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



**Report on Observance of Standards and Codes—
FATF Recommendations**

Luxembourg

OCTOBER 2004

INTERNATIONAL MONETARY FUND

LUXEMBOURG

**Report on Observance of Standards and Codes
FATF Recommendations for Anti-Money Laundering and Combating the Financing
of Terrorism**

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October 28, 2004

EXECUTIVE SUMMARY

This report provides a summary of the assessment of Luxembourg's observance of the FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations on Combating the Financing of Terrorism (FATF 40+8 Recommendations).

Luxembourg has in place a solid criminal legal framework and supervisory system to address the significant challenge of money laundering faced by this important international financial center. This is essential to meet the challenges to effective AML/CFT arising from the high level of cross-border business, the practice of strong bank secrecy, and the availability of numbered accounts, substantial private banking business, and certain investment vehicles.

Luxembourg is broadly compliant with almost all of the FATF Recommendations. The main areas requiring further attention relate to the limited scope of predicate offences and the reporting of suspicions of FT, the lack of a distinct legal framework for the FIU, and the low level of local prosecution of money laundering cases investigated within the country. There is a need also for the FIU and regulatory authorities to issue on a more regular basis substantive guidance on the implementation of AML/CFT laws, including on trends and techniques.

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GLOSSARY

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

I. INTRODUCTION

1. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations Combating the Financing of Terrorism* was prepared by a team composed of staff of the International Monetary Fund and an expert not under the supervision of Fund staff selected from a roster of experts in the assessment of criminal law enforcement and non-prudentially regulated financial activities.¹ The report provides a summary of the level of observance with the FATF 40+8 Recommendations, and provides recommendations to strengthen observance.²

Information and Methodology used for the Assessment

2. In preparing the detailed assessment, Fund staff reviewed the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter money laundering and financing of terrorism among prudentially regulated financial institutions. The expert not under the Fund supervision assessed the capacity and implementation of criminal law enforcement systems. The assessment is based on the information available at the time it was completed on November 30, 2003.

II. MAIN FINDINGS—SUMMARY

3. Luxembourg has in place a solid criminal legal framework and supervisory system to address the significant challenge of money laundering faced by this important international financial center. Luxembourg's geographical location, the free movement of capital and persons in the context of EU membership, and the international standing of its financial services sector are among the factors that create the environment for attracting cross-border financial services business. From the early 1980s, the authorities have recognized that private customers often seek confidential financial services, for a wide variety of reasons, and have pursued a policy to attract international financial services business to Luxembourg, based in part on a practice of strong bank secrecy. This does not stand in the way of disclosure by financial institutions of client details to the appropriate authorities in the case of suspected money laundering or other financial crime (tax offences are not within the definition of crime for these purposes, except when committed within the framework of a criminal organization). While the scope for development of domestic banking in the Grand Duchy is relatively limited, Luxembourg has built up a substantial cross-border business, most notably in private banking, and is the second largest provider of funds management services in the world (after

¹The team consisted of Jean-François Thony and Terry Donovan of the IMF, with Michael Lauber, Head of the Liechtenstein FIU, as the Independent AML/CFT Expert (IAE) to address law enforcement issues and certain other matters beyond the scope of the work of the Fund. Those parts of the ROSC attributable to the work of the IAE are shown in italics.

²The assessment was based on the 1996 version of the FATF Recommendations.

the US), and the largest provider to non-resident investors. This brings with it inherent risks of money laundering and terrorist financing that demand the implementation of the strongest level of controls.

4. While it is difficult, as in many cases, to assess with certainty the quality of day-to-day implementation, particularly in the areas of private banking and funds management, the strong AML/CFT control environment applied to Luxembourg financial institutions suggests that the scope for its system to be used for the initial placement of the proceeds of crime is limited. The main vulnerability is likely to arise at the subsequent layering stage, with the transfer from abroad of funds which have already been successfully introduced into the financial system. While Luxembourg is not without domestic crime, the main risks of money laundering arise therefore from crimes committed abroad, with the proceeds blended with legitimate funds in the Luxembourg system. At this point in the process, laundered money is much more difficult to detect. In Luxembourg, the availability of a variety of corporate structures (and of the service providers to create and manage them) that can be used to disguise the true identity of the beneficial owners of the underlying assets creates a particular vulnerability. The authorities have put in place controls broadly in line with the international standard, namely the FATF 40+8 Recommendations.

A. Criminal Justice Measures and International Cooperation

5. Luxembourg's legal and institutional framework provides a solid foundation for the fight against money laundering and financing of terrorism. The main legislative basis for AML/CFT is the law of April 5, 1993 on the Financial Sector (LoFS 93), later amended by several subsequent laws. This law addresses the prevention measures applicable to financial institutions and "professionals of the financial sector", as well as their reporting obligations.

