MSc in Business Administration

AML/CTF: A Compared Approach Between Portugal and the United States of America

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Dissertation submitted in partial fulfillment of requirements for the degree of MSC in Business Administration, at Universidade Católica Portuguesa, June 2010

ABSTRACT

Title: AML/CTF: A Compared Approach Between Portugal and the United States of America

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This dissertation aims to study the evolution of the compliance levels from 2006 to 2010 in two realities, Portugal and the USA, in a comparative study. Another topic that will be addressed is the evolution, during the same period, of the amount and quality of the reports made by obliged entities. In order to complete these goals, state-of-the-art literature on the topic was reviewed and relevant reports of each country were analyzed.

With this information in hand, it was possible to compare both countries in the evolution of: the number of reports filled in, with both a data and a graphical analysis; the quality level of the same reports, by using a quality report ratio, which represents the number of reports per investigation started; and the compared level of compliance between Portugal and the USA, with a descriptive analysis of the main changes performed.

The main conclusions taken in this dissertation include the fact that Portuguese reports have been increasing in terms of quality, although the situation in terms of quantity is not improving. The USA has had a high and constant number of reports throughout the whole period in study, maintaining, however, a low but constant level of quality. Finally, in terms of the level of compliance evolution, both countries show a trend of convergence, with Portugal having a very positive evolution in the latest years despite its late start in regulating against the crimes in analysis.

ACKNOWLEDGMENTS

First of all, I would like to thank my academic adviser, Prof. Miguel Trindade Rocha, for his guidance, patience and total availability to aid me during the process of writing my master thesis.

Finally, I would like to thank my family and friends, especially my mother and father, for all the unconditional support and positive criticism, both in my master thesis development and in all other areas of my life, making me who I am today.

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I. INTRODUCTION

1. Problem Statement

This dissertation's main subject is Financial Crime and Compliance, particularly the Anti-Money Laundering and Counter Terrorism Financing topics (hereon referred as AML and CTF, respectively) in Portugal and the USA. Therefore, an exploratory study will be performed, based on the FATF reports from both countries.

In this respect, this dissertation's research aims to study the evolution of the compliance levels of both Portugal and the USA since the FATF third mutual evaluation round in 2006 until 2010, with a special focus on the progress of reporting of suspicious actions of the entities subject to those new regulations.

In order to develop a clearer perspective of this objective, I have developed some research questions, to which I propose to answer until the end of this dissertation:

a. What is the impact that more legislation and greater awareness of the problem of money laundering have in terms of the reports delivered by subject entities?
b. After the changes performed since 2006, what can be taken from the USA case in order to improve the Portuguese reality, in terms of its level of compliance with the FATF Recommendations?

In both questions the methodology in use will be an exploratory study, with a descriptive and comparative approach. Addressing the first research question, the problem will be analyzed quantitatively, both with a data and a graphical analysis. The second research question study will be based on descriptive information, which illustrates the evolution that has taken place in the latest years and that allows for a comparison between both realities.

2. Dissertation Structure

After this brief introduction, this dissertation is comprised of four other chapters.

In Chapter 2 there is a review of state-of-the-art literature in the AML/CTF theme, with the goal of framing the research questions and hypothesis that will be studied afterwards.

In Chapter 3 there is a conceptual framework that illustrates the trail of thought followed in order to attain the hypothesis in study. Following this information, information on the compliance of both countries in 2006 is analyzed, as a basis to the study that is going to be done in the rest of the dissertation. Finally, there is a brief approach to the methodology used to obtain the information that was used in order to reach the results used thenceforward.

Chapter 4 contains the results and their discussion, which is made according to the methodology explained in Chapter 3.

This discussion leads to Chapter 5, which contains the conclusions of the study, as well as its main limitations and possibilities of future research in the same topic.

II. LITERATURE REVIEW

1. Introduction

a. Basic Concepts

Before starting the analysis of the problem in particular, it is important to frame some basic terminologies of this specific topic.

The worldwide most accepted definition of money laundering is the one used in the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances in 1988 – Vienna Convention - and in the United Nations Convention Against Transnational Organized Crime in 2000 – Palermo Convention (Schott, 2006):

- "The conversion or transfer of property, knowing that such property is derived from any [drug trafficking] offense or offenses or from an act of participation in such offense or offenses, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions;
- The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offense or offenses or from an act of participation in such an offense or offenses, and;
- The acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offense or offenses or from an act of participation in such offense…or offenses" (United Nations, 1988, Article 3, no.1 b) and c) (i); United Nations, 2000, Article 6, no.1).

Basically, "money laundering is the criminal's way of trying to ensure that, in the end, crime pays" (McDowell, Novis, 2008), because it is a way for criminals to disguise the origin of the money that is being laundered, which may come from drug trafficking or organized crime, for example (McDowell, Novis, 2008).

Concerning terrorism financing, its definition was approved in the International Convention for the Suppression of the Financing of Terrorism in 1999, by the United Nations. The agreement was on:

"Any person commits an offense within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and willingly, provides or collects funds 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:

- An act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex; or
- Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking any active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing an act" (United Nations, 1999, Article 2 nº1).

b. Background

Money laundering is a crime that, usually, involves large sums of cash (in 1996 it was estimated by the IMF that "money laundering ranged between US Dollar (USD) 590 billion and USD 1.5 trillion"[1]), making it a harmful externality for the economy. Furthermore, many times, it is an activity that is related to other types of crime. In fact, when criminal funds are derived from robbery, extortion, embezzlement or fraud, a money laundering investigation may be the only way to find the money's path[1]. Furthermore, this type of crime is more susceptible in emerging countries, as there is an increased effort of the major financial markets and of many OFC's (Offshore Financial Center) to fight against money laundering, giving the image of a greater protection in these territories (McDowell, Novis, 2008).

Generally, money launderers split the large piles of cash in order to avoid detection from the authorities. They make use of common ways to store or invest money, such as opening bank accounts and purchasing securities, so that its trace is lost. Once, money laundering was used above all to undercover the proceeds from tax evasion and fraud, having, nowadays, expanded to other activities, such as "drug trafficking, other forms of transnational crime and corruption, and, most recently, the bankrolling of terrorism" (Marlin-Bennett, 2008).

Historically, the USA and the UK were the first ones to criminalize money laundering. Particularly, the USA took the first legislative action AML in 1970 with the Bank Secrecy Act, obliging banks to report transactions over USD 10.000, followed by this crime's definition as a separate criminal offense in 1986 with the Money Laundering Control Act. Since then, both countries have been working together in order to make money laundering a worldwide recognized and legislated against crime (Kapstein, 1989).

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[1] http://www.fatf-gafi.org/document/29/0,3746,en_32250379_32235720_33659613_1_1_1_1,00.html#Whatinfluencedoesmoneylaundering

Indeed, money laundering may have devastating consequences both socially and economically, not only due to its large scale in terms of monetary values and people involved, but also in other aspects, such as:

- Private Sector: Many times money is laundered through front companies, where criminals use their core business as a façade in order to hide the illegal profits. Moreover, as these criminals earn large profits with their illegal activities, they are able to maintain the front companies selling below the market average prices. This situation severely harms legally established companies, which are forced to compete with another that has a clear competitive advantage over them.
- Financial Institutions: Money laundering may harm financial institutions in the sense that whenever these rely on the proceeds of this type of crime, they may suffer consequences in terms of their assets, liabilities or operations management. For example, due to these funds unexpected flows, if a bank receives a large sum of “dirty” money in one day it can be transferred away from that same bank in only a short period of time, which can create liquidity problems.
- International Markets: Money launderers usually reinvest their funds in places where it is more advantageous in terms of detection and not only looking for the higher rates of return. This way, money laundering can provoke a misallocation of resources from artificial distortions in asset and commodity prices, as well as an increased volatility of international capital flows, interest and exchange rates.
- Economic Distortion and Instability: Following the previously explained logic, money laundering can also harm economic growth, because criminals generally look for investment opportunities that hide the source of their proceeds, instead of looking for the highest return possible.
- Tax Influence: This crime also reduces government’s tax revenues, harming tax payers, who have to pay more than they would if all the agents in the economy worked legally.
- Privatization: Sometimes criminals have a greater buying power than legitimate purchasers, which in a privatization process can bring the company to the hands of a money launderer harming its business.
- National Reputational Risk: Nowadays, countries are rigorously concerned with their country-wide reputation, a concern that is greater with the global economy, with the confidence in markets and the profits benchmarks being very important. This way, a country’s negative reputation reduces legitimate businesses, augmenting the percentage of illegal ones from

international criminal organizations. Also, after losing its credibility, it is extremely difficult for a country to recover it, requiring its government to spend a great amount of resources in restoring the markets trust.

- Social Consequences: Money laundering attracts other illicit activities, such as drug trafficking, which drastically increases the government's spending in security and healthcare, decreasing the overall population lifestyle level (McDowell and Novis, 2008).

On the other hand, terrorism financing is a much more recent concept, which was only generally defined in 1999, as explained previously. However, this definition, contrarily to the one of money laundering, is subject to much more subjectivity, due to the divergences in political, religious and national issues that vary in a country-wide basis. Nonetheless, this concept has evolved in the following years, especially after September of 2001 and the terrorist attacks, after which FATF developed its nine Special Recommendations (Schott, 2006).

Terrorism has several grave consequences both economically and socially, with some of these being direct and the others indirect.

Direct consequences of terrorism include the destruction of life and property, the costs with the restoration of the systems and infrastructures and the emergency and assistance services needed and usually occur right in the aftermath of the terrorist attack. Direct economic consequences of terrorism are generally proportionate to the strength of the attacks, along with the size and characteristics of the economy that suffered the attack (Johnston and Nedelescu, 2005).

On the other hand, indirect consequences also take place, especially in the medium and long term. At first, customer and investor's confidence is affected, which may cause a "generalized drop in asset prices and a flight to quality that increases the borrowing costs for riskier borrowers" (IMF, 2001b). In the long run, terrorism can also have a negative impact on productivity, as transaction costs will rise through the increase of security measures, higher insurance premiums, or the increase of financial and counterterrorism regulations' costs (Johnston and Nedelescu, 2005).

2. International Standard Setters

a. United Nations

The UN was the first organization to fight money laundering in an international basis with the Vienna Convention in 1988, mentioned above. Also, it is one of the best prepared organizations to prevent this type of crime worldwide, not only due to its expansion and overall acceptance, having 191 country members, but also due to its constant action on the disclosure and prevention of money laundering and, subsequently, terrorism financing[2].

Nowadays, the UN has a specific division in order to deal with these crimes and others related with corruption and drug trafficking – the United Nations Office on Drugs and Crime. UNODC's main purpose is "to assist Member States in their struggle against illicit drugs, crime and terrorism"[3].

b. FATF

"The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing"[4].

In order to do so, after its creation in 1989, it has developed a series of Recommendations and Special Recommendations, regulating AML and CTF respectively. Besides the establishment of these recommendations, FATF has updated them through the years. Furthermore, FATF monitors its members progress in implementing the necessary measures in order to comply with the recommendations[2].

c. Egmont Group

The Egmont Group was created in 1995, in order to allow the different FIU's to better communicate between themselves, cooperating in the combat to money laundering and terrorism financing, enabling the implementation of country-wide programs in these areas[5].

Examples of this influence are the training offered and the promotion of personal exchanges, for a more effective action of each FIU, and the creation of the Egmont Secure Web (ESW), for a better and more secure communication between FIU's[4].

A Financial Intelligence Unit "is a central office that obtains financial report information, processes it in some way and then discloses it to an appropriate government authority in support of a

[2] http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236836_1_1_1_1_1,00.html
[3] http://www.unodc.org/unodc/en/about-unodc/index.html?ref=menutop
[4] http://www.egmontgroup.org/about
[5] http://www.egmontgroup.org/about/what-is-an-fiu

national anti-money laundering effort"[6]. Nowadays, these play a significant role in the AML and CTF processes, being responsible for the development of a relationship between financial and non-financial institutions and the law enforcement authorities responsible for the investigation and repression of these crimes. In addition, FIU's also assure the protection of the data shared by companies, creating an incentive for the participation of these in the information sharing cycle[5].

