that the relationship between number of suspect persons or entities to the number of STRs changed from 2001 to 2002. However, this trend was not analyzed and addressed in the annual report.</i></p> <p><i>The authorities in charge of AML/CFT enforcement attend international training seminars concerning asset forfeiture. However, even if the focus of the respective authorities in Luxembourg is put on the preventive side of the AML/CFT framework, (focusing on following the money flow instead of interrupting it), specific training in analysis can draw attention to new trends and provide a better understanding of the international money laundering phenomenon.</i></p>
Recommendations and Comments
<p>Authorities should consider easing the burden of proof as to the property of assets belonging to persons convicted for money laundering and/or the predicate offences.</p> <p>Legislation should be adopted to authorize any authority as designated by the Act to freeze accounts in application of UN resolutions taken as part of the powers of the Security Council, and of subsequent EC regulations, to provide authorities with adequate legal powers to freeze assets within this framework. In order to avoid that a person subject to an investigation seeks to create the appearance of a transfer of his assets to third parties, Luxembourg could consider a provision that opens the possibility of rendering void transactions during a “suspicious period” before the conviction, unless the transaction has been conducted in good faith.</p> <p>The creation of a central database of bank accounts could enhance the efficiency of the fight against money laundering and the financing of terrorism.</p>
Implications for compliance with FATF Recommendations 7, 38, SR III
<p>FATF 7: Implementation of FATF 7, 38 and SR III is limited by the high level of burden of proof and the absence of a centralized bank account database system</p> <p>SR III: lack of an adequate legal power to allow for the confiscation of terrorist assets on the basis of the UN resolutions; no specific requirement to file STRs on FT</p>
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels (compliance with criteria 17-24)
Description
<p>17. The FIU and the established procedures</p> <p>There is no law or regulation formally setting up an FIU in Luxembourg. The functions of the FIU are carried out by a specialized Unit within the Prosecutor’s Office (“FIU-Lux”) on the basis of four legal provisions:</p> <ul style="list-style-type: none">- Art. 40 (2) of the LoFS 93 and 89 (1) of the LoIS 91 which requires financial institutions and PSFs to inform, at their own initiative, the State Prosecutor of any fact that could raise a suspicion of money laundering;- Art. 40 (3) of the Law on the Financial Sector and 89 (2) of the Law on the Insurance Sector which provides that reporting parties shall refrain from carrying out the transaction before they have reported it to the Prosecutor. The Prosecutor can order the reporting party not to execute the transaction. In the case where the reporting parties cannot delay the execution of the transaction, they have to report it immediately after its execution.- Art. 26 (2) of the Criminal Investigations Code, according to which the State Prosecutor of the District Court of Luxembourg has sole jurisdiction on money laundering cases.- Art. 26-2 of the Criminal Investigations Code, which allows for the exchange of intelligence with foreign authorities in charge of AML/CFT. <p>Originally, the FIU function was performed by the Prosecutors of the Economic Crime Unit of the Prosecutor’s office, none of whom were being specifically assigned to this task. Following the recommendations of the first IMF mission in 2001, the FIU was strengthened and FIU-Lux is now composed of one full time and two half-time Prosecutors, and one financial analyst. FIU-Lux is a member of the Egmont Group and of FIUNET, the recently established internet-based network of FIUs within Europe.</p> <p>After the adoption of the LoFS 93, the Prosecutor issued a circular in May of the same year to clarify the</p>

procedures to disclose suspicious transactions, and the scope of the money laundering offence. Since then, no other circular or guidance has been issued on substantive issues, but in the periodic reports published in 1997, 2001, and 2003, some typologies were reported, with a view to give to the financial institutions and PSFs information on the type of mechanisms they could be faced with. Other circulars were issued since September 2001 to notify the names of suspected terrorists listed by various countries and organizations (US, UN, and EU). On their side, the IML in 1994, the BCL in 1998 and the CSSF in 2001 have issued circulars to specify some aspects of the reporting obligation. This reporting obligation, as stated above, is set out in article 40 (2) and (3) of the LoFS 93.

18. Access to additional information by reporting parties

Article 40 (2) of the LoFS 93 of 5 April 1993 and 89 (1) of the LoIS 91, authorize the FIU to obtain information from reporting parties, in accordance with procedures provided for by the applicable legislation. Bank secrecy as well as other professional secrecy rules are not able to be used against a request from the FIU.

19. Access to other information

Being part of the Prosecutor's office, the FIU has normal access to all financial, administrative, and/or law enforcement information accessible to the Prosecutor as a judicial authority.

20. Sanctions for failing to report

Article 64 of the LoFS 93 and 89-1 of LoIS 91 establishes as a penal offence any violation of the requirements to report suspicious transactions, including failure to report or to provide information at the request of the FIU, failure to comply with the freezing order by the Prosecutor, or tipping off customers. Violations are sanctioned by fines up to a maximum of EUR 125,000.

The draft bill No. 5165 would bring the maximum amount of the fine for violation of professional obligations up to EUR 1,250,000.

21. Dissemination of intelligence to domestic authorities

No legislative provision prevents the Prosecutor from disseminating information to other domestic competent authorities. Furthermore, the provision according to which information received by the authorities in application of art. 40 (1) and (2) cannot be used for other purposes than the fight against money laundering, does not apply to judicial authorities. Since the FIU is also a judicial authority, the Prosecutor can freely disseminate the information for judicial purposes.

22. Dissemination of intelligence to foreign authorities

Art. 26-2 of the Criminal investigations Code specifically authorizes the Prosecutor to share financial information and other relevant intelligence with foreign authorities responsible for the fight against money laundering. The communication of intelligence is done on the basis of existing treaties or of reciprocity.

The FIU also implements the EU Council Decision of December 17, 2000 on the cooperation between the European FIUs including through spontaneous exchange of information. The FIU has concluded Memoranda of Understanding (MOU) with the following countries: France, Belgium, Monaco, Finland. It is in the process of concluding such MOUs with other countries, including Russia.

The communication of intelligence is done, according to article 26-2, under the condition that the information is used for the sole purpose of the fight against money laundering and that it is covered by the professional secrecy of the recipient authority. The recipient authority has to obtain the agreement of the Prosecutor's Office prior to communicating this information to other authorities or third parties.

23. Statistics

Statistics:

Total Number of filed STRs

2000: 158

2001: 413

2002: 631

2003: expected ca. 750

Reporting financial intermediaries:

2000: 113 banks; 5 other financial intermediaries, 12 insurance companies

2001: 265 banks; 15 other financial intermediaries, 49 insurance companies

2002: 375 banks; 34 other financial intermediaries, 95 insurance companies

Requests of foreign FIUs:

2000: 20

2001: 45

2002: 83

Number of STRs filed by approaching business-relations:

2000: 15 (10.8% of the total number of filed STRs)

2001: 24 (7 % of the total number of filed STRs)

2002: 79 (14.4% of the total number of filed STRs)

Number of STRs where ML is confirmed:

2000: 27 (19.5% of the total number of filed STRs)

2001: 101 (27.4% of the total number of filed STRs)

2002: 135 (24.6% of the total number of filed STRs)

Reported predicate offences:

2000: fraud, embezzlement, etc.: 40.7%; drug trafficking: 37%

2001: fraud, embezzlement, etc.: 62.3%; drug trafficking: 16.8%; organized crime (incl. FT): 13.8%

2002: fraud, embezzlement, etc.: 68.8%; organized crime (inc. FT): 20%

amount of assets reported:

2000: ca. US\$360m

2001: ca. US\$2.4bn

2002: ca. US\$3.5bn

ongoing penal investigations in ML at the moment (since the existence of the AML/CFT legal framework):

3-4

convictions in ML (since the existence of the AML/CFT legal framework):

4 (national ML)

24. Adequacy of staff and structure

The Luxembourg FIU was set up in 1993 and is situated within the public prosecutors office. Since September 2002, the FIU is structured and staffed by 1 coordinating Prosecutor, 2 half-time Prosecutors, 1 financial analyst and 1 administrative secretary. There are plans to assign 5 criminal police investigators to assist the investigative work. The FIU, as part of the public prosecutors office, does not have a separate budget. The FIU runs a separate stand-alone database, not accessible by any other administrative or judicial authority, except the assisting team of criminal police officers. The FIU has been a member of the Egmont Group since 1997 and is the central authority in Luxembourg to receive, analyze and disseminate STRs and other relevant

intelligence concerning ML. Furthermore the FIU is allowed to exchange information with its foreign counterparts, and does so especially within the EU. The FIU issues guidelines and publishes annual reports. The reports contain relevant statistics related to the filed STRs, Typologies and other information dealing with latest developments in the AML/CFT framework. In particular the report outlines post September 11, 2001 experiences

The FIU is competent to obtain information and additional documentation if needed from the financial sector which is obliged to disclose suspicious transactions. The banking secrecy and other professional secrets do not prevent the FIU from having access to the necessary financial information from the obliged financial intermediaries.

The FIU disseminates financial information and intelligence to law enforcement or the investigating judge for further investigation or prosecutes directly in its capacity as public prosecutor. The double capacity of the FIU (FIU and judicial authority) allows it to prosecute any criminal offence on the basis of information gathered as FIU, even if it is not related to money laundering.

Analysis of Effectiveness

The Financial Intelligence Unit in Luxembourg is one of the judicial model, i.e., under the supervision and operation of a judicial authority, namely the Prosecutor's office. It benefits from ten years of experience in receiving suspicious transaction reports (STRs), and its authority is recognized and unchallenged. Its staff is very committed and maintains close relations with the financial sector. However, it lacks a clear and transparent legal framework to operate, and sufficient means and IT equipment to face the continuous rise in STRs and to fulfill a real analysis function. Financing of terrorism is not currently an offence for which suspicion needs to be disclosed.

Article 40 (2) of the LoFS 93 requires the disclosure of any fact which could constitute a money laundering offence. Financing of terrorism is not included as one of the offences which must give rise to a disclosure. However, since the law of August 12, 2003, financing of terrorism is included as one of the predicate offence of money laundering and as such, should be declared, to the extent to which the funds aimed at financing a terrorist organization are being laundered. Draft bill no. 5165 would, if adopted, correct this small flaw by extending the reporting obligation to suspicions of financing of terrorism itself.

The processing of suspicious transaction reports (STRs) by the FIU is made in the following manner: when an STR is received, the Prosecutor sends it to the Police for investigation, after checking against the Prosecutor database (chaîne pénale) and the mutual legal assistance database (which records all MLAT requests including names of persons involved). In some cases (3.3% in 2002), he also orders the bank to freeze the account, usually within 24 hours. The police then gather information by checking against databases including criminal records, FIUNET, and JUOBA, the FIU database, and continue the investigation if the suspicion is substantiated. If it appears that the assets or the transaction originate from, or are aimed at, a foreign country, the information gathered and the STR are sent to the foreign FIU, which FIU-Lux considers in its annual report 2001-2002 to be a "priority mission". It is unclear whether this transmission is made when the STR is received by the Prosecutor, or after investigation by the Police.

The operation of the FIU in Luxembourg has been rated as quite effective by a large number of our interlocutors during the mission. In particular, professionals of the financial sector have commended the responsiveness of the team, who provide feedback within a very short period after the STR had been filed, and who are open to their questions and requests for guidance in cases of doubt on the true nature of a transaction. The disclosure rate is gaining momentum, especially since the circular requiring financial institutions to file a report even when they refuse to enter in a business relationship with the client, as suggested by the first IMF mission. During interviews, financial institutions and PSFs have not mentioned any reluctance to interact directly with an FIU which is also the prosecution authority. The Prosecutor in charge of the unit is well-known and widely respected by his interlocutors who appreciate his availability and responsiveness. In brief, there seems to be a consensus about the appropriateness of the mechanisms which have been set up.

A deeper analysis gives a slightly different picture. A number of professionals have raised some concerns about the fact that some accounts frozen by the FIU remain for months without any action taken and/or any feedback given to the financial institution, whereas the reporting party is prohibited to inform his client of the reason why he refuses to defer to his instructions. Lack of long-term feedback was an issue raised in most of the meetings with professionals of the financial sector. The absence of clarity about the scope of powers of the FIU, because of the confusion between the FIU function and the prosecutorial role of the authorities in charge of receiving STRs, has also been reported. The mission notes with concern that the FIU has not been given a legal framework to operate apart from the few legal provisions mentioned above, and operates on the basis of powers which have been conferred to this authority for the purpose of prosecuting offences. Staff of the FIU acknowledge it and claim that the possibility to make use of the powers of the prosecutor is precisely what makes the FIU particularly efficient in comparison to other FIUs. This is certainly true but raises a question: FIUs are aimed at receiving, analyzing, and disseminating financial information, according to the Egmont Group definition. In other words, its purpose is to process the cases of suspicion brought to its attention by financial institutions, in order to substantiate suspicion before sending it to the authorities in charge of investigating offences. The objective is to provide an interface between the reporting party and the law enforcement agencies, in order to filter cases of suspicion and submit to criminal investigation only those cases where the suspicion was founded. If the STR is processed by the prosecuting authority through a criminal investigation and therefore considered as reporting a criminal offence, where is the FIU function? If it is not processed within the framework of a criminal investigation, what is the legal basis for the FIU to proceed, except from the power to request further information as provided in article 40(2) and the power to freeze the transaction of article 40(3)?

It is in this context that the Chamber of Commerce of Luxembourg, when requested to provide an official opinion on draft bill No. 5165, has voiced strong reservations as to the existing legal basis for the role of the Prosecutor's office in this respect, and as to the changes proposed in the draft bill.

Analyzing the current legal framework, the Chamber of Commerce⁹ is of the opinion that, with the exception of a case where the Prosecutor acts in response to an STR, the Prosecutor "could not require any document for the purposes of an investigation, and banks requested to do so would be allowed, if not required, to refuse to defer to such an instruction." In the Chamber's view, such information can only be requested "in accordance with procedures provided by the applicable legislation," and the only authority empowered to compel a bank to provide such information is the examining Judge.

Commenting on the amendment in the draft bill which would remove the words "in accordance with procedures provided by the applicable legislation," the Chamber of Commerce does not object to the fact that the law empowers an authority to obtain, without limit, any information for the purposes of fighting against money laundering and financing of terrorism. However, it strongly opposes the fact that such information be disclosed to the Prosecutor, because the Prosecutor may use such information, without limit, for any other purpose in his capacity to prosecute criminal offences of any kind.

In particular, the Chamber of Commerce relays a concern that was often raised during the discussions of the mission, which is that reporting parties face the risk that the disclosure of suspicious transactions to an authority which is both an FIU and the Prosecutor may be used against them as evidence of the fact that they, at some point, breached their professional obligations. Law enforcement authorities confirmed to the mission that such concern was widespread among financial institutions, and that it could be counter-productive in that financial institutions would refrain from disclosing if it could be used against them.

In conclusion, the Chamber of Commerce calls for the creation of an autonomous FIU, as in neighboring countries, or alternatively for limiting the possibility for the Prosecutor to make use of the information received

⁹ The Association of Banks and Bankers of Luxembourg have provided a substantive input in the drafting of the opinion.

in his capacity as an FIU, and for limiting his powers to access to such information.

In a document submitted to the assessment team after the mission, the authorities responded that, on the occasion of the adoption of the 1993 law, the Chamber of Commerce called for the FIU functions to be carried out by the Prosecutor, while limiting the possibility to prosecute other offences uncovered through STRs (“Specialty rule”). The Finance Commission of the Parliament eventually decided on the judicial option without applying the specialty rule, after having carefully reviewed all the possible alternatives. The fact that some bankers were prosecuted for violation of their professional obligations may explain why the Chamber of Commerce now expresses a different view. The authorities do not share the Chamber of Commerce’s opinion that the Prosecutor could not obtain information outside the scope of an STR, and consider that the concern expressed that the AML provisions require the professionals to “denounce themselves” as unjustified.

The mission will not comment on the proposal made by the Chamber for the introduction of another type of FIU. It is up to each country to decide, on the basis of criteria which relate in particular to the legal and administrative culture of the State, as to the form and scope of powers of the FIU.

However, Luxembourg could take advantage of the opportunity of the modification of the law to provide for a comprehensive legal framework for the operation of the FIU, including clarification on its role and functions, the scope of its powers, and its structure.

In relation to the violation of professional obligations, FIU-Lux mentioned in its report for 2001 and 2002 that they were two distinct cases which were sanctioned by the same penalties: the material breach of the obligations, which may be the result of a negligence or a lack of training, and the fraudulent violation of professional obligations. FIU-Lux indicates that it would be equitable that the law establish, with regard to sanctions applicable, a difference between negligent and fraudulent behavior. Imprisonment penalties should be considered for the latter.

Besides the described activity of receiving and disseminating the STRs, it is the role of an FIU to analyze them. The analysis capacity is one of the most important ones of any FIU. It allows a lot of information to be brought together to give a picture which identifies patterns and typologies of ML. Furthermore in a preventive AML/CFT framework as the Luxembourg one, it is of crucial importance to be able to act in a proactive manner in order to detect possible new threats and inform the financial sector as well as to propose to the government possible improvements to avoid being involved in future scandals and undermined by ML.

To be able to analyze a lot of information, an effective database, analytical tools and specialized appointed officers are necessary. However, the actual database of the FIU, due to its structure (basically focused on administrating the STRs and respective information), is not completely able to support the analytical task and the actual structure of the FIU (1 Prosecutor, 1 financial analyst, 2 half-time Prosecutors, 5 planned assisting police investigators) does not include a specific analytical division. Due to the size and structure of the financial market, the FIU follows the principle of transmitting financial information to the respective foreign counterparts in order to enable them to conduct their investigations. Consequently, the FIU has to rely even more on its own analysis capacity to detect links and coincidences among STRs and to produce intelligence for domestic investigations against financial institutions who are involved in ML, organized crime or FT. Furthermore, analysis and the production of intelligence can support the investigative work by detecting links between different STRs which not have been identified yet, and could result in new criminal investigations or the provision of further intelligence packages to foreign counterparts.

The total number of STRs has increased strongly since 2001. The actual number of staff of the FIU (in total: 3 persons-year at the Prosecutor-level, 5 persons-year planned at the assisting criminal police level) is too little to give an adequate response to this challenge. Mainly the Prosecutors direct the investigations, which are actually carried out by the police. One financial analyst is not adequate to properly analyze all the incoming STRs. Furthermore, carrying out real analyses i.e. criminal analysis to produce intelligence and support to on-going investigations, can be achieved only by recruiting specially trained analysts out of a pool of analysts for the entire police force. The authorities reported that this analytical support does not happen systematically and not very often but just in the most important criminal investigations due to the lack of trained personnel.

