Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee

SPI Project on the Amendment of the Anti-Money Laundering Law

Project Objective

To draft a proposal for amending the anti-money laundering law, according to the provisions of the EU Third Directive and in line with the banks' needs for rationalizing the AML reporting and avoidance of legal and reputational risks and with the competent authorities' requirements for high standards for anti-money laundering.

Project Working Group

Project Owner:	Petre Bunescu, Vice President, RBA
Project Manager:	Doru Bebe Bulată, Director, BCR
Deputy Project Managers:	Paula Lavric, State Secretary, AML Office Alis Avrămescu, Deputy Director, National Bank of Romania
Project Working Group Members :	Liana Teodorescu, Manager, Bancpost Magdalena Calangiu, Manager, Finansbank Victoria Preoteasa, Manager, OTP Bank România Constantin Jumuga, Manager, BRD-GSG Sergiu Bogea, Compliance Officer, Unicredit Isabelle Chelariu, Legal Advisor, National Bank of Romania Magdalena Scrieciu, Advisor, Ministry of Public Finance Simona Butoi, Expert, Ministry of Public Finance
Peer Reviewer:	Emile van der Does (World Bank)
RIA Expert:	Riccardo Brogi, Senior Regulatory Economist, Convergence Program
SPI Secretariat:	Ramona Bratu – SPI Director for Banks Products and Services and Oana Nedelescu – SPI Director for Analytics and Policy

RBA Board Meeting
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SUMMARY

Abstract

Abstract

The SPI Committee has approved at its September 14, 2006 meeting the undertaking of the project on Amending the Anti-Money Laundering Law. The approved objective of the project was "***to draft a proposal for amending the anti-money laundering law, according to the provisions of the EU Third Directive and in line with the banks' needs for rationalizing the AML reporting and avoidance of legal and reputational risks and with the competent authorities' requirements for high standards for anti-money laundering***".

The project has been placed under the ownership of Mr. Petre Bunescu, on behalf of the Romanian Banking Association. The project working group gathered representatives of banks (six members), AML Office (one member), National Bank of Romania (two members) and Ministry of Public Finance (two members). The project working group meetings have been held between November 14, 2006 and February 26, 2007.

The project has benefited from technical assistance received from the World Bank expert Emile van der Does, mobilized by the Convergence Program. Likewise, the project enjoyed the Convergence Program support for performing a regulatory impact assessment of the proposed legislative amendments on both banks and consumers.

The present document describes proposed amendments of the current legal framework, as well as the consultation process between different stakeholders for drafting the proposed legislative amendments. The proposal for amending the anti-money laundering law, as shown in Appendix 1, reflects the consensus of the AML Office, the National Bank of Romania, the Ministry of Public Finance and the banks. The AML Office proposal to enlarge the definition of external transfers has not met the consensus of the project working group (see Annex 2).

1. The current legal framework for the anti-money laundering and anti-terrorism financing activity

A world where the capital, people, information and businesses are rapidly and freely moving from one place to another gives multiple opportunities for the crime organizations. Therefore, the money laundering is one of the most powerful menaces to the integrity and stability of the financial system (see Annex 7 "The importance of preventing and fighting money laundering and the role of banks in preventing and fighting money laundering and terrorist financing").

Romania has taken the necessary measures in order to establish the legal and institutional framework for the anti-money laundering and anti-terrorist financing activities. In January 1999, the Romanian Parliament adopted the first anti-money laundering law. The

law has been further modified and improved based on the international standards evolution and on the experience gained by the law enforcement authorities in this matter (see Annex 6 "Primary and secondary AML regulations currently applicable to banks and the AML supervisory authorities").

2. The need to amend the current Romanian law

The current Law needs to be amended for the following reasons:

a. to bring it into line with the provisions of the EU Third Directive;
b. to align the Romanian AML practices with the international practices;
c. to reduce the legal, reputational and financial risks incurred by banks under the current legislation and to rationalize the AML reporting requirements for banks.

The principles for amending the current AML legislation are highlighted in Annex 3 ("Principles for the AML Law amendments").

3. Law no. 656/2002 amendment proposals

In order to align the Law no. 656/2002 provisions to the Third Directive and to the European current practice and in order to increase the efficiency of the anti-money and anti-terrorist financing activities, the banks' representatives in the project working group have drafted the initial amendment proposals (detailed in Annex 4).

The law amendment proposals prepared by banks have been discussed with the AML Office, NBR and the Ministry of Public Finance representatives in the project working group. The differences in opinions have been reconciled in further discussions (detailed in Annex 4). Also, the NBR and AML Office representatives proposed some other amendments referring to: the alignment of the external transactions definition to the provisions of the NBR Norms on the balance of foreign payments by including all the payments between residents and non-residents and the exception from reporting of the transactions between NBR and the State Treasury.

At the same time, the amendment proposals made by the banks' representatives were also revised by the World Bank's expert, Mr. Emile van der Does (appointed by Convergence Program as peer reviewer). The peer reviewer's independent opinions, reproduced in Annex 5, have been a useful benchmark in reaching the final form of the law amendment proposals.

