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A Critical Analysis in the Light of Evolving Global Standards

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THE EU LEGISLATIVE FRAMEWORK AGAINST MONEY LAUNDERING AND TERRORIST FINANCE: A CRITICAL ANALYSIS IN THE LIGHT OF EVOLVING GLOBAL STANDARDS

VALSAMIS MITSILEGAS* AND BILL GILMORE**

Abstract This article examines the evolution of the EU anti-money laundering legislative framework (which in recent years has also included measures to counter terrorist finance), by focusing in particular on recent legislation such as the third money laundering Directive and the Regulation on controls of cash entering the EU, both adopted in 2005. The analysis highlights the relationship between these instruments and international initiatives in the field (in particular FATF standards), and addresses the challenges posed to the European Union legislative and constitutional framework when attempting to accommodate global standards.

I. INTRODUCTION

The European Community and its Member States have participated actively in the development of international and regional money laundering countermeasures from their inception. These include both the United Nations 1988 Convention on drug trafficking and the Council of Europe 1990 money laundering Convention. Also significantly, European Community Member States (all of the 'old' 15) and the European Commission have participated in the Financial Action Task Force (FATF) either from the commencement of its operations or shortly afterwards, taking an active part in the development of the 1990 40 Recommendations.[1] These international standards were thus quite influential in the development of the Community response against money laundering. In 1991, the first EC money laundering Directive was adopted,[2] introducing into the Community legal order innovative money laundering countermeasures which had been developed in the international arena. Combining the approaches of the UN and the Council of Europe on the one hand, and the FATF on the other, the Directive followed a two-pronged approach of criminalization and prevention of money laundering, thus becom-

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[1] See WC Gilmore, *Dirty money: the evolution of international measures to counter money laundering and the financing of terrorism* (3rd edn, Council of Europe Publishing, 2004) 89–90.

[2] Council Directive of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, OJ L166, 28 June 1991, p 77.

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ing the first major regional instrument adopting a near comprehensive anti-money laundering framework.[3]

Since then, money laundering countermeasures in the European Union have developed substantially, and always in parallel with international developments in the field, in particular initiatives by the FATF. This article will examine the evolution of the EU anti-money laundering framework (which lately has come to include measures to counter terrorist finance), by focusing in particular on recent legislation such as the third money laundering Directive, adopted in 2005, and the Regulation on controls of cash entering the EU, adopted in the same year. The analysis will highlight the relationship between the negotiations and content of these instruments with international initiatives in the field, and address the challenges posed to the European Union legislative and constitutional framework when attempting to accommodate global standards.

II. ACTION BY THE EUROPEAN COMMUNITY — THE MONEY LAUNDERING DIRECTIVES

A. The first money laundering Directive and related measures

The 1991 money laundering Directive introduced a definition of money laundering, based on the 1988 UN Convention, and called on Member States to prohibit such money laundering, at least when it involves the proceeds of drug trafficking.[4] On the preventive side, and following the FATF 1990 Recommendations, it introduced a series of obligations for credit and financial institutions, including duties to identify customers and keep records, to refrain from transactions they know or suspect are linked with money laundering, not to tip off customers that they are being investigated for money laundering, and a proactive duty to report suspicious transactions to the competent national authorities.[5] Credit and financial institutions would be subject to sanctions — the nature of which was left to Member States to determine — in cases of non-compliance with these duties.[6]

[3] For a detailed analysis of the Directive see V Mitsilegas, *Money laundering countermeasures in the European Union. A new paradigm of security governance versus fundamental legal principles* (Kluwer Law International, The Hague/London/New York, 2003). The third strand of the FATF strategy is to strengthen international cooperation. Here separate action under the Third Pillar has been of significance. Of special relevance in this context are Arts 1–4 of the October 2001 Protocol to the Convention on Mutual Assistance in Criminal Matters between the Member States of the European Union, OJ C 326, 21 Nov 2001, 1. For the relevant explanatory report see, OJC 257, 24 Oct 2002, 1.

[4] Art 1 third indent and Art 2 respectively.

[5] Arts 4–8 of the Directive. The mandatory reporting duty went one step ahead of the FATF Recommendations at the time, which called for financial institutions to be permitted or required to report suspicions; however, the 1996 revised FATF Recommendations followed the EC model. See Mitsilegas, (n 3) 73.

[6] Art 14.

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The implementation of this regulatory and legislative framework by Member States took place over a period of time in the 1990s and was closely monitored by the Commission.[7] At the same time, Member States used the opportunities now offered by the third pillar of the EU Treaty, to complement the Directive's provisions with measures with a stronger criminal law element.[8] Thus, in 1998 the Council adopted a Joint Action on money laundering and confiscation of instrumentalities and proceeds from crime.[9] In the light of the uncertainty regarding the binding character and nature of Joint Actions,[10] the main provisions of this instrument were repealed three years later by a Framework Decision on the same subject.[11] The Framework Decision aims at obliging Member States not to make reservations to the 1990 Council of Europe money laundering Convention regarding the confiscation of proceeds of serious crime (with an exception regarding tax offences) and the criminalization of the laundering of the proceeds of serious crime.[12] It also takes a step beyond the Joint Action in calling on Member States to introduce specific penalties for the laundering of the proceeds of serious crime, as defined above.[13] Most Member States (at least from the 'old' 15) had implemented these provisions adequately by 2004.[14]

[7] See the Commission's two Reports to the Council and the European Parliament on the implementation of the Directive. First Report, COM (95) 54 final, Brussels 3 Mar 1995; and Second Report, COM (98) 401 final, Brussels, 21 July 1998.

[8] The third pillar of the EU Treaty, covering action in Justice and Home Affairs, was introduced by the Treaty of Maastricht (for an overview see V Mitsilegas, J Monar, and W Rees, *The European Union and Internal Security* (Palgrave, Basingstoke/New York, 2003)). It must be noted that the 1991 Directive pre-dated the Maastricht Treaty and was adopted under the—first pillar—EC Treaty. On the constitutional implications of this choice at EU level see part IV below.

[9] OJ L333, 9 Dec 1998, p 1.

[10] Joint Actions were included as a form of Union action in the third pillar in the Maastricht Treaty. This form of action is not repeated in the Treaty of Amsterdam, which introduced Framework Decisions as a clear form of binding third pillar legislation. For the legal issues arising from this succession in legislative form, in particular in the context of the 1998 Joint Action on organized crime, see V Mitsilegas, 'Defining organised crime in the European Union: the limits of European criminal law in an area of freedom, security and justice' (2001) 26 European Law Review, 565, 579.