The annual report of the FIU gives an overview of the key figures to measure the outcome of the AML/CFT framework. However, there remain some interpretations of figures not addressed in the report. For example: although the number of STRs increased by more than 50% from 2001 to 2002, this increase was not reflected in the number of suspect persons or entities. This would indicate that the relationship between the number of suspect persons and entities to the number of suspicious transactions changed from 2001 to 2002. This trend was not analyzed nor addressed in the report.

The number of credit institutions approved in Luxembourg declined from 202 in 2000 to 177 in 2002. In the same time period, the number of institutions filing STRs increased steadily, from 31 in 2000 to 80 in 2002. Out from the 31 institutions filing STRs in 2000, 6 of them filed ca. 44% of the total number of STRs filed by credit institutions. In 2002, out of the 80 filing credit institutions, 11 reported ca. 48% of the total. Since more institutions are now filing STRs and the percentage of STRs this represents is increasing slightly, this could be analyzed as an increasing of awareness. However, in 2002, out of the approved 174 credit institutions less than 50% filed STRs.

Analyzing the filing of STRs by other PSFs, in 2000, there were only 5 involved in this process, in 2002 34. All over the years from 1993 to 2002 there has been a significant increase of other PSFs filing STRs. However, the fact that the sector of credit institutions is heavily dominant in the disclosure of STRs to the authorities, bearing in mind that out of this sector less than 50% do file reports, raises a question about the actual commitment of the majority of the financial community. A further in-depth analysis is not possible due to the fact that figures do not exist as to the percentage of total assets represented by filing credit institutions.

Over all, even if there are statistics, the absence in the annual report of the FIU of analysis and intelligence on important issues and the absence of analytical tools as demonstrated by the structure and contents of the report, lead to the conclusion, that the present structure of the FIU is not adequate for the financial market. There is simply no distinction between investigative and intelligence work and not enough personnel to carry out a real analysis of the incoming STRs.

Having said that, it is not possible to measure the performance of the FIU. The functions within the same structure are too numerous for performance indicators to be developed.

Recommendations and Comments

Financing of terrorism should be added to money laundering as the offences for which suspicion should be disclosed.

A legal instrument should be developed to provide a clear framework for the operation of the FIU, whatever is the option chosen as to its form. Such legal instrument should define its role and function, in particular with regard to the analysis of intelligence, its interaction with financial institutions and PSFs, and foreign counterparts, its structure, as well as the means and powers provided for its operations. The FIU should continue its policy of openness with the financial sector, and as part of it, should issue circulars and guidance on a regular basis to clarify certain aspects of the implementation of the law.

Both the FIU itself and the law enforcement team which supports it should be further integrated and be given adequate means to fulfill their functions, in consideration of the growing number of STRs, the addition of the financing of terrorism duties, and the need to strengthen the analysis function of the Unit.

The FIU should be urgently equipped with the IT equipment necessary to run a modern database capable of analyzing financial mechanisms, checking databases and allowing for data-mining.

With regards to the offence of violations of professional obligations, the law should establish a distinction between cases of negligent and of fraudulent violations, with proportionate and dissuasive sanctions.

Implications for compliance with FATF Recommendations 14, 28, 32

FATF 14: the FIU has not issued guidelines on complex and unusual transactions
FATF 28: While some typologies have been listed in the annual reports of the FIU, no specific circular has been issued to provide guidance to the financial institutions on what constitutes a suspicious transaction.

**IV—Law enforcement and prosecution authorities, powers and duties
(compliance with criteria 25-33)**

Description

25 Designated law enforcement authorities

The state prosecutor of the District Court of Luxembourg has exclusive competence for investigating and prosecuting ML and FT.

The criminal police (organized crime, ML, drug trafficking) work in close co-operation with the investigative judges and the magistrates.

The customs services is not competent in ML matters.

However, customs officers are jointly with the police fighting against the drug criminality. Furthermore customs is competent to control the cargo and customer baggage at the airport. Due to the fact that the airport of Luxembourg is number 5 in cargo traffic in Europe, after September 11, 2001, customs increased its number of officers at the airport from 8 to 24.

According to the authorities, cooperation between the different law enforcement bodies is effective.

26. Legal basis for the use of a wide range of investigative techniques

Under article 88-1 of the Criminal Investigations Code, the examining Judge may order the surveillance of all kinds of communication means in the case of “particularly serious” offences, when normal investigation techniques are ineffective, and only on the person who is suspected to be the author or to have participated in the offence, or who may receive or transmit information to or from the suspected or the indicted person. These measures cannot be ordered against a person who is subject to professional secrecy, unless he is suspected to be the author of the offence.

According to the authorities, controlled deliveries and undercover operations can be operated, subject to the authorization of the General Prosecutor, the State Prosecutor or the examining Judge as appropriate. However, there is no legal framework, apart from the provisions of some international treaties (Vienna Convention, Schengen Agreement in particular) which delineates the scope and the conduct of such operations.

According to the authorities, these techniques are mainly used in drug cases and not often in ML or FT investigations.

27. Power to compel the production of documents

Such a power exists and is exercised under the control of the examining Judge during the pre-trial phase, who can order search and seizure of all documents, records and objects that may provide evidence of the offence or may be confiscated (art. 65 and 66 of the Criminal Investigations Code). During the time immediately after the commission of an offence (*flagrant délit*), this power may be exercised by a police officer under the instructions of the Prosecutor.

28. Existence of law enforcement task forces

Task forces in the meaning of a permanent “institution” do not exist. The police and customs are working closely together in investigations on drug trafficking and share information on a case-by-case basis. However, if there is a investigative need to have more government agencies assisting in a case of ML or FT, they may be asked for cooperation. These agencies would not be involved in executing actions.

On a multilateral level, police and customs are involved in regular specific common actions with the Netherlands, Belgium, France, and Germany.

29. Structure, fund and staff of the law enforcement bodies

The main body within the police dealing with ML and FT is the assisting unit to the FIU which is to be composed of 5 officers. This unit uses a stand alone database for all information related to ML and FT. Mainly the database is a tool to manage the incoming STR and the respective information. Analytical power of the database is minimal. In depth analytical work is not done in a lot of cases. The existing IT structure supports the production of the annual report and producing statistics.

30. Statistics

There are at the moment 4 cases of ML under investigation.

32. Training

The police officers involved in ML and FT are mainly trained in the basic police school and get additional courses in-house. The magistrates, working in the field of ML and FT are mainly trained on the job and in attending respective international working groups and seminars such as the FATF, the Egmont group of FIUs and the EU. 4 police officers and 2 prosecutors participated in a ML/FT training workshop in Washington D.C..

Analysis of Effectiveness

The FIU and law enforcement and prosecution authorities being the same, many of the comments made as to the FIU could be replicated in relation to the effectiveness of these authorities. The specialized police authorities and the prosecutor's office benefit from the fact that they are combined with the FIU, for maximum efficiency in prosecutions. However, the number of prosecutions is very low, due to the established policy of forwarding to foreign authorities all cases and suspicions of money laundering which relate to persons or funds originating from abroad. With regards to investigative techniques, these are limited to wire tapping and other related measures. The on-going monitoring of bank accounts, and the use of pro-active investigative techniques such as undercover operations, sting operations, front operations and controlled deliveries, are not provided for by the law. Controlled deliveries are carried out with the authorization of the Prosecutor, in the area of drug trafficking, but they have not been used in the area of money laundering or financing of terrorism. The use of more advanced investigative techniques may be dangerous and raise some legal questions insofar as they imply inciting a person to commit an offence by someone. However, they have proved in other countries to allow for spectacular results in terms of funds seized and organizations dismantled. The cost/benefit analysis of engaging in such techniques should be reviewed and, where the specialized law enforcement agencies intend to implement such techniques, there should be a strong legal framework to allow for it and to define its scope.

With regards to search and seizure of documents, the mission was informed that a gentleman's agreement existed between the banks and the investigative Judges, by which when the judge orders a search in a bank for documents in relation with a criminal investigation, it allows the bank to "spontaneously" hand the documents to the Judge within a period of 10 days, after which the search is carried out coercively. The investigating Judges specified to the mission that when there was a risk that such an agreement could jeopardize the investigation for any reason, they would opt for an immediate search.

The law enforcement bodies of Luxembourg seem to work closely together, within the country and with their respective foreign counterparts. Due to the size and structure of the financial place of Luxembourg, international law enforcement cooperation is of crucial importance. However, the domestic work of the law enforcement can be even more effective, if common databases or access to the respective data would be easier.

Special investigative techniques such as controlled delivery and undercover operations are not often used in ML and FT investigations, mainly due to the fact of the size of the country.

However, special investigative techniques, especially surveillance and monitoring of financial flows and other internal data of a financial intermediary could be used to support foreign ML investigations and detect possible involvement in ML of local staff.

<p><i>Statistics and Structure:</i> <i>The roughly 600 STRs produced 4 cases of ongoing penal investigation. The same planned 5 officers have to deal with police investigative techniques as well as with analytical work of the STRs. Furthermore, they have to prepare the basic material for the statistics. The question arises as to whether there are enough staff at the law enforcement level to deal with all the information in a proper way. Training of new officers in this unit takes some time. The authorities should consider restructuring the FIU and separate the investigative work from the intelligence work.</i></p> <p><i>Training of law enforcement happens on a regular basis. It could be enhanced by organizing joint workshops between the financial sector and the government analysts.</i></p>
Recommendations and Comments
<p>There should be a legal basis for a wider range of investigations, including at least monitoring bank accounts and controlled deliveries in drug trafficking, money laundering and financing of terrorism matters.</p> <p>Specialized law enforcement agencies, such as the anti-money laundering Section of the Judicial Police, should be equipped with sufficient human and technological means to carry out their functions.</p>
Implications for compliance with the FATF Recommendation 37
–
V—International Cooperation (compliance with criteria 34-42)
Description
<p>34. Legal framework on mutual legal assistance</p> <p>A law of August 08, 2000 has considerably changed the procedures applicable to mutual legal assistance (MLA), addressing some of the previously existing flaws which limited the capacity of Luxembourg to deliver swift responses to foreign requests for cooperation.</p> <p>This law allows for the execution in Luxembourg of foreign MLA requests for search, seizures or any other act implying a coercive action, emanating from foreign judicial authorities, bound or not by a treaty with Luxembourg, as well as with a “recognized” international judicial authority. (art.1).</p> <p>The requests are addressed to the Prosecutor General of the State who forwards it to the competent judicial authority if he does not object. The cases for refusal are the following:</p> <ul style="list-style-type: none">- if the request may prejudice the sovereignty, security, public order or other essential interests of the State- if the request relates to offences of a political nature- if the request relates to tax and customs offences under Luxembourg laws <p>The request may also be refused by the executing authority if some of the elements of information stipulated in art. 4 are missing, or if it is likely that the measures requested will not get the expected result.</p> <p>The decision to pursue the execution of the MLA request may be challenged by way of a petition filed within 10 days of the notification to the person “by which the measure is executed”. The language of this provision is formulated in a way which allows for the notification to the bank and not to the owner of the account, to avoid undue delays which occurred before the adoption of the law, because the executing Judge had to identify the address of the account owner in order to notify the measure. Petitions against such a decision do not prevent the measure from being executed. All petitions are examined together by the “Chambre du Conseil” of the Court, and may be appealed.</p>
<p>35. Provision of mutual legal assistance</p> <p><i>In 2001, 33 mutual legal assistance request related to ML were received. Under this category, there was an</i></p>

amount of ca. EUR 10m frozen. In 2002, the number of requests for mutual legal assistance was 30 with an amount of frozen money of ca. EUR 11m. There is no information about the status of these requests. It seems that there was no refusal to give assistance to these requests. On the administrative level, the FIU worked in 2000 on 20 requests from foreign counterparts, in 2001 on 45 and in 2002 on 83. There is no information in the annual report concerning the requests to foreign counterparts.

36. Conventions, treaties, arrangements or agreements

Luxembourg is a party to the following international MLA conventions and treaties, which form the legal basis of judicial cooperation in money laundering and financing of terrorism matters:

- European convention on judicial assistance in penal matters of 20.4.1959(enacted 21.7.1976) & additional protocol of 17 March 1978(enacted 27 August 1997)
- BENELUX Treaty on extradition and judicial assistance in penal matters of 27 June 1962 (enacted 26.2.1965)
- UN Convention of 20 December 1988-Vienna (enacted 17 March 1992) (art. 7)
- Council of Europe Convention of 8 November 1990 (enacted 14 June 2001)
- OECD Convention on corruption of foreign public officials-21 November 1997(enacted 15 January 2001) (art. 9)
- UN Convention for the suppression of the financing of terrorism (enacted 12 August 2003) (art.12, 13,14)

Luxembourg is also part of the Schengen agreement, which has also significantly streamlined the MLA procedures within the participating membership¹⁰.

In addition, mutual legal assistance bilateral treaties (MLATs) have been concluded with the USA and Australia.

37. Law enforcement cooperation

Luxembourg is a member of Interpol, party to the Europol convention of 1995 and party to the Schengen Agreement of 1990. *The exchange of information on the international level of police cooperation is operated via these institutions. Furthermore there are bilateral close contacts, particularly with the Netherlands, Belgium, Germany and France. The police keep records of all the requests received and transmitted, including those related to ML.*

38. Cooperative investigations

Controlled deliveries are authorized by the General Prosecutor, the State Prosecutor or the examining Judge, as appropriate. The framework for the conduct of such operations is the one existing in international treaties such as the Vienna Convention and the Schengen Agreement.

39. Coordination of seizure and forfeiture actions including asset-sharing agreements

There are no permanent task forces to coordinate the approach of seizure actions. This has to be authorized on a case by case basis.

The fight against terrorism and its financing is in the competence of the public prosecutor and the law enforcement agencies.

40. Extradition

Extradition is possible on the basis of the law of June 20, 2001 and of reciprocity, in the absence of international or bilateral treaty. It may be granted for all offences punished by more than one year in the law of Luxembourg

¹⁰ Convention for the application of the Schengen agreement of 19 June 1990 (enacted 3 July 1992) (art. 48-53)

and the law of the requesting State.

Article 3 to 14 provide details of the cases when extradition can be refused.

In particular, it is refused in the following cases:

- offences of a political nature
- for considerations of race, religion, and nationality
- for military offences
- for tax, customs, and currency exchange offences

Extradition will not be granted if the person is of Luxembourg nationality, or for long-time residents when they can be prosecuted in Luxembourg. The principle *aut dedere, aut judicare* (either give or judge) is not set out in the law, but Luxembourg is bound by its international obligations in this respect, pursuant to art. 6.2 of the European Convention on Extradition, art. 6.9 a) of the Vienna Convention, and art. 10.3 of the OECD Convention of 1997, in particular.

In cases of urgency, the authorities of the requesting States may request the provisional arrest of the person for which the extradition request is made. The law specifies the conditions and procedures for the arrest and detention of the person subject to extradition before the decision.

Where the person subject to extradition consents to the extradition, the extradition can be granted directly by the Minister of Justice.

42. Adequate financial, human or technical resources for international cooperation

Luxembourg initiated a 5 year plan to substantially increase the personnel of the police and judicial authorities. The police has a special unit which deals with the international information exchange. This unit is composed with 10 officers and 1 secretary. On the judicial level, the public prosecutor who is also in charge with the FIU deals with the mutual legal assistance.

Analysis of Effectiveness

The large amount of assets managed or deposited in Luxembourg by foreigners gives rise to a significant number of MLA requests. The overload of foreign requests and the previous procedures often resulted in the past in undue delays and Luxembourg was sometimes criticized by neighboring countries for its low and slow response to their requests. The law of August 8, 2000 has provided for a simpler procedural framework and is praised for its efficiency. Since its adoption, the number of petitions against measures executed in response to an MLA request, which were filed before for the main purpose of delaying the process, has dropped significantly to a dozen per year. The law is clear and simple, even though the conditions for granting the request, and the possibilities for refusal are extensive, in particular with regard to failure to provide specific details in the request. However, the law authorizes the executing Judge to ask for additional information without having to simply dismiss the request. According to the office of the Prosecutor General, no request has been refused until now for any of the reasons specified in art. 4 of the law. With the adoption of the law on extradition on June 20, 2001, Luxembourg has now a comprehensive framework for international cooperation. Luxembourg is a party to the international instruments designed to enhance judicial cooperation in criminal matters, apart from the Palermo convention.

The MLA law provides in its article 4 that MLA requests should be considered as “urgent and priority matters.” According to the judges with whom the mission met, the timeframe for the execution of MLA requests has significantly decreased. In case of urgency, MLA requests may be sent directly to the executing Judge.

Both mutual and extradition laws are in accordance with international standards.

Some figures are given in the annual report. However, the picture about the effectiveness of international cooperation cannot be completed with not having more key figures available such as, how many requests on the

<p><i>FIU level were made to foreign counterparts, were they made to get information in order to prepare a mutual legal assistance request (exchanging specific information to enable a enough substantiated judicial request), were there problems to resolve due to the fact of links of ML with tax evasion, etc. Furthermore it would be of crucial interest, how the judicial FIU resolves the problem of overlapping possibilities of international information exchange: in what kind of cases is the medium to communicate the FIU-FIU exchange, in what kind of cases is the medium Interpol and what kind of criteria exist to distinguish these possibilities. The police exchange of information, meaning the exchange between pure law enforcement agencies related to ML is working well and less crucial regarding the structure and size of the financial place and therefore its exposure to ML than the exchange on the intelligence and judicial level.</i></p>
<p>Recommendations and Comments</p> <p>The authorities should sign, ratify, and implement the Palermo Convention. The conclusion of bilateral mutual legal assistance treaties is recommended. The authorities should develop a system of tracking foreign requests and keeping statistics on the amounts of money frozen and confiscated at the request of foreign countries.</p>
<p>Implications for compliance with FATF Recommendations 3, 32, 33, 34, 37, 38, 40, SR I, SR V</p> <p>FATF 3 and 37: while there are multilateral and regional treaties in place, there are only 2 bilateral treaties in place, which is few for an international financial centre. FATF 38: some delays still in processing requests and burden of proof for confiscation is very high SR V: the absence of an STR system for terrorist financing limits the ability to exchange information in this matter</p>

B. Assessing Preventive Measures for Financial Institutions

32. The assessment sought to confirm that : (a) the legal and institutional framework is in place and (b) there are effective supervisory/regulatory measures in force that ensure that those criteria are being properly and effectively implemented by all financial institutions. Both aspects are of equal importance.

