EUROPEAN
COMMISSION

Brussels, XXX
[…](2016) XXX draft

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

supplementing Directive (EU) 2015/849 by identifying high-risk third countries with strategic deficiencies

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

CONTEXT OF THE DELEGATED ACT

A. EMPOWERMENT TO ADOPT THE ACT AND BACKGROUND

On 20 May 2015, a new framework on anti-money laundering and counter-terrorist financing ("AML/CFT") was adopted. The new rules consist of:

(a) Directive (EU) 2015/849[1] on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing ("the 4AMLD"), and

(b) Regulation (EU) 2015/847[2] on information accompanying transfers of funds ("FTR").

The new rules constitute a modern, coherent framework in the field, and are consistent with international standards and recommendations currently in force, mainly those issued by the Financial Action Task Force (FATF)[3].

One of the key elements in the EU legal framework is its risk based approach. Situations where there is a higher risk of money laundering or terrorist financing may justify enhanced measures, whereas, reversely, reduced risk may justify less rigorous controls.

The geographical/country risk is one of the factors to be considered when applying the risk based approach which results in the identification of high- risk third countries. This factor is at stake in the risk assessment conducted at national and sectoral levels. At EU level, according to Article 9(1) of the 4AMLD, third-country jurisdictions which have strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the Union ('high-risk third countries') must be identified in order to protect the proper functioning of the internal market. Article 9(2) of the Directive empowers the Commission to adopt delegated acts in order to identify those high-risk third countries, taking into account strategic deficiencies, and laying down the criteria on which the Commission's assessment is to be based. Based on this identification, obliged entities are called by Article 18(1) of the 4AMLD to apply enhanced customer due diligence measures when establishing business relationships or carrying out transactions with natural persons or legal entities established in the listed countries.

On 2 February 2016, the Commission announced a wide range of measures to cut terrorists off from their sources of revenue and to trace them through financial activities. Among the immediate priorities in the Action Plan is the adoption of a Delegated Act to identify high risk third countries with strategic deficiencies in their anti-money laundering/countering terrorist financing.

The clear identification of high-risk third countries is a necessary step in order to define a precise legal framework for conducting business and transactions with individuals or

---

1 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73).

2 Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006 (OJ L 141, 5.6.2015, p. 1).

3 International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations, February 2012 (updated October 2015)

undertakings legally established in the designated countries. As such, it addresses a growing demand for a global approach to tackle money laundering and terrorist financing risks posed by high risk jurisdictions. In addition, it will ensure increased legal certainty for economic operators and stakeholders in general as well as better protection mechanisms for the whole of the internal market. As a result of the publication of the list, the playing field for obliged institutions across the EU will be levelled, and proper competition among obliged entities will be safeguarded, by preventing the possibility that certain undertakings do not apply enhanced customer due diligence as a means to attract customers. Thus, it represents a cornerstone of the framework set in place by the Union to rise to the challenge of ensuring that the EU rules – and their enforcement – keep pace with evolving trends, developments in technology and an ever more interconnected trade and business environment. In sum, as well as answering a strategic objective that is ensuring the security of the financial system, this delegated act also contributes to securing an appropriate degree of protection for consumers, and promoting effective competition.

B. CRITERIA FOR IDENTIFYING HIGH-RISK THIRD COUNTRIES

Article 9 of the 4AMLD mandates the Commission to identify third country jurisdictions which have strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the Union. The Commission considers strategic deficiencies for assessing high-risk third countries, based on in particular the following criteria:

1. the legal and institutional framework of the concerned country considering four key requirements:
    a. criminalising money laundering and terrorist financing;
    b. customer due diligence (CDD);
    c. record keeping;
    d. reporting of suspicious transaction reports;
2. the powers of national competent authorities in the concerned country;
3. the effective application of AML/CFT measures in the concerned country.

This list of criteria in Article 9(2) is non-exhaustive. However, the criteria laid down have been considered as particularly relevant by the legislator.