[11] Framework Decision of 26 June 2001 on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and proceeds of crime, OJ L182, 5 July 2001, 1.

[12] Art 1(a) and (b) respectively. Serious crime is defined as an offence punishable by deprivation of liberty or a detention order for a maximum of more than one year. For States having a minimum threshold for offences in their legal system, serious crime as a predicate of money laundering covers offences punishable by deprivation of liberty or a detention order for a minimum of more than six months. In 2005 a new Council of Europe Convention on money laundering and the financing of terrorism was concluded. See, Council of Europe Treaty Series, No 198. The Convention and the Council played a full part in the negotiations. Art 52(4) saves relevant Community and EU rules among the Member States.

[13] Art 2. The penalty is deprivation of liberty for a maximum of not less than four years.

[14] See Report from the Commission based on Art 6 of the Council Framework Decision of 26 June 2001 on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds of crime, COM(2004) 230 final, Brussels, 5 April 2004. For an update see the second Report of the Commission on the subject, COM(2006) 72 final, Brussels 21 Feb 2006.

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As noted above, the 1991 Directive introduced a duty for credit and financial institutions to report suspicious transactions to the competent national authorities. However, the Directive did not contain any provisions regarding the nature, functions and powers of these authorities. Member States were left with discretion regarding the designation of such authorities, in order for the reporting system to better reflect the specific legal and socio-political domestic reality. This has led to the development of broadly three models of reporting systems in the Union: the independent/administrative model, where financial institutions report suspicions to an independent unit or a unit based within a government department (such as the Ministry of Finance); the police model, where suspicions are transmitted to a police/intelligence agency (such as NCIS in the UK); and the judicial model, where responsibility lies with the Public Prosecutor's office.[15] However, this diversity in national models has the potential to result in obstacles to cooperation in the light of the different nature and legal regulation of these units. In order to overcome such obstacles, Member States adopted a third pillar Decision in 2000 on cooperation between financial intelligence units.[16] The Decision calls on each Member State to set up a 'financial intelligence unit', which is defined in accordance with the definition adopted in 1996 by an ad hoc group of countries and international organizations called 'the Egmont Group'.[17] The Decision aims at boosting information exchange between national Financial Intelligence Units (FIUs) regardless of their nature and states that their performance must not be affected by their internal status, 'regardless of whether they are administrative, law enforcement or judicial authorities'.[18]

B. The second money laundering Directive

Initiatives to combat money laundering have not remained static over the years. The FATF, established with the aim of promoting effective action against this phenomenon, has been monitoring closely trends and typologies in money laundering, as well as the legal and practical effect of its

[15] For an analysis of these models with national examples of such units see V Mitsilegas, 'New forms of transnational policing: the emergence of financial intelligence units in the European Union and the challenges for human rights – Part I' (1999) 3(2) Journal of Money Laundering Control 147–60. See also JF Thony, 'Processing financial information in money laundering matters: the financial intelligence units' (1996) 3 European Journal of Crime, Criminal Law and Criminal Justice, 257–82.

[16] OJ L271, 24 Oct 2000, 4.

[17] According to this definition, a financial intelligence unit (FIU) is 'a central, national unit which, in order to combat money laundering, is responsible for receiving (and to the extent permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information which concern suspected proceeds of crime or are required by national legislation or regulation'. See Article 2 of the 2000 Decision. On the Egmont Group, see Gilmore (n 1) 79–88 and Mitsilegas (n 15) 155–6. Its definition has since been extended to embrace the financing of terrorism.

[18] Art 3. On the Decision, see Mitsilegas (n 3) 176–9.

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Recommendations and action by its member States. This resulted, in the mid-1990s, in the realization that the existing global anti-money laundering framework was not adequate to address the changes in money laundering operations (resulting, at least in part, from the introduction of money laundering countermeasures in the first place), the perceived vulnerabilities resulting from technological advances, or the profits derived from non-drug-related criminal activity. Taking these factors among others into account, the FATF revised its 40 Recommendations in 1996, with the main aim of extending the list of predicate offences for money laundering, extending the preventive duties beyond the financial sector, and updating the customer identification system taking into account new technologies.[19] These revisions were followed closely by the European Commission—itself a FATF member—which also monitored changes in money laundering typologies in the context of its Reports on the implementation of the 1991 Directive. These changes, coupled with the will to go hand in hand—and even one step ahead—of the FATF, led the Commission to table, in 1999, a proposal for a second money laundering Directive, updating the 1991 instrument.[20] In its explanatory memorandum, the Commission refers in detail to its relationship with the FATF, noting that:

> just as the 1991 Directive moved ahead of the original FATF 40 Recommendations in requiring obligatory suspicious transaction reporting, the European Union should continue to impose a high standard on its Member States, giving effect to or even going beyond the 1996 update of the FATF 40 Recommendations. In particular the EU can show the way in seeking to involve certain professions more actively in the fight against money laundering alongside the financial sector.[21]

However, this ambitious goal was not easy to achieve. Negotiations began in the summer of 1999 but dragged on for more than two years. This was mainly due to concerns by the European Parliament, which was co-legislating with the Council of Ministers on the Directive, regarding the impact of the extension of the Directive's duties to the legal profession in terms of the right to a fair trial and the principle of lawyer–client confidentiality.[22] Eventually, and in the post-9/11 era, a compromise was reached at the conciliation stage, and the second money laundering Directive was adopted in December 2001.[23]

The Directive introduced amendments to the 1991 text, and the two must therefore be read together. The influence of FATF standards is evident not only in the operative text, but also in a number of preambular provisions.[24]

[19] On the 1996 revisions, see Gilmore (n 1) 100–2.

[20] COM(1999) 352 final, Brussels 14 July 1999.

[21] p 3.

[22] For a detailed overview of these issues, the negotiations and the final outcome see Mitsilegas (n 3) 86–102.

[23] Directive 2001/97/EC of the European Parliament and of the Council of 4 Dec 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering, OJ L344, 28 Dec 2004, 76.

[24] See in particular Recitals 1, 7 (referring specifically to the 1996 revised FATF Recommendations), 8 and 14.