There are four different FIU models, depending on the institution that manages it:

- Judicial: The FIU is linked to the national judicial system, working in a way that allows for the information received to, directly and when justifiable, start a judicial process. Its greatest advantage is the FIU's independence from political power, along with an easier triggering of judicial processes. However, this model may decrease the availability of companies to share information, as the intermediary is directly linked with an institution with a great power over them, in case a crime is detected.
- Law Enforcement: FIU's are dependent of a law enforcement or security force system. This model allows a simpler access to the national and international police databases for the FIU, having a greater support for the investigation that is being held. Notwithstanding, similarly to judicial FIU's, as companies are dealing with a form of authority, they can become less receptive to the idea of sharing information, being necessary a prior proof of the cooperation relationship between them.
- Administrative: In this model, the FIU works under the management of a centralized and independent authority, making the bridge between companies and the judicial and law enforcement systems. Its main advantage is its independence from either the companies or obliged entities and the authorities. Even though this represents an advantage, it can also have a perverse effect. Due to its complete independence, the FIU is also further from the information sources, along with is distance from the investigation itself.
- Hybrid: The FIU's model is mixed if it has features of two or more of the above referred models. In this case, the advantages and disadvantages are the same as the ones from the models that constitute the hybrid model (Gleason and Gottselig, 2004).

3. Standard AML/CTF Regulation

a. FATF Recommendations

In order to fight money laundering, FATF has established the 40 FATF Recommendations in 1990, following the Vienna Convention of 1988. These recommendations were revised in 1996 and 2003 by

"FATF members, non-members, observers, financial and other affected sectors and interested parties"[6], keeping it in accordance with current times, while being accepted by both the IMF and the World Bank.

Moreover, there are the FATF IX Special Recommendations, which address the financing of terrorism. These were created in 2001 and revised in 2003 and 2004, being also accepted worldwide as paradigm of prevention and detection of terrorism financing.

b. European Directive 2005/60/EC, of 26 October

The European Parliament and Council have elaborated Directive 2005/60/EC, of 26 October, as a response to money laundering and other crimes with which it is connected. This Directive was developed in accordance with FATF Recommendations and Special Recommendations, repealing Directive 91/308/EEC, of 10 June (Directive 2005/60/EC, of 26 October).

As explained before, money laundering and terrorism financing are usually committed internationally, requiring an overall coordinated reply, instead of simply a national or Community initiative, which would produce limited effects. Therefore, the countries present in the EU, are enforced to comply with this Directive as a whole (Directive 2005/60/EC, of 26 October).

This Directive determines, in general, the scope, definitions and subjects exposed to the legislation, the rules related with customer due diligence, reporting obligations, record keeping and statistical data and other enforcement measures (Directive 2005/60/EC, of 26 October).

Complementary to this Directive, the European Parliament and Council have established another Directive, 2006/70/EC, of 1 August, in order to define the concept of PEP and the technical criteria for simplified customer due diligence procedures for exemption on grounds of a financial activity conducted on an occasional or very limited basis (Directive 2006/70/EC, of 1 August).

c. Consequences of Non-Compliance

Even though these reports contain "recommendations", they are not merely voluntary, since the IMF and the World Bank perceive them as models of good financial governance, increasing these recommendations and FATF's importance in the AML and CTF actions. This relevance brings consequences for the countries that do not comply with the established rules (Marlin-Bennett, 2008).

The direct consequence of non-compliance is the listing of countries in a set of Non-Compliant Countries and Territories (NCCT). The inclusion in this group, besides hurting a country's reputation overseas, grants foreign complying countries the authority to apply countermeasures against non-compliant countries, as explained in FATF Recommendation 21: "Financial institutions should give

[6] See FATF 40 Recommendations, Introduction.

special attention to business relationships and transactions (…) from countries which do not or insufficiently apply the FATF Recommendations. (…) Where such a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate countermeasures" (FATF 40 Recommendations). A non-compliant country can even reach a situation in which the major financial markets no longer accept trading with them, which may also occur with specific companies or institutions (Johnston and Nedelescu, 2005).

Besides countries, financial institutions should also make sure that the principles that are valid for them are also applied to branches and majority owned subsidiaries located abroad. This recommendation gains importance in countries that do not or insufficiently apply the FATF Recommendations. However, the only exception to the enforcement of FATF Recommendations is in the case that local applicable laws and regulations do not permit this implementation, in which case, according to FATF Recommendation 22, "competent authorities in the country of the parent institution should be informed by the financial institutions that they cannot apply the FATF Recommendations" (FATF 40 Recommendations).

Moreover, an effort has been made by FATF and its regional bodies (FSRB – FATF Style Regional Bodies) in order to further improve the AML regulation in regional terms. This joint work was mostly done through feedback and mutual evaluations, having proven to be effective, illustrated by the shortage verified in the list of NCCT's in the last years (FATF, 2007).

Additionally, there are several risks for individual financial institutions inside a country if a money laundering or terrorism financing situation occurs. Firstly, the reputation risk is the potential that, due to negative publicity, or suspicions or allegations of money laundering or terrorism financing, there will be a loss of confidence in the integrity of the financial institution, creating a sense of mistrust from its counterparts and reducing the probability of that institution to do business with others. Also, the operational risk is the potential that a given institution is not able to adequately apply or manage internal processes, people and systems, such as the application of CDD processes, creating a greater exposure of the financial institution to money laundering activities. Moreover, the legal risk is the possibility of law suits, adverse judgments, unenforceable contracts, fines and penalties generating losses or increased expenses for an institution, or even closure of such an institution. Finally, the concentration risk comes from an unidentified clients' identity. Even though limits are established in what concerns a bank's exposure to a single client or group of related clients, without instituting proper measures to precisely identify its clients, is becomes impossible for a bank to measure its concentration risk (Basel Committee on Banking Supervision, 2001).

4. Contrary Opinion About AML/CTF Frameworks

Although the requirements for AML and CTF are already in place in most countries, the truth is that money laundering still exists in a large scale worldwide. In fact, the creation of organizations that regulate and legislate against AML and CTF is not a sufficient procedure in order to efficiently fight against money laundering and terrorism financing (Marlin-Bennett, 2008).

Furthermore, least developed economies and weaker jurisdictions and institutions may face difficulties in the implementation of the regulatory standards and recommendations, as these have rigorous legal and regulatory requirements (Johnston and Nedelescu, 2005).

Financial intermediaries do not always have a strong economic incentive to report suspicious transactions, once, today, the probability of criminal conviction is low and fines are still small comparatively to the amounts involved in the crime itself. Besides, when there is a large group of smaller clients, its cost of reporting becomes very high, while, on the other hand, high-class clients give a great importance to their privacy, changing their intermediary if any problems were risen (FitzGerald, 2004). Moreover, while larger reporting entities have the structure to refuse clients who raise the slightest suspicion, smaller companies may tend to accept those clients, as long as their backgrounds do not reveal any problematic questions (Geiger and Wuensch, 2007).

Also, the creation, implementation and enforcement of criminal and civil law rules as well as banking regulation and supervision is in the competence of sovereign states. However, due to the growing globalization of the economy and financial services businesses, AML/CTF frameworks are coordinated internationally, so that international cooperation and preventive regulatory arbitrage can be promoted. This way, although members from each country are present in the FATF, they do not have the same decision power as they would have individually (Geiger and Wuensch, 2007).

In 2008, the United States Department of State Bureau for International Narcotics and Law Enforcement reported that, at that time, there were 57 major money laundering countries, with “far too many countries that boast solid AML/CTF standards and infrastructures are still simply not enforcing their laws. This is true in all corners of the world and for both developed and developing countries alike” (United States Department of State, 2008).

5. AML/CTF Systems in Study

a. Portugal[7]

Portugal has one of the lowest crime report rate per capita in Europe (40,5% in the 2010 balance), having only Greece behind. Reported car theft is one of the most reported crimes, although it has shrunk 10,1% between 2010 and 2009 (Sistema de Segurança Interna, 2010). Portuguese authorities believe that this crime is generally drug-related by the perpetrator.

In fact, due to its geographical condition with a long coastline and vast territorial waters, along with its privileged relationships with South America, Portugal is a point of logistical support in the transit of drugs destined to other countries in Europe, coming from South America and North Africa. Other types of crime that have been detected in Portugal are: corruption, traffic of works of art and cultural artifacts, extortion, embezzlement, tax offences and aiding or facilitating illegal immigration.

Furthermore, concerning the financing of terrorism, there is no clear evidence that there are Portuguese terrorist groups of any radical nationalist movements by foreign terrorist organizations inside Portugal. However, there are some indications that some of the criminal activity verified has contributed to support political parties or radical organizations active outside the Portuguese territory. Authorities also suspect that money remittance systems or cash couriers have been used to move funds.

The main actors in Portugal concerning the AML/CTF system are divided between obliged entities and supervisory bodies or overseeing bodies. Besides, these can be from the financial sector or the non-financial one.

The financial sector's obliged entities are subdivided in: credit institutions, financial companies, other financial intermediaries in securities, other financial institutions and insurance companies and pension funds management companies. Since 1995, the Portuguese Future and Options Exchange works in agreement with the Lisbon Stock Exchange, creating the PSI-20, composed by the 20 Portuguese leading companies' stocks.

In Portugal banking institutions are the main source of funding for the domestic economy. This banking system has changed severely since the 1980's, mostly due to the accession to the EU and to a consolidation process. In effect, most financial institutions in Portugal are consolidated within wider banking groups, with the system being concentrated around four big banking groups (BES, BCP, BPI and CGD), with the concentration rate in 2006 in approximately 75%, when there were still five players in the market.

[7] FATF 2006, Portugal, unless another source is referred throughout the text.

Insurance companies work entirely in insurance and reinsurance, together with the activities that are connected or complementary. According to Law 25/2008, of 5 June, insurance companies subject to the AML/CTF framework are just the ones that carry on activities within the area of life insurance. In Portugal, life insurance companies can also manage pension funds and insurance mutual funds are widely available as investment products. In the end of 2005, there were five companies dominating the market with 75% of market share (life) and 60% (non-life), with a trend that pointed to an even increasing concentration in the market. However, pension funds companies exclusively work in the management of pension funds, with a lower concentration rate (52,4% for the eight biggest companies in the end of 2005).

The regulation and supervision to the Portuguese financial sector is performed by three institutions: the Bank of Portugal (Banco de Portugal – BdP); the Portuguese Insurance Institute (Instituto de Seguros de Portugal – ISP); and the Securities Market Commission (Comissão de Mercado de Valores Mobiliários – CMVM). In order to institutionalize and organize co-operation between these three supervising institutions, the National Council of Financial Supervisors was created in 2000.

The BdP is the central bank of Portugal and is a part of the ESCB (European System of Central Banks) being responsible for the stability of the financial system, supervising all credit institutions and financial companies with their head office in Portugal. Internationally, the BdP has to manage the foreign assets of the country, act as an intermediary of the State's international monetary relations and to advise the government on economic and financial matters. The ISP is responsible for the prudential supervision of insurance and re-insurance companies, insurance intermediaries, pension funds and their management. The CMVM is in charge for the supervision of securities markets and these markets rules of conduct. This last organization has powers to watch over the application of the law by the entities under its supervision, although it does not investigate any crimes, exactly as the other two regulatory entities.

The non-financial sector, which is denominated Designated Non-Financial Businesses and Professions (DNFBP), is constituted by a great diversity of professionals and corporations. Lawyers, who have exclusive powers of attorney and are providers of legal advice. Solicitadores, which is a denomination exclusively used in Portugal, have a legal mandate to exercise specific responsibilities to carry out contracts and procedures covering all legal areas which are not restricted to lawyers. Notaries, who provide legal form and public faith to private acts and contracts. Statutory auditors, or ROC's (Revisores Oficiais de Contas), who have the exclusive legal authority to monitor a given company's accounts, according to the rules approved by their Professional Order and to the legal requirements relating to the auditing of accounts. Chartered accountants, or TOC's (Técnicos Oficiais de Contas), who plan, organize and co-ordinate the accounts of companies who are subject to corporation tax and who's accountancy is registered according to official accounting plans. Besides ROC's and TOC's, also external auditors and fiscal consultants are subject to AML/CTF laws. Real estate agents, intermediaries and dealers, who search for and collect information on a property or promote property for business use. Casinos, which are private establishments owned by or that can revert to the State. Moreover, the State is the only one that is allowed to operate gambling amenities, with the casinos' management being run only through a concession awarded by the State itself. Dealers of precious metals and stones, who need no license or authorization in order to run their business. Finally, every dealer that makes a transaction of value equal to or higher than € 15.000, independently of that transaction being completed in one or more operations.