The discussions on the different opinions and proposals, facilitated both by the arguments brought and by the peer reviewer's considerations and suggestions, led to the following main law amendment proposals:

- **Include the definition of the "politically exposed persons"** as given by the Third Directive and give an extensive definition in the secondary regulations;

- **Shorten the suspension period for the suspicious transactions** to 24 hours and the prolongation of the suspension period to 72 hours;
- **Increase the reporting threshold for cash transactions** from EUR 10,000 to EUR 15,000;
- **Increase the reporting threshold for external transfers** to from EUR 10,000 to EUR 50,000;
- **Reduce the reporting frequency for the cash and external transactions** from daily to bi-monthly;
- **Exclude from reporting some low-risk categories of transactions**: the transactions between banks and NBR and Treasury and the NBR's transactions with the Treasury;
- **Submit to the AML Office only the suspicions reasonably motivated**;
- **Improve the feedback received from the AML Office** through a bi-annual information of each bank, under confidentiality, through a secure communication network, on the suspicious transactions reported and analyzed by the AML Office that did not end in signs of money laundering offence;
- **Include the risk-based approach** in the law and secondary regulations.

The final amendment proposals are extensively presented in Annex 1. **The proposal made by the AML Office to enlarge the definition of external transfers has not met the consensus of the project working group (see Annex 2).**

Some other issues (the proposal of the non-disclosure of the reporting entity's identity, the reporting format, and the frequency of providing general information on AML typologies) will be further discussed by banks and the AML Office and will be solved by mutual agreement, outside the regulatory framework.

4. The estimated impact of the law amendment proposals

In order to support the project working group in promoting the proposed law amendments proposals based on evidence, Convergence Program has performed a regulatory impact assessment of the law amendments proposals on a sample of banks represented in the working group and on the consumers of financial services. The findings of the regulatory impact assessments are presented below.

4.1.The estimated impact of the law amendment proposals on banks

4.1.1. Summary of Impact Assessment

The following section sets out the main findings drawn from a Regulatory Impact Assessment on AML legislative proposals based on answers provided by a sample of banks accounting for about 50 percent of the market (total assets).

First, the assessment considers the amendments complying with the EU Third Directive by outlining both the qualitative implications (mainly qualitative simplification, improvement of relationship with customers and higher reputation) and the quantitative impact (changes of volumes).

Second, the assessment considers the other amendment proposals and provides indications on the quantitative implications (changes of volumes). Findings show the relevance of the impact brought by the various options analyzed by the project working group.

Finally, impact assessment makes an exercise of estimating the effects of the proposed provisions on the Profit and Loss of the banking industry as a whole (measured as additional costs and additional benefits).

4.1.2. The estimated impact of the law amendment proposals on banks

Proposals complying with EU Third Directive bring significant benefits in terms of qualitative simplification, improvement of relationship with customers and strengthening reputation. Below are outlined the main qualitative findings from answers given by sample banks:

- banks consider that the risk based approach will generate additional benefits for banks, mainly stemming from the potential reduction in the reputational risk;
- banks believe that the proposed provisions aimed at clarifying the responsibilities of the executive management further clarify the sharing of responsibilities within reporting entities and are in conformity with the international relevant standards;
- banks consider that the reduction of the suspension period and its prolongation can help improving the relationship with clients.

With regard to the impact on operational volume of sample banks background figures are as follows:

- Number of suspicious cases sent to AML Office could decrease by more than 25% by reporting only those cases where the suspicion is reasonably motivated (in 2006, 642 suspicious transactions have been reported by the sample of banks to the AML Office);
- Number of complaints due to suspended operations could decrease by 15% due to the reduction in the suspension period and its prolongation (in 2006 the banks in the sample suspended only 4 operations; however, all of them consider that the proposed provisions have a potential to bring an improvement in the relationship with clients).

Amendments in "Other Proposals Section" show significant operational volume impact on the AML-related banking activity. The number of cash transactions that the sample banks reported to AML Office in 2006 (with threshold at EUR10,000) was almost 10 million. Should the threshold increased at EUR 15,000 the number of reports would decrease by 75% (to 2.5 million).

Likewise, the overall number of cross-border transactions reported by sample banks in 2006 under the current framework (reporting threshold of EUR10,000) was about 430,000. If Option 1 was implemented (reporting threshold of EUR 50,000) the annual number of reported transactions would decrease by 71%. In case Option 2 was enacted

(reporting threshold of EUR 15,000) the annual number of transactions would decrease by 33%. The project working group has opted for Option 1.

The RIA shows that the rationalization of the AML reporting would bring about total annual benefits of RON 22mln. and total additional costs of RON 11mln (see Table 1). It is important to stress that most of the benefits are structural whereas costs are mainly one-off items[1].

4.2.The estimated impact of the law amendment proposals on consumers

A separate impact assessment has been conducted by the Convergence Program with the National Authority for Consumer Protection to determine the effects of the implementation of the law amendments from a consumer perspective.

The main findings indicate that most of the proposed amendments bring indirect benefits to consumers through a potential decrease in the costs of the bank products and services generated by the rationalization of the AML reporting (increase in the reporting thresholds for cash and external transactions, exemption of some operations from reporting, reporting based on reasonable suspicions).