Among the key criteria, it also remains of paramount importance to assess the effectiveness of the AML/CFT measures. The objective is not only to assess the legal framework compliance with AML/CFT requirements – but also whether those measures are effectively applied..

In making this analysis, data must be checked against various benchmarks that characterise the freedom to operate in the international financial system. It is therefore essential that those benchmarks are recognised globally as consistent and valid for appraising a national AML/CFT framework. The Commission therefore draw on already established benchmarks, and on reports on various jurisdictions drawn up and published by specialised global bodies such as those issued by the Financial Action Task Force (FATF) and FATF Style Regional Bodies (FSRBs). In particular, the following FATF Recommendations are considered as internationally agreed benchmarks concerning the criteria mentioned in article 9(2): Recommendations 3 (criminalising ML), 5 (criminalising TF), 10 (Customer due diligence (CDD)), 11 (Record keeping), 20 (reporting of suspicious transaction reports), Recommendations 26 to 35 (powers of national competent authorities) and FATF Immediate outcome 3, 4, 6, 7, 8, 9 (Effective application of AML/CFT measures). In addition, it is

worthwhile looking at further benchmarks in order to have a comprehensive view of the strategic deficiencies. This concerns for instance Recommendations 24 and 25 as well as Immediate outcome 5 which are crucial benchmarks to ensure transparency on beneficial ownership information. Another key element of competent authorities' powers is their ability to cooperate at international level; hence Recommendations 36 to 40 on international cooperation and immediate outcome 2 are particularly relevant.

On the basis of this analysis, third country AML/CFT regimes that pose significant threats to the global financial system can be identified. As a final step, the threat posed by those specific regimes must be checked against the Union's own financial system. In this context, the Commission takes into account the high level of integration of the international financial system, the close connection of market operators, the high volume of cross border transactions to/from the EU, as well as the degree of market opening to consider that any AML/CFT threat posed to the international financial system also represents a threat for the EU financial system.

Finally, the risks of terrorism and of organised crime also depend on the actual and potential intent – as well as the capacity of perpetrators to exploit the vulnerabilities of the financial system. High-risk jurisdictions are the ones in which the features of financial regulation increase the probability to offer money laundering services, used by the terrorist and criminal organisations. Both intent and capacity of perpetrators tend to increase in those high-risk third countries since their financial system is more vulnerable and easier to misuse. Their lax financial regulation may also be a calculated, intentional feature determined by policy makers on the basis of a cost-benefits analysis, depending on economic and institutional country variables, such as the growth level, the role of the financial industry, the sensitivity to the international reputation effect, the locally perceived threat of terrorism and/or of organised crime, the institutional attractiveness and the international degree of technical and political enforcement of sanction mechanisms.

C. APPROACH FOR IDENTIFYING HIGH-RISK THIRD COUNTRIES

As recognised in 4AMLD, the relevant Union legal acts should, where appropriate, be aligned with FATF standards[4] with a view to reinforcing the efficacy of the fight against money laundering and terrorist financing at a global level. Hence the intention of the EU legislator was to reflect in EU law a listings process similar to those being carried out by FATF.

According to recital 28 and Article 9(4) of 4AMLD, the Commission shall take into account relevant evaluation, assessments or reports drawn up by international organisations and standards setters with competence in the field of preventing money laundering and terrorist financing, i.e. it should consider for instance FATF Public Statements, mutual evaluation, or detailed assessment reports issued by those organisations.

At the same time, the Commission assessment is an autonomous process based on specific criteria, while taking into account evaluations made by FATF and other international organisations. Therefore, the Commission would remain free to go beyond the current requirements set by FATF either by keeping a third country on its list, even if de-listed by FATF, or by including additional third countries.