Each of these subdivisions have a correspondent overseeing entity: the Bar Association; the Chamber of Solicitadores; the Notaries and Registry Officials; the Professional Order of ROC's and the Professional Order of TOC's; the Authority for the Food and Economy Security (ASAE), which was known as IGAE before 2006; and the General Inspectorate for Gambling (IGJ), respectively.

In Portugal, the FIU is the Unidade de Informação Financeira (UIF) and is of the law enforcement model, being connected with the Portuguese criminal police – Polícia Judiciária (PJ). UIF's competences involve gathering, centralizing, collating and disseminating the information about the prevention and investigation of crimes as money laundering, terrorism financing and tax-related offences, at a national level. Moreover, it is responsible: for the cooperation and liaison with the judicial, supervision and control authorities as well as with financial and non-financial entities, internally; and for the cooperation with other FIU's, internationally (Decree-Law No. 42/2009 of 12 February, Article 5).

Another important organization in Portugal is the Central Department for Criminal Investigation and Prosecution (DCIAP – Departamento Central de Investigação e Acção Penal), which works on the dependency of the Prosecutor's General Office. The DCIAP co-ordinates and controls the investigation and prevention of violent, highly organized or extremely complicated crime. It has authority to investigate crimes involving terrorist organizations, terrorism, corruption and money laundering, being able to carry out operations against the two last ones. Finally, the DCIAP carries out enquiries and promotes criminal proceedings whenever the criminal activity happens in areas that belong to distinct judicial districts or following a decision of the leader of the DCIAP (the Deputy Attorney General).

In Portugal, the main law concerning money laundering and terrorism financing regulation is Law 25/2008, of 5 June, which revokes Law 11/2004, of 27 March. This Law takes into account the EU Directives no. 2005/60/CE, of 26 October, of the European Parliament and no. 2006/70/CE, of 1 August, of the European Commission.

This regulation starts with the definition of several concepts (article 2) relevant for AML/CTF, such as the ones of Politically Exposed Person (PEP), who are "natural persons who hold or who have held up to the previous twelve months prominent public or political functions and immediate family members, or persons known to be close associates of such persons through a business or commercial relationship" and Shell Bank, which is "a credit institution, incorporated in a State or jurisdiction in which it has no physical presence, involving meaningful mind and management, and which is unaffiliated with a regulated financial group". Still in the general dispositions chapter, Law 25/2008, of 5 June, identifies the entities that are subject to the defined rules, meaning financial and non-financial entities (articles 3 and 4), as well as the authorities that supervise them (article 38 to article 40).

Article 6 to article 37 enumerate the general duties for all the entities defined earlier, as well as the individual duties corresponding to each type of entity separately. The duties applicable to all obliged entities are presented in a list below:

- Duty of identification (article 7 of Law 25/2008, of 5 June): the obliged entities shall request and verify the identity of their clients and the respective representatives a) every time they start a business relationship, b) whenever they enter into transactions equal to or higher than € 15.000, c) when the transaction rises suspicions of involving funds coming from money laundering or terrorism financing activities, or d) when there are any doubts about the authenticity of customers' identification data.
- Duty of due diligence (article 9 of Law 25/2008, of 5 June): the obliged entities shall a) take the appropriate measures so that they are able to understand the ownership and control structure of the customer, b) obtain information on the purpose and the intended nature of the business relationship, c) obtain information on the origin and destination of the funds, d) continuously monitor the business relationship, or e) keep the information elements obtained during the business relationship up-to-date.
- Duty of refusal (article 13 of Law 25/2008, of 5 June): the obliged entities shall refuse any transaction, business relationship or occasional transaction when a) the elements concerning the proper identification of the client, his/her representative or beneficial owner are not provided as stated in article 7, or b) the information concerning the ownership and control

structure of the customer, the nature and purpose of the business relationship and the origin and destination of the funds is not provided as stated in article 9.

- Duty of document keeping (article 14 of Law 25/2008, of 5 June): a) the copies or references to the documents demonstrating compliance with the duty of identification and due diligence shall be kept for a period of seven years, counting from the moment in which the identification process takes place or when the business relationship ends, and b) any type of demonstrative documents containing records of the transactions shall always be kept for a period of seven years.
- Duty of examination (article 15 of Law 25/2008, of 5 June): without prejudice to the enhanced customer due diligence duty, the obliged entities shall examine with particular care and attention any conduct, activity or transaction whose features are particularly likely to be related to money laundering or terrorism financing.
- Duty of reporting (article 16 of Law 25/2008, of 5 June): the obliged entities shall inform both the DCIAP and the UIF every time they know or suspect that a given transaction is likely to incorporate a money laundering or terrorism financing offence, which may either have been attempted or consummated; these reports' privacy shall always be kept, as these can only be used in a judicial trial.
- Duty to refrain from carrying out transactions (article 17 of Law 25/2008, of 5 June): the obliged entities shall renounce to operations that are in any way connected or suspected to be connected to money laundering or terrorism financing, informing afterwards both the DCIAP and the UIF of its action; however, the mentioned operation may still occur either if it is not frozen by a judge in a period of two working days after the report has been made or if the refraining is not possible or may harm the future investigation of money laundering or terrorism financing.
- Duty of cooperation (article 18 of Law 25/2008, of 5 June): the obliged entities shall readily provide the cooperation that may be requested by either the DCIAP, the UIF, the judicial authority responsible for leading the enquiry or by the competent authorities to ensure compliance with the duties.
- Duty of secrecy (article 19 of Law 25/2008, of 5 June): the entities subject to the duties shall not disclose to their customers or to third parties (excluding the supervisory authorities and in cases when that information is critical for the investigation of a money laundering or terrorism

financing case) that they have made the reports legally due or that a criminal investigation is ongoing.

- Duty of controlling (article 21 of Law 25/2008, of 5 June): the obliged entities shall create and apply adequate internal policies and procedures for the compliance with the duties, namely as far as internal control, evaluation and risk management and internal audit are concerned, so as to effectively prevent money laundering and terrorism financing.
- Duty of training (article 22 of Law 25/2008, of 5 June): the obliged entities shall adopt the most appropriate measures so that those whose functions are relevant for the prevention of money laundering and terrorism financing, are able to develop their activity taking into account the obligations imposed by legislation and regulation in force concerning this matter.

Finally, Law 25/2008, of 5 June, also defines the consequences for the obliged entities that do not comply with the rules defined above. According to article 54, the fines vary with the activity of the offender (financial of non-financial sector) and with its state as legal or natural person. Therefore, the fines applicable to a financial entity vary from €25.000 to €2.500.000 for a legal person and from €12.500 to €1.250.000 for a natural person, while the fines valid for a non-financial entity (lawyers and solicitadores are subject to different penalties) vary from €5.000 to €500.000 for a legal person and from €2.500 to €250.000 for a natural person. Along with these fines, article 55 establishes additional penalties, depending on the seriousness of the offence and guilt of the offender: a) prohibition from exercising the profession or activity to which the breach of regulations relates for a period of up to three years; b) prohibition from being member of management or auditing boards as well as from holding chief executive, senior management, or management and supervisory posts in legal persons subject to this law, where the offender already holds a position such as the ones mentioned; and c) publicity of the final decision in one of the most read newspapers of the area where the offender has his/her head office or, in the case that he/she is a natural person, his/her residence, at the expense of the offender himself.

For lawyers (article 58) and solicitadores (article 59) the consequences are similar, with an entailment of disciplinary proceedings in the Bar Association and in the Chamber of Solicitadores that can, according to their seriousness and regarding the violation of duties, lead to: a) a fine between €2.500 and €250.000; b) a two year suspension of activity; c) a suspension of activity between 2 to 10 years; or d) expulsion.

Besides Law 25/2008, of 5 June, there are Law 52/2003, of 22 August (with changes made in Law 59/2007, of 4 September) and the CMVM Securities Code. The first one regards the prevention against terrorist organizations and terrorism itself, while also addressing the penalties against this type of crime. The second regulates the securities exchange rules, defining the concepts involved and the crimes that can be involved with this type of transaction.

b. USA[8]

The USA signed and ratified the OECD 1997 Convention on Combating Bribery of Foreign Public Officials in International Transactions and the Palermo Convention of 2001. Nevertheless, this protection against money laundering and other crimes does not happen just between the political class. Socially, individuals expect that the businesses with which they interact in their day-to-day activities will not have criminal connections, protecting themselves and their business relationships from any money laundering or terrorism financing threats and possibilities.

In fact, apart from the civil and criminal penalties, offenders have a very high risk of getting their income and reputation levels shortened due to the negative publicity that these types of crimes arise. In addition, the USA media takes an active role in informing and denouncing the cases of money laundering and terrorism financing. All of these efforts create a culture of AML/CTF compliance in financial and non-financial obliged entities.

In the USA, drug trafficking profits represent a large fraction of the total of funds related with money laundering activities. Furthermore, it has been proven that cities with a higher amount of drug seizures are some of the ones with higher total assets seized (in US Dollars), namely New York, Miami and Los Angeles. In the group of the top ten asset seizures, the primary offences found, besides drug trafficking, are immigration violations, fraud and firearms violations.

The most reported SAR (Suspicious Activity Report) is structured cash deposits followed by immediate and regular international wire transfers that are conducted through correspondent accounts either by individuals or businesses. Besides this way of laundering money others are also used, such as: bulk-cash smuggling; trade-based money laundering; insurance products; casinos; and money services businesses.

On the other hand, terrorism financing remains a concern in the USA, mostly due to the influence of 9/11 and, afterwards, as a result of the possibility of performing SAR's together with the publicity surrounding some financial institutions with customers and transactions with possible ties to terrorism. However, given the high criminal penalties associated with the involvement in terrorism

[8] FATF, 2006, USA, unless another source is referred throughout the text.

financing activities, almost no one openly acknowledges the intended terrorist-related use to which raised funds are to be applied.

In the USA, the main actors are divided between obliged entities, supervision entities and institutional bodies. The obliged entities belong to one of two distinct sectors: financial or DNFBP's.

As financial entities, there are the banking sector, the securities sector, the insurance sector and the money services businesses.

Inside the banking sector, institutions can work either at national or state level, being able to affiliate more broadly with securities and insurance underwriters since 1999, with the Gramm-Leach-Bliley Financial Modernization Act. Besides this distinction, banks may vary in size from global banks to regional and community banks. Global banks operate internationally, lending and trading currency, along with their usual business activities. Regional banks operate with several branches and ATM locations inside a multi-state area, providing banking services to individuals. Community banks are directed to small business markets, targeting retail and being based locally. Recently, online banks are proliferating, either as separate institutions or as expansions made by traditional banks.

In the securities sector, brokerage firms can take three different forms: full-service; discount; or online organizations. Full-service brokers give advice to customers about the development of their investment portfolios, manage their investments and recommend which investments to buy. Discount firms generally do not offer advice about specific securities. Online brokerage offer their services through the internet, so that they are able to keep costs and fees at a low level. Moreover, brokerage firms also provide investment banking services, also advising businesses on merger and acquisition strategies. Finally, companies varying from very large mutual fund management to self-employed personal financial advisers or financial planners, which specialize in providing investment advice, portfolio management and trust, fiduciary and custody activities are also part of this sector.

The insurance sector is divided by type of activity, between life, property/casual and health. Moreover, it is also possible to distinguish different distribution channels used by insurance companies in order to offer their products, such as: direct response marketing, by selling a policy directly to the insured; agents, who may be captive, representing just one insurance company, or independent, representing more than one insurance company; internet.