Other benefits will stem from the introduction of the risk based approach. The risk based approach will imply that clients will be classified in different categories of risk of money laundering, with different level of monitoring instead of applying the same complex monitoring procedures for all clients. Also, some benefits can be envisaged from the reduction of the suspension period for suspicious transactions and its prolongation as clients who will turn to be "low risk" will be served more promptly.

The main costs implied by the introduction of the law amendments proposals target specific categories of clients, such are the politically exposed persons who will be subject to closer monitoring.

5. Conclusions and recommendations

The project working group members have also agreed to solve some of the issues raised through discussions and bi-lateral agreements between banks and the AML Office, outside the law, as follows: establishing a codification system in order to ensure the confidentiality of the reporting entities, changing the reports format and setting up the frequency for the AML Office general information on the suspicious transactions and the typology of the money laundering and terrorist financing transactions.

The amendment proposals sent for approval reflect the consensus created among the banks, AML Office, the NBR and MoPF's representatives and take into consideration the peer reviewer's suggestions and recommendations.

[1] All quantitative data refer to annual impact by using a conservative assessment.

The Project Owner, on behalf of the Project Working Group, is recommending:

1. The presentation of the amendment proposals to the RBA Board for approval;
2. The preparation by the SPI Secretariat of a note to support the discussion that the Project Owner will have with the AML Office management for withdrawing the proposal on enlarging the definition of external transfers;
3. The endorsement of the Project Working Group of the final legislative proposals;
4. The presentation of the final amendment proposals to the SPI Committee meeting to be endorsed and proposed to the competent authorities.

ANNEX 1

Final Law Amendments Proposals (in Romanian only)

ANNEX 2

The pros and cons of the AML Office proposal to modify the definition of external transfers

The AML Office proposed the modification of Art. 2 let. d) which defines the external transfers as "***operations of payments and cashing between persons situated on the Romania's territory and persons situated abroad***".

The AML Office proposal enlarges the definition of external transfers, by including the operations of payments and cashing between residents and non-residents in Romania, as follows: "***by external transfers in and from accounts it is understood the cross-border transactions, as they are defined in OG 6/2004 approved by Law 119/2004, as well as the operations of payments and cashing between residents and non-residents in Romania***".

This proposal has not met with the consensus of the project working group. The arguments of the different stakeholders, as well as those of the peer reviewer are presented below.

AML Office Arguments (in favor of enlarging the definition of external transfers)

- align the definition of external transfers provided in the law with the definition stipulated in the NBR norms regarding the statistical reporting for balance of payments;
- increase the efficiency of the AML Office supervision activity by supplying additional information on transactions that can constitute money laundering;
- the IBAN codes could be used for identifying the operations between residents and non-residents.

Banks' and Ministry of Public Finance Arguments (against enlarging the definition of external transfers)

- the present definition of external transfers is fully compliant with FATF standards;
- the proposal does not reflect the provisions of the Third Directive which does not stipulate a requirement to report transactions other than the suspicious transactions; in this context, the Romanian provisions on reporting external transactions above a certain threshold is already exceeding the provisions of the Third Directive;
- no other European country has a similar provision in the legislation (the only case identified in the world is Nigeria).
- the IBAN codes do not include references regarding the residence, making it thus impossible to determine the resident status of the Romanian bank beneficiary of

the domestic transfer (the change of the IBAN codes would be against international relevant standards);
- in applying the current law, banks already undertake all the necessary measures for the identification and the reporting of transactions between residents and non-resident in Romania with ML relevance through suspicious transactions reporting;
- at present, in the legislation, there are different definitions for residents and non-residents, depending on the scope of the various laws and regulations (foreign exchange regulation, fiscal treatment, population statistics, KYC norms);
- the AML Office did not provide evidence that would support the concerns related to money laundering carried out between residents and non-residents in Romania.

NBR Arguments

- the definitions provided in a law / regulation have to be in accordance with the scope of the respective law (i.e. for statistical reports, supervision, etc.); from this point of view, the current definition is fully in line with the FATF recommendations;
- all the recommendations formulated by the banks' and MOPF representatives are shared by the NBR.

Peer Reviewer Arguments

- it is necessary to factor in the AML Office institutional capacity to analyze all the information requested from the reporting units. The other countries' experience demonstrates that the FIUs have a limited capacity to analyze all the information received and in practice they suffer from an overkill of information;
- the enlargement of the definition has to be based on indications that the transactions between residents and non-resident in Romania have been indeed used for money laundering purposes or are likely to be so in the future.

SPI Secretariat Observation

The AML Office request can be understood from the point of view of bringing all non-resident beneficiaries of a bank transfer under the same reporting obligation, whether they have a foreign account or a non-resident account with a Romanian bank.

It is important to bear in mind that the blanket reporting obligation for foreign transfers is itself an important exception to the bank-based risk management principle promoted by the Third Directive. The international benchmarking has shown that many EU countries do not have such a blanket reporting obligation. They require that banks report any suspicious transaction as determined through their in-house risk management systems.