The fundamental nature of the list of high-risk third countries is not to apply a pure "name and shame" approach, but rather to openly indicate the jurisdictions with which the Union is

[4] The Commission is a founding member of the FATF and hence contributes to the development of those standards as well as to the work of the FATF International Cooperation Review Group (ICRG).

determined to maintain a dialogue in view of removing identified deficiencies and where the willingness to co-operate exists on the part of the identified jurisdictions. The objective is not to limit the economic or financial relations with the listed countries; on the contrary, such a list will contribute to increase the confidence of financial entities dealing with these countries by ensuring the application of appropriate controls. Such an approach is consistent with the objective of strengthening support to third countries in complying with UNSCRs legal requirements and FATF recommendations as outlined in the Commission's Action Plan on Terrorist Financing.

D. INFORMATION FROM INTERNATIONAL ORGANISATIONS AND STANDARD SETTERS

The Commission participates to the work of the FATF, of which it is a member, and is called to contribute to the implementation of its standards. Hence the Commission primarily monitors compliance of third countries with international AML/CFT standards in the context of FATF.

FATF is the global standard setting body for countering money laundering and terrorism financing[5]. It promotes effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. It issues the so-called FATF Recommendations ("International Standards on combatting money laundering and the financing of terrorism & proliferation") which are the global AML/CFT standards.

FATF's work is complemented and mirrored by nine FATF-Style Regional Bodies (FSRBs), in total representing more than 180 countries.

As a representative body that possesses the knowledge of experts in legal, financial and economic questions, FATF has endeavoured to identify countries and territories that do not co-operate in the global fight against money laundering. FATF has developed a set of criteria to identify having strategic deficiencies in their AML/CFT regimes that pose a risk to the international financial system. Such assessment is made based on a solid assessment process ("mutual evaluation process") – a peer evaluation process that assesses effective compliance with FATF standards (including on-the-spot visits). Similarly progress made by those countries is assessed by FATF, based on dedicated peer evaluations and use of on-site visits to deepen knowledge concerning effective application of newly adopted rules.

Since 2007, the International Cooperation and Review Group (ICRG), which is a working group of the FATF, has been responsible for identifying "high-risk" and "non-cooperative jurisdictions". After the G20 summit in Pittsburgh in October 2009, the ICRG substantially expanded the scope of its review, having been instructed to "issue a public list of high-risk jurisdictions by February 2010". Since 2010, the ICRG has been reviewing jurisdictions on a rolling or ongoing basis following a due process. Following an initial identification by FATF or an FSRB of a given jurisdiction, a preliminary review of the jurisdiction is carried out, which includes outreach and the opportunity for it to comment on the draft report. This constitutes the basis for the FATF decision on whether to conduct a full review. During a full review, a jurisdiction has an opportunity to discuss the report and develop a plan to address

[5] Its membership has grown to 37: 35 States and two regional organisations – including the Commission, in addition to which there are numerous associates and observers. 15 Member States are Members of FATF and the remaining 13 are members of "MONEYVAL", the FATF-style regional body that conducts mutual assessment exercises of the AML/CFT measures in place in countries of the Council of Europe

deficiencies identified. Hence all countries assessed by FATF or an FSRB have the opportunity to express their views following a due process – and any action plan being developed is being reviewed (and ideally agreed) by the country. According to the new ICRG procedure adopted in October 2015, a one-year observation period is being granted to countries considered for ICRG referral in order to give time to remedy shortcomings before moving forward with the ICRG process. Therefore countries ultimately identified by FATF as "high- risk" benefit from sufficient time to be aware of the identified deficiencies and to take corrective measures.