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The main changes brought about by the Directive were: the extension of predicate offences to include, in a manner reminiscent of the third pillar Framework Decision on confiscation, 'serious crime';[25] the intensification of identification duties;[26] and the extension of the *ratione personae* scope of the Directive.[27] The duties prescribed by the 1991 text now apply also to professions such as auditors, external accountants and tax advisers, estate agents, art dealers, and to casinos. More controversially, they also apply to lawyers, ie notaries and other independent legal professionals, when engaged in a series of specified financial activities.[28] To assuage fears that the imposition of such duties would effectively mean the end of the confidential nature of the lawyer–client relationship with consequential implications for the concept of a fair trial, and at the insistence of the European Parliament, the Directive provides for the possibility of exempting lawyers on a number of occasions from the duties of suspicious transaction reporting and (not) tipping off.[29] However, such exemption of lawyers is not obligatory, but relies upon the discretion of Member States. Moreover, being the outcome of a political compromise, these provisions—in particular those relating to the exemption from reporting duties[30]—would benefit from further clarification. This may come from the Court of Justice, after a reference for a preliminary ruling from the Cour d'Arbitrage of Belgium following a case brought by the Brussels bar.[31] The Belgian court has asked the Court of Justice if the inclusion of members of the independent legal profession within the scope of the Directive infringes the right to a fair trial as guaranteed by Article 6 ECHR and, as a consequence, Article 6(2) TEU.[32] The Court's ruling is awaited with interest.

C. The third money laundering Directive

Member States were given 18 months to implement the second money laundering Directive, the deadline being 15 June 2003.[33] One would expect that,

[25] This includes drug trafficking, organized crime, fraud and corruption—with the exception of corruption, these offences are defined by reference to UN or EU instruments. Serious crime also includes 'an offence which may generate substantial proceeds and which is punishable by a severe sentence of imprisonment in accordance with the penal law of the Member State'. But this definition should be aligned with the one in the 1998 Joint Action (presumably this now means the 2001 Framework Decision)—Art 1(E).

[26] Revised Art 3.

[27] New Art 2a.

[28] See Art 2a(5).

[29] Revised Art 6(3) and new Art 8(2). For a detailed analysis of the position of lawyers under the Directive see Mitsilegas (n 3) 96–102 and 146–51.

[30] Art 6(3) exempts lawyers, auditors and tax advisors 'with regard to information they receive from or obtain on one of their clients, in the course of ascertaining the legal position for their client or performing their task of defending or representing their client in, or concerning, judicial proceedings, including advice on instituting or avoiding proceedings, whether such information is received or obtained before, during or after such proceedings'.

[31] Cour d'Arbitrage, Arret No 126/2005 of 13 July 2005. See also OJ C243, 1 Oct 2005, 10.

[32] ibid.

[33] Art 3(1) of the 2001 Directive.

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at the time of writing, the Commission and Member States would be focusing on how it has been implemented across the EU (of now 25 members). However, the adoption of a revised—and controversial—anti-money laundering Directive as recently as 2001, did not stop the Commission tabling in 2004 a proposal for a third Directive, amending the two earlier texts.[34] The main justification for this proposal has again been the need to update EC law in the light of new work by the FATF.[35] Indeed, in 2003 the FATF issued a revision of its 40 Recommendations, to take into account developments in money laundering typologies. Revisions were aimed in particular at extending the scope of predicate offences, providing guidance on customer identification requirements, which now must take place on a 'risk-sensitive' basis and take into account specific categories of individuals in this context (such as politically exposed persons), focusing on the (mis)use of corporate vehicles, and dealing specifically with the work of FIUs.[36]

However, there has been one more reason put forward for the prioritization of further amendments to the EC anti-money laundering framework: the 'war on terror'. Following 9/11, the FATF mandate was extended to cover not only money laundering, but also terrorist finance. This signalled the main element of the global strategy to undercut terrorist funding, a central component of which is to extend the anti-money laundering legal and regulatory armoury to terrorist finance activities. This approach is reflected in a series of eight Special Recommendations that the FATF adopted in October 2001; a ninth measure was promulgated in October 2004. While some of these Recommendations reflect pre-existing commitments undertaken in the framework of the UN and obligations imposed by the Security Council,[37] others refer specifically to the use of the anti-money laundering framework in this context. Here the focus has been on the monitoring of wire transfers, the regulation of alternative remittance systems, the targeting of cross-border cash movements by terrorists, and taking steps to reduce the vulnerability of the non-profit sector to abuse.[38]

Negotiations between the Council and the European Parliament did not prove to be as difficult as in the case of the second money laundering Directive, and agreement was reached after the first reading. The third money laundering Directive was thus published in November 2005—a long text (47

[34] COM(2004) 448 final, 30 June 2004.
[35] ibid 3.
[36] For a detailed analysis see Gilmore (n 1) 105–11.
[37] These include the 1999 UN Convention for the Suppression of the Financing of Terrorism and Security Council Resolution 1373 (2001), both calling for the criminalization of terrorist finance.
[38] For a detailed analysis see Gilmore (n 1) 120–9. See also Gilmore, 'International Financial Counterterrorism Initiatives' in C Fijnaut, J Woaters, and F Naert (eds), *Legal Instruments in the Fight Against International Terrorism* (Brill, Leiden, 2004) 189. On the nature and scope of the October 2004 initiative on cross-border cash movements see, *Financial Action Task Force: Annual Report 2004–2005* (FATF, 2005) 8.

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Articles), which repeals the earlier Directives.[39] The major changes begin in the title of the instrument, which now refers to money laundering 'and terrorist financing'. The aim of complying with international standards is again reflected in the Preamble, with specific references to the threat from terrorism,[40] the need to take into account the work of the FATF[41] and the need to change customer identification provisions in the light of international developments.[42]

A number of changes involve the criminal law-related aspects of the Directive. As with the previous two Directives, this one states that money laundering is prohibited.[43] However, the definition of money laundering is amended to align the definition of 'serious crime' in the Directive with the one in the 2001 Framework Decision on confiscation.[44] Moreover, the Directive now also prohibits 'terrorist financing'. The definition is similar, but not identical to that found in the UN 1999 Convention, and terrorism is formulated in accordance with the relevant EU Framework Decision.[45] Another interesting addition, that may have criminal law repercussions, is Article 27, which calls on Member States to protect employees who report suspicions of money laundering or terrorist financing from being exposed to threats or hostile action. The nature and means of such protection are left unspecified, and the broader issue is whether the Community has competence to impose this obligation, which may lead to the inclusion of such employees in protection schemes under national criminal justice systems, in a first pillar instrument.[46]

To align the Community framework with FATF-related developments, major changes have been introduced in the field of customer identification and due diligence. Chapter II of the Directive is now entitled 'customer due diligence' and comprises no less than 15 Articles,[47] many of them expanded from the earlier text. A new provision is Article 6, which prohibits anonymous

[39] Directive 2005/60/EC of the European Parliament and of the Council of 26 Oct 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, OJ L309, 25 Nov 2005, p 15.