To assure the AML Office that the absence of a reporting obligation provision regarding domestic transfers to non-resident clients does not open an inadvertent regulatory loophole, it may be advisable that the RBA stipulates in its explanatory

assistance to members banks that risk management systems have to be designed to place under enhanced surveillance transfers to non-resident beneficiaries. The NBR may wish to reflect a similar guidance in its own regulatory documentation.

ANNEX 3

The principles for AML Law amendment

As outlined above, the current AML Law needs to be amended in order to:

1. bring it into line with the provisions of the EU Third Directive;
2. align the Romanian AML practices with the international practices;
3. reduce the legal, reputational and financial risks incurred by banks under the current legislation and to rationalize the AML reporting requirements for banks.

1. The alignment of the Romanian legislation to the provisions of the Third Directive

Law no. 656/2002 (with its further modifications and amendments) has to be updated by December 15 2007, to incorporate the provisions of the Directive 2005/60/EC (the Third Directive) of the European Parliament and Council with respect to the following principles:

1) the risk based approach of the clients – this is a very important concept that has to be retrieved in the procedure on know-your-customer and maintaining the relationships with the clients; the proper implementation of this concept should allow the credit institutions to adjust their requirements on anti-money laundering to their activity specificities, concentrating on the highest risk areas and ensuring a more efficient management of these risks. In this context, the definition of the beneficial owner and the identification requirements should be clarified;

2) the definition of the politically exposed persons - the national politicians are excluded from the definition given by the Third Directive (whilst member countries are encouraged to include them in their national regulations) and only the non-resident politicians should be subject to a closer evaluation and monitoring;

3) FIU's feedback on a case by case basis: the direct feedback of FIUs to the banks' reports on suspicious transactions is essential for the proper implementation of the risk based approach concept; the proper motivation and training of the specialized staff; ensuring the possibility for the compliance officers' assessment on the anti-money laundering activity quality and a more efficient utilization of the suspicious transaction reports.

The current legislation does not define the risk based approach requirements and how politically exposed persons should be treated. The Romanian legislation makes only general reference to the obligation of identifying the beneficial owner and the general information that should be provided by the AML Office on the types of money laundering and terrorist financing transactions.

2. Harmonization of the Romanian legislation with international practices

All European Union countries are implementing or have implemented the modifications brought by the Third Directive. Although all the national regulations have as reference

the European legislation and the FATF Recommendations, there are differences in implementation among the different states laws. The harmonization of the Romanian legislation with other European states laws is necessary for ensuring the same operational and transactional level for the market players on the European financial market (see Box 1 on "International Comparison of Relevant Legal Provisions for AML Reporting and Identification Requirements).

Box 1. International Comparison of Relevant Legal Provisions for AML Reporting and Identification Requirements

A relevant example is the one on **reporting obligations**: the European legislation provides the obligation of reporting "suspicious transactions", which has been adopted by all national legislations. Recognizing the higher money laundering risk of the cash transactions, Italy has foreseen the monthly reporting of the cash transactions over the limit of EUR 12,500. In Romania, in order to capture suspicious transactions, the current law stipulates the daily reporting of cash and external transactions over EUR 10,000 performed by clients and by credit institutions (see Box on reporting requirements). Other countries, such as Austria, Greece, France, Hungary, UK, don't have an obligation for reporting cash and external transactions. The project working group proposes that in the future threshold for reporting cash transactions is set at EUR 15,000 and the one for reporting external transfers at EUR 50,000, which are also in line with the current economic realities. At the same time, the project working group proposed the reduction of the frequency of the AML reporting from daily to bi-monthly.

Another example refers to the **identification requirement**. In the EU, the transaction value to which the identification obligations apply is, generally, EUR 15,000, with two exceptions: Italy with EUR 12,500 and Hungary with EUR 8,000. In Romania, the current law and the KYC regulations state that the identification obligation applies in any cases, regardless the transaction value. The law amendment proposals propose that at least the reporting thresholds should be brought in line with the thresholds set up for identification purposes in other countries.

The **suspension period** for the reported suspicious transactions by the FIU is not the same throughout Europe or some of the national laws do not have provisions on the suspension (such as the English, Greek, French laws). In Austria the suspension operates until the end of the next banking day, in Italy the suspension period is of 48 hours and in Hungary 24 hours. In Romania, AML Office can suspend a transaction for three banking days and can request prosecutors to prolong this period up to 4 banking days. The PWG proposes that in the future the suspension period be of 24 hours and the prolongation of the suspension period be of 72 hours.

3. Diminishing the risks deriving from compliance requirements

The non-observance of all the legal requirements on anti-money and anti-terrorist financing could expose the reporting entities to financial, legal and reputational risks. This exposure is considerable and the risks could be better managed by implementing the proposed changes. The risks incurred by banks are described in Box 2.

Box 2. The risks incurred by banks in applying the current AML legal framework

The reporting entities are exposed to the **financial risks** under the current law provisions as they could register direct or indirect losses from the lack of inadequate procedures, personnel or systems. The supervisory authorities could apply penalties for non-observance of the required adequacy.

A penalty could also be applied for the transactions missing from the daily reports, although the major part of banks is using automated reporting solutions and the lack of a transaction is not the result of the banks' negligence or intended mistake (as human intervention is not involved).