The money services business sector is very large and diverse, ranging from very large and international companies, to small convenience stores in inner city neighborhoods. This sector encompasses: money transmitters; currency dealers and exchangers; check cashers; issuers of traveler's checks, money orders or stored value; and sellers or redeemers of traveler's checks, money orders or stored value.

The DNFBP group is comprised of accountants, casinos, dealers in precious metals or stones, lawyers and other independent legal professionals, notaries public, real estate agents, trust and company service providers and the non-profit sector.

Accountants can be: public accountants, who provide accounting and auditing services on a fee basis; certified public accountants, who are accountants that have received a qualifying certificate from an authorized state entity; and accounting firms, which also provide financial and investment advice. Apart from their gaming facilities and services, casinos provide financial services, such as customer deposit or credit accounts and receiving transfers directly from other institutions. Dealers in precious metals or stones show great differences in size, in the sources of supply and in the business models used, varying from single artisan goldsmiths to publicly traded manufacturers and from large-scale producers to small dealers that sell unique and rare gemstones on an individual basis. Lawyers need to be licensed by an appropriate authority, such as a bar association.

The Financial Crimes Enforcement Network (FinCEN) is the administrative FIU of the USA. It was created in 1990 by the U.S. Department of the Treasury, where it still belongs today, in order to "provide a government-wide multisource financial intelligence and analysis network"[9].

In practice, FinCEN main functions are: to receive and maintain financial transactions data; to analyze and disseminate that data for law enforcement purposes; and to build global cooperation with counterpart organizations in other countries and with international bodies. In addition, FinCEN administers the Bank Secrecy Act (BSA), as amended by Title III of the USA PATRIOT Act of 2001, along with other legislation (FinCen Annual Report, 2010).

The BSA was instituted in 1970 and requires financial institutions from the USA, such as banks and insurance companies, to detect and prevent money laundering, by applying a series of procedures in their activities. Financial institutions are, therefore, obliged to keep records of cash purchases of negotiable instruments, while reporting cash transactions exceeding USD 10.000 (daily aggregate amount) and any other suspicious activity[10].

The USA PATRIOT Act of 2001 was established after the 9/11 terrorist attacks in the USA, enlarging the scope of the BSA by covering terrorism financing and money laundering. This Act has

[9] http://www.fincen.gov/about_fincen/wwd/
[10] http://www.fincen.gov/statutes_regs/bsa/

brought additional responsibilities to the FinCEN, as it acquired new authorities and relevance in the U.S. Treasury Department[11].

The main legislation against money laundering and terrorism financing in the USA is comprised of Title 18 USC 1956 and 1957 for the first crime and of Title 18 USC 2339A, 18 USC 2339B and 18 USC 2339C for the last one. In addition, the USA PATRIOT Act, established in 2001, amended some of the existent laws and regulations, enforcing the power of FinCEN and the Secretary of Treasure.

However, Title III will be the only one from the USA PATRIOT Act addressed in this literature review, as it is the most relevant one in terms of the AML/CTF framework. It is divided in three subtitles: A - international counter money laundering and related measures; B – BSA amendments and related improvements; and C – Currency Crimes and Protection (USA PATRIOT Act).

Title 18 USC 1956 – Laundering of monetary instruments defines what is considered money laundering in subsections (a)(1)(A) (i) and (ii), (a)(2) (A) and (B)(i) and (a)(3) (A) and (B). These are followed by the penalties consequent to the practice of money laundering: the offender has to pay the greater value between the property, funds or monetary instruments involved in the transaction and USD 10.000. In the case that the crime was enacted along with the avoidance of the transaction reporting requirement under State or Federal law, the offender is subject to a fine of a maximum of USD 500.000 or twice the value of the property, funds or monetary instruments involved in the transaction and/or the imprisonment of the offender for a maximum of 20 years. Title 18 USC 1957 - Engaging in monetary transactions in property derived from specified unlawful activity, contrary to section 1956, criminalizes the proceeds of crime without the additional requirement that this spending be accompanied by the relevant criminal intent, as long as the monetary transaction at discussion has a value greater than USD 10.000 and derives from a specified unlawful activity. The penalty for this crime is a fine under Title 18 of the United States Code or, in the case the court finds it more appropriate, a fine of a maximum of twice the amount of the criminally derived property involved in the transaction, which can be coupled with imprisonment for a maximum of 10 years.

Title 18 USC 2339A – Providing material support to terrorists, as the Title’s designation indicates condemns everyone who “provides material support or resources or conceals or disguises the nature, location, source, or ownership of material support or resources, knowing or intending that they are to be used” (Title 18 USC 2339A (a)) in any kind of terrorist act. The penalty for this crime includes a fine and an imprisonment of at most 15 years, which can rise to an indefinite one if the terrorist act results in

[11] http://www.fincen.gov/statutes_regs/patriot/

the death of any person. Title 18 USC 2339B - Providing material support or resources to designated foreign terrorist organizations defines that anyone that incurs in this unlawful conduct knowingly of the involvement of the organization in terrorist activities shall be fined and/or imprisoned for no more than 15 years, or in the same case as before, for any period deliberated by the court if any person dies as a result of the terrorist act. If the offender is a financial institution which knowingly has in its possession funds related with terrorist organizations, the referred institution shall be fined in the higher amount between USD 50.000 and twice the amount of the referred funds. Finally, Title 18 USC 2339C – Prohibitions against the financing of terrorism defines that anyone who attempts, conspires or acts directly or indirectly willingly and unlawfully in order to provide or collect funds to be used by terrorist organizations or in terrorist acts, shall be fined and/or imprisoned for a maximum of 20 years. Also, this Title establishes that anyone that knowingly conceals funds to be used in terrorist acts shall be fined and imprisoned for no more than 10 years.

Concerning the USA PATRIOT Act, Subtitle A from Title 3 is comprised of sections about the duties of North American companies, national and international cooperation and duties when in a business situation with a foreign company of primary money laundering concern (USA PATRIOT Act).

Section 312 displays the changes in legislation on CDD, where the duty of due diligence is explained, as well as the steps to be taken in an enhanced due diligence process, which shall be followed when the counterpart is under an offshore banking license or when it is under a banking license issued by a foreign country that has been designated either as non-cooperative to international AML procedures or principles or by the Secretary of Treasury as warranting special measures due to money laundering concerns. Another duty is established in Section 326, the duty of identification and verification of accountholders. Related to this Section, there are three minimum requirements: financial entities need to verify the identity of any person that wishes to open an account; those entities also need to maintain records of the information respecting to all their clients, in order to verify a person's identity; and consulting lists shall be provided to financial entities with information about known or suspected terrorists and terrorist organizations by any government agency (USA PATRIOT Act).

Section 314 regulates the national cooperation among financial institutions, regulatory authorities and law enforcement authorities in what concerns information sharing about individuals, entities and organizations involved in suspicious activities or transactions. In terms of international cooperation, there are sections 328 and 330 on the identification of originators of wire transfers and investigations of money laundering, financial crimes and the finances of terrorist groups, respectively. Section 311 contains the special measures to be taken whenever a financial institution is operating outside the USA with an entity of primary money laundering concern. Financial entities shall: keep records of the identity of the participants in the transaction, as well as the identity of the beneficial owner of the funds involved and a description of the transaction itself; keep information on certain payable-through accounts and on certain correspondent accounts, as asked by the Secretary, with the identity of the client and which is comparable to that which the depository institution obtains in the ordinary course of business with respect to its customers residing in the USA (USA PATRIOT Act).

Subtitle B relates to modifications made to the BSA, including amendments relating to reporting of suspicious activities, which establishes that, in most cases, the identity and the content of the report itself must be kept secret from all the actors in the transaction, independently of who has made the report. Finally, Subtitle C regulates on crimes related to cash smuggling and currency counterfeiting with foreign countries and inside the USA (USA PATRIOT Act).

III. METHODOLOGY

1. Conceptual Framework and Hypothesis Formulation

As explained before, money laundering and terrorism financing are very dangerous phenomena worldwide due to the values involved and the organization evident in each offence. Therefore, given the last developments concerning the data gathering on these crimes, the official organizations AML/CTF have established rules and regulations against them, such as the FATF Recommendations and Special Recommendations, followed by the evaluation of each country's compliance with the third mutual evaluation report, in 2006. Figure 1, shown below, illustrates the differences between both countries in study in this dissertation – Portugal and the USA, as well as the exploratory hypothesis in study.

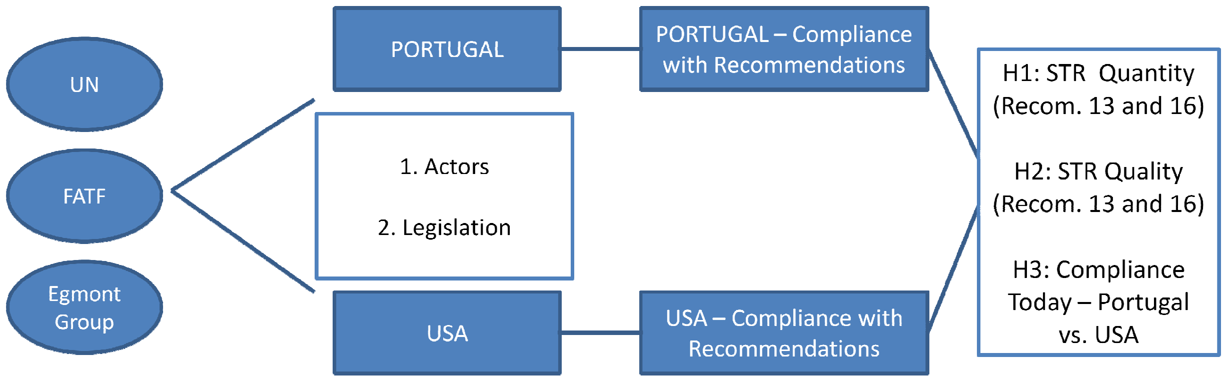


Figure 1: Conceptual Framework

Research Question 1: What is the impact that more legislation and greater awareness of the problem of money laundering have in terms of the reports delivered by subject entities?

Concerning the levels of compliance of these countries, both have discrepancies between their financial entities and DNFBP's compliance levels, with the last ones being much less compliant than the first group.

An example of this difference is observed in the STR or SAR reports presented by the obliged entities. Furthermore, the problem with the filling in of these reports is not only about the quantity, but also the quality, meaning that not always the reported transactions are truly suspicious, which by law is one of the premises that needs to be verified for the report to be made in both countries (besides the total amount of the operation).

<u>H1</u>: Concerning the environment described in research question 1, the number of STR's or SAR's filled in will increase.

With a more focused legislation and a greater awareness of the phenomenon of money laundering, it is possible to reach the conclusion that the better informed people inside the obliged entities are, the greater the number of reports filled in would become, due to their better evaluation of the money laundering suspicious situations.

However, if the number of reports being filled in was higher than it would be necessary, due to the lack of knowledge of the ones filling in the reports, the total number of reports can also decrease. In reality, in the medium to long term, quantity is expected to slowly decrease to an almost constant state as the quality of the reports increases, similar to a learning curve effect.

<u>H2</u>: Concerning the environment described in research question 1, the quality of the STR's or SAR's filled in will increase.

It would be expected that with a better legislation and more information about the problem, the people involved would produce better results.

<u>Research Question 2</u>: After the changes performed since 2006, what can be taken from the USA case in order to improve the Portuguese reality, in terms of its level of compliance with the FATF Recommendations?

FATF Recommendations and Special Recommendations are addressed by the assessed countries with the objective of improving their evaluated situation, increasing the number of compliant recommendations. This evolution is monitored by FATF, which produces reports every two years in order to provide information on the progress of each country's situation, depending on the reports sent by the countries themselves on the legislation changes, for example. However, it is important to denote that these reports are not equal to the ones from mutual evaluations, which only happen every 6 years, with the next being scheduled to 2012.

After these biennial reports on the Portuguese situation, it becomes imperative to compare the current compliance situation of both countries, providing guidance to possible ways of improving Portuguese compliance levels.

H3: Nowadays, the level of compliance with FATF Recommendations is similar in both Portugal and the USA.

After 5 years and almost in a year of a new mutual evaluation, it is expected that Portugal has already solved, if not all, most of the non-compliant status recommendations. If this is not the case for all of them, the USA may have possible solutions to Portuguese problems.