[40] Recital 1.

[41] Recital 5.

[42] Recital 9.

[43] On the significance of the use of this terminology, see part IV below.

[44] Art 3(5)(f). It is interesting to note that the general reference to 'corruption' in the previous indent remains unchanged from the 2nd Directive.

[45] Art 1(4). Terrorist financing is defined as 'the provision or collection of funds, by any means, directly or indirectly, with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out any of the offences within the meaning of Arts 1 to 4 of Council Framework Decision 2002/475/JHA of 13 June 2002 on combating terrorism'. The difference with the UN Convention lies in the *mens rea* element, where the wording is slightly different (Art 2(1) refers to 'unlawfully and wilfully' collecting), as well as in what constitutes terrorism.

[46] Recital 32 in the Preamble implicitly recognises the potential impact on national systems by stating that 'although the Directive cannot interfere with Member States' judicial procedures, this is a crucial issue for the effectiveness of the anti-money laundering and anti-terrorist financing system'.

[47] Arts 6–19 of the Directive.

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accounts or anonymous passbooks. This makes explicit a prohibition which one Member State, Austria, was defying for a large part of the 1990s, resulting in the Commission referring the case to Luxembourg and the near-blacklisting of the country by the FATF (these actions were discontinued after Austria's eventual compliance).[48] The provisions on customer identification have been expanded to introduce various levels of diligence, which may range from simplified due diligence[49] to enhanced due diligence, in particular when cross-frontier correspondent banking with third countries, transactions with politically exposed persons, or the use of shell banks is involved.[50] This 'layering' is primarily achieved by the use of the principle of due diligence 'on a risk-sensitive basis'.[51] This is in compliance with the new FATF approach embraced in 2003, and may be a useful principle in ensuring that the institutions and professions concerned are not unnecessarily overburdened with obligations.[52]

On the reporting duties, the most significant change has been the inclusion in the Directive of express provisions covering financial intelligence units (FIUs), presumably to follow the express reference to FIUs in the revised FATF recommendations. Member States are asked to establish FIUs with specific tasks, and the units are given maximum powers of access to national databases; however, no data protection provisions accompany this maximum access.[53] Moreover, suspicious transaction reporting is now viewed within the specific context of FIUs, as the institutions and persons involved must now send suspicions not to the competent authorities, but to the FIU.[54] This also applies to the case of legal professionals, notwithstanding the fact that the 2001 Directive allowed Member States to make provisions for suspicious transactions to be transmitted to self-regulatory bodies (eg bar associations) instead of the 'competent authorities'. The 2005 Directive continues to allow for this option, but these designated bodies must in such cases 'forward the information to the FIU promptly and unfiltered'.[55] The value of a specific exemption from the ordinary regime if bar associations are required to transmit the reports unfiltered is by no means self-evident.

On the subject of lawyers, the exception from reporting duties remains.[56] However, an important change has been made to the 'tipping off' provision,

[48] See, Gilmore (n 1) 138–9. Similar banking practices had existed in a number of new Member States but had been largely addressed prior to the formulation of the third Directive.

[49] Arts 11–12.

[50] Art 13.

[51] Arts 8(2), 11(2) and 13(1).

[52] This approach is also reflected in the chapter on performance by third parties (Arts 14–19). Art 14 allows Member States to permit institutions and persons covered by the Directive to rely on third parties to meet the requirements of customer due diligence under certain conditions.

[53] Art 21. According to para 3, Member States must ensure that FIUs have access, directly or indirectly, on a timely basis, to the financial, administrative and law enforcement information that they require to properly fulfil their tasks.

[54] Art 22.

[55] Art 23(1).

[56] Art 23(2). On similar terms, lawyers may be exempted in some occasions from reporting when unable to comply with customer due diligence requirements—Art 9(5).

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now mainly in Article 28. The controversial reference to the possibility of Member States exempting lawyers from this obligation, inserted in 2001, has been deleted. The reason behind this amendment was clarified in the 2004 Commission proposal as follows: 'The Member State option to allow members of the professions acting as legal advisors to inform their client that a report is being made has been dropped as it is not in conformity with the revised FATF 40 Recommendations.'[57] Instead, Article 28(6) now states that where lawyers seek to dissuade a client from engaging in illegal activity, this will not constitute tipping off within the meaning of the Directive, an exemption specifically contemplated by the interpretative note to FATF Recommendation 14. In this context, therefore, the protection of lawyers has been watered down substantially in comparison with the 2001 Directive.[58]

It should be noted that the above was by no means the only alteration to the pre-existing approach to the prohibition on tipping off. One modification, now reflected in Article 28(1), has been to include, by way of addition, the prohibition of disclosure to a customer or third party that an investigation 'may' be carried out. Previously the restriction was limited to instances in which an investigation was already underway. A potential loophole has therefore been closed off, thus maximizing the protection afforded to the investigation of possible money laundering and terrorist financing activities. In a similarly positive manner, paragraph 2 now explicitly provides that the prohibition does not apply to disclosures made to national competent authorities, including self-regulatory bodies, or to law enforcement.

Somewhat more contentious are the other exceptions to the basic rule which now find reflection in the text of this Article. These facilitate, inter alia, disclosures within financial conglomerates, professional networks and, in certain cases involving the same customer and transaction, between relevant institutions or persons. Such disclosures can extend to third countries outside of the Union subject to the satisfaction of an equivalence test.[59] Member States must inform each other, and the Commission, where they consider that a third country meets this requirement.[60] The Commission is, in turn, empowered to adopt a decision that the country in question does not so qualify.[61] These Article 28 provisions, as drafted, also give rise to questions concerning their compatibility with the 2003 FATF standards in this sphere.

Along with the human rights concerns that arise from these and the FIU provisions, there are also a number of issues arising from an EU constitutional law perspective. The FIU provisions in the 2005 Directive coexist with the

[57] COM(2004) 448 final, 6.

[58] On this point, see the correspondence between the House of Lords European Union Committee and the UK Treasury during the scrutiny of the Directive. In particular letter from Lord Grenfell of 8 Dec 2004 to Stephen Timms and his response of 21 Mar 2005.

[59] See Art 28(3)–(5).

[60] Art 28(7).

[61] See Arts 29 and 40(4).

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2000 third pillar Decision on FIUs, which has not been repealed. The relationship between these two instruments is unclear. Prima facie it could be argued that the Directive regulates the relationship between the institutions and persons covered by the Directive, while the Decision covers the relationship between FIUs of the different Member States and their cooperation. However, there are provisions which overlap, such as the definition of an FIU (which is broader in the Directive as its work also covers terrorist finance). Moreover, the existence of Community competence to require, via a first pillar instrument, Member States to ensure that FIUs have access to, inter alia, police data, is questionable.