The reporting entities are also exposed to the **legal risk** generated by:
1) possible legal disputes on the non-observance of the legal requirements and standards with the supervisory authorities;
2) possible legal disputes on the penalties applied by the supervisory authorities;
3) possible legal disputes with the clients for delaying the execution of the transactions.
This risk could have a negative influence on the operations and the activity of the reporting entities and the costs of such court trials could be higher than the legal taxes or the penalties.

The **reputational risk** represents the possibility of negative publicity to the reporting entity's business practice and/or to the persons related to such entities (clients, shareholders, management, etc) that could end in losing the trust in their integrity. The negative publicity made by the AML Office on the penalties or sanctions applied could have heavy consequences on a bank's image in the eyes of its clients, other banks and correspondent banks.

ANNEX 4

Initial Law no. 656/2002 amendment proposals

In order to align the Law no. 656/2002 provisions to the Third Directive and to the European current practice and in order to increase the efficiency of the anti-money and anti-terrorist financing activities, the banks' representatives in the project working group have made several amendment proposals, detailed in Table 1.
The main proposals referred to:

Proposals for harmonization with the Third Directive

1. adding to the definitions sections the „politically exposed persons" definition, according to Art. 3.8. in the Third Directive;
2. introducing the possibility that the compliance officer analyzes the reports on suspicious transactions and send to the AML Office only the cases of reasonable suspicion, in line with the provisions of Art. 22 (1) a) of the Third Directive and with the provisions of the Italian and English law (now compliance officers have to send all the reports on suspicious transactions they receive from branches without any right to have a deeper analysis) **–** see Art. 3. - (1)of the Romanian law**;**
3. reduction in the suspension period (from 3 banking days to 24 hours) and in the prolongation of the suspension period (from 4 banking days to 48 hours). The Directive provides the possibility of suspending the suspicious transactions; some laws don't provide this (UK, Greece, France, UK), and some others foresee a 24 hours /48 hours period (Austria, Hungary and Italy, with no prolongation and generally under the condition of not disturbing the current business). See Art. 3 - (2) and Art. 3 - (3) of the Romanian law**;**
4. protection of all reporting entities (legal persons also) by non-disclosing their identity on reports, in line with Art. 27 of the Third Directive – see Art. 6 - (1^1) of the Romanian law**;**
5. AML Office's obligation to provide twice a year to the reporting entities general information on AML activities, typologies (it is already in the current law, without any frequency), in line with Art. 35 (2) Third Directive – see Art. 6 - (7) of the Romanian law**;**
6. AML Office's obligation to provide feedback on the results of the reports on suspicious transactions within 6 months from reporting date according to Art. 35 (3) Third Directive see Art. 6 - (7) of the Romanian law**;**
7. no penal, civil or disciplinary accountabilities for non-execution or delayed execution of a transactions, according to Aryt.26 Third Directive and legal provisions in some countries (France, Austria) – added in Art. 7 of the Romanian law**;**
8. the risk based approach of the clients according to Chapter 2, Customer due diligence, Art. 6 – 17 of the Third Directive, to be included in the KYC rules issued by the supervisory authorities and the amending term (60 days from law enactment date) - see Art. 9 - (7) of the Romanian law;

9. more persons to be appointed for law applications by the reporting entities, in case the nature, volume and complexity of their activity require so – see Art. 14. - (1) of the Romanian law;

10. clarifications on the responsibilities of the executive management, of the persons appointed to apply the law in the reporting entities and of the compliance officers (executive management to approve and implement the internal policies and procedures, the compliance officers to co-ordinate the implementation process) – see Art. 14 - (1^1)**;**

11. the accountability of all reporting entities for the application of the law (not only of some of them – see Art. 14 (2) of the Romanian law.

Provisions for rationalizing the AML reporting

12. increase in the reporting threshold from EUR 10,000 to EUR 15,000 for cash transactions and from EUR 10,000 to EUR 50,000 for cross-border transfers. The Third Directive doesn't provide any reporting for these transactions, but for example in Italy cash transactions over EUR 12,500 are monthly reported). See Art. 3 - (6) and Art. 3 - (7) in the Romanian law **;**

13. bi-monthly reports for the cash transactions and cross-border transfers instead of daily reporting – see Art. 3 - (6) of the Romanian law**;**

14. not including the cash operations between banks, between banks and the central bank and between banks and the State Treasury in the report to the FIU (no money laundering risk) - see Art. 3 - (6) of the Romanian law;

15. credit institutions to be consulted when the FIU is designing the report for cash transactions and cross-border transfers – see Art. 3 - (9) of the Romanian law**;**

16. decrease in the identification threshold from EUR 10,000 to EUR 5000 for prudential reasons – see Art. 9 - (2) of the Romanian law**;**

The above mentioned amendment proposals have been discussed with the authorities' representatives in the project working group (AML Office, National Bank of Romania and the Ministry of Public Finance), who expressed their views on the proposed changes and/or formulated other proposals (details in Annex 1).