Table 2: Detailed Assessment of the Legal and Institutional Framework for Financial Institutions and its Effective Implementation

<p>I—General Framework (compliance with criteria 43 and 44)</p>
<p>Description</p> <p><i>The Legal framework for prevention of money laundering and financing of terrorism in the financial sector.</i></p> <p>The general legal framework is constituted, with regard to preventive measures for financial institutions, by the Law of April 5, 1993 on the Financial Sector (“LoFS 93”), which defines the rules applicable to the supervision of the Financial Sector. The Law originally covered financial institutions, i.e., credit institutions and other “Professionals of the Financial Sector” (PSF), which comprise financial advisors, brokers, commission agents, private portfolio managers, professionals acting for their own account, distributors of parts in UCI's, underwriters, market makers, professional custodians of securities or other financial instruments, currency exchange dealers, and professionals exercising debt recovery). The law of March 12, 1998 implementing the European Directive 93/22/EEC of May 10, 1993 on investment services in the securities field introduced the designation of ‘investment firm’ into the LoFS 93, thus covering under this name commission agents, private portfolio managers, professionals acting for their own account, distributors of parts in collective investment schemes and underwriters. A separate law of May 31, 1999 provided for the addition to the list of PSFs of company domiciliation businesses, which are bound to carry out customer identification both by this law and under LoFS 93. Payment and settlement system operators have been added to the list of PSFs by the law of January 12, 2001. Finally, by an amendment of Law of August 2, 2003, PSF</p>

now includes also the following businesses: transfer and registrar agents (agents de transfert et de registre), professionals carrying out loan operations (professionnels effectuant des opérations de prêt), professionals carrying out securities lending (professionnels effectuant du prêt de titres), professionals carrying out money transfer services (professionnels effectuant des services de transfert de fonds), administrator of unit trusts (administrateurs de fonds communs d'épargne), managers of non-coordinated CIS (gestionnaires d'OPC non coordonnés), client communication agents (agents de communication à la clientèle), administrative agents of the financial sector (agents administratifs du secteur financier), computer system and communication network operators of the financial sector (opérateurs de systèmes informatiques et de réseaux de communication du secteur financier) as well as professionals providing company incorporation and management services (professionnels effectuant des services de constitution et de gestion de sociétés). A law of March 30, 1988 also regulates Collective Investment Schemes (CIS). The setting up and management of a CIS can only be done by regulated professionals.

The LoFS 93 contains three articles dealing the fundamental principles of AML/CFT prevention in the financial sector: art. 38 (definition of money laundering), art. 39 ("know your customer" and record-keeping obligations) and art. 40 (obligation to cooperate with the authorities).

A new Law, amending the LoFS 93, as well as other laws and codes is being considered, to give effect to the European Directive 2001/97/CE of December 4, 2001, and to a certain extent to the revised FATF 40 recommendations. This draft is intended to expand the scope of the money laundering offence, and also the range of professionals subject to AML/CFT obligations. Pursuant to article 2 of the draft bill N° 5165 the law would apply to 17 categories of persons. In these categories are included among others financial institutions and PSFs, insurance and re-insurance companies, pension funds, CIS, stock exchanges, external auditors, accountants, real estate agents, public notaries, lawyers (when they assist or represent their clients in financial operations), tax advisers, casinos, and all businesses carrying out cash transactions for an amount in excess of EUR 10,000. This law will establish on a clear statutory basis the Prosecution Office as the FIU, and the CSSF as the competent authority to give effect to AML/CFT standards. It specifies the scope of requirements for each profession concerned.

The LoFS 93 has been complemented by 60 circulars issued by the CSSF (and its predecessor), many of which provide information on the evolution of the FATF NCCT list, or on the list of terrorists and terrorist groups established by UN Security Council resolutions 1267, 1333 and 1390, and the European Commission Regulation EC 881/02. It is widely accepted that these Circulars do not in themselves have force of law and cannot add new legal requirements. Typically they state as their basis a specific provision of LoFS 93 or other law and, according to the authorities, are intended "to provide guidance to financial professionals, on the basis, in particular, of the provisions of the law of April 5, 1993 on the financial sector, on how they are supposed to observe the professional obligations imposed upon them by law in order to prevent their exploitation for the purposes of money laundering".

The most important circulars from the perspective of AML/CFT are:

- **Circular 94/112 of 25 November 1994** on the measures to combat money laundering and prevention of the use of the financial sector for the purpose of money laundering. This circular reflects the legislative changes that have been introduced since the law of 5 April 1993 on the financial sector. It deals, in particular, with the following areas: identification of customers, identification of beneficial owners, monitoring, record keeping, internal procedures and training of staff, suspicious transaction reporting.
- **Circular 98/143 of 24 November 1998**, which draws the attention of regulated professions to the new predicate offences added to the law, and the new offences for violation of professional obligations.
- **Circular CSSF 2000/21 of 11 December 2000** on the laundering of funds related to bribery and corruption and financial professionals' relationships with politically exposed persons (PEPs). The circular draws the attention of financial professionals to the need to take particular care when they intend to establish business relationships with persons exercising public functions in a State or with persons and companies that are linked to PEPs.
- **Circular CSSF 01/40 of 14 November 2001**. This circular repealed the presumption by which financial institutions were not required to check the identity of beneficial owners in the case of business introduced by certain professionals (in particular lawyers or public notaries), whose normal professional activities include depositing third party assets with financial institutions. In addition, the circular states that the reporting obligation established by article 40(2) of the LoFS 93 extends to circumstances where a professional is in contact with a person prior to entering in a business relationship or conducting a transaction. The fact that

suspicious prevented the financial institution from opening an account or conducting a transaction does not exempt the financial institution from the obligation to report.

- **Circular CSSF 02/78 of 27 November 2002.** This circular provides guidance as to the action to be taken by regulated professions when facing suspicious cases, in particular by questioning the client on the source of funds and requesting all appropriate additional information. It provides information as to the predicate offences, in particular the fact that all crimes are predicate offences when committed by a criminal group or organization.

With regard to the Insurance sector, the legal framework is based on the law of December 6, 1991 on the Insurance Sector (LoIS 91), as amended by various laws, and in particular in relation to AML/CFT, the law of August 11, 1998 expanding the scope of the money laundering offence and the law of May 31, 1999 on company domiciliation. The implementation of AML/CFT provisions for the Insurance Sector is limited to life insurance products, as per articles 86 to 91 of LoIS 91.

43. Bank secrecy

There is a culture of strong bank secrecy in Luxembourg, which is to a certain extent enshrined in law, particularly in relation to the strict limits on information which banks may disclose to the tax authorities. Article 41 of the LoFS 93 defines the secrecy obligation of financial institutions and PSFs, the violation of which is sanctioned by the provisions of art. 458 of the Penal Code. However, art. 41 (2) provides that this secrecy obligation ceases when the disclosure of information is imposed by law, and 41 (7) states that disclosures made under a legal requirement cannot entail any penal or civil liability.

Article 40 (1) provides that regulated professions must provide “a response and a cooperation as comprehensive as possible” to any lawful request made by the authorities responsible for the implementation of the law. Section (2) of this article specifies that they are required to provide, at the request of the authorities responsible for the fight against money laundering, all information necessary in accordance with existing procedures, and must disclose, at their own initiative, any fact that could be related to money laundering.

With regard to the Insurance Sector, art. 111-1 waives the professional secrecy when the disclosure of confidential information is authorized or imposed by a legal provision. The same provision states that the professional secrecy does not exist in relation to foreign and national authorities in charge of supervision of the insurance sector.

44. Competent authority for AML/CFT

Article 40 (2) of the LoFS 93 provides for the requirement to cooperate with the “authorities responsible for the fight against money laundering”, without being more specific. Article 43 (2) of the LoFS 93 states that “the CSSF monitors the application of the laws and regulations relating to the financial sector by the persons subject to its supervision”, which, de facto, makes CSSF the authority responsible for ensuring effective implementation of the AML/CFT legislation, which is part of LoFS 93. However, their role does not extend to insurance companies, which are under the supervision of the Commissioner for Insurance (CaA), or to the implementation of criminal justice measures.

Article 15 of the draft bill N° 5165 provides that “the CSSF is to be the competent authority for ensuring the implementation of the professional AML/CFT requirements by the entities under its supervision”.

In discussions with financial professionals, the mission did not encounter any indication that the financial services industry had any doubts in practice as to the powers of the CSSF to apply preventive measures for AML/CFT, and to enforce compliance therewith by institutions under CSSF supervision. Neither were there any reservations expressed about the mandatory nature in practice of the contents of the guidance in CSSF circulars, particularly as they are predicated on specific provisions of the LoFS 93 and subsequent legislation.

Analysis of Effectiveness

In the area of preventive measures, the legal and institution structure was found to be largely effective in practice, though the limitation of the current legal provisions needs to be addressed to avoid the risk of their being undermined by any legal uncertainty. This is true for example with regard to “know you customer” procedures, which are left for

<p>the main part to circulars, which are not in themselves legally binding.</p> <p>Regarding banking secrecy, despite the very clear language of the articles dealing with provision of confidential information to the authorities, there seems to be a problem of interpretation by the financial sector. The Chamber of Commerce of Luxembourg has issued on September 16 2003 an opinion on the draft Law no. 5165, which, when describing the existing legal framework, states that, under its normal legal powers, the Prosecutor’s Office (which acts as the FIU) cannot require a bank to provide it with a document and if so required, the bank “has the right, if not the obligation, to refuse to comply”. For the Chamber of Commerce, article 40 (2) does not confer any specific power to the prosecutor to obtain information, since the bank must cooperate, according to this provision, “within the framework of existing procedures”, and that no procedure confers a specific power to the prosecutor to do so. Article 40 (3), according to the author of the opinion, confers a limited power to the prosecutor, which exists only in the area of AML/CFT, and only after an STR has been filed. This interpretation is probably shared by many members of the banking community, since CSSF issued a circular in 2001¹¹, reminding banks to cooperate fully with the Prosecutor-FIU and “<i>refrain from systematically objecting on the grounds of bank secrecy</i>”. According to the authorities, cooperation has improved since the issuance of this circular.</p> <p>In terms of powers of CSSF, the authorities rely on art. 43 of LoFS as the legal basis to grant to CSSF the power to act as a competent authority. This provision does not explicitly convey any power in relation to AML/CFT and does not give authority in AML/CFT matters on entities which are not supervised by CSSF, such as the insurance companies. It is intended that draft bill no. 5165 will address this issue. In the interim, the CSSF is operating effectively in practice as the AML/CFT competent authority with respect to preventive measures for the financial professionals under its supervision.</p>
<p>Recommendations and Comments</p>
<p>The authorities should take steps, by law, regulation (if appropriate), or other legally enforceable means, to supplement the basic AML/CFT principles contained in the LoFS 93, in providing a continuing legal basis for the effective implementation of the FATF Recommendations. If the authorities wish to continue to take advantage of the flexibility of regulatory or other circulars as the means of implementation, one approach would be to clarify in law the scope of powers given to CSSF to provide guidance and instructions by way of circulars, non compliance with which being considered as a violation of a professional obligation.</p> <p>The authorities need to act further to ensure that all financial professionals accept their statutory reporting obligations to the FIU and CSSF, and do not seek to frustrate measures to achieve effective implementation of AML/CFT measures.</p>
<p>Implications for compliance with FATF Recommendation 2</p>
<p>FATF 2 - Further steps are needed to ensure that secrecy laws do not inhibit effective implementation of AML/CFT measures.</p>
<p>II—Customer identification (compliance with criteria 45-48 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 68-83 for the banking sector, criteria 101-104 for the insurance sector and criterion 111 for the securities sector)</p>
<p>Description</p>
<p>45. Anonymous accounts Anonymous accounts or accounts in fictitious names are prohibited. There is also a requirement in the LoFS 93 (and equivalent for other categories of financial institution) to identify each customer.</p>

¹¹ Circular 01/40

46. Identification of customers

Article 39 of the LoFS 93 provides that regulated institutions and PSFs must require identification of their customers by means of supporting evidence when entering into business relations, particularly when opening an account or savings account, or when offering safe custody facilities. For occasional customers, this obligation extends to any transaction over EUR 10,000,¹² or to any transaction, whatever is the amount, when there is suspicion of money laundering.¹³ The requirement to identify the customer is waived when the client is a credit institution or a PSF subject to an equivalent identification requirement.¹⁴

The identification is done on the basis of a document “providing evidence” (“*document probant*”). Neither the law nor circular 94/112 require that the document must bear a photograph of the customer. Circular 94/112 only states that the identifying document must “establish the identity of the person”. In practice, credit institutions and PSFs require a passport or an identity card, and indicated that they did not encounter difficulties in practice in complying with this requirement.

Circular 94/112 requires financial institutions and PSFs to keep identification documents up to date, through periodic reviews, and specifies that, for accounts opened before the full AML procedures, the institution should not allow the withdrawal of the funds as long as the identification has not been updated.

In the insurance sector, the identification of the customer is currently mandatory only in the area of life insurance. Article 87 of the LoIS 91 requires, in the same terms as the LoFS 93, the production of a document providing evidence of the identity (*document probant*). The identification is not required

- when it relates to a total annual premium of less than the equivalent of EUR 1,000, or a single premium of less than EUR 2,500.
- when the insurance is subscribed within the framework of a employment contract or for the business activities of the customer, when there is no redemption clause and cannot be used as a guarantee for a loan.
- when the payment is effected by transfer from a bank account.

A provision of the draft bill No. 5165, when enacted, would extend the requirement to non life and reinsurance business, which is an important business segment in Luxembourg.

46.1 Identification of legal entities

The identification of legal entities is not explicitly provided for by law, but authorities consider that they are included in the generic term of “customers”, consistent with the language of the European directive. Guidance is provided to supervised institutions by the CSSF in Circular 94/112, which states that “the identity of customers that are legal entities must be established on the basis of the following official documents: extract from the register of commerce (if available), articles of association. When the client carries out an financial sector activity involving the management of third parties’ assets, a copy of the authorization to do so, or the mention that such authorization is not necessary, must be recorded. The authorities indicate that, for legal entities registered in Luxembourg, these documents contain information on the legal form of the company, its address, the names and addresses of directors as well as on the provisions regulating the power to bind the entity and to verify that any person purporting to act on behalf of the company is so authorized, so that the identities of the persons in charge can be confirmed. Where the articles of association of a company do not comprise the names and addresses of the directors and administrators and proxy holders (as prescribed by Luxembourg legislation), financial professionals are expected to establish the identity of these individuals before entering into a business relationship with them.

¹² Art. 39 (2)

¹³ Art. 39 (3)

¹⁴ Art. 39 (6)

There is no explicit legal requirement to verify the personal identity of those who have been confirmed to have authority to conduct transactions on corporate accounts.

Banks interviewed in the course of the mission maintained that their policy was not to deal with corporate entities before having a full understanding of the prospective customer, its business and its ownership. They acknowledged the difficulties of establishing the true identity of the owners of certain corporate structures, but indicated that, in the event that the information was inadequate, they would not proceed to open an account relationship. The mission was not in a position to verify this directly.

46.2 Numbered accounts

Numbered accounts are not prohibited by law and banks interviewed in the course of the mission indicated that they are used extensively by Luxembourg banks in practice, in particular in the area of private banking. Both the authorities and financial professionals indicate that, in law and in practice, numbered accounts are not treated any differently from nominative accounts in terms of the requirements for customer identification. The only difference is that the number of bank staff who have access to the identification information is limited to (typically) 3 management or operational staff. In addition, the bank's AML/CFT compliance function and auditors have access to the identity details, as does the CSSF as supervisor and the FIU, in exercising its powers. The mission was informed that resident and non-resident customers often request numbered accounts with the intention of limiting the number of people with knowledge of their financial affairs. The authorities and the banks maintain that this is the only distinguishing aspect of these accounts and that withdrawals and other transactions are strictly controlled to ensure proper identification of the customer on each occasion to avoid any misuse: transactions may take place only at the location where the account is maintained, with identification by the particular relationship manager who knows the customer.

47. Identification of beneficial owner

The identification of beneficial owners is a legal requirement provided by art. 39 (3) of the LoFS 93 (and equivalent for other categories of regulated institution). This provision is drafted in accordance with the FATF recommendation.

Until 2001, there was no such requirement to identify the beneficial owner when the customer was a lawyer or a notary acting on behalf of a client. Banks and other financial professionals were allowed to presume that the lawyer or notary had properly identified their client, as allowed by circular 94/112. Circular 01/40 disallowed this presumption and now banks and other financial professionals ask the lawyer or notary whether he is acting for himself or for a third party, and in the latter case identification of the client (beneficial owner) must be provided.

In the insurance sector, when the insurance company has a doubt as to whether the customer is the beneficial owner, or when it is certain that he does not act on his own behalf, the professional must take reasonable measures to get information on the actual identity of the beneficial owner (art. 87.5 of the LoIS 91).

While the legal provisions in this area are strong, financial professionals interviewed in the course of the mission spoke of the difficulties that they sometimes encounter to satisfy themselves that they have accurately identified the final beneficial owner. They maintained that, in the absence of convincing ownership information, they would not risk their reputations by opening an account or conducting a transaction. The mission is not in a position to verify that this approach is representative of the industry as a whole. They also informed the mission that the typical (non-resident) corporate structures with which the financial professionals deal would have no more than one level of identity screening, and would often be created for a client by the bank itself or by another Luxembourg financial professional well known to the bank.

48. Originator information on wire transfers

There is no legal requirement to include originator information in wire transfers, and there is no provision for it in any of the existing circulars. The authorities indicate that they consider that it derives indirectly from the provision of

paragraph (6) of article 39 of the LoFS 93. Pursuant to this provision "...credit institutions and other professionals of the financial sector shall keep the following information for use as evidence in any investigation into money laundering (...) in the case of transactions, the supporting evidence and records, consisting of the original documents or copies having similar status as evidence under Luxembourg law, for a period of at least five years following execution of the transactions, without prejudice to the longer periods of retention prescribed by other laws." A provision in draft bill no. 5165, when enacted, will require financial institutions and PSFs to include meaningful originator information in wire transfers.