2. System Compliance with FATF Recommendations

According to each country's individual level of compliance of the FATF Recommendations and Special Recommendations, FATF has attributed a degree of compliance to each recommendation for both Portugal and the USA (see Appendix 2 – Table 5). This analysis will allow for a study on the evolutionary trends of the levels of compliance of both countries, in addition to the understanding of how the situation was immediately after the third mutual evaluation in 2006.

Portugal is: totally compliant (C) with recommendations 4, 8, 10, 14, 19, 20, 28, 35, 36, 37, 38, 39 and 40; largely in compliance (LC) with recommendations 1, 2, 3, 5, 11, 13, 15, 17, 18, 21, 22, 23, 26, 27, 29, 30, 31 and with special recommendations II, IV, V, VI, VIII and IX; partially compliant (PC) with recommendations 7, 12, 16, 24, 25, 32, 33 and 34 and with special recommendations I, III ; and non-compliant (NC) with recommendation 6 and with special recommendation VII. In this reality, Recommendation 9 does not apply, as financial institutions are not allowed to rely on intermediaries or other third parties to perform some elements of the customer due diligence process.

On the other hand, the USA is: totally compliant (C) with recommendations 2, 4, 14, 18, 19, 20, 25, 27, 28, 29, 37 and 40 and with special recommendations II, VIII and IX; largely in compliance (LC) with recommendations 1, 3, 6, 7, 8, 9, 10, 11, 13, 15, 17, 21, 22, 23, 26, 30, 31, 32, 35, 36, 38 and 39 and with special recommendations I, III, IV, V, VI and VII; partially compliant (PC) with recommendations 5 and 24; and non-compliant (NC) with recommendation 12, 16, 33 and 34.

Both countries show fairly good compliance levels with FATF Recommendations and Special Recommendations, as shown in the graphs[12] presented below, where it is also possible to verify that both countries totally or largely comply with the majority of the recommendations proposed by FATF.

[12] Based on the information from Table 5 of Appendix 2.

Although the USA has a higher weight on NC recommendations, it also has the higher percentage of LC and C recommendations (85%). On the other hand, Portugal has its weights divided between PC, LC and C recommendations (97,4%) (see Appendix 1 – Table 3).

Figure 2: Level of Compliance with FATF Recommendations

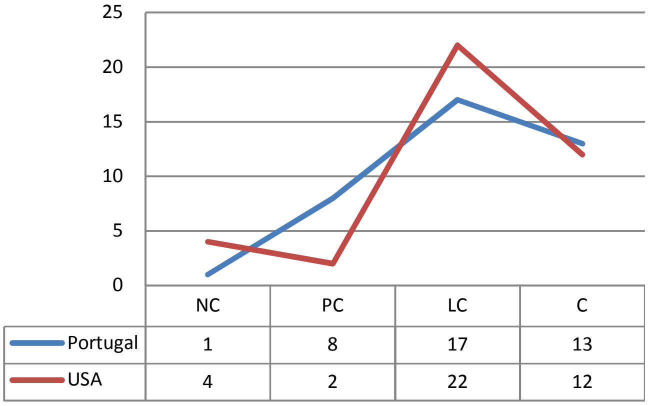
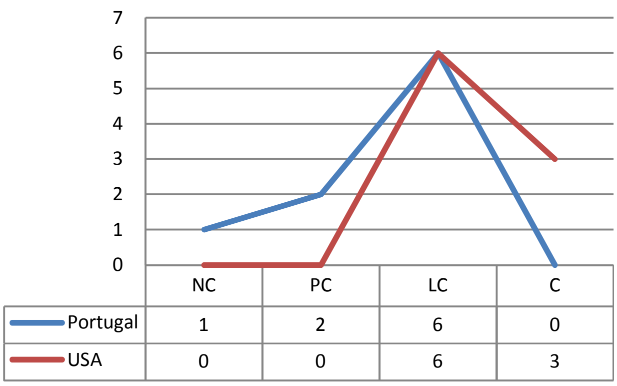


Figure 3: Level of Compliance with FATF Special Recommendations



In terms of Special Recommendations, the USA's situation is much more favorable than the one of Portugal, as the first has a high level of compliance (100% of LC and C special recommendations), while Portugal do not have any C special recommendations, having the most special recommendations rated as LC (66,7%) (see Appendix 1 - Table 4).

3. Sources and Data Collection

In order to compare Portugal and the USA in the hypothesis defined, an exploratory study will be performed.

In the research presented in the following chapter, both descriptive and quantitative data will be used, in order to have a well supported reasoning. All the data collected and used here on depictures faithfully both the Portuguese and the American realities, as it was gathered from institutional and reliable sources.

With the purpose of testing H1, data was collected from UIF and FinCEN reports concerning the number of STR's made by obliged entities in the period from 2006 to 2010. The data collected was organized in tables and later used to create graphs that show the future evolution of the variable in study. One should take into consideration when observing the results presented in the next chapter that the data referring to the USA Fiscal Year represents the period starting in October 1st and ending in September 30th, while in Portugal the Fiscal Year goes from January 1st to December 31st.

In the case of H2, the information collected about the number of investigations was taken from the Criminal Investigation figures, present in the IRS website, for the USA and from the UIF annual reports for Portugal, while the data on the number of reports came from H1. With these statistics a ratio was formed – report quality ratio – which indicates the quality of the reporting of each country in the period being studied. Again, a graphical analysis was made to verify the evolution of the results.

Finally, addressing H3, the data collection was made from the updates of 2008 and 2010 to the FATF third mutual evaluation report for Portugal and from the FATF mutual evaluation reports of 2006 for Portugal and the USA. This information was analyzed, in what concerns the recommendations in study in this hypothesis, in first place to create the table on the compliance evolution in Portugal, with the data available on the reports from 2008 and 2010, and then to create a comparative perspective between both countries in terms of what can be extracted from the USA case to the Portuguese reality.

IV. RESULTS AND DISCUSSION

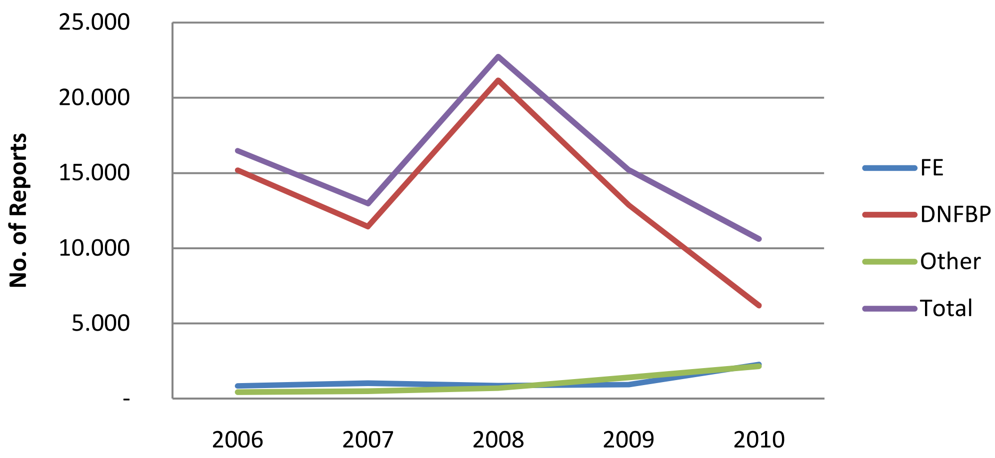
In this chapter the data, both descriptive and quantitative, and the results obtained with its treatment will be analyzed in order to reach concrete conclusions that are able to clarify the hypothesis and answer the research questions proposed in the previous chapter.

1. Reports Evolution

<u>Portugal</u>

Since the third mutual evaluation in 2006, there were some changes in the Portuguese AML/CTF environment, in order to comply with the recommendation made by FATF. Besides the tangible modifications in legislation, for instance, with the revocation of Law 11/2004, of 27 March, and the establishment of Law 25/2008, of 5 June, there was an increase in consciousness of the extent of crimes such as money laundering, although reporting and convictions are still at a lower level than expected [13].

Figure 4: Total Reports - Portugal



Source: UIF (2006); UIF (2007); UIF (2008) ; UIF (2009) ; UIF (2010) (adap.)

In Portugal, as illustrated in the graph above, the total number of STR's had its peak in 2008, having decreased every year since then (see Appendix 3 – Table 6). Greatly responsible for that reduction were the DNFBP's, which reports correspond to the majority of reports, being approximately 90% of total reports in most of the period in analysis (see Appendix 3 – Table 7), following the trend of

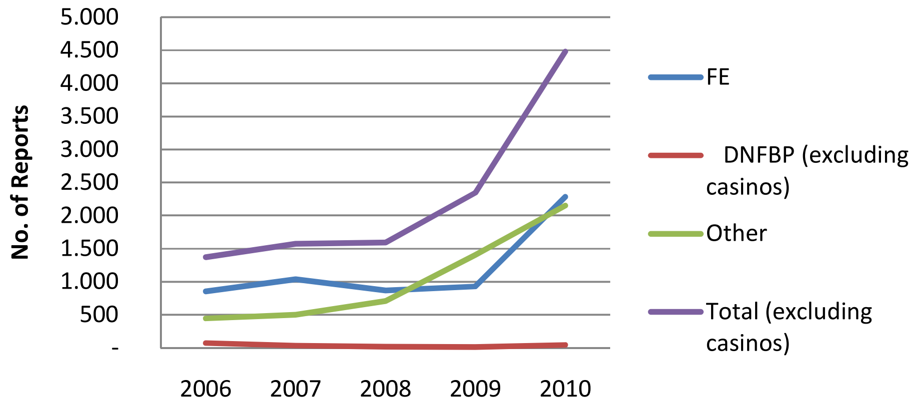
[13] http://www.inverbis.net/tribunais/branqueamento-capitais-condenacoes.html

the total. With much lower numbers appear financial entities (FE) and Other[14], even though both of these sectors have increased their responsiveness during the period in study.

However, when one closely analyzes DNFBP's reports, it is perceivable that they do not all result from suspect operations. In fact, many times, they "do not present any reason for suspicion other than the amount of the transaction"(UIF, 2010), which is insufficient, as the operation has to be suspicious by itself. An especially representative example of these entities are casinos, since these obliged entities have one of the greatest percentages of reports that do not result in any suspicious activity. Since 2006 and until 2009, from 60.504 STR's from casinos, no operation has been marked as suspicious (UIF, 2006; UIF, 2007; UIF, 2008; UIF, 2009).

With the great influence that DNFBP's have on the total number of reports, along with the large impact of casinos' STR's inside this figure, what would be the modifications seen in the total reports graph when analyzing this reality without the influence of casinos' reports?

Figure 5: Total Reports - Portugal (excluding Casinos)



Source: UIF (2006); UIF (2007); UIF (2008) ; UIF (2009) ; UIF (2010) (adap.)

In effect, casinos' reports were severely influencing the total number of reports, not only in quantity and quality, but also in their quantity evolution in time. Without counting these reports, the total number of reports is increasing in Portugal since the third mutual evaluation, with FE's being the

[14] Customs are always considered as in the Other group in this dissertation, once they are not subject entities, reporting without obligation, while in the annual reports of the Portuguese FIU they only belong to the Other group in 2010.

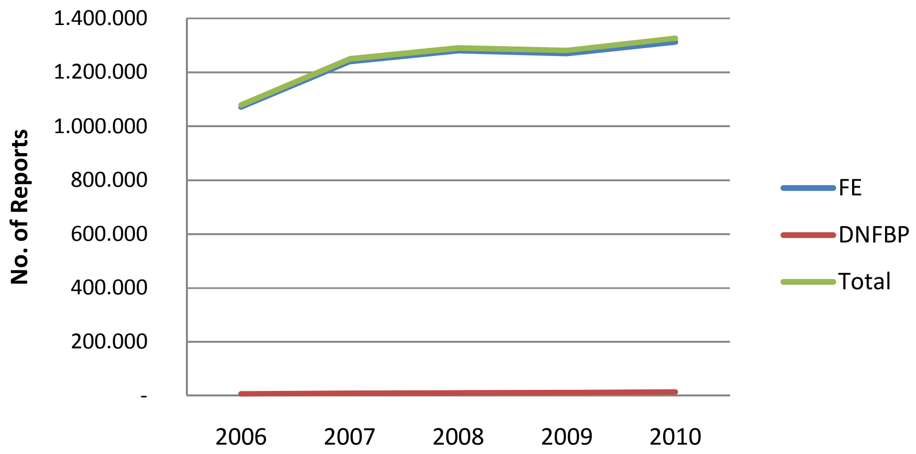
entities with the most reports filled in during most of the time, together with a great increase in the reports of Others in 2010. Excluding casinos, DNFBP's represent only a very small portion of the total number of reports (see Appendix 3 – Table 6)[15].