At the end of the process, FATF identifies jurisdictions with weak measures to combat money laundering and terrorist financing in two FATF public documents that are issued three times a year, following its plenaries:

- In respect of high-risk jurisdictions, FATF issues a document called "**improving global AML/CFT Compliance: ongoing process**". It identifies jurisdictions with strategic deficiencies which have provided a high- level political commitment to address the deficiencies by implementing an action plan developed in conjunction with FATF.
- FATF also issues a "**Public Statement**" that is geared towards non-cooperative jurisdictions, identifying those that have not adequately addressed strategic AML/CFT deficiencies or which have not committed to an action plan to address them, and it calls on FAFT members to consider the concomitant risk emanating from these jurisdictions. Finally the public statement also identifies jurisdictions which have strategic AML/CTF deficiencies which make them subject to countermeasures in order to protect the international financial system from the ongoing and substantial money laundering and terrorist financing (ML/FT) risks emanating from those jurisdictions. Such countermeasures called by FATF are justified by the fact that those third countries repeatedly failed to address the identified weaknesses.

FATF monitors the implementation of the action plans of these listed jurisdictions: if one is listed as high risk and fails to make sufficient progress, it could then be listed in the Public Statement and subject to countermeasures. A jurisdiction may also progress in the opposite direction: once it has made adequate progress in implementing an action plan, FATF will remove it from the Public Statement, and respectively from the document "improving global AML/CFT Compliance: ongoing process". In this context, FATF ensures an onsite visit in such jurisdictions before any decision to delist a jurisdiction, in order to assess whether newly adopted rules are effectively applied on the ground. The FATF's process thereby looks both at the sufficiency of regulatory measures and also their effective implementation.

E. RESULTS OF THE COMMISSION'S ANALYSIS

The Commission took into account, as appropriate, the most recent FATF Public Statement, FATF documents (Improving Global AML/CFT Compliance: on-going process), FATF reports on International Cooperation Review, and the mutual evaluations report carried out by FATF and FSRBs in relation to the risks posed by individual third countries in line with Article 9(4). In particular, it considered the outcome of the FATF 27th Plenary meeting and the high-risk countries identified by FATF[6].

[6] See FATF public statement and FATF document "Improving Global AML/CFT Compliance: on-going process" published on 24 June 2016:

As a result of this assessment, the Commission identified a number of third countries that have strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the Union. Hence those countries should be included in the Delegated Act provided under article 9 of 4AMLD.

In order to take into account the level of commitment that has been demonstrated by the high-risk third countries, in the context of the FATF, to correct the identified weaknesses, those third countries are listed in separate sections of the annex to the Delegated Act, as follows:

(1) High- risk third countries that have provided a written high-level political commitment to address the identified deficiencies and have developed an action plan with FATF, in view of fulfilling the requirements laid down in Directive (EU) 2015/849. The Commission welcomes these commitments and calls on these jurisdictions to complete the implementation of action plans expeditiously and within the proposed timeframes. The implementation of these action plans will be closely monitored.

(2) High-risk third countries that have provided a high-level political commitment to address the identified deficiencies, and have decided to seek technical assistance in the implementation of the FATF Action Plan, in view of fulfilling the requirements laid down in Directive (EU) 2015/849. Until these countries implement the measures required to address the identified deficiencies, they present money laundering and terrorist financing risks that pose significant threats to the financial system.

(3) High-risk third countries that present ongoing and substantial money laundering and terrorist financing risks, having repeatedly failed to address the identified deficiencies. The Commission is particularly concerned by the ongoing and substantial money laundering and terrorist financing risks emanating from those jurisdictions and calls for rapid action to address the identified deficiencies.

The consequences attached to those different parts of the annex are similar. All countries identified in the annex of the Delegated Act shall be equally considered as "high risk third countries" in the meaning of article 9(1) of 4AMLD. Therefore enhanced due diligence shall be applied by obliged entities when dealing with natural persons or legal entities established in those high-risk third countries.

This list will be reviewed by the Commission at appropriate times. As stressed in Recital 28 of the 4AMLD, the Commission will adapt its assessments to the changes made to information sources from international organisations and standard setters, such as those issued by FATF. Hence the Commission will update this list to reflect progress made by those high risk third countries in removing the strategic deficiencies. Depending on a country's progress (or lack of progress), as confirmed by FATF or other international organisations, the Commission may move any high risk third countries from one section of the list to another one.