Banks interviewed in the course of the mission indicated that, as a matter of practice, they would ask for further information in the case of incoming wire transfers that did not identify the originator, or which were not in accordance with the profile of their customer. Their stated policy is to include originator information on outgoing transfers. The assessors cannot say whether this is representative of the banking system as a whole.

Sectoral specific criteria

68. While there is currently no specific legal provision requiring a graduated customer acceptance policy, Circular 94/112 includes some useful KYC guidance, including in relation to the preparation of a customer profile. Particular guidance is given by the CSSF in other circulars in relation to certain categories of high risk customer (e.g., politically exposed persons (PEPs), persons and/or funds coming from noncooperative countries or territories (NCCT)). The CSSF includes this area in its onsite inspection work. The draft bill No. 5165, when enacted, would require monitoring of customers on a risk based approach.

69. In accordance with Circular 94/112, every account opening request for a new customer must be submitted to a specially designated manager or management body of the bank or other financial professional for written authorization. Accounts for PEPs have to be approved at senior management level, under Circular 2000/21.

70. The identification of beneficial owners is a legal requirement under Art. 39 (3) of the LoFS 93. Circular 94/112 specifies that, when customer identity is being established, banks and other financial professionals must require customers to supply them with a statement to the effect that they are, or are not, acting on their own behalf. If case of doubt, this doubt must be allayed. Formerly, there was a presumption for accounts operated by lawyers and notaries that they had already carried out due diligence on their client. Under Circular 01/40, this presumption is no longer valid, and the ultimate beneficial owner must be established.

71. Under Circular 94/112 banks and other financial professionals must prepare a procedures manual for AML/CFT, to include account opening procedures. While, under the circular, the account opening procedure must be entirely complete before the bank may execute any transaction on the customer's behalf, funds may be accepted prior to the completion of all identification procedures. Such funds must remain blocked, and may not be withdrawn or transferred, or returned to the customer, until all documentation is complete. Customer identification documentation must be reviewed regularly and kept up to date.

72. Despite the fact that most business of banks and other financial professionals in Luxembourg relates to non residents, there are no additional provisions in the circulars for non resident business. However, the authorities would maintain that appropriate provisions are included for all customers, in that it is necessary before commencing a customer relationship to establish the purpose of the account and note the source of funds in each case.

73. Private banking is one of the core banking activities in Luxembourg, whether conducted as a component of the business of the large retail banks or in a dedicated private bank, many of which are subsidiaries of well known international banks. CSSF has not issued any specific requirements for enhanced due diligence for private banking operations. However, the authorities point to aspects of the due diligence requirements which apply to all financial professionals as particularly appropriate, e.g., legal requirement to identify beneficial owner, guidance on the preparation of a customer profile, and need to record the purpose of the account and source of funds.

74. Information on the refusal of banking facilities by another bank would not normally be available across the banking system.

75. As noted, where funds are received by a financial professional prior to the completion of customer due diligence requirements, the funds have to be blocked until the identification process is complete. Banks indicated that they would regard a long delay in supplying the necessary information as suspicious and this would lead to the filing of an STR with the FIU. There is no information on whether STRs are being filed in such circumstances.

76. There is no specific requirement in relation to identification of the parties to trusts. However, the authorities point to the general identification and due diligence requirements, which they interpret to include trustees, settlors and beneficiaries. Financial professionals interviewed indicated that they would in practice identify as far as feasible all parties to a trust. They would also obtain information on the purpose of the trust and the source of funds.

77. Corporate vehicles are particularly important in Luxembourg, yet there is no specific guidance in relation to due diligence for them. Again, the authorities point to the general due diligence provisions and KYC obligations of financial professionals. The key legal provision is Art 39 (3) of the LoFS 93 which requires the identification of the beneficial owner. This can be difficult in some cases. Where the beneficial owner cannot be identified, the business relationship should not proceed. Financial professionals interviewed indicated that they decline business in any case where they are not satisfied with the information provided on the ultimate beneficial owner or the source of funds, or where the corporate structure is unduly complex. It was not possible for the mission to confirm that this reflects the practice of financial professionals generally.

78 and 79. Under Circular 94/112, introduced business may be accepted by a bank only where mandated and subject to detailed procedural agreements. Customer identification may not be delegated except in the case of other financial professionals in Luxembourg or those subject to equivalent regulation in other countries, including equivalent AML/CFT provisions. However, in all cases, even if the direct customer identification is carried out by another financial professional, the bank retains responsibility for the due diligence and the KYC documentation must be maintained in Luxembourg, even when the customer is a nonresident.

In accordance with the EU AML Directives (2001/97/EC and 91/308/EEC), customers who are themselves credit institutions or financial professionals, in Luxembourg or in another EEA country, and subject to AML/CFT requirements, need not be subject to identification requirements. This gives rise to a potential risk of particular relevance to Luxembourg, where non resident banks or other regulated entities to which this exemption applies open account relationships in Luxembourg in their own names, as nominee for or otherwise on behalf of third party customers – a very common occurrence. In these cases, the Luxembourg bank is entirely dependent on the KYC carried out by the originating financial professional (typically abroad), and neither the bank nor the Luxembourg authorities are in a position to identify the beneficial owner. Although entirely consistent with the terms of the relevant EU Directives, the scale of the application of this exemption in Luxembourg, possibly combined with obscure ownership structures, could create a significant reputational risk factor, particularly in cases of complicated or obscure ownership structures.

80 and 81. Circular 2000/21, supplementing 94/112 and 98/153, introduced special requirements regarding the laundering of funds connected with bribery and corruption. Under the circular, additional controls and internal procedures should be applied when establishing business relationships with PEPs, The process should involve the institution's management at the highest level.

82. Circular 94/112 refers to account opening by correspondence, with regard to the need to have copies of identification documentation certified by a professional (examples specified), and to obtain plausible responses to the other standard account opening questions. There are currently no specific provisions covering internet banking, other than a clarification published in the CSSF annual report 2000, to the effect that certification is not required where the internet account is opened with funds transferred from a bank in a FATF country. The CSSF has also devised a procedure being used by at least one bank to assist in verifying that the funds originate from the bank and account specified by the customer and no other source. The draft bill No. 5165 is intended to include requirements for non face to face operations.

There is currently one dedicated internet bank in Luxembourg, but a number of traditional banks also offer internet banking, including internet account opening. At least one bank would allow a distance customer to operate an

internet account for a period of time even if KYC requirements were not fully complete. It is understood that the initial account opening deposit would come from another bank in a FATF country.

83. There are no additional requirements or limits for the provision by Luxembourg banks of correspondent banking arrangements for banks abroad. The authorities point out that, for historical and currency reasons, Luxembourg has never been a center for the operation of correspondent banking. Discussions with banks confirm that networks of such accounts exist, including for banks in non FATF countries, and are used for normal transfer and settlement purposes. While there is nothing to suggest that Luxembourg is being used by banks with poor AML/CFT requirements to gain access to the international banking system, nonetheless it cannot be entirely ruled out, and more attention should be given to this particular risk.

For customer identification procedures in general, there are a number of ways in which the CSSF seeks to assess compliance in the case of banks. In addition to having access to the reports of internal audit, CSSF requires the external auditors to submit an annual long form report, which includes AML/CFT in its coverage. In addition, the CSSF conducts a number of AML/CFT onsite inspections each year, using a standard questionnaire and template approach. All deficiencies identified are followed up with the bank concerned and remedial action required. Inspection material was discussed with the CSSF by the mission. Relative to the number of inspections being conducted, the number of deficiencies being found by the CSSF examiners is statistically significant. Many relate to poor documentation of some aspects of the account opening procedures (e.g., source of funds). In a small number of cases, customer identification documentation was missing from the file or out of date. Typically, the examiners reported that relationship managers had a better understanding of the customer and his transactions than the file record indicated.

Full KYC is required by law for all customers, including customers existing on the coming into force of the customer identification requirements in 1993/94. Neither the LoFS 93 nor the CSSF circulars provided for the sort of grandfathering of the existing customer base as in the case in a number of other countries. Therefore, all existing customers needed to be reidentified, including information on purpose of account and origin of funds. This requirement was not well received by the banking sector. After 10 years, some banks reported that many accounts have still not been reverified. According to the CSSF, banks opted sensibly to concentrate first on categories of account holder thought to be most at risk for money laundering. The CSSF indicated that the accounts yet to be reverified are in the retail sector. The assessors established that work remains in the private banking sector also.

Securities Firms and Funds industry

As for most part these businesses are financial professionals subject to CSSF supervision, the KYC provisions of the LoFS 93 and CSSF circulars are applicable. For funds administrators and transfer agents, one aspect is particularly relevant. As noted for Criterion 79, above, customers who are themselves credit institutions or financial professionals, in Luxembourg or in another EEA country, and subject to AML/CFT requirements, need not be subject to identification requirements. This gives rise to a potential risk where non resident banks or other regulated entities to which this exemption applies open account relationships in Luxembourg in their own names, as nominee for or otherwise on behalf of third party customers. In the case of funds, cross border sales typically come through an international distribution network. Where the subscription originates with a bank or other regulated entity in a FATF country subject to AML/CFT requirements, it is that entity which has carried out the customer due diligence. No further work on KYC is conducted in Luxembourg. Where the foreign bank or other regulated financial professional acquires the holding as nominee for its client, which is common, neither the fund administrator nor the CSSF have any way of knowing the identity of the beneficial owner. The information does not exist in Luxembourg.

For non-FATF countries and unregulated distributors in FATF countries (e.g., for the large amount of business coming from unregulated investment firms in Germany), the KYC work may not be delegated. It is the responsibility of the fund administrators in Luxembourg, and the identification documentation must be retained in Luxembourg. In practice, given the international nature of the funds business, CSSF has sometimes had difficulty in achieving full compliance with this requirement. Currently, the CSSF does not carry out onsite inspections to assess compliance with AML/CFT requirements for funds administrators or transfer agents. A long form audit report is due to be introduced from end 2003, which will include a section on AML/CFT.

Insurance 101-104

In the insurance sector, the identification of the customer is currently mandatory only in the area of life insurance. Article 87 of the LoIS 91 requires, in the same terms as the LoFS 93, the production of a document providing evidence of the identity (*document probant*). The identification is not required

- when it relates to a total annual premium of less than the equivalent of EUR 1,000, or a single premium of less than EUR 2,500.
- when the insurance is subscribed within the framework of an employment contract or of the professional activity of the customer, when there is no redemption clause and it cannot be used as a guarantee for a loan.
- when the payment is effected by transfer from a bank account.

Where applicable, information on the beneficial owner must be obtained.

A provision of the draft bill No. 5165, when enacted, would extend the requirement to non life and reinsurance business, which is an important business segment in Luxembourg. For life assurance, the beneficiaries must also be identified, at least at the time of the first payment to them. Art 3 (1) would provide that additional information should also be collected to reduce the risk of ML or FT, for example, additional KYC information such as the purpose of the business relationship and the origin of the funds.

Analysis of Effectiveness

The legal requirement to identify customers is generally in line with the international standards. Considering the prevalence and importance as bank customers in Luxembourg of corporate structures designed to obscure beneficial ownership, it is of critical importance that financial professionals are specifically required by law to identify legal entities and to conduct sufficient enquiries and collect sufficient information to know their customers. Getting one or two documents (the extract of the Register of Commerce, if it exists, and the articles of association) would often not provide a sufficient basis on which to know the customer.

With regard to numbered accounts, the explanations provided for their extensive use are not persuasive. It is difficult to believe that customers who trust significant sums of money to a bank in a country that promotes itself on the basis of bank secrecy have such little confidence in the general staff of that bank that they anticipate they will breach their legal duty of customer confidentiality and reveal details of the customer; therefore, the identity of the customer needs to be kept secret from most staff. While the controls on the operation of numbered accounts as described to the assessors seem reasonable, there remains some concern about the potential for abuse of this type of account.

Given the variety of structures operated in and from Luxembourg to legally separate the apparent from the real ownership of bank accounts and other assets managed by financial professionals there, identification of the true beneficial owner in each case, as required by law, can present a difficult challenge. This is an important risk factor for AML/CFT and a threat to the reputation of Luxembourg.

A legal requirement for the inclusion of originator information for wire transfers will be included in the next AML/CFT law. In the meanwhile, banks interviewed were conscious of the risks and had addressed them in appropriate internal procedures.

It is the view of the mission that particular risks can arise from the current arrangements concerning the opening and operation of accounts by lawyers, notaries, accountants, auditors and other such professionals. Discussions with the private sector pointed to actual practices, that do not correspond with the requirements, as explained to the mission by the authorities. Where accounts are opened by these professionals on behalf of named clients, it is accepted that KYC must be carried out by the bank on the client or beneficial owner. However, where funds are lodged to accounts in the name of the professional, there appears to be an assumption that this signifies that the funds are those of the professional and that no further enquiries are necessary. This raises a question about the possible absence of controls on intermingled or 'jumbo' client accounts being maintained by the professionals. Based on discussions during the mission, there are indications that banks do not inquire as to the source or beneficial ownership of funds in such accounts. Given the scale and importance in Luxembourg of business sourced through these professionals, and the wide use of additional structures to shield the identity of beneficial owners, this represents an area of potentially significant risk. It is accepted that these professions are subject to self regulation and that they would be included

within the scope of AML/CFT obligations under the draft bill No. 5165. Nonetheless, this area needs to be examined closely by the authorities to seek methods of effectively controlling the underlying reputational risk.

There seems to be a standard practice of opening accounts for new customers in Luxembourg and accepting funds in the absence initially of complete KYC information. This is subject to the control that the funds involved remain absolutely blocked until full KYC has been conducted. Thus financial professionals impose an additional compliance burden on themselves by having to maintain the block. CSSF onsite work indicates that these controls are not always properly maintained or documented, giving rise to the risk once the account has been opened, that the necessary follow up might not always take place, and a customer may succeed in using the account without adequate identification.

There is merit in the view of the authorities that the same high standard of controls should apply both to resident and non resident customers. However, having regard to the scale of non resident business in Luxembourg and the additional risks of cross border business, this approach is valid only if the standards universally applied are those appropriate to higher risk international business. The addition of specific reference to the additional risks of cross border business in CSSF guidance material would be helpful.

Certain important financial services business lines common in Luxembourg are designed first and foremost to disguise or create a legal distance from the beneficial owner of the underlying funds. While the legal principles in this area are strong, and indications to the mission are that compliance is taken seriously by the financial sector, this is the least one would expect considering the significant inherent risks of this type of (mainly cross border) business. Included here are private banking services, hold mail arrangements, trusts, Anstalten, Stiftungen, SOPARFI, Art. 29 companies, holding companies and other corporate vehicles. No additional guidance has yet been provided by the authorities specifically on the AML/CFT risks arising from the extensive use of these arrangements. While these structures are designed primarily to address tax issues, it can be very difficult in practice to distinguish this from an ML or FT objective in a well prepared business proposal.

While internet banking is not a major element of the banking system, current online account opening practices, as described to the mission, leave scope for some abuse, and do not appear to be strictly in line with current CSSF guidance on this subject. As for other financial services products, difficulties arising from accepting new customers online are not peculiar to Luxembourg. However, it appears that additional steps may need to be taken by CSSF to ensure that the risks arising from this business are addressed effectively. The ideal would be to require some form of face to face contact, in Luxembourg or elsewhere, as part of the account opening process, but it is accepted that this can be difficult to achieve in practice. An exclusive reliance on the initial funds having come from a bank account in another FATF country has been shown elsewhere to be a target for money launderers. CSSF is conscious of the practical difficulties and are open to developing tailored control systems, where necessary.

In the securities sector (broadly defined), the funds area is strategically important for Luxembourg. As the second biggest mutual funds market in the world, and the largest with regard to cross border business, the need for adequate controls is clear. While the potential use of funds products as a means of ML are probably more limited than for some other financial products, their use cannot be excluded, and they have been found among the financial assets held by money launderers in cases in the past. In this context, a particular vulnerability arises for Luxembourg due to the (quite valid under the EU AML directives) use of exemptions for the conduct of customer due diligence. For the most part, Luxembourg funds are marketed internationally by distribution networks of financial professionals. Where these operations are based in FATF countries and subject to their own national AML/CFT obligations, no further customer due diligence is conducted in Luxembourg. Rather than a KYC approach, therefore, there is in effect a "know your distributor" approach. The quality of KYC can be no better than that applied locally in the target country where, it could be argued, the seller of the Luxembourg fund investment might not have the same incentive to be so thorough in applying KYC as the money is immediately going to a regulated entity in another jurisdiction. Also, where commissions are paid for originating these investments, there may be a strong incentive not to turn away business. A further risk arises from a possible excess reliance on discrimination between FATF and non FATF which may lead to over confidence with regard to KYC measures conducted in FATF member countries.

The CSSF does not currently conduct onsite inspections covering this aspect of the funds business but is introducing

long form audit reporting. Offsite supervision conducted includes approval of the fund's promoters and other parties, its prospectus and other documentation and the proposed distribution network. In the case of non FATF and unregulated distributors, customer due diligence must be conducted in Luxembourg. CSSF have confirmed that they have identified cases where this requirement is not complied with, and have required remedial action, which is sometimes difficult to achieve. It is the view of the mission that this is potentially a significant risk area that warrants additional attention.

The risk is increased further where fund investments in Luxembourg funds are held in the name of nonresident regulated financial professionals from FATF countries, acting on behalf of clients. In this case, information on the beneficial owner is not available in Luxembourg, such that neither the fund administrator, the auditors or the supervisory authority can make any assessment of the risk of ML or FT. For example, it is not possible for funds administrators to know whether any of the names on UN lists feature as beneficial owners of these fund investments. This situation is not peculiar to Luxembourg and is a feature of the global distribution of funds products. Nonetheless, the risks involved need to be highlighted and understood, and the scale of the business in Luxembourg and the prevailing culture of secrecy may make Luxembourg particularly attractive to undesirable business, giving rise to a hidden source of imported reputational risk.