Another important constitutional point involves the increased use of comitology in the Directive. This means that on a number of occasions decisions on definitions in and amendments to the Directive will not be taken under the ordinary legislative procedure under which the Directive was adopted (co-decision between the European Parliament and the Council), but by a committee chaired by the Commission and consisting of representatives of Member States.[62] This would result in practice in minimal parliamentary scrutiny at both the European and national level. In the case of the Directive, Article 40 calls for adoption under this procedure by the Commission and the Committee on the Prevention of Money Laundering and Terrorist Finance established by Article 41, of a number of measures in order to take account of technical developments in the field. These include in particular clarifications of the technical aspects of definitions of concepts such as beneficial ownership, politically exposed persons, business relationship, and shell bank.[63] These concepts are central to the delimitation of the duties set out by the Directive in applying the FATF standards, and their definition may have significant implications for the liability of the institutions and persons involved, but also for the fundamental rights of the individuals covered by these (such as politically exposed persons).[62a] In view of the issues at stake, the use of comitology in this context may not provide adequate safeguards for transparency and the protection of fundamental rights. It remains to be seen how these, and the other Directive provisions, will be implemented. In the light of criticism of legislative and regulatory overload, the deadline for implementation is 15 December 2007.[64]

[62] On Comitology in general, see House of Lords European Union Committee, *Reforming Comitology,* 31st report, session 2002–3. See also CF Bergström, *Comitology. Delegation of Powers in the European Union and the Committee System* (OUP, Oxford, 2005).

[62a] A first example of 'comitology' implementation has been the Commission Directive 2006/70/EC of 1 August 2006 regarding the definition of 'politically exposed persons' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis, OJ L214, 4 Aug 2006, p 29.

[63] Art 40(1)(a).

[64] Art 45(1).

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III. ASSOCIATED INITIATIVES

While the third Directive enjoys pride of place in the efforts of the Union to prevent money laundering and to curb the financing of terrorism, it is not comprehensive in its coverage. Accordingly a range of associated initiatives have been taken in order to ensure the appropriate satisfaction of international standards.

The catalyst for such measures has been the FATF Special Recommendations on Terrorist Financing. As noted above, these were first formulated in October 2001 in the immediate aftermath of the 9/11 attacks[65] and were supplemented in October 2004. Of the nine Special Recommendations, four are closely associated with the FATF's preventative approach; namely, those relating to alternative remittance systems (SRVI), wire transfers (SRVII), non-profit organizations (SRVIII), and cash couriers (SRIX). In all but one instance the strategy for ensuring compliance has involved, or envisages, a Community legislative response. The sole exception relates to SRVIII on non-profit organizations.[66] While consideration was given to the use of a binding Regulation to guarantee the desired level of enhanced transparency in the non-profit or charitable sector,[67] it was eventually decided to place particular reliance on the formulation of a framework for a Code of Conduct.[68] The Justice and Home Affairs Council on 1 and 2 December 2005 took note of the relevant Commission Communication. It also articulated five principles which Member States should take into account when implementing counterterrorism measures in this vital sphere of activity. They are that:

- Safeguarding the integrity of the non-profit sector is a shared responsibility of States and non-profit organizations.
- Dialogue between Member States, the non-profit sector and other relevant stakeholders is essential to build robust defences against terrorist finance.

[65] See, eg, Gilmore, (n 1) 123–9.

[66] It is worded as follows: 'Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused: (i) by terrorist organisations posing as legitimate entities; (ii) to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and (iii) to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.' The associated Interpretative Note as well as the 'International Best Practices' paper of 11 Oct 2002 can be consulted at <www.fatf-gafi.org>.

[67] See Communication from the Commission to the Council and the European Parliament on the Prevention of and the Fight against Terrorist Financing, COM(2004) 700 final, Brussels, 20 Oct 2004, para 5.2.

[68] Commission Communication to the Council, the European Parliament and the European Economic and Social Committee: The Prevention of and Fight against Terrorist Financing through enhanced national level coordination and greater transparency of the non-profit sector, COM(2005) 620 final, Brussels, 29 Nov 2005.

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- Member States should continually develop their knowledge of their non-profit sector, its activities and vulnerabilities.
- Transparency, accountability and good governance lie at the heart of donor confidence and probity in the non-profit sector.
- Risks of terrorist finance are managed best where there are effective, proportionate measures for oversight.[69]

Of the remaining initiatives designed to give effect to the relevant FATF Special Recommendations, only one had, at the time of writing, completed the legislative process, namely, the Regulation of 26 October 2005 on controls of cash entering or leaving the Community.[70] It will apply from 15 June 2007. As paragraph 4 of the preamble makes clear, the text has been designed with the requirements of FATF SRIX on cross-border cash movements by terrorists and criminals firmly in mind.

The physical cross-border transportation of cash and bearer negotiable instruments by money launderers and other criminals is by no means new. Indeed, the original 1990 version of the FATF Recommendations urged study of the feasibility of measures to detect or monitor cash at international borders.[71] A similar light touch approach was carried over into the 1996[72] and 2003[73] revisions of the FATF's 40 Recommendations. However, more recent study of the use of such methods by terrorist financiers (eg by Jemaah Islamiah in relation to the Bali and Jakarta bombings) resulted in the conclusion that a more prescriptive approach was now warranted. This process culminated in October 2004 when the FATF issued SRIX. As has been noted elsewhere, this calls upon jurisdictions to:

- implement a declaration or disclosure system for detecting physical cross-border transportations of currency and bearer monetary instruments;
- give competent authorities the legal power to stop or restrain currency and monetary instruments that are suspected of being related to money laundering or terrorist financing, or that are falsely declared or disclosed;
- have effective sanctions available to deal with people who make false declarations or disclosures; and
- confiscate currency and monetary instruments that are related to money laundering or terrorist financing.[74]

[69] Press Release, 2696th Council Meeting, Justice and Home Affairs, Brussels, 1–2 Dec 2005, 14390/05 (Presse 2960), 25–6.
[70] OJL309, 21 Nov 2005, 9.
[71] Recommendation 23.
[72] Recommendation 22.
[73] Recommendation 19(a).
[74] *Financial Action Task Force: Annual Report, 2004–2005*, FATF, 2005, 8.

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At the same time FATF Recommendation 19 was amended to bring it into line with the new standard. The FATF has also issued both an interpretative note and a best practices paper to assist members of the international community in the effective implementation of SRIX.