USA

In the USA the situation is different from Portugal, not only because the universe of obliged entities reporting is much bigger, but also because these reporting entities differ in some aspects from Portugal.

According to the third mutual evaluation report on the USA, one of the main topics of Recommendation 16's faults is the fact that the only sector of DNFBP's that reports suspicious transactions in the country are casinos. Furthermore, only recently (since 2003) have the insurance sector companies started to comply with the reporting requirement, which makes it more difficult to gather information on the development of money laundering crimes.

Figure 6: Total Reports - USA



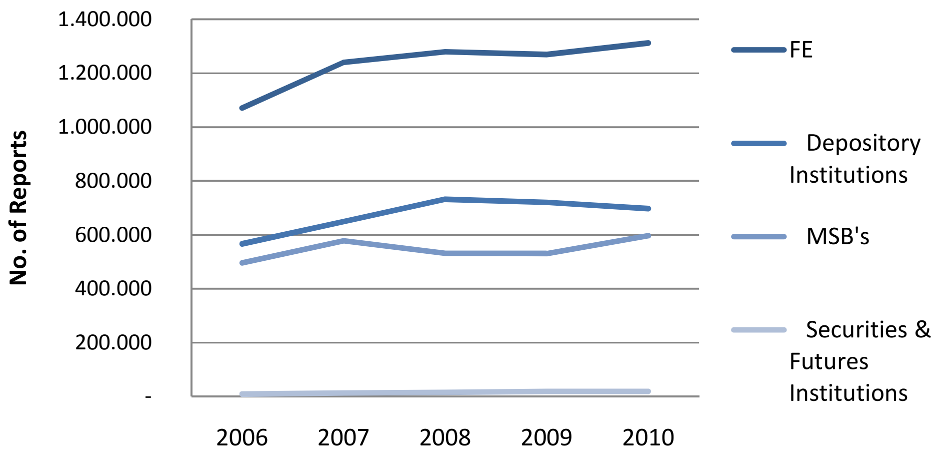
Source: FinCEN (2011) (adap.)

Besides the distinctions from the Portuguese reality already pointed out, from the graph above it is possible to conclude that FE's are the main sector reporting suspicious operations, with DNFBP's being responsible only for a small portion of the reporting activity, as they are only constituted by the casinos' sector.

[15] It is important to denote that this observation (about casinos in Portugal) does not have the objective of discouraging DNFBP's or casinos themselves from reporting suspicious activities as they find suitable. However, this way of reporting, as it has been done in the years in study, becomes unfruitful for the analysis of the total number of reports and its evolution and also very difficult to investigate for the authorities, due to its size and to the heavy weight that would be put onto the investigation infrastructure.

Excluding the year of 2009, the number of requests has always been increasing, with both FE's and DNFBP's being responsible for that rise (Appendix 3 – Table 8). However, even though DNFBP's reports have continued to grow in 2009, the overwhelming size of the FE report sample (always close to 100%, although dropping – Appendix 3 – Table 9) provoked the decrease in the number of reports in the last couple of years. This high significance of the FE sector deserves greater attention.

Figure 7: Reports from FE - USA



Source: FinCEN (2011) (adap.)

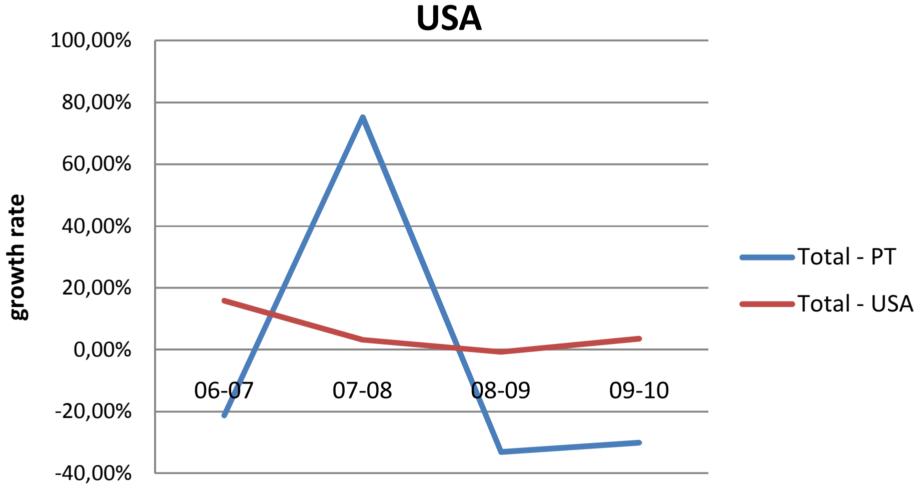
When addressing each sector inside the FE group, it is visible that all of them display distinct patterns of growth, with an almost inverse variation between depository institutions and MSB's from 2007 onwards. Moreover, in the FE group, the hierarchy of sectors with the highest number of reports has remained unchanged, with depository institutions at the leading position and securities and futures institutions much lower than the other two sectors (see Appendix 3 – Table 8).

Summarizing, the main differences between Portugal and the USA in this matter are the opposite proportions for each group, FE's and DNFBP's, the obliged entities which report and the great difference in terms of size between both countries, as seen in table 1 below.

Table 1 – Differences Between the Reporting Situation in Portugal and the USA	
Portugal	USA
• DNFBP's have a total number of reports much higher than FE's • Every entity mentioned in the Literature Review chapter is obliged to report every suspicious activity, every time that activity respects the parameters defined by law • The highest number of reports made in a year was of 22.733.	• FE's represent almost 100% of the reporting entities • All the FE's report, although insurance companies do it for only a few years. In the DNFBP group only casinos report suspicious activities • In 2010 1.326.628 reports were filled in and, since 2006, the total number of reports was always higher than 1M.

Due to the huge difference in size between both countries, it would not be accurate to compare them using absolute values. Hence, yearly growth rates will be used to express the distinctions between these economies.

Figure 8: Total Reports Variation: Portugal vs. USA



As presented in the graph above, Portugal has had a much higher growth rate of the number of reports from 2007 to 2008, a period in which the USA has maintained its values almost constant. However, as explained before, this great variation in the Portuguese situation occurred as a result of the reporting from DNFBP's, in particular casinos. From that period on both countries have been decreasing their number of reports, although the decrease rate is much lower for the USA than for Portugal, excluding the last period, in which the USA has inverted its previous tendency, having grown slightly (see Appendix 3 – Table 10).

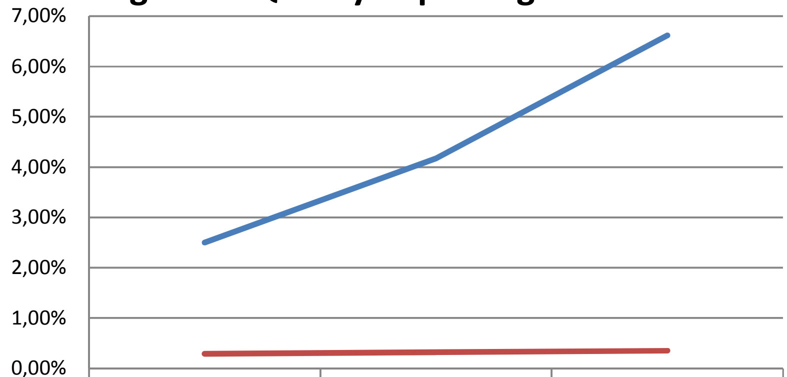
2. Reports Quality

Besides the total number of reports evolution analysis, it is also important to evaluate the reports quality level. Thus, the following ratio will be used, as a measure of ratio quality:

$$\textbf{Quality Reporting Ratio} = \frac{\text{Total No. of Investigations}}{\text{Total No. of Reports}}$$

The Quality Reporting Ratio determines the number of investigations that are started for each report that is filled in. Ultimately, this ratio shows if the reports being sent are really suspicious money laundering or terrorism financing situations.

Figure 9: Quality Reporting Ratio



	2008	2009	2010
Portugal	2,50%	4,17%	6,62%
USA	0,29%	0,32%	0,35%

After applying this ratio to the countries being studied it is possible to say that Portugal is in a better situation concerning the quality of its reporting. In fact, while the USA has much more reports due to its larger structure and size, they are not all relevant for investigation.

Furthermore, Portugal's curve has a greater slope than the one of the USA, indicating that the first one's reports quality is increasing more than the last. In fact, the USA is almost constant in terms of report quality as its values only very slightly change (Appendix 4 – Table 11 and 12).

3. Improving Compliance Levels

a. Portuguese Evolution

Before the comparison between Portugal and the USA, it is pivotal to verify which were the changes made in terms of the level of compliance of Portugal to the FATF Recommendations since 2006.

Mostly until the end of 2008, many changes have been made, especially in the Portuguese AML/CTF legislation, in order to turn the recommendations which were rated NC or PC in 2006 to a state of compliance. Table 2 below lists the recommendations to which Portugal was rated NC or PC in 2006 and the main changes made from that year until the end of 2010:

Table 2 – **Portuguese Actions to Comply with FATF Recommendations**

Recommendation No.	Main Actions Taken:
6 – Politically Exposed Persons	• Enhanced Due Diligence requirements were defined in Law 25/2008, of 5 June • The same Law also determines a detailed definition of PEP • Law 25/2008, of 5 June, establishes an enhanced due diligence duty for transactions with foreign PEP's • Finally, the regulatory institutions (BdP, CMVM and ISP) issued regulations requiring financial institutions to obtain information from their clients in a business relationship.
7 – Correspondent Banking	Law 25/2008, of 5 June, institutes an enhanced due diligence to financial institutions every time these establish correspondent banking relationships with foreign institutions.
12 – DNFBP (R. 5, 6, 8-11)	• All the DNFBP's are subject to the Portuguese AML/CTF legal framework, being addressed in Law 25/2008, of 5 June, all the duties towards AML and CTF and the CDD measures needed to be taken in any suspicious transaction • Also, the PEP definition and the enhanced due diligence obligation include DNFBP's.
16 – DNFBP (R. 13-15 & 21)	• Law 25/2008, of 5 June, clarifies that neither the Bar Association nor the Chamber of Solicitadores retain information on the reporting of suspicious transactions to the FIU and the Attorney General of the Republic made by lawyers and solicitadores • Several training sessions were provided to the workers from DNFBP's, such as the ones from the Chamber of Solicitadores, the Service of Gambling Inspection, the Chamber of Chartered Accountants, the Order of Statutory Auditors and the Institute for Registers and Notaries • Law 25/2008, of 5 June, also enforces DNFBP's supervision authorities to

	issue warnings with the identification of countries and jurisdictions that do not apply the FATF Recommendations in a satisfactory manner, making it compulsory for DNFBP's to identify the country of origin of their counterpart in any foreign transaction • Finally, from 2008 to 2010 the number of sanctions for DNFBP's has risen.
24 – DNFBP – Regulation, Supervision and Monitoring	Until 2008: • Until the issuance of Law 25/2008, of 5 June, ASAE was the institution with the most important number of DNFBP's, such as the real estate sector and the exchange of high value goods • The INCI (Institution for Construction and Real Estate) was created in order to manage reports coming from the real estate sector, in the place of ASAE • Finally, the Statutory Auditors Statute was adapted in conformity with Law 25/2008, of 5 June, and with the internal law of Directive no.2006/43/EC, of 17 May. Until 2010: • The INCI, the Institute for Registrars and Notaries, the Bar Association and the Chamber of Solicitadores, the Order of Chartered Accountants and the Order of Statutory Auditors each published pieces of information, in order to raise the awareness of the people in each of these DNFBP sectors.
25 – Guidelines & Feedback	• Most DNFBP's oversight authorities have developed guideline reports, already referred in Recommendation 24. In addition to the entities mentioned, the ASAE and the Gambling Inspection also issued in 2008 those same reports • The feedback on the results and follow-up of the communications on money laundering and terrorism financing from the reporting entities is in charge of the Portuguese FIU. In practice, this already happened prior to 2008, but it was only legislated on that year.
32 – Statistics	• The General Directorate for Justice Policy, responsible for the justice and law enforcement statistical data, has started a reformulation of the Statistics Information System, with data being collected from the cases present in court, defendants and convicted persons in criminal courts of first instance

	• The main information collected consists of the amount of frozen, seized and confiscated assets for the State, the amount of money laundering enquiries, accusations and convictions, the number of crimes of terrorist organizations and the number of cross-border cash declarations, for example.
33 – Legal Persons – Beneficial Owners	Besides the existing obligation for companies to register in the National Registry of Legal Persons and, for commercial companies, in the Commercial Register, where all the information about the company and its owners is stored, Law 25/2008, of 5 June, requires from the obliged entities the identification of the beneficial owner of legal persons.
34 – Legal Arrangements – Beneficial Owners	• Even though trusts are not contemplated in the Portuguese legislation, they are allowed in the Madeira Free Trade Zone • In this territory, there is a Commercial Register Department of the Free Trade Zone, responsible for the management of the registries of trusts in the Madeira Free Trade Zone, which is also subject to the AML/CTF Law 25/2008, of 5 June, being obliged to report any suspicious operations regarding the creation or management of trusts.