Life assurance business on behalf of nonresidents is a very significant component of the Luxembourg financial services market. It is among the range of products offered for investment purposes to attract the business of medium to high net worth individuals, alongside private banking, funds products, corporate structures, etc. As such, it is similarly vulnerable to abuse by money launderers, particularly at the layering and subsequent stages of the ML process. Typology information published by the FIU, and analyzed independently by the CaA, points to a range of possible abuses of these products, based on the 180 or so STRs filed by the insurance sector to date. Discussions during the mission confirmed a keen awareness of the risks and the existence of a range of controls. The quality of customer due diligence is critical to protecting the system and cannot be assessed directly by the mission. The CaA conducts onsite inspections of life companies, on a 3–4 year cycle, and includes coverage of AML/CFT measures.

Recommendations and Comments

It is recommended that the principle of the identification of legal entities be explicitly required by law, in view of the implementation of the revised FATF recommendations, the interpretative notes of which provide that “the basic principles [of customer identification] should be set out in law or regulation, while more detailed elements [...] could be required by law or regulation or by other enforceable means issued by a competent authority.”

There should be a specific requirement for the personal identification of all persons authorized to operate accounts in the name of corporate entities. In the case of companies incorporated outside Luxembourg, there should be a specific requirement that PSFs obtain (and satisfy themselves of the veracity of) the names and addresses of directors, in addition to verifying their power to bind the company.

The authorities should introduce specific customer due diligence requirements for trusts and other such entities, in line with the international requirement.

In the light of the risk to Luxembourg's reputation from their misuse, the authorities should consider whether the continued availability of numbered accounts is warranted, given that both the authorities and the bankers maintain that numbered accounts offer little or no practical benefit to customers. At a minimum, the CSSF should pay particular attention to the proper management and control of numbered accounts in the course of its onsite inspections and in discussions with supervised institutions and their auditors. The CSSF should consider conducting a targeted onsite analysis to test the rationale for numbered accounts, particularly across the range of private banks.

On the same basis, the CSSF should target in its supervision the opening and operation of accounts involving complex structures, where identification of the beneficial owner presents particular difficulties, as this represents an area of potential reputational risk for the Luxembourg and its financial system.

The authorities should proceed to introduce the planned requirements for inclusion of originator information on wire transfers, within the time frame indicated by the FATF.

Further to the strong legal provisions in this area, additional attention should be given by the authorities to confirming effective implementation measures in high risk areas of particular importance in Luxembourg, particularly for products and structures designed to hide the purpose and true identity of the beneficial owner, whether these products are developed within Luxembourg or elsewhere.

As part of the application of appropriate KYC requirements, the authorities should issue further guidance highlighting the particular risk factors of non resident business.

The area of client funds held in the accounts of lawyers and other professionals, without disclosure of the identity of the client, should be examined carefully by the authorities, to ensure in the context of the Second EU AML Directive and the revised FATF 40, that more effective measures are put in place to avoid such arrangements being used to circumvent the legal requirements for identification of the beneficial owner. The legal profession should take additional internal measures to prevent any abuse of the profession in ML and FT schemes.

Controls for accounts opened by correspondence and through the internet should be reviewed by the authorities to make them as comprehensive, effective and consistent as possible, considering the practical constraints involved. If effective measures cannot be achieved, opening of accounts electronically would not meet the requirements of the law.

CSSF should ensure that the outstanding work to reverify old accounts is expedited.

The authorities should reassess the KYC and reputational risks arising from the use of international distribution networks in the funds area, to determine whether the current system meets all international obligations in the ML and FT area. The introduction of onsite inspections for funds, including for AML/CFT, would support current compliance efforts and help to raise awareness of the risks. This may require an additional allocation of resources.

Implications for compliance with FATF Recommendations 10, 11, SR VII

FATF 10 and 11: Identification requirements for legal entities and beneficial owners should be made more explicit.

SR VII: The authorities should proceed with identification requirements for wire transfers.

III—Ongoing monitoring of accounts and transactions (compliance with Criteria 49-51 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 84-87 for the banking sector, and criterion 104 for the insurance sector)

Description

49. Monitoring of unusual or complex operations.

Art. 39 (7) of the LoFS 93 requires financial institutions and PSFs “to pay particular attention to any transaction that they consider to be particularly susceptible, by its nature, of being linked with money laundering.” Circular 94/112 interprets this requirement as the obligation of the professional to have a sound understanding of the transactions carried out by their customers, and annexes a list of transactions that can be considered as unusual by nature or in relation to the client. In such case, the circular states that, if the professional does not have all of the information needed to rule out a connection with money laundering, but has no specific indication that laundering has actually occurred, it should refuse to execute the transaction, or should terminate the business relationship. If the professional has a suspicion of money laundering, he must report to the FIU / Prosecutor. No obligation exists either in the law or

in the circular to set forth the findings in writing, as required by FATF Recommendation 14.

There is no equivalent obligation regarding unusual or complex transactions placed on the insurance sector by the LoIS 91.

50. and 50.1 Relations with non cooperative jurisdictions

There is no specific requirement under the LoFS 93 to pay special attention to business relations and transactions with persons in countries which do not have in place adequate systems to prevent or deter money laundering.

As a consequence of the NCCT listing by the FATF, CSSF has issued a number of circulars drawing attention to the listing or delisting of countries as part of the NCCT exercise and requiring financial institutions and PSFs to take special precautionary measures. These measures are:

- to pay special attention to transactions made with counterparts in these jurisdictions
- to design special policies to be approved by management and monitored by the compliance officer.
- Auditors must check and report on compliance with internal procedures
- Financial institutions and PSFs are reminded that branches and subsidiaries in these countries are subject to the same measures as those applicable in Luxembourg.

The legal basis of these circulars is open to question, to the extent to which they seek to create specific requirements. Circular 00/16, the first of the series relating to NCCTs, states that it is intended to implement the legal obligation under art. 39 (7) requiring financial institutions and PSFs “to pay particular attention to any transaction that they consider to be particularly susceptible, by its nature, of being linked with money laundering.”

51. Enhanced scrutiny to wire transfers without originator information

There is no requirement in laws or in implementation circulars regarding wire transfers. The authorities plan to address this subject in the context of the draft bill No. 5165 and the guidance documentation to be prepared based on it. In practice, banks interviewed in the course of the mission were conscious of the risks and indicated that, in cases of doubt, additional information would be sought to establish the origin of the funds being received electronically. The mission is not in a position to verify this.

Sector specific criteria

84. The mission was informed that there are difficulties in practice for banks to consolidate their customer account information on a global basis. Luxembourg parent banks are legally free to so consolidate but, according to the CSSF, will do it in practice only through their internal audit function. As banks in Luxembourg are, for the most part, subsidiaries of international banks, the task for them is to consolidate upwards, which is not currently provided for as an exception to Luxembourg’s strict bank secrecy laws. The authorities propose to address this to some extent in the draft bill No. 5165, Art 16 of which would provide for group internal audit to have access to customer information necessary for consolidated KYC risk management with regard to AML/CFT.

85. Ongoing monitoring of accounts is included within the range of control measures required by CSSF for financial professionals subject to their supervision, who are required to develop internal control procedures and include AML/CFT in the work program of the internal auditor. In addition, for banks (currently) and funds (from end 2003) the external auditor must submit a long form audit report to the CSSF which includes a section on ongoing monitoring for AML/CFT purposes. Also, CSSF conducts a number of onsite inspections of banks, during which ongoing monitoring of transactions is assessed.

A similar approach is taken by the CaA in respect of life assurance companies.

At the operational level, banks in particular have been looking at ways to make use of technology to assist in ongoing transaction monitoring. While some still use a manual approach, the mission was made aware of at least limited use of computer products to produce exception reports for monitoring purposes. At least one bank is at an advance stage of introducing a sophisticated computer solution. However, the challenge is to determine appropriate filtering

<p>parameters to reflect the particular product set and largely non resident customer base in Luxembourg.</p> <p>86. As noted, Art 39 (7) of LoFS 93 requires that credit institutions shall examine with special attention any transaction which they regard as particularly likely, by its nature, to be related to money laundering. CSSF circulars deal with certain types of high risk customer (including PEPs and NCCTs). Circular 94/112 calls on banks to have a thorough understanding of transactions that customers request them to carry out and to monitor carefully the history of transactions.</p> <p>87. There is no specific requirement or guidance in relation to the provision of correspondent banking. The general requirements apply with regard to monitoring transactions. The authorities maintain that Luxembourg is not a center for correspondent banking. However, the mission understands that, as would be expected, networks of correspondent relationships exist, including in non FATF countries, for normal operational reasons. The CSSF has indicated that guidance in this area can be issued in the context of draft bill No. 5165.</p>
<p>Analysis of Effectiveness</p> <p>The current legal provisions and guidance on monitoring of ongoing transactions need fall short of the standard in some respects. Some additional points need to be clarified (and, in the case of insurance, introduced), particularly for unusual and complex transactions, an area which is of particular risk for Luxembourg.</p> <p>The CSSF circulars meet the requirement of criterion 50.1 that “effective measures [be] in place to ensure that financial institutions are advised of concerns about weaknesses in the AML/CFT systems of other countries. Additional guidance should be provided to the industry as to countries with weak AML/CFT systems, since systemic deficiencies exist also in a number of countries which are not on the NCCT list. There should be a more explicit legal basis to deal with countries without an adequate AML/CFT framework.</p> <p>There is no provision relating to wire transfers, but some banks, at least, apply control measures.</p> <p>It is potentially a serious impediment to the global fight against money laundering that international financial professionals (particularly banking groups with a Luxembourg subsidiary and funds administrators abroad with related businesses in Luxembourg) are currently prohibited by Luxembourg’s secrecy laws from transferring personal data of their Luxembourg customers to the head office abroad, as part of their overall consolidated assessment of group AML/CFT risk.</p>
<p>Recommendations and Comments</p> <p>The current legal provisions and guidance on monitoring of ongoing transactions need to be strengthened to be in line with the standard. Some additional points need to be clarified (and, in the case of insurance, introduced), particularly for unusual and complex transactions, an area which is of particular risk for Luxembourg.</p> <p>Provide by law or other enforceable means for the specific record-keeping of unusual transactions.</p> <p>Add in the law the specific requirements with regard to business relationships with countries which do not have adequate systems in place.</p> <p>Require financial institutions and PSFs to implement special measures when receiving wire transfers which do not contain originator information.</p> <p>The barrier to the transfer of personal customer data for international financial services groups from Luxembourg operations needs to be addressed.</p>
<p>Implications for compliance with FATF Recommendations 14, 21, 28, SR VII</p> <p>FATF 14: Enforceable requirements should be introduced for unusual transactions. SR VII: The authorities should proceed with identification requirements for wire transfers.</p>

<p>IV—Record keeping (compliance with Criteria 52-54 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 88 for the banking sector, criteria 106 and 107 for the insurance sector, and criterion 112 for the securities sector)</p>
<p>Description</p> <p>The requirement to maintain records of customer identification and transactions and accounts for five years after the end of the business relationship is properly reflected in the LoFS 93, under article 39 (6). Circular 94/112 provides some specifics about the documents to be stored. In particular, documents to be kept are the account opening form signed by the client, a copy of the official documents required as proof of identity, and the documents required for the purposes of the identification of beneficial owners.</p> <p>The same provision provides that documents and records relating to transactions must be kept for 5 years after the transaction has taken place.</p> <p>These records must be kept at the disposal of the authorities, according to art. 40 (1) & (2) of the LoFS 93 which states that regulated businesses must cooperate fully with the authorities responsible for the fight against money laundering, by providing them, at their request, with all information necessary in accordance with procedures provided by the applicable legislation. This obligation extends to the investigations and prosecutions, for which the Code of Criminal Investigations has granted specific powers to the Police, the Prosecutor and the Investigating Judge, under certain conditions to compel possessors of documents or information useful for the conduct of criminal investigations to produce them. However, the Chamber of Commerce (and de facto, the Luxembourg Association of Banks and Bankers) is of the opinion that this power does not extend to the Prosecutor, outside the framework of his capacity as de facto Financial Intelligence Unit, when a suspicious transaction report has been filed.</p> <p>In the life insurance sector, art. 88 of the LoIS 91 sets out an obligation equivalent to art. 39 (6) of the LoFS 93 both for identification and transaction related material. Art 3 (8) of the draft bill No. 5165 would extend this requirement to nonlife and reinsurance business.</p>
<p>Analysis of Effectiveness</p> <p>Both the law and its implementation appear to be effective in practice. The extension of coverage to non life and reinsurance business will be a positive development.</p>
<p>Recommendations and Comments</p> <p>—</p>
<p>Implications for compliance with FATF Recommendation 12</p> <p>—</p>
<p>V—Suspicious transactions reporting (compliance with Criteria 55-57 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 101-104 for the insurance sector)</p>
<p>Description</p> <p>55. Duty to report, to establish procedures and duty of the FIU or competent authority to establish guidelines</p> <p>Financial institutions and PSFs (art. 40 (2) of the LoFS 93) as well as life insurance companies (art. 89 (1) of LoIS 91) have the duty to report, at their own initiative, all facts that could raise a suspicion of money laundering. The law does not specify how quickly the suspicious transaction report (STR) must be filed after the financial institution becomes suspicious. Art. 40 (3) provides that the reporting party must refrain from carrying out the transaction until the STR has been filed. In the case where delaying the operation would not be possible, the reporting institution must file the STR immediately afterwards. However, there is currently no legal requirement to declare suspicions of FT when it is not related to ML. The draft bill No. 5165 proposes to update the legal framework in this respect.</p> <p>Art. 40 (5) requires financial institutions and PSFs to institute internal procedures to prevent the occurrence of money laundering transactions. These procedures include training programs for employees to help them to identify suspicious transactions and to instruct them on the way to proceed in such cases.</p>

The FIU / Prosecutor has provided some guidance to the financial sector industry by means of the publication of annual reports, which include statistics, trends and typologies. The CSSF issued detailed guidance through its circulars, including a description of money laundering and its techniques and a listing of potential signs of suspicious activity. The circulars also include an explanation of the laws and requirements and guidance on compliance. The main circular on the subject was issued in 1994, with some aspects clarified in 2002.

56. Protection for liability in case of disclosure

Paragraph (2) of article 41 of the LoFS 93, which defines the professional secrecy rule in force in financial institutions and PSFs, sets out that "The obligation of secrecy ceases when the revelation of information is authorized or imposed by or under the terms of a legal provision, even if the implementation of such provision shall have preceded the present law."

Paragraph (7) of the same article provides that any person, who is bound by the duty of secrecy referred to in paragraph (1) of this article and has legally revealed information covered by this duty, cannot incur a penal or civil liability from this act alone.

The draft bill n° 5165 would amend these provisions and replicate the text of the European Directive by stating that "the disclosure in good faith to the Luxembourg authorities responsible for combating money laundering and financing terrorism by a professional or by an employee or director of such a professional of the information referred to in the paragraphs above shall not constitute a breach of any restriction to the disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, and the institution or person or its directors or employees shall not incur any liability of any kind. This provision provides for a larger protection of financial professionals, but also the employees of financial institutions, from any liability for making available findings or reporting suspicions in good faith to the FIU.

57. Prohibition of "tipping off"

Paragraph (4) of article 40 prohibits financial institutions and PSFs, their directors and employees from disclosing to the customer concerned or to other third persons that information has been transmitted to the authorities or that a money laundering investigation is being carried out.

This prohibition is reaffirmed in draft bill N° 5165. However, a provision in a previous section of article 5 of the draft would allow the reporting party, when the Prosecutor orders the freezing of a transaction, to inform his client that the transaction is not carried out in execution of such an order. This provision does not seem to be consistent with the prohibition of "tipping off."

Analysis of Effectiveness

Basic AML guidance has been provided to financial professionals and PSFs, but many aspects have not been updated for 10 years. Therefore, international developments and trends in the intervening period are not adequately addressed. The typologies information published by the FIU could be expanded and developed further to provide more comprehensive guidance.

While the legal provisions are largely in line with the standard, it is difficult to assess whether the financial professionals are prepared to fully accept their legal obligation to file STRs. There are ongoing efforts by the FIU to further increase awareness of these obligations and the CSSF has issued a circular clarifying the circumstances in which STRs should or should not be filed in the case of a bank declining the business of a potential customer.

The reaction of the Banking Association highlights a reluctance to comply with the reporting requirements. One reason given is the potential personal legal liability of officials of STR reporting banks, if, in filing an STR, it should emerge that the bank has not complied fully with its legal requirements, for example in the area of customer identification. The banking association sees this situation of potential self incrimination as a barrier to effective reporting of suspicious transactions. It is calling for clarification in this regard of the respective roles of the FIU and the CSSF, in regulating the implementation of AML/CFT measures by financial professionals.