Criminalization of ML and FT

6. Money laundering is criminalized by article 506-1 of the Penal Code and Article 135-5 and 135-6 of the same code established as an offence the financing of terrorism. Two laws were also adopted in 2000 and 2001 to streamline the mutual legal assistance and extradition procedures, and the framework for international cooperation set up by these laws has helped to provide a better and quicker response to mutual legal assistance requests. A new draft law has been adopted in first reading by the Parliament which would substantially amend the legal framework, but it has not been taken into consideration in the AML/CFT assessment since it is not yet in force. If adopted in its present form, however, it would result in a legal framework likely to fall short in some important respects of the requirements of the revised FATF recommendations, particularly as regards predicate offences, customer due diligence, and the operation of the financial intelligence unit (FIU).

7. Luxembourg is a party to the international instruments addressing money laundering and financing of terrorism except for the Palermo convention, which was signed but not ratified by Luxembourg. Criminal laws are in line with its international obligations, apart

from the criminalization of money laundering, the scope of which is too limited to comply with existing standards on the money laundering-related predicate offences.

Confiscation of proceeds of crime or property used to finance terrorism

8. The effectiveness of confiscation laws in money laundering matters is difficult to assess, given the low rate of prosecutions for money laundering and financing of terrorism offences. However, the scope of confiscation is quite broad and its application should not be a problem. To enhance the effectiveness of confiscation measures, Luxembourg could consider alleviating the burden of proof of the origin of the seized assets, as suggested by the Vienna, the Strasbourg and the Palermo conventions. With regard to the freezing of assets on the basis of the UN Resolutions, Luxembourg has actively implemented its obligations to search and freeze assets of the persons considered to provide support to terrorist organizations, by issuing circulars to financial institutions. However, today, less than half a dozen accounts have been identified as being related to a person or entity on the list. While the EC regulations provide an adequate legal basis for freezing the assets, the specific nature of these measures, taken outside the framework of a criminal investigation or prosecution, and outside the scope of the exercise of FIU functions, would require the enactment of specific provisions to empower authorities to give immediate effect to these obligations.

The FIU and processes for receiving, analyzing and disseminating intelligence: functions and authority

9. The Financial Intelligence Unit (FIU) in Luxembourg is one of the judicial model, i.e., under the supervision and operation of a judicial authority, namely the Prosecutor's office. It benefits from ten years of experience in receiving suspicious transaction reports (STRs). However, it lacks a clear and transparent legal framework to operate as a distinct FIU, and sufficient means and IT equipment to face the continuous rise in STRs and to fulfill a real analysis function. Financing of terrorism should be added explicitly to money laundering as the offences for which suspicion should be disclosed.

Law enforcement and prosecution authorities and duties

10. *The FIU and law enforcement and prosecution authorities being the same, many of the comments made as to the FIU could be replicated in relation to the effectiveness of the latter. The specialized police authorities and the prosecutor's office are taking great benefit of the fact that they are combined with the FIU, for a maximum efficiency in prosecutions. However, the number of prosecutions is very low, due to the established policy of forwarding to foreign authorities the cases and suspicions of money laundering which relate to persons or funds originating from abroad. Pro-active investigative techniques are limited to wire tapping and other related measures.*

International cooperation

11. Given the amount of assets managed or deposited in Luxembourg by non-residents, the number of requests for mutual legal assistance is very important for Luxembourg. The overload of foreign requests and the previously existing procedures often resulted in the past in undue delays and Luxembourg was sometimes criticized by neighboring countries for its low and slow response to their requests. The law of August 08, 2000, has provided for a simpler procedural framework and is praised for its efficiency. The adoption of a law on extradition on June 20, 2001 has completed Luxembourg's now comprehensive framework for international cooperation. Luxembourg is a party to all the main instruments designed to enhance judicial cooperation in criminal matters, apart from the Palermo convention.

B. Preventive Measures for Financial Institutions

12. Luxembourg has a well developed supervisory framework that encompasses AML/CFT preventive measures broadly in line with international standards. The CSSF is the competent authority for banks, funds management, and a range of financial sector professionals. The AML law has provided the main basis for AML/CFT preventive measures. The law has been supplemented by 60 circulars issued by the CSSF (and its predecessors) that, although they do not in themselves have direct force of law, provide useful guidance to financial professionals on implementing provisions of the AML/CFT legislation. There is a culture of strong bank secrecy in Luxembourg, but there are mechanisms to permit access to information needed by foreign and national authorities responsible for financial sector supervision.