Summary of consensus-building discussions

Different opinions were formulated on the following issues:

- the definition of the politically exposed persons, where a more detailed explanation of the area of coverage has been suggested;
- the cases when the compliance officer can report a transaction as being suspicious, respectively after analyzing the reports received and finding a reasonable suspicion;
- the suspension period for the suspicious transactions reported, where a longer period was counter-proposed or the possibility of replacing the suspension measure with non-execution of the suspicious transactions was mentioned;
- the prolongation of the suspension period and of the notification period for the suspicious transactions reported, where longer periods were required than the ones proposed by banks;
- the increase in the reporting threshold for external transactions;

- non-disclosure of the reporting entity's name on the reports, where a disagreement was formulated;
- consultations with the banks on the report format, where the counter-proposal was not to change the law, but to start the consultation process, in fact;

4. the general feedback on typology of the money laundering transactions, where there was a disagreement on having mentioned the frequency in the law and the case by case feedback, where the concern on the AML Office institutional capabilities was expressed;
- the issuer of the secondary regulations for all the reporting entities to be the AML Office instead of other supervisory authorities, for uniformity purposes.

NBR's and AML Office's representatives formulated also proposals for amending the law referring to: the alignment of the external transactions definition to the provisions of the NBR Norms on the balance of foreign payments by including all the payments between residents and non-residents and the exception from reporting of the transactions between NBR and the State Treasury.

The amendment proposals made by the banks' representatives were also revised by the World Bank's expert, Mr. Emile van der Does (appointed by Convergence Program as peer reviewer). The peer reviewer's independent opinions, reproduced in Annex 4, have been a useful benchmark in reaching the final form of the law amendment proposals.

Consensus-building conclusions

The discussions on the different opinions and proposals, facilitated both by the arguments brought and by the peer reviewer's considerations and suggestions, led to the following conclusions on the law amendment:

- to maintain in the law the definition of the "politically exposed persons" as given by the Third Directive and to give an extensive definition in the secondary regulations;
- not to include a definition for external transfers aligned to the NBR regulation on the external balance of payments as it is not in line with the FATF definition;
- to maintain the proposed amendment in Art. 3 -1 regarding the transactions to be reported as it is the translation of the terms used by the Third Directive, but not to quote anymore the Italian example as the Italian law hasn't been aligned yet to the provisions of the Third Directive and the example could be misleading;
- the suspension period for the suspicious transactions to be of 24 hours, which is a feasible option. As for NBR suggestion not to suspend suspicious transactions but to refuse their execution, two arguments were brought: first, according to the KYC regulations banks have already this possibility, and second, sometimes it is in the interest of the investigations to let the transactions be executed;
- the prolongation of the suspension period to 72 hours (instead of 48 hours as proposed by banks), in order to give to the competent institutions enough time to take the appropriate measures;

- to capture the specificities of each area of the financial market, the specialized supervisory bodies will issue KYC regulations, not only the AML Office. The NBR concern on the uniformity of these regulations is addressed by the amendment proposed by banks containing a broad description of the content of these regulations;
- to keep the proposal for Art. 14 – 1 and not to include the reference to the compliance officer as banks give different meanings to this position;
- to include also in the transactions excepted from reporting to AML Office the NBR's transactions with the Treasury;
- to increase the reporting threshold for external transfers to from EUR 10.000 to EUR 50.000 as a recognition of the current economic realities;
- the bi-annual information of each bank, under confidentiality, through a secure communication network, on the suspicious transactions reported and analyzed by the AML Office that didn't end in signs of money laundering offence;
- to replace throughout the law the term "banks" with "credit institutions".

The final amendment proposals are extensively presented in Annex 1.

<u>Other considerations</u>

As for the proposal of the non-disclosure of the reporting entity's identity, banks and the AML Office agreed not to include an amendment in the law, but address the banks' concerns on the confidentiality by concluding an agreement and attributing the reporting banks some codes to be mentioned on the Suspicious Transaction Report (STR).

At the same time, the issue on the consultations between banks and the AML Office on the report format is not included in the amendment proposals as it could create a discriminating situation for the other reporting entities, but the dialogue remains open on this issue for discussions among the stakeholders.

Another issue that is to be solved outside the legislative framework is the frequency of the information to be made by the AML Office to all the reporting entities and supervision authorities, as the AML Office's obligation to inform is already provided by the law, but a bi-annual frequency exceeds its institutional capacity.

Also included in – Table 1 with law amendments as proposed by the project working group members (available in Romanian only).

ANNEX 5

Peer reviewer's opinion on the proposed amendments

General comment

I assume there is a substantial body of more detailed, lower legislation that implements the current draft law and many of the FATF/EU requirements. There are some basic obligations- pertaining in particular to certain principles of customer due diligence (CDD) however, which, according to FATF should be dealt with in primary or secondary legislation. As far as CDD is concerned, the obligations laid down in the present law are rather limited.

Although articles 9(1) and 11 contain obligations to identify a certain category of beneficial owner (the principal in an agency relationship and the beneficiary of a transaction) these clauses do not cover the entire definition of beneficial owner as defined by FATF or by the EU, as the persons who ultimately owns or controls the customer. The controlling part is only partially covered (again the principal/agency relationship) and the ownership part (the shareholder) is not covered at all. A representative of a legal entity is not necessarily "controlled" by the shareholder- and not necessarily acting on his behalf.