Of the two options provided by the FATF, the Regulation has adopted the obligatory declaration and not the disclosure system. Pursuant to Article 3(1) any natural person carrying cash of a value of EUR10,000 or more must declare that sum when entering or leaving the Community. That declaration must in turn contain details on a number of matters ranging from identifier information concerning the declarant to 'the provenance and intended use of the cash'.[75] Information may also be recorded where the value falls below the threshold but 'there are indications of illegal activities associated with the movement of cash'.[76] It should be noted that, as envisaged by SRIX, the Regulation defines cash very broadly. It means:

(a) bearer-negotiable instruments including monetary instruments in bearer form such as travellers cheques, negotiable instruments (including cheques, promissory notes and money orders) that are either in bearer form, endorsed without restriction, made out to a fictitious payee, or otherwise in such form that title thereto passes upon delivery and incomplete instruments (including cheques, promissory notes and money orders) signed, but with the payee's name omitted.
(b) currency (banknotes and coins that are in circulation as a medium of exchange).[77]

Other provisions address such matters as the powers of competent national authorities,[78] the exchange of information with other Member States or the Commission[79] as well as with third countries,[80] and the introduction of effective, proportionate and dissuasive penalties.[81]

Still progressing through the legislative machinery in Brussels are the initiatives relevant to wire transfers and alternative remittance systems. The former is both better known and further advanced. This takes the form of a proposal for a Regulation on information on the payer accompanying transfers of funds.[82] This was brought forward by the Commission in July 2005 and EcoFin agreed on a general approach that December.[83] As both the explanatory memorandum and the preamble to the draft text both note, the explicit purpose of this initiative is to transpose SRVII on wire transfers into Community legislation.

[75] Art 3(2).
[76] Art 5(2).
[77] Art 2(2).
[78] Art 4.
[79] Art 6.
[80] Art 7.
[81] Art 9.
[82] COM(2005) 343 final, Brussels, 26 July 2005.
[83] Press Release, 2698th Council Meeting, Economic and Financial Affairs, Brussels, 6 Dec 2005, 14763/05 (Presse 311), 15.

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As has been noted elsewhere, the use of wire transfers in money laundering schemes has been well known in law enforcement circles for many years. Indeed, on various occasions in the 1990s the FATF engaged in discussions with the industry in an effort to ensure that a meaningful audit trail would be available to the authorities in relevant cases.[84] In the wake of the terrorist attacks against the United States in September 2001—and the associated reliance of the hijackers on relatively small value transfers to fund their activities—the issue was subjected to urgent reconsideration. The outcome was SRVII which reads thus:

> Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain.
>
> Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).

Following consultations with the private sector an interpretative note was issued in February 2003 to provide further guidance on the implementation of this new standard. However, it soon became apparent that both a range of technical issues and the matter of the treatment of batch transfers would require reconsideration if this initiative was to avoid unnecessarily negative consequences for the operation of these payments systems. A revised interpretative note was then issued by the FATF on 10 June 2005.[85] This recognizes that it will take some time to put in place consequential legislative, regulatory and practical changes. An international deadline of the end of December 2006 was set for this purpose.

In the words of Article 1 of the draft Regulation, it establishes 'rules on information to accompany transfers of funds, concerning the payers of those funds, for the purposes of the prevention, investigation, detection and prosecution of money laundering and terrorist financing'. As envisaged by the FATF revised interpretative note, it exempts credit and debit card transactions and transfers between payment service providers acting on their own behalf.[86]

While the FATF draws a distinction between cross-border and domestic wire transfers, this is reflected in the draft Regulation in somewhat differing regimes for transfers within the Community and those which involve other States and territories.[87] As the Commission has explained, 'simplified information (the

[84] Gilmore (n 1) 124–5.

[85] For the major differences between the two see, *Financial Action Task Force: Annual Report 2004–2005*, 8.

[86] Art 2.

[87] See COM(2005) 343 final, Brussels, 26 July 2005, 8 clarifying that this measure will extend to the European Economic Area. See also Art 18 concerning agreements with territories and countries outside the Community.

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account number of the payer or unique identifier) has to be applied to transfers of funds within the EU, whereas complete information on the payer has to be applied to transfers of funds between the EU and other jurisdictions'.[88] This fundamental distinction is then built into the various parts of the draft text but is particularly prominent in Chapter II ('Obligations for the payment service provider of the payer') and Chapter III ('Obligations for the payment service provider of the payee').

While a detailed discussion of this initiative lies beyond the scope of this article,[89] it should be noted that it has been heavily influenced both by the general terms of SRVII and by the much more detailed guidance to be found in the interpretative note.[90] By way of illustration it envisages that the Regulation will apply from the same date as the international standard (1 January 2007)[91] 'in order to establish a coherent approach in the field of combating money laundering and terrorist financing . . .'[92] Interestingly, Article 16 of the draft acknowledges the dynamic nature of policy development in this area of concern by providing a simplified amendment procedure to take account of certain categories of change in international standards in future years.

The final legislative initiative of relevance for present purposes is contained in Title II of the December 2005 proposal for a Directive on payment services in the internal market. This is intended, inter alia, to transpose a central element of SRVI of the FATF into Community law in a uniform manner.[93]

The objective of this Special Recommendation 'is to increase the transparency of payment flows by ensuring that jurisdictions impose consistent anti-money laundering and counter-terrorist financing measures on all forms of money/value transfer systems particularly those traditionally operating outside the conventional financial sector and not currently subject to the FATF Recommendations'.[94] There has been concern for some time within specialist anti-money laundering circles that informal systems, often referred to as alternative remittance services, or underground or parallel banking systems, were vulnerable to abuse by criminal elements. Such concerns were heightened after September 2001 in the light of further study on the typologies of terrorist financing.[95] A central feature of SRVI is to require all providers of money

[88] ibid 4.

[89] The draft Regulation raises important issues related inter alia to the imposition of criminal sanctions for non-compliance (issues of first pillar competence may also arise in this context), and data protection. See also the concerns raised recently by the House of Lords EU Committee—letter by Lord Grenfell to Ivan Lewis MP, Economic Secretary to the Treasury, 23 Mar 2006.

[90] See, eg, para 3 of the preamble.

[91] Art 20.

[92] Preamble, para 22.

[93] COM(2005) 603 final, Brussels, 1 Dec 2005, 7.

[94] *Interpretative Note to Special Recommendation VI: Alternative Remittance*, para 1. Text available at <www.fatf-gafi.org>.

[95] Gilmore (n 1) 37–8.