13. Anonymous accounts are prohibited in Luxembourg. Customer identification procedures are mandated by law for customers, without distinction between natural and legal persons. CSSF Circulars provide detailed guidance.

14. Banks interviewed in the course of the mission indicated that numbered accounts are used extensively in Luxembourg, particularly in the private banking area. The authorities and banks indicated that they are not treated any differently from nominative accounts as regards customer identification, except that access to the information is confined to those needing to know.

15. The identification of beneficial owners is a requirement of the AML law. Financial professionals interviewed identified difficulties in practice in some cases in identifying the ultimate beneficial owner. There is no legal requirement to include originator information in wire transfers. However, banks interviewed indicated that their internal procedures address this issue in line with international standards.

16. Most business of banks and other financial professionals in Luxembourg relates to nonresidents. This business is subject to the same controls for AML/CFT purposes as resident business, but there is no requirement for enhanced due diligence for nonresident

business to accord with best international practice. Neither is there any specific guidance relating to the use of corporate vehicles, which are particularly important in Luxembourg.

17. Customer due diligence procedures carried out by a regulated entity in Luxembourg or in a range of other countries is accepted for their purposes by Luxembourg financial services entities. While consistent with the exemption available under the relevant EU Directives and international standards, the scale of the application of this exemption in Luxembourg could create reputational risks, particularly in cases of complicated or obscure ownership structures.

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

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

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

21. The legal framework for the insurance sector is based on the LoIS 91, with the implementation of AML/CFT measures currently limited to life insurance products. The competent authority is the CaA. Customer identification requirements are similar to those for banks, albeit with exemptions for low-value business. Life assurance business on behalf of non-residents is a very significant component of the Luxembourg financial services market.

C. Summary assessment against the FATF Recommendations

22. Luxembourg is broadly compliant with almost all of the FATF Recommendations. As indicated in Table 1, the main areas requiring further attention relate to the limited scope of predicate offences and for reporting of suspicions of FT, the lack of a distinct legal framework for the FIU, and the low level of local prosecution of money laundering cases investigated in the country. There is a need also for the FIU and regulatory authorities to issue more regularly substantive guidance on the implementation of AML/CFT laws, including on trends and techniques. These and other areas requiring action are highlighted in the Table 1 (below). In addition, in areas in which Luxembourg has been assessed as meeting the FATF standard, the assessors have included in Table 2 some technical and general suggestions to further strengthen the framework which the authorities may wish to consider.

Table 1. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
40 Recommendations for AML	
General framework of the Recommendations (FATF 1-3)	The barrier to the transfer of personal customer data for international financial services groups from Luxembourg operations needs to be addressed. The authorities should proceed as soon as possible with their plans for a legislative amendment to the bank secrecy provisions to permit transfer to the auditors of international financial services groups of customer details in Luxembourg subsidiaries or branches of foreign banks or other financial professionals.
Scope of the criminal offense of money laundering (FATF 4-6)	The scope of predicate offences should expand to cover all serious profit-generating crimes.
Customer identification and record-keeping rules (FATF 10-13)	<p>The principle of the identification of legal entities should be explicitly required by law. There should be a specific requirement for the personal identification of all persons authorized to operate accounts in the name of corporate entities.</p> <p>Attention should be given to high risk areas such as products and structures designed to hide the purpose and true identity of the beneficial owner, whether these products are developed within Luxembourg or elsewhere. The CSSF should target in its supervision the opening and operation of accounts involving complex structures, where identification of the beneficial owner presents particular difficulties.</p> <p>Controls for accounts opened by correspondence and through the internet should be reviewed. If effective measures cannot be achieved, opening of accounts electronically would not meet the requirements of the law.</p>
Increased diligence of financial institutions (FATF 14-19)	<p>Specific provisions for record-keeping of unusual transactions should be set by law or other enforceable means.</p> <p>The authorities need to act further to ensure that all financial professionals accept their statutory reporting obligations to the FIU and CSSF, and do not seek to frustrate efforts to achieve effective implementation of AML/CFT measures.</p> <p>It would be preferable in order to avoid any possible difficulty to include the requirements for internal audit and the designation of a compliance officer or function in the law, as the circulars, not having direct force of law, cannot create additional legally enforceable requirements</p>

Reference FATF Recommendation	Recommended Action
Measures to cope with countries with insufficient AML measures (FATF 20-21)	Add in the law the specific requirements with regard to business relationships with countries which do not have adequate systems in place.
Other measures (FATF 22-25)	A law should be adopted to provide a clear framework for the operation of the FIU. <i>The FIU and the law enforcement team which supports it should be further integrated and be given adequate means to fulfill their functions. The FIU should be urgently equipped with the IT equipment necessary to run a modern database.</i>