Therefore I would suggest inclusion of the definition of beneficial owner in the law and an obligation to identify him.
Another (though in my opinion less fundamental) issue that arises is the question of conducting ongoing due diligence which, again according to FATF, is a fundamental obligation that reporting institutions should undertake vis-a-vis their customers. I assume you intend to deal with this at a lower level, but you may wish to consider including a basic obligation to conduct ongoing due diligence on your customer in this law.

Specific comments

Ad 1- This makes good sense assuming this also implies including enhanced due diligence obligations when entities are dealing with PEPs.
Ad 2- This is a sensible proposal. Not all employees of a reporting entity have sufficient knowledge/expertise to always recognize whether something is truly suspicious or not. As phrased currently the compliance officer seems little more than a collection point of STRs. It is in the interest of enhancing the quality of reports submitted to the FIU to ensure the compliance officer has a filtering function as proposed.
Ad 3- Do you mean 24 hours or one working day? If the former, how will you deal with this if a report is submitted to you just before the weekend or a holiday?
Are you sure that in those cases you will be able to gather sufficient information to determine whether it is suspicious or not? Or do you intend to use the extension in that case? But will 72 hours then be sufficient? I assume this reduction has been suggested by financial institutions who fear repercussions when not-executing or delaying a transaction, but the real issue is whether you feel that these suspension periods are sufficient. for the FIU to do its work properly Unfamiliar with the Romanian situation I

cannot judge that- but I do think you do need evidence showing that indeed you can gather the information within the time frame proposed. The mere fact that financial institutions are exerting pressure is not sufficient. This has to be a workable proposal.
Ad 4- I assume this does not in any way relate to physical transportation of cash across (soon to be) EU borders (ref Reg EC no 1889/2005). In that case this seems a sensible increase of the threshold. I could imagine that indeed the current threshold generates a lot of information that the FIU cannot use.
Ad 5- Again considering the lack of urgency of this information, there are good reasons to extend the reporting time period Ad 6- This is a sensible proposal.
Ad 7- I would certainly consult with your financial institutions in drawing up the reporting form- because consultation on these matters is always a good idea.
The question is whether you need to lay this down in law. I cannot see a potential for it having any negative side effects, so in that sense I suppose there is no down side, but do you really need to have it in the law?
Ad 8-This is a sensible proposal- the question is whether, if the case ever comes to court, the judge will uphold the nondisclosure.
Ad 9- Providing more detailed and more frequent information to the private sector should always be encouraged. The question, again, is whether the FIU has sufficient capacity to do so. The core functions of an FIU (receipt, analysis and dissemination of STRs) will always take precedence. Though it is certainly essential that the FIU provide feedback, one must be careful not to impose obligations it cannot fulfill. Lack of knowledge of the specific circumstances prevent me from answering this question, but I would make sure that the FIU is confident it can meet this obligation before imposing it.
Ad 10- See remarks related to 9
Ad 11- Phrased like this, I don't think the proposed exemption is acceptable.
There can be no blanket exemption of liability for failure to execute a transaction, it should obviously be related to the suspicion of money laundering or terrorist financing. I am not sure the article 7, as currently phrased, does not already cover what you aim to achieve by this addition. The non-execution or delayed execution of the transaction will, I assume, always be related to the submission of information in good faith (ie the submission of an STR). If it is not (and I cannot readily think of an example), then you should consider whether you would want the financial institution to be protected in those situations. I would certainly insist on the "good faith" element. Having dealt with this issue in my former job quite extensively, I would suggest you ask the financial institutions (again I assume this proposal comes from them) why the current provision is not sufficient under Romanian law (the fact that France and Austria have apparently included it in their legislation is not relevant in this regard), whether this has ever been a real issue for them (in which they were held liable or a law suit was threatened) and if not, what concrete situations they envisage in which inclusion of these proposed words would be relevant.
Ad 12- I cannot comment on prudential considerations but I have no reason to assume this would not be a sensible proposal.
Ad 13- The risk based approach is one of the novelties introduced by the 2003 FATF 40 and the third EU Directive. Although it takes more effort and thought to implement, ultimately the result is that one can apply a "light touch" to the manifold low risk situations that occur, and that is in the interest of not unduly hampering business. If

Romania has the capacity to implement the risk based approach, I would certainly encourage it to do so.
Ad 14- As far as I can see article 14 already allows for the assignment of "several persons" (art 14 (1)) with responsibilities in applying the present law.
Ad 15- Indeed the current enumeration of responsibilities is rather limited and a slight elaboration may be in order.
Ad 16- When reading the article, I was wondering why certain reporting entities had been excluded so the proposal seems most appropriate. I see no reason for exclusion of certain reporting entities and I thus agree that it is sensible to make reference to all institutions under art 8, not just some of them.

ANNEX 6

Primary and secondary AML regulations currently applicable to banks

The Romanian anti-money laundering legislation has been elaborated in accordance with the European Directives on the prevention of using the financial systems for money-laundering purposes and with the 40 FATF (Financial Action Task Force) Recommendations.

The current Law focuses on three major principles:

- client identification;
- identification of the funds origin;
- identifying the nature of the transactions.