<p>Recommendations and Comments</p>
<p>The FIU and regulatory authorities, as appropriate, should update and expand the coverage of their published AML/CFT guidance.</p> <p>The authorities need to act, in a collaborative manner or by stronger means if necessary, to ensure that the necessary legal provisions (current or amended) can be applied effectively, so that the financial professionals accept their legal responsibility to report to the FIU.</p> <p>The authorities should ensure that a reporting requirement for suspicions relating to FT is included in the law, as proposed.</p>
<p>Implications for compliance with FATF Recommendations 15, 16, 17, 28</p>
<p>FATF 15: no requirement to file a STR for FT; institutions are reluctant to comply with the reporting requirements. – Any remaining uncertainty among financial institutions about reporting responsibilities or legal protections should be addressed in order to achieve effective implementation.</p> <p>FATF 17: clients can be informed regarding freezing of accounts</p> <p>FATF 28: guidance on typologies and AML/CFT preventive measures needs to be updated and expanded</p>
<p>VI—Internal controls, Compliance and Audit (compliance with Criteria 58-61 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 89-92 for the banking sector, criteria 109 and 110 for the insurance sector, and criterion 113 for the securities sector)</p>
<p>Description</p>
<p>Article 40 (5) of the LoFS 93 requires credit institutions and PSFs to:</p> <ol style="list-style-type: none"> a. “establish adequate procedures of internal control and communication in order to forewarn of and prevent operations related to money laundering; b. take appropriate measures so that their employees are aware of the legal provisions concerning professional obligations within the financial sector. These measures shall include the participation of the employees concerned in special training programs to help them recognize operations which may be related to money laundering as well as to instruct them how to proceed in such cases.” <p>For life assurance companies, an equivalent requirement is contained in the LoIS 91.</p> <p>Circular 94/112 elaborates on the legal obligations created by the law by requiring financial institutions and PSFs to design an AML/CFT program including policies, procedures and internal controls, as well as the designation of a person responsible, at the level of general management, and adequate procedures when hiring personnel. Financial institutions and PSFs are required to develop a manual of procedures, and an awareness program for employees including continuous education, information meetings, the designation of a person to whom employees can refer, and the issuance of material on money laundering, describing typologies.</p> <p>Although not referred to as a compliance officer, the circular calls for the designation of a person, at management level, as part as the program against money laundering. The CSSF plans to introduce further guidance by circular with regard to developing generally the compliance function of financial professionals, including in the area of AML/CFT. Banks interviewed in the course of the mission confirmed that they have created distinct compliance functions.</p> <p>The CSSF requires each bank to provide it with a copy of its internal procedures documentation, on an updated basis. These controls are also assessed by both internal and external audit, including coverage in the long form audit report prepared annually by the external auditors for the CSSF. In cases where CSSF conducts onsite AML/CFT inspections, particular attention is given to the appropriate application of internal controls.</p> <p>The need for an internal audit function in each regulated financial professional is contained, not in the law, but in a circular. Where an institution is too small to carry the cost of having an internal auditor on staff, the CSSF permits</p>

<p>the outsourcing of this function, typically to an external auditing firm, though not the institution’s own external auditor.</p> <p>The regulatory framework does not require financial institutions to carry out a systematic screening for applicants for employment. Financial professionals interviewed in the course of the mission indicated that they apply standard recruitment practices including confirming that candidates do not have a criminal record.</p> <p>According to article 35 (2) of the LoFS 93, financial professionals must ensure that the professional duties are also applied by their branches and subsidiaries and entities in which they hold a qualifying holding regardless of whether they are domestic or foreign. This obligation extends to AML/CFT requirements under the Law, but it does not make it specific that when differing requirements apply in the host country, branches and subsidiaries should apply the higher standard. Circular 94/112 provides that the Luxembourg standard should be regarded as the minimum and that the host country requirements should be met as well. The circular further states that, if the legal framework of the country does not allow for the application of the Luxembourg standard, contact should be made with the CSSF (formerly IML) to look for a solution</p>
<p>Analysis of Effectiveness</p> <p>Requirements for internal control systems and their implementation appear to be effective.</p> <p>The application of the guidance with regard to the internal audit function and the designation of a compliance officer is effective in practice.</p>
<p>Recommendations and Comments</p> <p>It would be preferable in order to avoid any possible difficulty to include the requirements for internal audit and the designation of a compliance officer or function in the law, as the circulars, not having direct force of law, cannot create additional legally enforceable requirements.</p>
<p>Implications for compliance with the FATF Recommendations 19, 20</p> <p>FATF 19: internal audit and compliance requirements should be mandatory</p>
<p>VII—Integrity standards (compliance with Criteria 62 and 63 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 14 for the securities sector)</p>
<p>Description</p> <p><i>Professional integrity</i></p> <p>The activity of financial institutions and PSFs is subject to the approval of the CSSF (art. 2 and 14 of the LoFS 93, art. 27 of the LoIS 91). This approval is subject to the condition that the members of the administrative, managerial and supervisory bodies, as well as the shareholders demonstrate their “professional respectability” (art. 7(1) and 19). These articles state that the assessment of professional respectability is based on their previous criminal records and on all information, which might show that the persons concerned enjoy a good reputation and present all the guarantees of irreproachable conduct. This provision meets the requirement that the law should prevent criminals from gaining control or holding a management function in financial institutions and PSF businesses. Since this check extends to shareholders, it could in theory prevent criminals from gaining a significant investment interest in the financial institution, unless the shareholder is a front company.</p> <p>The approval can be withdrawn, if “the conditions of its granting are not met anymore” (art. 11-1 and 23-2 of the LoFS 93). This provision allows for the supervisory authority to reexamine the situation of regulated professionals during the exercise of their activity.</p> <p>With regard to insurance companies, art. 29 (2) of the LoIS 91 stipulates that in order to receive the approval of the CaA, the “qualities of the shareholders and partners must be satisfactory, taking into account the need for a sane and prudent management of the company.”</p> <p>In addition, art. 103 provides that no insurance business can be conducted without the approval of the CaA. In order to receive approval, directors of Luxembourg insurance companies, general agents of foreign companies, insurance inspectors, agents or brokers, as well as all persons who carry out an insurance transaction in direct contact with</p>

<p>customers, must show that they satisfy the professional knowledge requirements, as well as morality and respectability standards. (art. 104). The Minister can withdraw the approval if the conditions for granting it are not met any longer (art. 110).</p> <p><i>Prevention of the unlawful use of shell companies, charitable or non-profit organizations.</i></p> <p>The situation with regard to shell companies and other corporate vehicles was discussed previously under Customer Identification. There are no provisions in Luxembourg law or guidance addressing explicitly the AML/CFT risks of these entities. However, Art. 39 of the LoFS 93 requires financial professionals to identify the beneficial owner in all cases, including for such structures.</p> <p>Recognizing the inherent risk of such structures from an AML/CFT perspective, in its onsite inspection work, CSSF focuses on the use of client impenetrable structures and opaque legal entities, to ensure that the financial professional has properly identified the beneficial owner. However, the coverage of the onsite program has been quite limited to date.</p> <p>With regard to charities, CSSF has written to all CISs and their service providers where their documentation indicates that they may transfer part of their returns or profits to charitable organizations. The letters asked for the verification of the true beneficiary prior to the transfer of funds.</p>
<p>Analysis of Effectiveness</p>
<p>Adequate measures are in place to prevent criminals acquiring significant holdings in financial institutions, or being in positions of control.</p> <p>Given the importance of the development and use of opaque corporate structures in Luxembourg, it is not possible to conclude that enough is yet being done by the authorities to minimize the risk of abuse of these structures for ML or FT purposes.</p>
<p>Recommendations and Comments</p>
<p>The authorities should consider the development of specific requirements and guidance highlighting the various forms of corporate vehicle and the ML and FT risks they entail. The scope of this initiative would need to cover all categories of professional (including inter alia lawyers and accountants) who may be involved in creating or operating such structures or acting on their behalf.</p> <p>The CSSF should increase its onsite monitoring for financial professionals under its supervision using a risk based approach, which would be expected to include entities at risk from the use of opaque corporate structures. Particular attention should be given to the private banking sector, where there appears to be a tendency to assume that the bankers are fully aware of the purpose and ownership of all entities with which they transact: it would be useful to test the validity of this assumption.</p>
<p>Implications for compliance with FATF Recommendation 29</p>
<p>–</p>
<p>VIII—Enforcement powers and sanctions (compliance with Criteria 64 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 93-96 for the banking sector and criteria 115-117 for the securities sector)</p>
<p>Description</p>

With regard to the financial sector, CSSF, who is the competent authority for the surveillance of financial institutions and PSFs (art. 42 of the LoFS 93), is mandated to “monitor the implementation of laws and regulations on the financial sector by persons subject to the law” by article 43 (2) of the LoFS 93. CSSF is entitled to require from financial institutions and PSFs the information necessary for the exercise of its mission, and to carry out inspections (art. 53). In addition, it reviews the external audits of the regulated professions, and can require external auditors to undertake checks on certain aspects of the activities of financial institutions and PSFs (art. 54).

If an entity subject to CSSF's supervision fails to observe the required legal, regulatory or statutory provisions, article 59 of the LoFS 93 grants the CSSF the right to order the entity, by registered letter, to remedy the situation within a prescribed period. At the end of the period, if the requirements imposed by CSSF have not been implemented, it may:

- suspend the members of the board of directors or of the management or decision making bodies or any other persons who, by their action, negligence or imprudence, have brought about the situation in question or whose continuation in office could prejudice the implementation of measures aimed at recovery or reorganization;
- suspend the right of vote attached to the shares or partnership shares owned by the shareholders or members whose influence is likely to be detrimental to the sound and prudent management of the entity;
- suspend the carrying on of the entity's business or, if the situation in question relates to a specific branch of activity, the carrying on of such an activity.

In addition, CSSF may impose a disciplinary fine of EUR 125 to EUR 12,500 on the persons in charge of the administration or of the management of the institutions subject to its supervision under the terms of the present law, as well as on physical persons subject to the same supervision, in cases where they refuse to submit (...) information or if such documents prove to be incomplete, inaccurate or false; if they interfere with or impede the CSSF's inspections; (...) or if they do not comply with the previously described injunctions of the CSSF (art. 63).

The violation of professional obligations may also be punished by penal sanctions under art. 64 of the LoFS 93, up to a maximum of EUR 1,250 to EUR 125,000 as it related to the obligation to identify customers, to co-operate with the authorities, to disclose suspicious transactions, and to refrain from tipping off. Violation of the record keeping obligation, the enhanced due diligence requirements, and of the requirement to institute internal programs are not subject to penal sanctions, but only to the above mentioned administrative sanctions.

It is envisaged in the draft bill n° 5165 to bring the amount of the fines for violations of professional obligations up to EUR 1,250,000, and to extend it to all violations of professional obligations.

In the insurance sector, the violation of the requirement to identify customers, to take measures to identify the beneficial owner, to cooperate with the authorities, to report suspicious transactions, to refrain from carrying out a transaction after filing an STR, and to tip off customers, is punished by a maximum fine of **[LFR5,000,000]** Violation of the obligation to keep records and to set up internal programs is not punished by a penal sanction. (Art. 89-1 of the LoIS 91) However, in all cases, the supervisory authority can issue an administrative fine up to EUR 2,500 for violation of the legal provisions, and in addition, can pronounce one of the following decisions:

- a warning
- a formal written reprimand (“blame”)
- the prohibition to carry out certain transactions or any other restriction in the exercise of the activity. (art. 109)

The Minister may withdraw his approval if the professional concerned commits a serious violation of the obligations under the LoFS 93 or any other penal law in force in Luxembourg.

Analysis of Effectiveness

The CSSF and CaA have a range of powers to sanction breaches of regulatory requirements by any of the financial professionals under their supervision. These powers have been used as needed and their use, or the threat of use, appears to be effective. For example, the CSSF confirmed in its 2002 Annual Report that it had applied fines in a number of cases, and that 4 managers of financial institution had resigned as a result of action taken by the CSSF.

Recommendations and Comments
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IX—Cooperation between supervisors and other competent authorities (compliance with Criteria 65-67 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 97-100 for the banking sector and criteria 118-120 for the securities sector)
Description
<p>65. Adequate means for the supervisor</p> <p>The CSSF now has more than 200 staff covering the banking and securities areas. It has developed expertise in the policy and technical aspects of AML/CFT and has built up experience in the area of onsite inspections of banks, including on AML/CFT. The CSSF does not carry out inspection work outside Luxembourg. Application of appropriate supervisory measures for AML/CFT appears to be more difficult in the funds area, not least due to the international nature of fund distribution structures, the degree of delegation by Luxembourg funds of customer due diligence measures to regulated foreign distributors and the absence of onsite inspections by CSSF for AML/CFT in the funds area.</p> <p>The CSSF has an internal coordination committee dealing with AML/CFT matters, which has recently produced detailed proposals to improve the AML/CFT preventative regime, in the context of the draft bill No. 5165.</p> <p>The CaA appears to have appropriate resources and skills to provide for effective supervisory measures covering AML/CFT for life assurance companies. Measures do not yet extend to general and reinsurance, but this is planned in the draft bill No. 5165. CaA carries out onsite inspections of life companies, including of AML/CFT measures, on a 3–4 year cycle.</p> <p>66. Cooperation with other domestic authorities</p> <p>The supervisory authorities appear to cooperate effectively with each other and with other authorities involved with the fight against ML and FT. All agencies have specific legal reporting requirements to the FIU / Prosecutor in the event of a suspicion of ML.</p> <p>Following a recommendation of the IMF’S FSAP mission of 2001/02, the authorities created a coordination committee (COPILAB), including all relevant supervisory and enforcement bodies and industry representatives. This committee has overseen the development (in conjunction with the IMF) and implementation of a comprehensive action plan to achieve effective AML/CFT measures in Luxembourg. The establishment of this committee has been commended by all professionals and authorities involved, and appears to be working very effectively.</p> <p>67. Cooperation with foreign supervisory authorities</p> <p>Art. 44 of the Law allows for the widest exchange of information with foreign supervisory authorities by waiving professional secrecy of CSSF staff for this purpose. This information can be provided with the following restrictions:</p> <ul style="list-style-type: none"> - it must be necessary for the achievement of the surveillance mandate of the requesting authority - the foreign authorities must be bound by the same professional secrecy - the information submitted cannot be used for purposes other than those for which they have been requested. <p>The exchange of information can be performed with the following authorities:</p> <ul style="list-style-type: none"> - supervisory authorities of countries of the European Union - authorities of other countries in charge of supervision of credit institutions, investment companies, PSFs, insurance companies - authorities in charge of supervision of entities and professionals involved in bankruptcy procedures - authorities in charge of supervision of accountants and auditors of financial institutions - central banks - authorities in charge of the monitoring of payment systems. <p>Article 15 of the LoIS 91 provides for the same possibility of exchange of information with foreign counterparts and</p>

<p>regulatory authorities under the same conditions.</p> <p>The CSSF considers that a foreign supervisory authority in the discharge of its function as home authority is entitled to visit Luxembourg in order to verify compliance with home country KYC requirements. Customer files may be reviewed. Acquired knowledge may only be used for the purposes of consolidated supervision and must be protected by professional secrecy obligations. Nominative data on clients may not be taken abroad.</p> <p>Currently internal auditors of banking groups with subsidiaries in Luxembourg can review customer files. However, by application of the bank secrecy law, nominative data on clients may not be taken abroad.</p>
<p>Analysis of Effectiveness</p> <p>Structures for domestic cooperation measures in the area of AML/CFT have been developed and strengthened over the last 2 years and appear to be operating at an effective level.</p> <p>In practice, adequate access to information is being provided to foreign supervisors to assist in consolidated supervision. Group auditors have access to customer data locally, but not outside of Luxembourg.</p> <p>In the insurance area, while the assessors did not encounter any particular concerns impinging on the effectiveness of preventive measures, a timespan shorter than the current 3-4 years between onsite inspections would strengthen the position of the CaA in minimizing the risk of ML and FT in the sector.</p>
<p>Recommendations and Comments</p> <p>The authorities should proceed as soon as possible with their plans for a legislative amendment to the bank secrecy provisions to permit transfer to the auditors of international financial services groups of customer details in Luxembourg subsidiaries or branches of foreign banks or other financial professionals.</p>
<p>Implications for compliance with FATF Recommendation 26</p> <p>–</p>

C. Description of the Controls and Monitoring of Cash and Cross Border Transactions

Table 3: Description of the Controls and Monitoring of Cash and Cross Border Transactions

<p>FATF Recommendation 22:</p> <p>Description</p> <p>There are no restrictions on or monitoring of cash movements into or out of Luxembourg.</p>
<p>FATF Recommendation 23:</p> <p>Description</p> <p>–</p>
<p>Interpretative Note to FATF Recommendation 22:</p> <p>Description</p> <p>–</p>

D. Ratings of Compliance with FATF Recommendations, Summary of Effectiveness of AML/CFT efforts, Recommended Action Plan and Authorities' Response to the Assessment

Table 1. Ratings of Compliance with FATF Recommendations Requiring Specific Action

FATF Recommendation	Based on Criteria Rating	Rating
1 – Ratification and implementation of the Vienna Convention	1	Compliant
2 – Secrecy laws consistent with the 40 Recommendations	43	Largely compliant
3 – Multilateral cooperation and mutual legal assistance in combating ML	34, 36, 38, 40	Largely compliant
4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses.	2	Materially non-compliant
5 – Knowing ML activity a criminal offense (Vienna Convention)	4	Compliant
7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	7, 7.3, 8, 9, 10, 11	Largely compliant
8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions; (e.g., foreign exchange houses)		See answers to 10 to 29
10 – Prohibition of anonymous accounts and implementation of customer identification policies	45, 46, 46.1	Largely compliant
11 – Obligation to take reasonable measures to obtain information about customer identity	46.1, 47	Largely compliant
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	52, 53, 54	Compliant
14 – Detection and analysis of unusual large or otherwise suspicious transactions	17.2, 49	Largely compliant
15 – If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	55	Largely compliant
16 – Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU	56	Compliant
17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU	57	Compliant
18 – Compliance with instructions for suspicious transactions reporting	57	Compliant
19 – Internal policies, procedures, controls, audit, and training programs	58, 58.1, 59, 60	Compliant
20 – AML rules and procedures applied to branches and subsidiaries located abroad	61	Compliant
21 – Special attention given to transactions with higher risk countries	50, 50.1	Largely compliant
26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to	66	Compliant

cooperate with judicial and law enforcement		
28 – Guidelines for suspicious transactions’ detection	17.2, 50.1, 55.2	Largely compliant
29 – Preventing control of, or significant participation in financial institutions by criminals	62	Compliant
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	22, 22.1, 34	Compliant
33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	34.2, 35.1	Complaint
34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	34, 34.1, 36, 37	Largely Compliant
37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	27, 34, 34.1, 35.2	Compliant
38 – Authority to take expeditious actions in response to foreign countries’ requests to identify, freeze, seize and confiscate proceeds or other property	11, 15, 16, 34, 34.1, 35.2, 39	Largely Compliant
40 – ML an extraditable offense	34, 40	Compliant
SR I – Take steps to ratify and implement relevant United Nations instruments	1, 34	Compliant
SR II – Criminalize the FT and terrorist organizations	2.3, 3, 3.1	Compliant
SR III – Freeze and confiscate terrorist assets	7, 7.3, 8, 13	Materially non-compliant
SR IV – Report suspicious transactions linked to terrorism	55	Materially non-Compliant
SR V – provide assistance to other countries’ FT investigations	34, 34.1, 37, 40, 41	Compliant
SR VI – impose AML requirements on alternative remittance systems	45, 46, 46.1, 47, 49, 50, 50.1, 52, 53, 54, 55, 56, 57, 58, 58.1, 59, 60, 61, 62	Not applicable
SR VII – Strengthen customer identification measures for wire transfers	48, 51	Not yet applicable

Table 2. Summary of Effectiveness of AML/CFT efforts for each heading

Heading	Assessment of Effectiveness
Criminal Justice Measures and International Cooperation	
I—Criminalization of ML and FT	Luxembourg is a party to all the main international instruments addressing money laundering and financing of terrorism except for the Palermo Convention. Criminal laws are in line with its international obligations, apart from the criminalization of money laundering, which refers to a too narrow list of predicate offences compared to any other standard, except for offences committed in the framework of criminal