This assessment is made without prejudice to the Commission continuing to identify, on an ongoing basis, additional jurisdictions that pose a risk to the international financial system.

F. CONSEQUENCES OF THE PUBLICATION OF THE UNION LIST

---

http://www fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-june-2016.html
http://www fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-june-2016 html

As a direct consequence of the establishment of the list, obliged entities in all Member States will be bound to apply enhanced customer due diligence measures (ECDD) according to article 18 of 4AMLD when dealing with natural persons or legal entities established in high-risk third countries.

Through the establishment of the list, proper competition among obliged entities will be safeguarded, by preventing the possibility that certain undertakings do not apply enhanced customer due diligence towards high-risk countries as a means to attract customers. At the same time, Member States are not required to include, in their national regimes, a specific list of ECDD measures and thus, heterogeneous implementation regimes of ECDD measures towards countries with deficiencies exist. In order to ensure an effective level playing field and limit the risk of forum-shopping, the Commission will further proposes harmonisation of ECDD measures to be applied in those cases[7].

In respect of the "high countries third countries" identified by the Commission, all those countries have been publicly identified by FATF as having strategic deficiencies in their AML/CFT regimes. Most Member States already implement a number of ECDD measures in their national regime in practice in respect of the identified countries. However, a common Union list ensures uniform, binding effects at EU level, completing the EU framework in that context and reinforcing at the same time international efforts carried out in FATF. Hence the Commission reinforces global efforts to protect the financial system from the risk posed by those countries.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

No public consultations were held by the Commission given the fact that the list of high-risk third countries corresponds to that agreed internationally.

On 3 June 2016, the Expert Group on Money Laundering and Terrorist Financing (EGMLTF) was consulted on the approach to be followed by the Commission, the preliminary results of its assessment, and the key elements to be inserted in the Delegated Act. EGMLT unanimously supported the proposals made by the Commission which are reflected in this Delegated Act. It also expressed that the Delegated Act should be closely aligned with the outcome of the FATF assessment on high-risk third countries, including on the level of commitment.

On 24 June 2016, EGMLTF was consulted on the draft delegated act by written procedure.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

This delegated act lays down the list of high-risk third countries.

The legal effects of the publication of the list are governed by the basic act, Directive (EU) 2015/849, in particular Article 18. Obliged entities must apply enhanced customer due diligence measures when dealing with natural or legal entities established in those third countries.

[7] Proposal for a Directive of the European Parliament and of the Council […] amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and Directive 2009/101/EC on coordination of safeguards required of companies

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

supplementing Directive (EU) 2015/849 by identifying high-risk third countries with strategic deficiencies

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC[8], and in particular Article 9(2) thereof,

Whereas:

(1) The Union must ensure efficient protection mechanisms for the whole of the internal market, with a view to increase legal certainty for economic operators and stakeholders in general in their relationships with third-country jurisdictions. The integrity of financial markets and the proper functioning of the internal market as a whole are seriously threatened by jurisdictions with strategic deficiencies in their national anti-money laundering and terrorism financing frameworks. Those jurisdictions that have in place deficient legal and institutional frameworks with poor standards for controlling money flows pose significant threats to the financial system of the Union.

(2) All Union obliged entities under Directive (EU) 2015/849 should apply enhanced due diligence measures in their relationship to natural persons or legal entities established in high-risk third countries, thereby ensuring equivalent requirements for market participants across the Union.

(3) Article 9 of Directive (EU) 2015/849 lays down the criteria on which the Commission's assessment is to be based and empowers the Commission to identify high-risk third countries taking into account those criteria.

(4) The identification of high-risk third countries must be based on a clear and objective assessment which focuses on a jurisdiction’s compliance with the criteria laid down in Directive (EU) 2015/84 regarding its legal and institutional framework, the powers and procedures of its competent authorities and the effectiveness of the anti-money laundering and countering the financing of terrorism (AML/CFT) system in addressing money laundering or terrorist financing risks of the third country.