Reference FATF Recommendation	Recommended Action
<p>Implementation & role of regulatory and other administrative authorities (FATF 26-29)</p>	<p>The authorities should take steps to provide a firm and continuing legal basis for the circulars issued to ensure effective implementation of the FATF Recommendations. The FIU and CSSF should issue circulars and guidance on a regular basis to clarify certain aspects of the implementation of the law.</p> <p>The authorities should consider the development of specific requirements and guidance highlighting the various forms of corporate vehicle and the ML and FT risks they entail. The scope of this initiative would need to cover all categories of professional (including inter alia lawyers and accountants) who may be involved in creating or operating such structures or acting on their behalf.</p> <p>The CSSF should increase its onsite monitoring for financial professionals under its supervision using a risk based approach, which would be expected to include entities at risk from the use of opaque corporate structures. Particular attention should be given to the private banking sector, where there appears to be a tendency to assume that the bankers are fully aware of the purpose and ownership of all entities with which they transact: it would be useful to test the validity of this assumption.</p> <p>The authorities should introduce specific customer due diligence requirements for trusts and other such entities, in line with the international requirement.</p> <p>The authorities should reassess the KYC and reputational risks arising from the use of international distribution networks in the funds area, to determine whether the current system meets all international obligations in the ML and FT area. The introduction of onsite inspections for funds, including for AML/CFT, would support current compliance efforts and help to raise awareness of the risks. This may require an additional allocation of resources.</p> <p>CaA should consider increasing the frequency of its on-site inspection work.</p>

Reference FATF Recommendation	Recommended Action
Other forms of cooperation – Focus of improved mutual assistance on money laundering issues (FATF 36-40)	<p>There should be a legal basis for a wider range of investigations, including at least monitoring bank accounts and controlled deliveries in drug trafficking, money laundering and financing of terrorism matters.</p> <p><i>Specialized law enforcement agencies, such as the anti-money laundering Section of the Judicial Police, should be equipped with sufficient human and technological means to carry out their functions.</i></p> <p><i>More emphasis should be given to local prosecution of offences even when some elements have been committed abroad.</i></p>
8 Special recommendations on terrorist financing	
III. Freezing and confiscating terrorist assets	A law should be adopted to provide adequate legal power to freeze accounts in application of UN resolutions taken as part of the powers of the Security Council.
IV. Reporting suspicious transactions related to terrorism	The authorities should ensure that a reporting requirement for suspicions relating to FT is included in the law, as proposed.
VII. Wire transfers	The authorities should proceed to introduce the planned requirements for inclusion of originator information on wire transfers, within the time frame indicated by the FATF, and require financial institutions and PSFs to implement special measures when receiving wire transfers which do not contain originator information.

Table 2. Other Recommended Actions

Reference	Recommended Action
Legal Issues	<p>Luxembourg should become party to the Palermo Convention on Transnational Organized Crime.</p> <p>Authorities should consider introducing some legal provisions to alleviate the burden of proof of the knowledge element (mens rea) of the offence, in the respect of general principles of law such as the presumption of innocence. Authorities should consider easing the burden of proof as to the property or assets belonging to persons convicted for money laundering and/or the predicate offences.</p> <p>Authorities could consider a provision that opens the possibility of rendering void transactions during a “suspicious period” before the conviction, unless the transaction has been conducted in good faith.</p> <p>With regards to the offence of violations of their duties by financial businesses and other professional concerned, the law should establish a distinction between cases of negligent and of fraudulent violations, with proportionate and dissuasive sanctions.</p>

Reference	Recommended Action
<p>Customer Due Diligence Issues</p>	<p>The authorities should consider whether the continued availability of numbered accounts is warranted, or at a minimum, should pay particular attention to the proper management and control of numbered accounts in the course of its onsite inspections.</p> <p>As part of the application of appropriate KYC requirements, the authorities should issue further guidance highlighting the particular risk factors of non resident business.</p> <p>Authorities should examine carefully the issue of client funds held in the accounts of lawyers and other professionals, to ensure that more effective measures are put in place to avoid such arrangements being misused. The legal profession should take internal measures to prevent any abuse of the profession in ML and FT schemes.</p> <p>CSSF should ensure that the outstanding work to re-verify old accounts is expedited.</p> <p>The creation of a central database of bank accounts would greatly enhance the efficiency of the fight against money laundering and the financing of terrorism.</p>

D. Authorities' Response to the ROSC

(October 15, 2004)

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

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