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or value transfer services to be licensed or registered and become subject to the full range of countermeasures envisaged in the FATF standards. The new licence system for payment institutions provided for in Title II of the proposed Directive should be viewed in that light. It will be noted, however, that the Commission has, perhaps controversially, adopted a gradualist approach in this regard.[96] In its words: 'The introduction of a derogation for certain categories of money remitters shall facilitate the gradual migration of these providers from the unofficial economy to the official sector.'[97]

IV. KEEPING UP WITH GLOBAL STANDARDS: IMPLICATIONS FOR EU CONSTITUTIONAL LAW

A. General

So far, the symbiotic relationship between the development of money laundering countermeasures in international fora and the evolution of such measures in the EC/EU has been amply demonstrated. Apart from the important issues that the adoption of such standards by the Community raises regarding the protection of fundamental rights, the willingness of the Community institutions and Member States to keep up with, but also to go beyond, international initiatives by Community law, has resulted in a series of constitutional dilemmas for the European Community.

B. The money laundering Directives

The first such dilemma was posed at the time of the negotiations of the first money laundering Directive. This was in 1990, before the Maastricht Treaty was adopted and entered into force. Any legislation dealing with money laundering countermeasures would thus have to be adopted with a legal basis under the EC Treaty. With money laundering legislation being, arguably, predominantly of a criminal law nature and having as its primary objective the combating of crime, finding a legal basis in the EC Treaty would seem a difficult task. Moreover, even if an appropriate legal basis was found, a further constitutional obstacle would be the limits of Community law—at least at the time—in accommodating criminal law, and the limits of EC competence to adopt legislation on criminal offences and sanctions.[98]

[96] Arts 21 and 22.

[97] COM(2005) 603 final, Brussels, 1 Dec 2005, p 7.

[98] On this debate see inter alia M Wasmeier and N Thwaites, 'The "battle" of the pillars: does the European Community have the power to approximate national criminal laws?' [2004] European Law Review 29, 613–35; M Delmas-Marty, 'The European Union and Penal Law' (1998) 4(1) European Law Journal 87–115; M Anderson et al, *Policing the European Union* (Clarendon Press, Oxford, 1995) ch 6; and, around the time of the adoption of the 1991 Directive, H Sevenster, 'Criminal Law and EC Law' (1992) 31 Common Market Law Review 29, 29–70.

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In the context of the 1991 Directive, a solution was found on both counts. It was deemed that preventing money laundering was essential to ensure the integrity of the Community financial system and the internal market—thus a dual free movement/internal market legal basis was eventually used.[99] This was notwithstanding the fact that the primary objective of the Directive was of a criminal law nature. However, the limits of Community competence to define criminal offences and impose criminal sanctions become evident in the negotiation of the Directive. While the Commission originally proposed that money laundering should be treated as a criminal offence under the Directive, Member States reacted in the Council, taking the view that the Community had no such competence. However, and since foundational money laundering legislation without some sort of sanction for money laundering per se is hard to conceive, a compromise was reached and money laundering was not criminalized by the Directive, but 'prohibited'. In this way, Community law did not impose an express obligation on Member States to act in criminal matters, but in reality left them with little choice. A Declaration affirming the criminalization of money laundering was attached to the Directive and money laundering was soon de facto criminalized in all Member States.[100]

Since the adoption of the 1991 Directive, the EU constitutional landscape has changed significantly. The Maastricht Treaty introduced the third pillar, granting express powers to the Union (but not the Community) to adopt legislation in criminal matters. In the field of money laundering, issues of confiscation and criminalization of the laundering of the proceeds of serious crimes have thus been dealt with under the third pillar. The third pillar also provided a legislative avenue for the adoption of the 2000 Decision on financial intelligence units, thus acknowledging that FIU cooperation is an activity that falls within the third, and not the first, pillar. This was done notwithstanding the fact that many FIUs are not based within police authorities in Member States. At the same time, and in spite of the opportunities offered by the third pillar, the second money laundering Directive followed exactly the same pattern as its 1991 predecessor, by continuing to 'prohibit' money laundering and calling on Member States to bring their legislation (on the 'prohibited' money laundering) into line with the third pillar 1998 Joint Action on confiscation.

This cross-pillar complexity was exacerbated by the third money laundering Directive. While the 'prohibition' formula has not changed—notwithstanding the Commission's attempt to introduce criminal law in the draft—the Directive aligned the definition of the 'prohibited' money laundering with the 2001 Framework Decision on confiscation. In an attempt to be aligned with the revised FATF Recommendations, it introduced provisions on the role and powers of FIUs, including powers of access to national police records, a

[99] Arts 57(2) and 100(A), now Arts 47(2) and 95 respectively. For an analysis of negotiations and outcome, see Mitsilegas (n 3) 56–63.
[100] Mitsilegas (n 3) 65.

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matter arguably falling within the third, and not the first, pillar. Moreover, as said above, the Directive provisions coexist, and at times overlap, with the third pillar Decision on FIU cooperation.

Matters, at least regarding the money laundering offences and Community competence, may take a different turn following the recent ECJ ruling on environmental crime.[101] Based on the view that the Community does not have competence to introduce criminal offences and sanctions, the Council adopted a Directive on environmental crime defining the behaviour in question, and a third pillar Framework Decision on environmental crime introducing criminal offences and sanctions. The Commission challenged the validity of the third pillar measure arguing that the criminal offence provisions should have been adopted under the first pillar, as they would contribute to the attainment of a Community objective, ie the protection of the environment. The Council, supported by no less than 11 Member States, argued that criminal law falls within the third and not the first pillar and that introducing such legislation in the first pillar would be in breach of the principle of conferral in EC law. However, in a seminal judgment, the Court found for the Commission and annulled the Framework Decision.[102]

Following that judgment, the Commission published a Communication arguing that the Court's ruling meant that a number of measures adopted in similar style must be recast.[103] This list includes the third money laundering Directive and the 2001 Framework Decision on confiscation. This is notwithstanding the fact that the Directive introduced a provision aligning the definition of 'serious crime' with that of the Framework Decision. Given this development, the de facto criminalization of money laundering in all EU Member States, and the fact that the only aspect of the Framework Decision which could fall under the first pillar in this context is arguably the money laundering offences article, the Commission's proposal would have little practical value. But it would have the symbolic value of introducing criminal offences and sanctions on money laundering in the first pillar. Member States appear reluctant to follow the Commission's proposals beyond environmental crime, and have agreed to introduce a special procedure to be followed within the Council when the Commission tables proposals involving measures relating to the criminal law of Member States in the future.[104] It remains to be seen if the Commission's stance will lead to either a paralysis in the implementation of the Directive or going back to the drawing board for a fourth money laundering Directive.[105]

[101] *Commission v Council*, Case C-176/03, 13 Sept 2005.