Source: FATF (2008); FATF (2010)

In effect, with the actions enumerated before, Portugal has become either totally compliant (C) or largely compliant (LC) with all FATF Recommendations, as these changes correspond to most of the topics pointed out by the FATF in the third mutual evaluation report.

The same applies to FATF Special Recommendations, which were not mentioned in the previous table, because most of the changes performed (in the ones that Portugal was NC or PC) were originated by UE regulations, such as Regulation (EC) no.1781/2006 of the European Parliament and the Council, of 15 November, which became effective in European countries after its approval (FATF, 2008; FATF, 2010).

b. Comparison with the USA

Firstly, it is important to refer that, in order to improve the Portuguese levels of compliance, the comparison will be made exclusively between recommendations which level of compliance is higher in the USA than in Portugal.

According to the 2006 levels of compliance of both countries, the recommendations corresponding to this condition were: 2, 6, 7, 18, 25, 27, 29 and 32. However, nowadays the situation has changed, as explained in table 2, thus reducing the number of recommendations available for a comparison.

Recommendations 6 and 7, which were NC and PC in 2006, respectively, are now totally compliant after the modifications explained previously. Recommendation 18 has become C, due to the creation of article 30 of Law 25/2008, of 5 June, referring to shell banks. Recommendations 2, 27 and 29 only have effectiveness issues preventing total compliance, with recommendation 2 being the one with the greatest developments in the latest years, since the legal persons' liability in cases of money laundering is now established in article 46 of Law 25/2008, of 5 June.

Therefore, recommendations 25 and 32 are the ones that can benefit from the comparison between Portugal and the USA[16]. Although these have already been modified from 2006 to 2010, they still need some adjustments in order to be totally compliant.

Recommendation 25

In terms of the issuance of guidance reports, the main distinction between both countries is that the USA started informing its DNFBP's about the AML/CTF framework much sooner than Portugal. In fact, while Portugal started elaborating guidance reports for its DNFBP's after the establishment of Law 11/2004, of 27 March, the USA elaborated its first AML/CTF guidance report in 1998. Furthermore, in 2004, the only DNFBP's oversight entities that issued guidance reports specific for their sector were the IGAE (now ASAE) and the IGJ. In the USA, by 2004, sectors inside the DNFBP's which already had several guidance reports included casinos, dealers in precious metals and stones and lawyers.

These different traits in both countries show that North American DNFBP's were informed sooner of their obligations when dealing with money laundering situations, which may have given them a greater know-how about suspicious situations.

Nonetheless, today both countries are increasingly closer in terms of DNFBP guidance, as Portuguese oversight entities have already issued specific sector reports in several sectors, as shown in Table 2. Even so, besides publishing sector specific reports, DNFBP oversight entities could promote educational conferences, similarly to what happens in the USA with Lawyers, for example. These conferences are focused mainly on compliance issues and the impact that AML laws have on the specific activities of each sector (FATF, 2006 - USA).

[16] Although today the Portuguese level of compliance with recommendation 32 is similar to the one in the USA, a comparison of the present situation is important due to the poor statistic evidence in Portugal until the third mutual evaluation in 2006.

Recommendation 32

Concerning the statistics gathered, the situation of both countries in terms of their compliance is fairly similar to the one enunciated for recommendation 25. The USA has begun detailing AML/CTF statistics for a longer period, having nowadays more detailed information.

However, Portugal has immensely progressed, especially since the third mutual evaluation of 2006. Nowadays, both countries have very similar statistics reported in general, such as the number of money laundering enquiries, accusations and convictions or the amount of reports received by each FIU. The main sources of statistics in both cases are the FIU's reports, FinCEN for the USA and UIF for Portugal.

Between the information provided by these FIU's the great difference is the depth to which the reports from each of the reports go into. While the Portuguese reports have the number of reports made to the FIU and, in some years, the distribution of these reports by region, the North American reports detail the information by month and by state, both separately and together.

V. MAIN CONCLUSIONS

1. Conclusion

<u>Research Question 1</u>: What is the impact that more legislation and greater awareness of the problem of money laundering have in terms of the reports delivered by subject entities?

<u>H1</u>: Concerning the environment described in research question 1, the number of STR's or SAR's filled in will increase.

Firstly, it is important to refer that, from 2006 to 2010, the total number of reports has increased in the first years in the USA, being now almost constant, without having a clear trend in Portugal. However, when removing casinos from the universe of reporting entities in Portugal (according to the logic explained in the previous chapter), the total number of reports increases substantially.

Moreover, assuming this situation for Portugal, financial entities are the main reporting sector in both countries. DNFBP's are well below the financial entities mark in the USA and in Portugal, being almost constant, which evidences a situation that needs to be addressed, with better information for the obliged entities of this sector. Logically, with casinos in the picture, DNFBP's are always the sector with most reports in Portugal, although in this case, they do not evidence any trend in terms of increase or decrease of the number of STR's.

<u>H2</u>: Concerning the environment described in research question 1, the quality of the STR's or SAR's filled in will increase.

In terms of the quality of the reports filled in, Portugal is in a better situation than the USA. In fact, Portugal displays an increasing quality report ratio during the whole period in study, which, with less obliged entities in conditions to report suspicious activities in terms of money laundering and terrorism financing than the USA, is superior to the almost constant and very low ratio for the USA.

Therefore, the possibility of the decrease or the maintenance of a constant number of reports due to the quality level being sufficiently high is not happening in any of the countries. While Portugal is still increasing its quantity and quality of reports, both at the same time, the USA has still to improve the quality of the reports sent, although it already has a relatively stable number of reports being sent to the authorities.

<u>Research Question 2</u>: After the changes performed since 2006, what can be taken from the USA case in order to improve the Portuguese reality, in terms of its level of compliance with the FATF Recommendations?

<u>H3:</u> Nowadays, the level of compliance with FATF Recommendations is similar in both Portugal and the USA.

Since 2006, a lot has changed in the level of compliance of Portugal to the FATF Recommendations, which were NC, PC and LC. The country has evolved greatly in terms of legislation, training and on the statistics presented.

Nevertheless, even though the evolution has been positive, it is still possible to improve some aspects of the Portuguese reality. It was verified that some of these aspects were present in the USA situation. That was the case with guidance and guideline reports (recommendation 25) and statistics (recommendation 32). In the first one, the suggestion proposed is the creation of educational conferences for DNFBP's, focused on compliance issues, since these entities have greater difficulties in the identification of suspicious money laundering activities. In the second one, although both countries are already similar in terms of the information presented, Portugal could also cross information between the monthly amount of reports and the Portuguese geographical region where it took place.

Finally, although there are still remarks to be done to the Portuguese compliance situation, it needs to be highlighted that the USA and Portugal are now becoming increasingly similar, when comparing their compliance levels, especially in the recommendations in which the USA was much better than Portugal in the third mutual evaluation of 2006.

All in all, there is a positive evolution trend towards the full compliance with international regulations in both countries, along with the display of good local practices in terms of the prevention of money laundering and terrorism financing. On the other hand, both Portugal and the USA need to discover a suitable approach, so that the reporting situations are better judged by the obliged entities, especially for the DNFBP sector. This is vital, because even if a country has all the mechanisms put into practice, through laws and regulations for example, if a great number of its obliged entities does not act as they are supposed to, the regulations are not put into practice. This enhanced judgment will provide better information and more comprehensive statistics in what concerns the crimes of money laundering and terrorism financing.

2. Limitations and Future Research

The main limitation of this study was the little amount of information available about the topic studied, especially in a country-wide level. This is particularly true in the case of Portugal, where there is a scarce number of studies about the AML/CTF frameworks, either foreign or internal (the most in-depth ones are from the Portuguese FIU). Furthermore, in the existing reports, in both Portugal and the USA, the statistics are not as thorough as wanted by the authors due to the short responsiveness in terms of reporting, especially from DNFBP's.

In terms of future research about AML, at large, it is possible to perform a study discussing the distinct definitions of PEP, presenting the most suitable one as a solution. Another option is to study whether the costs related with the institution of measures to detect and prevent against suspicious transactions and activities, such as CDD and, in special cases, the enhanced CDD, are in line with the results obtained.

Additionally, in particular about the problem addressed in this dissertation, another future research possibility is to develop other quality report indicators, in order to test the results presented in this dissertation. In addition, a same study as the one presented here can be carried out having as subject of study the obliged entities of a specific sector (either financial entities or DNFBP's), so that it would be possible to determine the reasons for the amount of reports displayed in each of them, as well as the evolution exhibited in the last years.

VI. APPENDIX

Appendix 1: Level of Compliance with FATF Recommendations in 2006

Table 3 – **COMPLIANCE FATF RECOMMENDATIONS**				
	Portugal		**USA**	
NC	1	2,6%	4	10,0%
PC	9	23,1%	2	5,0%
LC	17	41,0%	22	55,0%
C	13	33,3%	12	30,0%
Total	39		40	

Table 4 – **COMPLIANCE FATF SPECIAL RECOMMENDATIONS**				
	Portugal		**USA**	
NC	1	11,1%	0	0,0%
PC	2	22,2%	0	0,0%
LC	6	66,7%	6	66,7%
C	0	0,0%	3	33,3%
Total	9		9	