(5) All findings upon which the Commission's decision to include a jurisdiction in the list of high-risk third countries is to be based should be documented by robust, verifiable and up to date information.

[8] OJ L 141, 5.6.2015, p. 73.

(6) It is essential that the Commission fully acknowledges relevant work already undertaken at international level for identifying high-risk third countries, in particular that of the Financial Action Task Force ('FATF'). With a view to ensuring the integrity of the global financial system, it is of the highest importance that the list of third countries laid down at Union level is closely aligned, as appropriate, with those lists agreed internationally. By promoting a global approach at international level, the Union contributes to enhancing the financial integrity worldwide and better protecting the international financial system from high-risk countries. Such a global approach serves to achieve equivalent conditions for obliged entities and avoid any disruptive effect on the international financial system.

(7) In line with the criteria set out in Directive (EU) 2015/849, the Commission took into account all available expert assessments of factors that contribute to making a country or jurisdiction particularly vulnerable to money laundering, terrorist financing or other illicit financial activity. In particular, the Commission took into account, as appropriate, the most recent FATF Public Statement, FATF documents (Improving Global AML/CFT Compliance: on-going process), FATF reports on International Cooperation Review, and the mutual evaluations report carried out by FATF and FATF-Style Regional Bodies in relation to the risks posed by individual third countries in line with Article 9(4) of Directive (EU) 2015/849.

(8) In accordance with the latest relevant information, the Commission's analysis has concluded that Afghanistan, Bosnia and Herzegovina, Guyana, Iraq, Lao PDR, Syria, Uganda, Vanuatu and Yemen should be considered third-country jurisdictions which have strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the Union. Those countries have provided a written high-level political commitment to address the identified deficiencies and have developed an action plan with FATF, in view of fulfilling the requirements laid down in Directive (EU) 2015/849.

(9) In accordance with the latest relevant information, the Commission's analysis has similarly concluded that Iran should be considered third-country jurisdiction which has strategic deficiencies in its AML/CFT regimes that pose significant threats to the financial system of the Union. This country has provided a high-level political commitment to address the identified deficiencies, and has decided to seek technical assistance in the implementation of the FATF Action Plan, in view of fulfilling the requirements laid down in Directive (EU) 2015/849. Until this country implements the measures required to address the identified deficiencies, it presents money laundering and terrorist financing risks that pose significant threats to the financial system.

(10) In accordance with the latest relevant information, the Commission's analysis has similarly concluded that the Democratic People’s Republic of Korea (DPRK) should be considered third-country jurisdiction which has strategic deficiencies in its AML/CFT regime that pose significant threats to the financial system of the Union. This country presents ongoing and substantial money laundering and terrorist financing risks, having repeatedly failed to address the identified deficiencies.

(11) It is essential that the Commission extends an invitation to all third-country jurisdictions identified as high-risk to fully cooperate with the Commission and international bodies with a view to agreeing and effectively implementing measures for correcting the strategic deficiencies in their anti-money laundering and terrorism financing regimes.

(12) It is of the utmost importance that the Commission conducts a permanent monitoring of developments in the assessment of legal and institutional frameworks in place in third countries, the powers and procedures of competent authorities, and the effectiveness of their AML/CFT regimes with a view to updating the list of high-risk third countries with strategic deficiencies.

HAS ADOPTED THIS REGULATION:

Article 1

The list of third-country jurisdictions which have strategic deficiencies in their anti-money laundering and countering the financing of terrorism regimes that pose significant threats to the financial system of the Union ("high-risk third countries") is laid down in the Annex.

Article 2

This Regulation shall enter into force on the third day following that of its publication in the *Official Journal of the European Union*.

Done at Brussels,

For the Commission
The President