The role of the law is to protect the banking system, to ensure the confiscation of the illicit proceeds and to punish the offenders and their accomplices. The main obligations of the credit institutions are:

- reporting the suspicious transactions;
- reporting of the cash transactions in RON or foreign currency over EUR 10000;
- reporting the external transfers over EUR 10000;
- sending data and information required by the AML Office;
- drawing up internal policies and procedures for the anti-money laundering and anti-terrorist financing, including high standards for staff employment and continuous personnel training.

Box. 1 "Reporting Requirements" shows the reporting requirements as well as the necessity to rationalize the AML reporting system.

The know-your-customer requirements for the credit institutions are detailed in by the NBR Norms no. 3 on the know-your-customer standards, modified by NBR Norms no. 13. The Norms extend the client concept (not only the account owners with a credit institution, but any other person who enters into any kind of relationship with the credit institutions) and emphasizes the credit institutions' obligations regarding the client identification and acceptance, the classification into risk categories, the maintenance of a clear evidence on the clients and their transactions, the monitoring of the transactions and the reporting of the suspicious transactions.

Supervisory authorities for preventing and fighting against money laundering, their role and the banks' obligations towards them

The AML Office was established in 1999 as a specialized institution, having as objective the prevention and fight against the money laundering and terrorist financing that receives, analyzes, processes data and informs prosecuting authorities.

The observance of the applicable legislations is a duty shared by the AML Office with the supervisory authorities of the banking and financial system (National Bank of Romania, the Insurance Supervisory Commission, etc).

Box 1. Reporting requirements and the need for rationalizing the reporting system

I. The current framework

1.Reporting requirements for the suspicious transactions before their execution

At present the Romanian laws foresees the ex-ante reporting of suspicious transactions, the AML Office being able to decide their suspension for three banking days. This extended term has proven to jeopardize the bank relationship with the client. The delay in executing the transactions could be subject of complaints or court trials or could signal to the client that his transactions are subject to inquiries. The RIA conducted on a sample of banks representing more than 45 percent of the market shows that very few suspensions have occurred in practice. However, the current provisions are perceived by banks as having the potential to jeopardize the relationship with their clients.

International practice shows that these suspensions are for shorter periods of time, of 48 hours at the most, and only when there are well-grounded signs of money laundering or terrorist financing.

2. ***Daily reporting requirements***

The current law stipulates the reporting entities' obligation to report daily all the cash transactions and external transfers over EUR 10.000. The report format and content is established through AML Office decision.

II. How to rationalize the reporting system

The 24 hours **deadline** for submitting the report is very short and puts a very high pressure on the reporting entities that need to adjust their systems and to allocate additional staff in order to generate, verify and send the reports within a couple of hours. It has to be mentioned that the daily report can comprise thousands of operations.

The **content** of the daily report is very detailed, the reporting entities have to obtain and provide many information on the reported transactions, in may cases excessive (such as the complete address, the ID series and number for the client or his representative). The report on the cash transactions has 35 columns and the report on external transactions has 56 columns.

Getting all the reportable information on the clients and transactions, the correct and complete filling in of the two daily reports entails considerable efforts from the reporting entities and could have a negative influence on the rest of the activity and even on the customer relationship.

The **reporting threshold** of EUR 10.000 for single or multiple related transactions is quite low compared to the average value of the transactions performed currently by credit institutions and to the identification threshold indicated by the Third Directive of EUR 15.000. This low threshold entails sustained efforts to adapt the IT system and to continuously evaluate the identification criteria for the reportable transactions.

ANNEX 7

The importance of preventing and fighting against money laundering and terrorist financing for the financial system

Money laundering is the process by which the offenders try to hide the origin and the beneficial ownership of the proceeds generated by their criminal activities. The offenders try to find a way of disguising the proceeds coming from drug trafficking, weapon trafficking, smuggling, frauds, kidnapping and theft, in order to conceal their illicit origins and to legitimize the ill-gotten gains of crime. If successful, this activity would allow maintaining the control over these proceeds and, ultimately, would give a legitimate cover to their criminal origin. ***Therefore, money laundering is a process by which the illicit profits are given a legal appearance by the offenders who, without being discredited, can enjoy them later.***

The financing of terrorism represents the financial support, in any form, of terrorism or of those who encourage, plan, or engage in terrorism. Money laundering and terrorist financing often display similar transactional features, mostly having to do with concealment and disguise.

In the last years, the importance of fighting against organized crime and stopping the offenders to legitimize the results of their criminal activities by transforming them from "dirty" to "clean" funds have been largely recognized, both at the national and at the international level.

The use of the financial-banking systems for money laundering could undermine the individual financial institutions and ultimately, the entire financial system. At the same time, the increasing integration of the financial systems and the removing the constraints to the free capital circulation facilitated the money laundering and complicated the money follow up.

If not controlled, the money laundering process could undermine the efforts for maintaining a free and competitive market and could affect the sound economic development. Money laundering represents a major contaminating factor for the entire economy. This phenomenon could erode the country's financial institutions' integrity by increasing the demand for cash, by influencing the interest rate and exchange rate levels and, at the same time, could generate inflation. Through their illegal methods, offenders could invest in economic areas where the money laundering could be perpetuated.