	<p>organizations.</p> <p>With regard to the ratification of the Palermo Convention, the authorities consider that since all its provisions have been implemented, the need to ratify it is not urgent and there is no prospect of the convention being ratified in the near future. However, by not being party, Luxembourg cannot take advantage (and offer the benefit to other countries) of the other specific provisions of the convention, and in particular of the mutual legal assistance and extradition provisions, which provide extended possibilities of international cooperation in organized crime matters.</p> <p>The list of predicate offences is far too narrow. A large number of profit-making crimes are excluded from the list, except when they are committed as part of the activity of an organized crime group. Draft bill no. 5165 is intended to correct this flaw. However, while this new law will improve notably the scope of predicate offences, it is important to point out that it still does not meet the new requirement instituted by the FATF in revised Recommendation 1 for those countries which would choose the list approach. Since Luxembourg, as a FATF member State, has committed itself to implement the revised recommendations, Luxembourg should consider taking advantage of the modification of the law to extend the scope of predicate offences at least to those designated in the new recommendations.</p> <p>In relation to the self-laundering issue, the mission notes that despite the inclusion of self-laundering by a later amendment, the original definition of money laundering, which was worded to exclude self-laundering (ceux qui auront facilité... ceux qui ont apporté leur concours...) has not been modified, which may lead to interpretation difficulties.</p> <p>Figures of prosecutions for AML/CFT cases in the country are very low. Only four prosecutions for money laundering have been carried out since the adoption of the first money laundering drug-related offence, three of them having successfully resulted in a conviction. Three to five other cases are still being investigated by an Examining Judge, but concern domestic laundering without cross-border implications. Like in every country, the main problem encountered has been the difficulty of providing evidence of the origin of funds. However, there is no prospect to introduce in the law any legal means to alleviate the burden of proof, as was done in neighboring countries. The difficulties may also result from the “list approach” chosen by Luxembourg for the predicate offences rather than an “all crimes” approach. The prosecutor has not only to provide</p>
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	<p>evidence of the existence of a predicate criminal offence, but also to prove that this offence is one of those listed, and not any other one. Another factor is, according to the authorities, the fact that most laundering schemes uncovered had an origin in another country, and either the evidence was sent abroad, or the investigation was carried out in Luxembourg on the basis of a mutual legal assistance request, the offenders being prosecuted elsewhere.</p> <p>While the law allows for prosecution of AML/CFT cases as long as some of its elements have been perpetrated in Luxembourg, even when the predicate offence has been committed abroad, there seems to be a deliberate policy of prosecuting authorities to hand over quasi systematically to foreign authorities money laundering cases uncovered as a result of an STR or any other investigation when it appears that, at some point, the case has a foreign connection or the funds originated from elsewhere. The authorities justify this approach for reasons of efficiency. Evidentiary material and the offenders are abroad, and prosecuting in Luxembourg would mean a complicated international cooperation procedure, including extradition of offenders, which is particularly difficult with neighboring countries which do not extradite their nationals.¹⁵</p> <p>The offence of financing of terrorism has been integrated in the legal framework of Luxembourg by a law of 2003, and it is too early to determine its actual effectiveness. However, it was drafted in a way which should ensure its effective implementation.</p>
II—Confiscation of proceeds of crime or property used to finance terrorism	<p>The effectiveness of confiscation laws in money laundering matters is difficult to assess, given the low rate of prosecutions for money laundering and financing of terrorism offences. However, the scope of confiscation is quite broad and its application should not be a problem. To enhance the effectiveness of confiscation measures, Luxembourg could consider alleviating the burden of proof of the origin of the seized assets, as suggested by the Vienna, Strasbourg and Palermo conventions.</p> <p>With regards to the freezing of assets on the basis of the UN Resolutions, Luxembourg has actively implemented its obligations to search for and freeze assets of the persons considered to provide support to terrorist organizations, by issuing circulars to financial</p>

¹⁵ One interlocutor suggested also, to explain the low rate of prosecutions in Luxembourg, that such prosecutions could affect the reputation of the country.

	<p>institutions. However, today, less than half a dozen accounts have been identified as being related to a person or entity on the list, and the total amount of assets which remain seized in relation to Security Council Resolutions amounts to EUR 3,500,, according to the information received from the authorities. These figures, compared to the size of the financial centre, raise questions about the effectiveness of the measures taken.</p> <p>The recourse to the legal powers conferred to the Prosecutor as an FIU raises an issue, since his power to freeze a transaction is limited to case where a financial institution has declared its suspicion. In the case of the implementation of UN resolutions, accounts have to be frozen not because a suspicion arose from the movements on the accounts or the behavior of the owner, but just because the name of this person or entity appears on a list issued by the UN Security Council. As it occurred in other countries, the use of legal powers to freeze accounts when they are not meant for this purpose could be challenged in court.</p> <p>The ability to trace money laundering or financing of terrorism assets is limited by the fact that there is no central database of bank accounts held in Luxembourg.</p> <p><i>The possibility for the public prosecutor to suspend a financial transaction is (with the exception of FT) just used in practice only if the judicial authorities get the confirmation of such demand by a mutual legal assistance request or if the FIU has enough indicators allowing it to request the opening of a domestic penal investigation.</i></p> <p><i>However, the preventive focus of the Luxembourg AML/CFT framework puts the focus more on following and monitoring suspicious financial movements than on freezing assets to interrupt the laundering chain.</i></p> <p><i>The FIU is producing a comprehensive annual report which contains the main figures to be able to measure the outcome of the AML/CFT system. However, it could be helpful to understand some significant changes in the figures by commenting on them.</i></p>
<p>III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels</p>	<p>The Financial Intelligence Unit in Luxembourg is one of the judicial model. It benefits from ten years of experience in receiving suspicious transaction reports (STRs), and its authority is recognized and unchallenged. Its staff is very committed and maintains close relations with the financial sector. However, it lacks a clear and transparent legal framework to operate, and sufficient means and IT equipment to face the</p>

	<p>continuous rise in STRs and to fulfill a real analysis function. Financing of terrorism should be added to money laundering as the offences for which suspicion should be disclosed.</p> <p>Article 40 (2) of the LoFS 93 requires the disclosure of any fact which could constitute a money laundering offence. Financing of terrorism is not included as one of the offences which must give rise to a disclosure. However, since the law of August 12, 2003, financing of terrorism is included as one of the predicate offence of money laundering and as such, should be declared, to the extent to which the funds aimed at financing a terrorist organization are being laundered. Draft bill no. 5165 would, if adopted, correct this small flaw by extending the reporting obligation to suspicions of financing of terrorism itself.</p> <p>In general, professionals of the financial sector have commended the responsiveness of the FIU, who provide initial feed-back within a very short period after the STR had been filed, and who are open to their questions and requests for guidance in cases of doubt on the true nature of a transaction. The disclosure rate is gaining momentum, especially since the circular requiring financial institutions to file a report even when they refuse to enter in a business relationship with the client, as suggested by the first IMF mission. During interviews, financial institutions and PSFs have not mentioned any reluctance to interact directly with an FIU which is also the prosecution authority.</p> <p>However, a number of professionals have raised some concerns about the fact that some accounts frozen by the FIU remain for months without any action taken and/or any feedback given to the financial institution, whereas the reporting party is prohibited to inform his client of the reason why he refuses to defer to his instructions. Lack of long term feedback was an issue raised in most of the meetings with professionals of the financial sector. The absence of clarity about the scope of powers of the FIU, because of the confusion between the FIU function and the prosecutorial role of the authorities in charge of receiving STRs, has also been reported. The mission notes with concern that the FIU has not been given a legal framework to operate apart from the few legal provisions mentioned above, and that, while perfectly legally, it operates on the basis of powers which have been conferred to this authority for the purpose of prosecuting offences.</p> <p><i>The FIU structure does not include a specific analytical division. Due to the size and structure of the financial place, the FIU follows the principle of transmitting</i></p>
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	<p><i>financial information to the respective foreign counterparts in order to enable them to conduct their investigations.</i></p> <p><i>The total number of STRs has increased strongly since 2001. The actual number of staff of the FIU is too little to give an adequate response to this challenge.</i></p> <p><i>The number of institutions filing STRs increased steadily, from 31 in 2000 to 80 in 2002. Out from the 31 institutions filing STRs in 2000, 6 of them filed ca. 44% of the total number of STRs filed by credit institutions. In 2002, out of the 80 filing credit institutions, 11 reported ca. 48% of the total. Since more institutions are now filing STRs and the percentage of STRs this represents is increasing slightly, this could be analyzed as an increasing of awareness. However, in 2002, out of the approved 174 credit institutions less than 50% filed STRs.</i></p> <p><i>Analyzing the filing of STRs by other PSFs, in 2000, there were only 5 involved in this process, in 2002 34. All over the years from 1993 to 2002 there has been a significant increase of other PSFs filing STRs. However, the fact that the sector of credit institutions is heavily dominant in the disclosure of STRs to the authorities, bearing in mind that out of this sector less than 50% do file reports, raises a question about the actual commitment of the majority of the financial community.</i></p>
IV—Law enforcement and prosecution authorities, powers and duties	<p>The FIU and law enforcement and prosecution authorities being the same, many of the comments made as to the FIU could be replicated in relation to the effectiveness of these authorities. The specialized police authorities and the prosecutor's office benefit from the fact that they are combined with the FIU, for maximum efficiency in prosecutions. However, the number of prosecutions is very low, due to the established policy of forwarding to foreign authorities all cases and suspicions of money laundering which relate to persons or funds originating from abroad. With regards to investigative techniques, these are limited to wire tapping and other related measures. The ongoing monitoring of bank accounts, and the use of pro-active investigative techniques such as undercover operations, sting operations, front operations and controlled deliveries, are not provided for by the law. Controlled deliveries are carried out with the authorization of the Prosecutor, in the area of drug trafficking, but they have not been used in the area of money laundering or financing of terrorism. The use of more advanced investigative techniques may be dangerous and raise some legal questions insofar as they imply provoking the commission of an offence by someone. However,</p>

	<p>they have proved in other countries to allow for spectacular results in terms of funds seized and organizations dismantled. The cost/benefit analysis of engaging in such techniques should be reviewed, and in case the specialized law enforcement agencies would intend to implement such techniques, there should be a strong legal framework to allow for it and to define its scope.</p> <p>With regards to search and seizure of documents, the mission was informed that a gentleman's agreement existed between the banks and the investigative Judges, by which when the judge orders a search in a bank for documents in relation with a criminal investigations, it allows the bank to "spontaneously" hand the documents to the Judge within a period of 10 days, after which the search is carried out coercively. The investigating Judges specified to the mission that when there was a risk that such an agreement could jeopardize the investigation for any reason, they would opt for an immediate search.</p> <p><i>The law enforcement bodies of Luxembourg seem to work closely together, within the country and with their respective foreign counterparts. Due to the size and structure of the financial place of Luxembourg, international law enforcement co-operation is of crucial importance. However, the domestic work of the law enforcement can be even more effective, if common databases or access to the respective data would be easier.</i></p> <p><i>Special investigative techniques such as controlled delivery and undercover operations are not often used in ML and FT investigations, mainly due to the fact of the size of the country.</i></p> <p><i>However, special investigative techniques, especially surveillance and monitoring of financial flows and other internal data of a financial intermediary could be used to support foreign ML investigations and detect possible involvement in ML of local staff.</i></p> <p><i>Statistics and Structure:</i></p> <p><i>The roughly 600 STRs produced 4 cases of ongoing penal investigation. The same planned 5 officers have to deal with police investigative techniques as well as with analytical work of the STRs. Furthermore, they have to prepare the basic material for the statistics. The question arises as to whether there are enough staff at the law enforcement level to deal with all the information in a proper way. Training of new officers in this unit takes some time. The authorities should consider restructuring the FIU and separate the investigative work from the intelligence work.</i></p>
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	<p><i>Training of law enforcement happens on a regular basis. It could be enhanced by organizing joint workshops between the financial sector and the government analysts.</i></p>
V—International cooperation	<p>The large amount of assets managed or deposited in Luxembourg by foreigners gives rise to a significant number of MLA requests. The overload of foreign requests and the previous procedures often resulted in the past in undue delays and Luxembourg was sometimes criticized by neighboring countries for its low and slow response to their requests. The law of August 08, 2000, has provided for a simpler procedural framework and is praised for its efficiency. Since its adoption, the number of petitions against measures executed in response to an MLA request, which were filed before for the main purpose of delaying the process, has dropped significantly to a dozen per year. The law is clear and simple, even though the conditions for granting the request, and the possibilities for refusal are extensive, in particular with regard to the specific details to be included in the request. However, the law authorizes the executing Judge to ask for additional information without having to simply dismiss the request. According to the office of the Prosecutor General, no request has been refused until now for any of the reasons specified in art. 4 of the law. With the adoption of the law on extradition on June 20, 2001, Luxembourg has now a comprehensive framework for international cooperation. Luxembourg is a party to all main instruments designed to enhance judicial cooperation in criminal matters, apart from the Palermo Convention.</p> <p>The MLA law provides in its article 4 that MLA requests should be considered as “urgent and priority matters”. According to the judges with whom the mission met, the timeframe for the execution of MLA requests has significantly decreased. In case of urgency, MLA requests may be sent directly to the executing Judge.</p> <p>Both mutual and extradition laws are in accordance with international standards.</p> <p><i>The picture about the effectiveness of international cooperation cannot be completed with not having more key figures available such as, how many requests on the FIU level were made to foreign counterparts, were they made to get information in order to prepare a mutual legal assistance request, were there problems to resolve due to the fact of links of ML with tax evasion, etc.</i></p>

	<p><i>The police exchange of information, meaning the exchange between pure law enforcement agencies related to ML is working well.</i></p>
<p>Legal and Institutional Framework for All Financial Institutions</p>	
<p>I—General framework</p>	<p>In the area of preventive measures, the legal and institution structure was found to be largely effective in practice, though the limitation of the current legal provisions needs to be addressed to avoid the risk of their being undermined by any legal uncertainty.</p> <p>Regarding banking secrecy, despite the very clear language of the articles dealing with provision of confidential information to the authorities, there seems to be a problem of interpretation by the financial sector. The Chamber of Commerce of Luxembourg has issued on September 16, 2003 an opinion on the draft Law no. 5165, which, when describing the existing legal framework, states that, under its normal legal powers, the Prosecutor’s Office (which acts as the FIU) cannot require a bank to provide it with a document and if so required, the bank “has the right, if not the obligation, to refuse to comply.” For the Chamber of Commerce, article 40 (2) does not confer any specific power to the prosecutor to obtain information, since the bank must cooperate, according to this provision, “within the framework of existing procedures,” and that no procedure confers a specific power to the prosecutor to do so. Article 40 (3), according to the author of the opinion, confers a limited power to the prosecutor, which exists only in the area of AML/CFT, and only after an STR has been filed. This interpretation is probably shared by many members of the banking community, since CSSF issued a circular in 2001,¹⁶ reminding banks to cooperate fully with the Prosecutor-FIU and “<i>refrain from systematically objecting on the grounds of bank secrecy</i>”. According to the authorities, cooperation has improved since the issuance of this circular.</p> <p>In terms of powers of CSSF, the authorities rely on art. 43 of LoFS as the legal basis to grant to CSSF the power to act as a competent authority. This provision does not explicitly convey any power in relation to AML/CFT and does not give authority in AML/CFT matters on entities which are not supervised by CSSF, such as the insurance companies. The CSSF is operating effectively</p>

¹⁶ Circular 01/40.

	<p>in practice as the AML/CFT competent authority with respect to preventive measures for the financial professionals under its supervision.</p>
<p>II—Customer identification</p>	<p>The legal requirement to identify customers is generally in line with the international standards. Considering the prevalence and importance as bank customers in Luxembourg of corporate structures designed to obscure beneficial ownership, it is of critical importance that financial professionals are specifically required by law to identify legal entities and to conduct sufficient enquiries and collect sufficient information to know their customers. Getting one or two documents (the extract of the Register of Commerce, if it exists, and the articles of association) would often not provide a sufficient basis on which to know the customer.</p> <p>With regard to numbered accounts, the explanations provided for their extensive use are not persuasive. It is difficult to believe that customers who trust significant sums of money to a bank in a country that promotes itself on the basis of bank secrecy have such little confidence in the general staff of that bank that they anticipate they will breach their legal duty of customer confidentiality and reveal details of the customer; therefore, the identity of the customer needs to be kept secret from most staff. While the controls on the operation of numbered accounts as described to the assessors seem reasonable, there remains some concern about the potential for abuse of this type of account.</p> <p>Given the variety of structures operated in and from Luxembourg to legally separate the apparent from the real ownership of bank accounts and other assets managed by financial professionals there, identification of the true beneficial owner in each case, as required by law, can present a difficult challenge. This is an important risk factor for AML/CFT and a threat to the reputation of Luxembourg.</p> <p>A legal requirement for the inclusion of originator information for wire transfers will be included in the next AML/CFT law. In the meanwhile, banks interviewed were conscious of the risks and had addressed them in appropriate internal procedures.</p> <p>It is the view of the mission that particular risks can arise from the current arrangements concerning the opening and operation of accounts by lawyers, notaries, accountants, auditors and other such professionals. Discussions with the private sector pointed to actual practices that do not correspond with the requirements, as explained to the mission by the authorities. Where accounts are opened by these professionals on behalf of</p>