[102] For an analysis, see V Mitislegas, 'Constitutional Principles of the European Community and European Criminal Law' (2007) European Journal of Law Reform, forthcoming.

[103] Communication on the implications of the Court's judgment of 13 Sept 2005, COM(2005) 583 final, Brussels 24.11.2005.

[104] See the Conclusions of the Justice and Home Affairs Council of 21 Feb 2006, doc 6077/06 (Presse 38), 10.

[105] It is interesting that the Commission does not suggest recasting of the Directive in the light of the third pillar Decision on FIUs.

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C. Controls of cash

Problems of legal basis arise also in the context of the cash controls Regulation, introducing into the Community legal order FATF standards on the detection of physical cash movements.[106] The primary purpose of these measures is to combat terrorism via tackling terrorist finance, which would point to a third, rather than a first, pillar legal basis. The content of the Regulation is also linked more with enforcement purposes, involving controls and the obligation of those entering or leaving the Community to declare sums of cash under certain conditions. After a change in the title and the content of the Commission's initial proposal,[107] the Regulation was adopted under the first pillar, with a dual legal basis of Articles 95 and 135 TEC. However, the adequacy of either of these two provisions, or both of them in combination, as a legal basis for this measure is questionable.

Article 135 deals with customs cooperation in the Community. The provision explicitly states that such measures will not concern the application of national criminal law or the national administration of justice. Furthermore, as seen above, the content of the Regulation has been watered down to exclude interference with national criminal law. However, even in its finally adopted form, the Regulation still involves *cooperation* between national customs authorities and does not prime facie cover strictly national currency controls at the border of individual Member States, which are the cases envisaged in the Regulation.[108] The Regulation essentially involves action at the external border of the Community. However, the EC Treaty provisions specifically designed to provide a legal basis for Community measures on border controls (principally Article 62 TEC) , specifically involve controls on persons, and not capital.

Article 95 on the other hand is aimed at ensuring the smooth functioning of the internal market. Using the rationale of the money laundering Directives, the Preamble to the Regulation claims that the introduction of proceeds of crime in the financial system is detrimental to its functioning; therefore, the measure is necessary to safeguard the integrity of the internal market.[109] However, the link of this objective with the content of this measure is also tenuous. If money laundering involves large sums of money and sophisticated

[106] Special Recommendation IX of 22 Oct 2004. See also recital 4 of the Regulation.

[107] The original proposal was of a Regulation 'on the prevention of money laundering by means of customs co-operation', COM(2002) 328 final, Brussels 25 July 2002. As regards the content, provisions that might be considered to be related to national criminal justice systems, such as those of detention of cash, have been watered down and specific compliance conditions were left to national legislation. Provisions calling for proceedings to be initiated in cases of suspected non-declaration or misdeclaration of cash have been deleted. For an analysis of such changes and the impact on the legal basis, see letter by Dawn Primarolo, a Treasury Minister, to Lord Grenfell, Chairman of the House of Lords EU Committee (1 Feb 2005).

[108] It should also be noted that the Regulation covers in addition controls of cash *leaving* the Community.

[109] Recital 2.

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transactions which might jeopardize the financial system, terrorist finance involves smaller sums, in cash (specifically covered by the measure in question), which rarely enter the financial system in the first place. It is difficult to see how cash entering—or leaving—the Community in this manner will jeopardize the soundness of the financial system, and thus the internal market. As the Court of Justice has ruled, the measures referred to in Article 95(1) are intended to improve the conditions for the establishment of the internal market and must genuinely have that object, actually contributing to the elimination of obstacles to the free movement of goods or to the freedom to provide services, or to the removal of distortions of competition.[110] This test is not however met with the cash controls Regulation. Moreover, any objective of safeguarding the internal market is incidental to the primary objective of this measure,[111] which is combating and preventing terrorism.[112]

Similarly, Article 308 TEC is not an appropriate legal basis, as it is triggered if action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and if the Treaty has not provided the necessary powers. Combating terrorism is not a Community objective,[113] but it falls within the broader third pillar objective of developing the Union as an 'area of freedom, security and justice'.[114] It is thus arguable that the appropriate legal basis for such measure would therefore lie in the third, and not the first, pillar.

V. CONCLUSION

The European Union has made great efforts to keep up to speed with, if not abreast of, global initiatives to counter money laundering and terrorism finance by both taking an active part, in the form of the Commission and some Member States, in international fora shaping global standards—such as the

[110] Case C-376/98, *Germany v Parliament and Council* [2000] ECR I-8419, paras 83, 84 and 95, and Case C-491/01, *British American Tobacco (Investments) and Imperial Tobacco* [2002] ECR I-11453, para 60. For a recent comprehensive analysis see the Opinion of AG Leger in the '*PNR'* case—Cases C-317/04, *European Parliament v Council*, and C-318/04, *Parliament v Commission*, paras 140–50.

[111] On the inadequacy of an incidental objective to form an adequate legal basis in the PNR context, see Opinion of AG Leger, para 147.

[112] Although this objective is not clearly visible in the Preamble of the Regulation, it is clearly stated that the FATF Special Recommendations—developed with the aim of combating terrorist finance—must be taken into account (recital 4). Moreover, the adoption of the measure has been flagged up by Member States as a priority in the various counter-terrorism action plans adopted after Madrid and was adopted as a matter of urgency. The UK Government had to override the national parliamentary scrutiny reserve by the House of Lords EU Committee and justified its decision on urgency grounds. See letter of Primarolo (n 108).

[113] See also the analysis of the Court of First Instance in Case T-315/01, *Kadi v Council and Commission,* para 115 .

[114] Art 2 TEU. The AFSJ objective also appears in the first pillar, but specifically in the context of the measures in Title IV which involve action on immigration, asylum and border controls.

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FATF—and by attempting to implement such standards very soon after their adoption. The latter task has not always been devoid of legal and constitutional difficulties, touching mainly upon issues of the competence of the EC/EU to adopt specific global standards, but also upon issues of protection of civil liberties and fundamental rights, as the fight against money laundering and terrorist finance is increasingly viewed as a security issue. The largely uncritical adoption by the EU, in the form of binding legislation, of global 'soft law' standards raises questions of both the legitimacy of EU action and the compatibility of the new legislation with fundamental rights and EU constitutional principles. Those questions may proliferate in the light of the continuing momentum to align the EU framework against money laundering and terrorist finance with FATF standards.

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