	<p>named clients, it is accepted that KYC must be carried out by the bank on the client or beneficial owner. However, where funds are lodged to accounts in the name of the professional, there appears to be an assumption that this signifies that the funds are those of the professional and that no further enquiries are necessary. This raises a question about the possible absence of controls on intermingled or 'jumbo' client accounts being maintained by the professionals. Based on discussions during the mission, there are indications that banks do not inquire as to the source or beneficial ownership of funds in such accounts. Given the scale and importance in Luxembourg of business sourced through these professionals, and the wide use of additional structures to shield the identity of beneficial owners, this represents an area of potentially significant risk.</p> <p>There seems to be a standard practice of opening accounts for new customers in Luxembourg and accepting funds in the absence initially of complete KYC information. This is subject to the control that the funds involved remain absolutely blocked until full KYC has been conducted. Thus financial professionals impose an additional compliance burden on themselves by having to maintain the block. CSSF onsite work indicates that these controls are not always properly maintained or documented, giving rise to the risk once the account has been opened, that the necessary follow up might not always take place, and a customer may succeed in using the account without adequate identification.</p> <p>There is merit in the view of the authorities that the same high standard of controls should apply both to resident and non resident customers. However, having regard to the scale of nonresident business in Luxembourg and the additional risks of cross-border business, this approach is valid only if the standards universally applied are those appropriate to higher risk international business. The addition of specific reference to the additional risks of cross-border business in CSSF guidance material would be helpful.</p> <p>Certain important financial services business lines common in Luxembourg are designed first and foremost to disguise or create a legal distance from the beneficial owner of the underlying funds. While the legal principles in this area are strong, and indications to the mission are that compliance is taken seriously by the financial sector, this is the least one would expect considering the significant inherent risks of this type of (mainly cross-border) business. Included here are private banking services, hold mail arrangements, trusts,</p>
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	<p>Anstalten, Stiftungen, SOPARFI, Art. 29 companies, holding companies and other corporate vehicles. No additional guidance has yet been provided by the authorities specifically on the AML/CFT risks arising from the extensive use of these arrangements. While these structures are designed primarily to address tax issues, it can be very difficult in practice to distinguish this from an ML or FT objective in a well-prepared business proposal.</p> <p>While internet banking is not a major element of the banking system, current online account opening practices, as described to the mission, leave scope for some abuse, and do not appear to be strictly in line with current CSSF guidance on this subject. As for other financial services products, difficulties arising from accepting new customers online are not peculiar to Luxembourg. However, it appears that additional steps may need to be taken by CSSF to ensure that the risks arising from this business are addressed effectively. The ideal would be to require some form of face to face contact, in Luxembourg or elsewhere, as part of the account opening process, but it is accepted that this can be difficult to achieve in practice. An exclusive reliance on the initial funds having come from a bank account in another FATF country has been shown elsewhere to be a target for money launderers. CSSF is conscious of the practical difficulties and are open to developing tailored control systems, where necessary.</p> <p>In the securities sector (broadly defined), the funds area is strategically important for Luxembourg. As the second biggest mutual funds market in the world, and the largest with regard to cross border business, the need for adequate controls is clear. While the potential use of funds products as a means of ML are probably more limited than for some other financial products, their use cannot be excluded, and they have been found among the financial assets held by money launderers in cases in the past. In this context, a particular vulnerability arises for Luxembourg due to the (quite valid under the EU AML directives) use of exemptions for the conduct of customer due diligence. For the most part, Luxembourg funds are marketed internationally by distribution networks of financial professionals. Where these operations are based in FATF countries and subject to their own national AML/CFT obligations, no further customer due diligence is conducted in Luxembourg. Rather than a KYC approach, therefore, there is in effect a “know your distributor” approach. The quality of KYC can be no better than that applied locally in the target country where, it could be argued, the seller of the Luxembourg fund investment might not have the same incentive to be so thorough in applying KYC as the</p>
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	<p>money is immediately going to a regulated entity in another jurisdiction. Also, where commissions are paid for originating these investments, there may be a strong incentive not to turn away business. A further risk arises from a possible excess reliance on discrimination between FATF and non FATF which may lead to over confidence with regard to KYC measures conducted in FATF member countries.</p> <p>The CSSF does not currently conduct onsite inspections covering this aspect of the funds business but is introducing long form audit reporting. Offsite supervision conducted includes approval of the fund's promoters and other parties, its prospectus and other documentation and the proposed distribution network. In the case of non FATF and unregulated distributors, customer due diligence must be conducted in Luxembourg. CSSF have confirmed that they have identified cases where this requirement is not complied with, and have required remedial action, which is sometimes difficult to achieve. It is the view of the mission that this is potentially a significant risk area that warrants additional attention.</p> <p>The risk is increased further where fund investments in Luxembourg funds are held in the name of nonresident regulated financial professionals from FATF countries, acting on behalf of clients. In this case, information on the beneficial owner is not available in Luxembourg, such that neither the fund administrator, the auditors or the supervisory authority can make any assessment of the risk of ML or FT. For example, it is not possible for funds administrators to know whether any of the names on UN lists feature as beneficial owners of these fund investments. This situation is not peculiar to Luxembourg and is a feature of the global distribution of funds products. Nonetheless, the risks involved need to be highlighted and understood, and the scale of the business in Luxembourg and the prevailing culture of secrecy may make Luxembourg particularly attractive to undesirable business, giving rise to a hidden source of imported reputational risk.</p> <p>Life assurance business on behalf of nonresidents is a very significant component of the Luxembourg financial services market. It is among the range of products offered for investment purposes to attract the business of medium to high net worth individuals, alongside private banking, funds products, corporate structures, etc. As such, it is similarly vulnerable to abuse by money launderers, particularly at the layering and subsequent stages of the ML process. Typology information published by the FIU, and analyzed independently by the CaA, points to a range of possible abuses of these</p>
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	<p>products, based on the 180 or so STRs filed by the insurance sector to date. Discussions during the mission confirmed a keen awareness of the risks and the existence of a range of controls. The quality of customer due diligence is critical to protecting the system and cannot be assessed directly by the mission. The CaA conducts on-site inspections of life companies, on a 3–4 year cycle, and includes coverage of AML/CFT measures.</p>
<p>III—Ongoing monitoring of accounts and transactions</p>	<p>The current legal provisions and guidance on monitoring of ongoing transactions need to be strengthened to be in line with the standard. Some additional points need to be clarified—and, in the case of insurance, introduced—particularly for unusual and complex transactions, an area which is of particular risk for Luxembourg.</p> <p>The CSSF circulars meet the requirement of criterion 50.1 that “effective measures [be] in place to ensure that financial institutions are advised of concerns about weaknesses in the AML/CFT systems of other countries.” Additional guidance should be provided to the industry as to countries with weak AML/CFT systems, since systemic deficiencies exist also in a number of countries which are not on the NCCT list. There should be a more explicit legal basis to deal with countries without an adequate AML/CFT framework.</p> <p>There is no provision relating to wire transfers, but some banks, at least, apply control measures.</p> <p>It is potentially a serious impediment to the global fight against money laundering that international financial professionals (particularly banking groups with a Luxembourg subsidiary and funds administrators abroad with related businesses in Luxembourg) are currently prohibited by Luxembourg’s secrecy laws from transferring personal data of their Luxembourg customers to the head office abroad, as part of their overall consolidated assessment of group AML/CFT risk.</p>
<p>IV—Record keeping</p>	<p>Both the law and its implementation appear to be effective in practice. The extension of coverage to non life and reinsurance business will be a positive development.</p>
<p>V—Suspicious transactions reporting</p>	<p>While the legal provisions are largely in line with the standard, it is difficult to assess whether the financial professionals are prepared to fully accept their legal obligation to file STRs. There are ongoing efforts by the FIU to further increase awareness of these obligations</p>

	<p>and the CSSF has issued a circular clarifying the circumstances in which STRs should or should not be filed in the case of a bank declining the business of a potential customer.</p> <p>The reaction of the Banking Association highlights a reluctance to comply with the reporting requirements. One reason given is the potential personal legal liability of officials of STR reporting banks, if, in filing an STR, it should emerge that the bank has not complied fully with its legal requirements, for example in the area of customer identification. The banking association sees this situation of potential self incrimination as a barrier to effective reporting of suspicious transactions. It is calling for clarification in this regard of the respective roles of the FIU and the CSSF, in regulating the implementation of AML/CFT measures by financial professionals.</p>
<p>VI—Internal controls, compliance and audit</p>	<p>Requirements for internal control systems and their implementation appear to be effective.</p> <p>The application of the guidance with regard to the internal audit function and the designation of a compliance officer is effective in practice.</p>
<p>VII—Integrity standards</p>	<p>The authorities should consider the development of specific requirements and guidance highlighting the various forms of corporate vehicle and the ML and FT risks they entail. The scope of this initiative would need to cover all categories of professional (including inter alia lawyers and accountants) who may be involved in creating or operating such structures or acting on their behalf.</p> <p>The CSSF should increase its onsite monitoring for financial professionals under its supervision using a risk based approach, which would be expected to include entities at risk from the use of opaque corporate structures. Particular attention should be given to the private banking sector, where there appears to be a tendency to assume that the bankers are fully aware of the purpose and ownership of all entities with which they transact: it would be useful to test the validity of this assumption.</p>
<p>VIII—Enforcement powers and sanctions</p>	<p>The CSSF and CaA have a range of powers to sanction breaches of regulatory requirements by any of the financial professionals under their supervision.</p>
<p>IX—Co-operation between supervisors and other competent authorities</p>	<p>Structures for domestic cooperation measures in the area of AML/CFT have been developed and strengthened over the last 2 years and appear to be operating at an effective level.</p>

	<p>In practice, adequate access to information is being provided to foreign supervisors to assist in consolidated supervision. Group auditors have access to customer data locally, but not outside of Luxembourg.</p> <p>In the insurance area, while the assessors did not encounter any particular concerns impinging on the effectiveness of preventive measures, a time span shorter than the current 3–4 years between onsite inspections would strengthen the position of the CaA in minimizing the risk of ML and FT in the sector.</p>
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Table 3: Recommended Action Plan to Improve the Legal and Institutional Framework and to Strengthen the Implementation of AML/CFT Measures in Banking, Insurance, and Securities Sectors.

Criminal Justice Measures and International Cooperation	Recommended Action
I—Criminalization of ML and FT	<p>The scope of predicate offences should expand to cover all profit-making crimes, and at least all offences included in the FATF list.</p> <p>Authorities should consider introducing some legal provisions to alleviate the burden of proof of the knowledge element (mens rea) of the offence, in the respect of general principles of law such as the presumption of innocence.</p> <p>More emphasis should be given to local prosecution of offences even when some elements have been committed abroad.</p>
II—Confiscation of proceeds of crime or property used to finance terrorism	<p>Authorities should consider easing the burden of proof as to the property of assets belonging to persons convicted for money laundering and/or the predicate offences.</p> <p>A law should be adopted to give to an authority the power to freeze accounts in application of UN resolutions taken as part of the powers of the Security Council and subsequent EC regulations.</p> <p>Authorities could consider a provision that opens the possibility of rendering void transactions during a “suspicious period” before the conviction, unless the transaction has been conducted in good faith.</p> <p>The creation of a central database of bank accounts would greatly enhance the efficiency of the fight against money laundering and the financing of terrorism.</p>
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	<p>Financing of terrorism should be added to money laundering as the offences for which suspicion should be disclosed.</p>

	<p>A law should be adopted to provide a clear framework for the operation of the FIU.</p> <p>The FIU and CSSF should issue circulars and guidance on a regular basis to clarify certain aspects of the implementation of the law.</p> <p>The FIU and the law enforcement team which supports it should be further integrated and be given adequate means to fulfill their functions.</p> <p>The FIU should be urgently equipped with the IT equipment necessary to run a modern database.</p> <p>With regards to the offence of violations of their duties by financial businesses and other professional concerned, the law should establish a distinction between cases of negligent and of fraudulent violations, with proportionate and dissuasive sanctions.</p>
<p>IV—Law enforcement and prosecution authorities, powers and duties</p>	<p>There should be a legal basis for a wider range of investigations, including at least monitoring bank accounts and controlled deliveries in drug trafficking, money laundering, and financing of terrorism matters.</p> <p>Specialized law enforcement agencies, such as, the anti-money laundering section of the Judicial Police, should be equipped with sufficient human and technological means to carry out their functions.</p>
<p>V—International cooperation</p>	<p>—</p>
<p>Legal and Institutional Framework for Financial Institutions</p>	
<p>I—General framework</p>	<p>The authorities should take steps to provide a firm and continuing legal basis for the instruments used (regulations, circulars, or other enforceable means) to ensure effective implementation of the FATF Recommendations.</p> <p>The authorities need to act further to ensure that all financial professionals accept their statutory reporting obligations to the FIU and CSSF, and do not seek to frustrate measures to achieve effective implementation of AML/CFT measures.</p>
<p>II—Customer identification</p>	<p>The principle of the identification of legal entities should be explicitly required by law.</p> <p>There should be a specific requirement for the personal identification of all persons authorized to operate accounts in the name of corporate entities. In the case of companies incorporated outside Luxembourg, there should be a specific requirement that PSFs obtain (and satisfy themselves of the veracity of) the names and addresses of directors, in addition to verifying their power to bind the company.</p>

	<p>The authorities should introduce specific customer due diligence requirements for trusts and other such entities, in line with the international requirement.</p> <p>The authorities should consider whether the continued availability of numbered accounts is warranted, or at a minimum, should pay particular attention to the proper management and control of numbered accounts in the course of its onsite inspections.</p> <p>The CSSF should target in its supervision the opening and operation of accounts involving complex structures, where identification of the beneficial owner presents particular difficulties.</p> <p>The authorities should proceed to introduce the planned requirements for inclusion of originator information on wire transfers, within the time frame indicated by the FATF.</p> <p>Attention should be given to high risk areas, such as, products and structures designed to hide the purpose and true identity of the beneficial owner, whether these products are developed within Luxembourg or elsewhere.</p> <p>As part of the application of appropriate KYC requirements, the authorities should issue further guidance highlighting the particular risk factors of nonresident business.</p> <p>Authorities should examine carefully the issue of client funds held in the accounts of lawyers and other professionals, to ensure that more effective measures are put in place to avoid such arrangements being misused. The legal profession should take internal measures to prevent any abuse of the profession in ML and FT schemes.</p> <p>Controls for accounts opened by correspondence and through the internet should be reviewed. If effective measures cannot be achieved, opening of accounts electronically would not meet the requirements of the law.</p> <p>CSSF should ensure that the outstanding work to re-verify old accounts is expedited.</p>
III—Ongoing monitoring of accounts and transactions	<p>The current legal provisions and guidance on monitoring of ongoing transactions need to be strengthened to be in line with the standard. Some additional points need to be clarified (and, in the case of insurance, introduced), particularly for unusual and complex transactions, an area which is of particular risk for Luxembourg.</p> <p>Provide by law or other enforceable means for the specific record-keeping of unusual transactions.</p>

	<p>Add in the law the specific requirements with regard to business relationships with countries which do not have adequate systems in place.</p> <p>Require financial institutions and PSFs to implement special measures when receiving wire transfers which do not contain originator information.</p> <p>The barrier to the transfer of personal customer data for international financial services groups from Luxembourg operations needs to be addressed.</p>
IV—Record keeping	—
V—Suspicious transactions reporting	<p>The FIU and regulatory authorities, as appropriate, should update and expand the coverage of their published AML/CFT guidance.</p> <p>The authorities need to act, in a collaborative manner or by stronger means if necessary, to ensure that the necessary legal provisions (current or amended) can be applied effectively, so that the financial professionals accept their legal responsibility to report to the FIU.</p> <p>The authorities should ensure that a reporting requirement for suspicions relating to FT is included in the law, as proposed.</p>
VI—Internal controls, compliance and audit	<p>It would be preferable in order to avoid any possible difficulty to include the requirements for internal audit and the designation of a compliance officer or function in the law, as the circulars, not having direct force of law, cannot create additional legally enforceable requirements.</p>
VII—Integrity standards	<p>The authorities should consider the development of specific requirements and guidance highlighting the various forms of corporate vehicle and the ML and FT risks they entail. The scope of this initiative would need to cover all categories of professional (including inter alia lawyers and accountants) who may be involved in creating or operating such structures or acting on their behalf.</p> <p>The CSSF should increase its onsite monitoring for financial professionals under its supervision using a risk based approach, which would be expected to include entities at risk from the use of opaque corporate structures. Particular attention should be given to the private banking sector, where there appears to be a tendency to assume that the bankers are fully aware of the purpose and ownership of all entities with which they transact: it would be useful to test the validity of this assumption.</p>
VIII—Enforcement powers and sanctions	—
IX—Co-operation between supervisors and other	The authorities should proceed as soon as possible with their

competent authorities	plans for a legislative amendment to the bank secrecy provisions to permit transfer to the auditors of international financial services groups of customer details in Luxembourg subsidiaries or branches of foreign banks or other financial professionals.
Banking Sector based on Sector-Specific Criteria	These criteria are included within the recommendations above as relevant to all financial institutions, which (with the exception of insurance), are supervised by the CSSF.
Insurance Sector based on Sector-Specific Criteria	
II—Customer identification	A number of the customer identification recommendations in the Framework for Financial Institutions (above) are relevant for life insurance business, particularly those applicable to cross-border investment-type activities.
III—On-going monitoring of accounts and transactions	See recommendations for financial institutions.
IV—Record keeping	–
V—Suspicious transaction reporting	–
VI—Internal controls, compliance and audit	CaA should consider increasing the frequency of its on-site inspection work.
Securities Sector based on Sector-Specific Criteria	Many of the recommendations in the Framework for Financial Institutions (above) are relevant also to the securities sector (and in particular the funds management area). Certain aspects below are worth highlighting.
II—Customer identification IV—Record keeping	The authorities should reassess the KYC and reputational risks arising from the use of international distribution networks in the funds area, to determine whether the current system meets all international obligations in the ML and FT area.
VI—Internal controls, compliance and audit	The introduction of onsite inspections for funds, including for AML/CFT, would support current compliance efforts and help to raise awareness of the risks. This may require an additional allocation of resources.

E. Authorities' Response to the Assessment

(October 15, 2004)

The Luxembourg authorities welcome the main findings of the IMF mission's report which are summarized by the conclusion that "Luxembourg has in place a solid criminal legal framework and supervisory system to address the significant challenge of money laundering faced by this important international financial center."

The authorities appreciate the detailed recommendations addressed to them by the Fund mission. They are committed to take these recommendations into account when formulating future legislation and regulation, in particular when transposing the EU's third anti-money laundering draft directive now being discussed. They also note that, in order to remain fully compliant with the FATF recommendations, national legislation will have to evolve in line with those recommendations and their interpretation.

On one precise point, which the mission's report underlines (although it acknowledges its consistency with the international standard), namely the fact that under the bill being enacted in order to fulfill the transposition of the EU's second anti-money laundering directive, violations of professional obligations will be criminally sanctioned only if committed knowingly, the authorities wish to explain that this change is supposed to strengthen the present situation, as it addresses two criticisms made by the Fund's mission: it will introduce the required differentiation between negligent and fraudulent behavior, and it should eliminate any reluctance by professionals to cooperate with the authorities based on the concern of potential self-incrimination as a result of reporting.