Appendix 2: Recommendations and Compliance in Each Country

Table 5 - **Recommendations and Compliance in Each Country**

Recommendation No.	PORTUGAL		UNITED STATES OF AMERICA	
	Rating	Summary of Factors Underlying Rating	Rating	Summary of Factors Underlying Rating
		LEGAL SYSTEMS		
1. ML Offense	LC	The statistics that are available suggest doubts as to the effectiveness of the ML offenses in Portugal given the low number of convictions.	LC	• The list of domestic predicate offenses does not fully cover 2 out of the 20 designated categories of offenses specifically (insider trading and market manipulation and piracy) • The list of foreign predicate offenses does not cover 8 out of the 20 designated categories of offenses • The definition of "transaction" in s.1956(a)(1) means that mere possession as well as concealment of proceeds of crime , does not constitute the laundering of proceeds • The definition of "property" in relation to the section 1956(a)(2) offense (international money laundering) only includes monetary instruments or funds.
2. ML Offense – mental elements and corporate liability	LC	• Criminal liability for ML does not clearly extend to legal persons. However, law 11/2004 foresees a range of proportional and dissuasive sanctions that can be applied to legal persons. • The statistics that are available suggest doubts as to the effectiveness of the ML offenses in Portugal given the low number of convictions.	C	-
3. Confiscation and provisional measures	LC	Only a small amount of money has been confiscated which may reflect on the effectiveness of the system.	LC	• Where the proceeds are derived from one of the designated categories of offenses that are not domestic or foreign predicate offenses for ML, a freezing/seizing or confiscation action cannot be based on the money laundering offense • Property of equivalent value

				which may be subject to confiscation cannot be seized/restrained.
PREVENTIVE MEASURES				
4. Secrecy laws consistent with the Recommendations	C	-	C	-
5. Customer due diligence	LC	• There is no specific, explicit, requirement for CDD for occasional wire transfers that are not suspicious, under SR VII below €12,500 • Identification requirements for beneficial owners are not completely contained in law, but also in supervisors instructions • For some entities in securities sector that are not covered by BdP regulations (venture capital companies and securitization companies) the CMVM regulations do not explicit comply with some requirements regarding identification of beneficial owners of legal persons, ongoing due diligence, failure to satisfy complete CDD. There are no provisions for securities sector that impose the duty to scrutiny transactions undertaken throughout the course of the relationship to ensure that these transactions are consistent with the institutions knowledge of the customer, their business and risk profile and where necessary, the source of funds. Regulations for the securities sector do not provide explicit mention of the refusal to open accounts or carry out transactions, or to making a suspicious transaction report • In regard to low risk situations particularly the application of situations with EU and FATF members (when there is no suspicion of ML) some of the current exemptions mean that,	PC	• No obligation in law or regulation to identify beneficial owners except in very specific circumstances (i.e. correspondent banking and private banking for non-U.S. clients) • No explicit obligation to conduct ongoing due diligence, except in certain defined circumstances • Customer identification for occasional transactions limited to cash deals only • No requirement for life insurers issuing covered insurance products to verify and establish the true identity of the customer, (except for those insurance products that fall within the definition of a "security" under the federal securities laws) • No measures applicable to investment advisers and commodity trading advisors • Verification of identity until after the establishment of the business relationship is not limited to circumstances where it is essential not to interrupt the normal course of business • No explicit obligation to terminate the business relationship if verification process cannot be completed • The effectiveness of applicable measures in the insurance sector (which went into force on 2 May 2006) cannot yet be assessed.

		rather than reduced or simplified CDD measures, no CDD measures apply whatsoever for these cases • There is no explicit mention of TF in relation to the duty of CDD in suspicious transactions • Issue of effectiveness of the supervisors instructions due to the short period of time since their entry into force (June/July 2005).		
6. PEP's	NC	• There is no requirement for appropriate risk management systems to determine whether a potential customer, a customer or the beneficial owner is a PEP • There is no legal requirement for financial institutions to obtain senior management approval for establishing business relationships with a PEP nor to take reasonable measures to establish the source of wealth and the source of funds • It is not so clear about effectiveness in practice in part due to some confusion about national versus international PEPs.	LC	• Measures relating to PEPs do not explicitly apply to MSBs, the insurance sector, investment advisers and commodity trading advisors.
7. Correspondent banking	PC	• The obligation to gather information should be applicable to all respondent institution and not exempt institutions from EU members or FATF members. Article 2.8 of BdP Instruction 26/2005 does not include the explicit mention "including whether it has been subject to a ML or TF investigation or regulatory action." • The requirement to obtain approval from senior management is not set up in legislation or regulation • There is no regulation with respect to payable-through accounts.	LC	• No obligation to require senior management approval when opening individual correspondent accounts.
8. New technologies & non face-to-face	C	-	LC	• No explicit provision requiring life insurers MSBs, or investment advisers and commodity trading advisors to have policies and procedures

business				for non face-to-face business relationships or transactions.
9. Third parties and introducers	N/A	-	LC	• No explicit obligation on relying institution to obtain core information from introducer • No measures have been applied to investment advisers and commodity trading advisors, or the insurance sector.
10. Record keeping	C	-	LC	• Life insurers of covered products are only required to keep limited records of SARs, Form 8300s, their AML Program and related documents.
11. Unusual transactions	LC	• There is no regulation to set forth findings in writing for those entities falling only under the regulations and supervision of the CMVM.	LC	• In the insurance, and MSB sectors, there is no specific requirement to establish and retain (for five years) written records of the background and purpose of complex, unusual large transactions or unusual patterns of transaction that have no apparent or visible economic or lawful purpose (outside of the SAR, CTR and Form 8300 requirements) • No measures have been applied to investment advisers and commodity trading advisors.
12. DNFBP – R. 5, 6 and 8 to 11	PC	• The deficiencies in the implementation of Recommendation 5, 6 and 11 that apply to financial institutions also apply to DNFBPs • There are few implementation measures that clarify the specific obligations of DNFBPs (similar to regulations and circulars for financial institutions) • Portugal has not implemented explicit AML/CTF measures concerning PEPs applicable to DNFBPs • There is no requirement that DNFBPs have policies in place to deal with the misuse of technological developments (Recommendation 8) • More generally, the implementation of the FATF	NC	• Casinos are not required to perform enhanced due diligence for higher risk categories of customer, nor is there a requirement to undertake CDD when there is a suspicion of money laundering or terrorist financing (R.5) • Accountants, dealers in precious metals and stones, lawyers and real estate agents are not subject to customer identification and record keeping requirements that meet Recommendations 5 and 10 • None of the DNFBP sectors is subject to obligations that relate to Recommendations 6, 8 or 11 (except for casinos in relation to R.11).

		requirements (both ML and TF) by DNFBPs raises concerns given the low number of STRs submitted.		
13. Suspicious transaction reporting	LC	• The low number of STRs filed by the financial entities by a limited number of financial institutions raises the issue of effectiveness of the reporting requirement.	LC	• The existence of a USD 5,000 threshold for reporting suspicious activity • No measures have been applied to investment advisers and commodity trading advisors • The effectiveness of measures in the insurance and mutual funds sectors cannot yet be assessed.
14. Protection & no tipping-off	C	-	C	-
15. Internal controls, compliance & audit	LC	• There is no explicit regulation that the compliance officer should be at the management level • Training facilities for employees have been established but effectiveness could be improved especially in the insurance sector.	LC	• AML Program requirements have not been applied to certain non-federally regulated banks, investment advisers and commodity trading advisors • It is not yet possible to assess the effectiveness of these measures in the insurance sector • There is no obligation under the BSA for financial institutions to implement employee screening procedures.
16. DNFBP – R. 13 to 15 and 21	PC	• All DNFBPs are subject to comprehensive regulations with regard to reporting duties. However only 10 suspicious transactions were reported from 2003 to 2005 • No co-operation procedures have been so far established between the Bar Association and the Chamber of Solicitadores on the one hand, and the DCIAP or FIU/PJ, on the other hand. • Even though training is not satisfactory yet except in the area of casinos, the evaluation team noted the planning for improvements concerning this matter • There is no obligation to give special attention to business relationships and transactions with persons (including legal	NC	• Casinos are the only DNFBP sector that is required to report suspicious transactions; however, there is a threshold on that obligation • Accountants, lawyers, real estate agents and TCSPs are not subject to the "tipping off" provision or protected from liability when they choose to file a suspicious transaction report • Accountants, lawyers, real estate agents and TCSPs are not required to implement adequate internal controls (i.e. AML Programs) • Dealers in precious metals, precious stones, or jewels are required to implement AML programs; however, the effectiveness of

		persons) from or in countries which do not or insufficiently apply the FATF Recommendations • Sanctions provided by law are in particular proportionate, as fines have a wide range of amounts and Article 47 of Law 11/2004 allows to imposition of supplementary penalties. However no sanctions have been imposed yet, except in the supervisory area of ASAE (formerly the IGAE).		implementation cannot yet be assessed • There are no specific obligations on accountants, lawyers, real estate agents or TCSPs to give special attention to the country advisories that FinCEN has issued and which urge enhanced scrutiny of financial transactions with countries that have deficient AML controls.
17. Sanctions	LC	• No sanctions have been imposed by the supervisors since Law 11/2004 (the main AML Law) came into effect, although some proceedings are pending.	LC	• Some banking and securities participants are not subject to all AML/CTF requirements and related sanctions at the federal level • The effectiveness of the measures in the insurance sector cannot yet be assessed • There are concerns about how effectively sanctions are applied in the MSB sector given the current level of the IRS's resources.
18. Shell banks	LC	• There is no explicit regulation that obliges financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.	C	-
19. Other forms of reporting	C	-	C	-
20. Other DNFBP & secure transaction techniques	C	-	C	-
21. Special attention for higher risk countries	LC	• The requirement to monitor business relationships and transactions from or in non-cooperative countries, or for countries that do not or insufficiently apply FATF Recommendations, is not clearly articulated in the law, although the BdP is able to require this through circular letters • There does not appear to be a	LC	• In the insurance sector, there is no specific requirement to establish and retain written records of transactions with persons from/in countries that do not or insufficiently apply the FATF Recommendations • No measures have been applied to investment advisers and commodity trading advisors.

		mechanism for advising institutions about concerns on weakness in AML/CTF systems of other countries.		
22. Foreign branches & subsidiaries	LC	• An explicit regulation that requires institutions to pay particular attention to their branches and subsidiaries in countries which do not or insufficiently apply the FATF recommendations is missing • There is no definite legal obligation that, where the minimum AML/CTF requirements of the home and host countries differ, branches and subsidiaries in host countries are required to apply the higher standard, to the extent that local laws and regulations permit.	LC	• BSA requirements do not apply to the foreign branches and offices of domestic life insurers issuing and underwriting covered life insurance products.
23. Regulation, supervision and monitoring	LC	• Even though the three supervisors exercise comprehensive supervision on the basis of information provided by the financial entities themselves and audit reports the number of AML/CTF supervisory/regulatory visits is relatively low.	LC	• Some securities sector participants are not subject to supervision for AML/CTF requirements • The effectiveness of the measures in the insurance sector cannot yet be assessed • Concerns about IRS examination resources.
24. DNFBP – regulation, supervision and monitoring	PC	• With regard to all DNFBPs competent authorities or SROs are designated to perform monitoring and ensuring compliance of DNFBPs with AML/CTF requirements. However except for the IGJ and IGAE/ASAE, no inspections or other monitoring activities were carried out by the competent authorities • Where an oversight role exists the SROs do not have sufficient resources to perform these functions.	PC	• There is no regulatory oversight for AML/CTF compliance for accountants, lawyers, real estate agents or TCSPs • The supervisory regime for Nevada casinos is currently not harmonized with the BSA requirements.
25. Guidelines & Feedback	PC	• There is very little guidance provided to the DNFBPs under the new Law 11/2004 by the competent authorities, except for IGAE/ASAE and casinos.	C	-
		INSTITUTIONAL AND OTHER MEASURES		
26. The FIU	LC	• The FIU is not the recognised competent authority to receive and analyse STRs in relation to	LC	• The effectiveness of FinCEN, is impeded by: - perceptions concerning the

		TF.		value of its products and the risk that overemphasis on FinCEN's network function will weaken its place in the AML/CTF chain; - the handling of the huge amount of 14 million reports of which 70% are still filed in a paper format; - the fact that SAR filing is only done in 30-60 days after detection; and - insufficient adequate/timely feedback to reporting institutions • Since terrorism-related information in requests from foreign FIUs is shared with law enforcement—for networking—without the prior authorization of the foreign FIU, the U.S. does not act in accordance with international principles of information exchange established by the Egmont Group.
27. Law enforcement authorities	LC	• There are relatively few ML prosecutions initiated. This raises effectiveness issues under the requirement of recommendation 27 to ensure that ML or TF cases are properly investigated [issue of effectiveness].	C	-
28. Powers of competent authorities	C	-	C	-
29. Supervisors	LC	• Few sanctions have been imposed by the supervisory to date. The ISP and CMVM have not imposed any sanctions since the introduction of law 11/2004. Therefore it is not possible to assess the effectiveness of the sanctions regime. [issue of effectiveness]	C	-
30. Resources, integrity and training	LC	• DNFBPs are not adequately supervised for AML/CTF compliance.	LC	• The IRS is not adequately resourced to conduct examinations of the entities that it is responsible for supervising, in particular, the MSB and insurance sectors.

31. National co-operation	LC	• Although formal co-operation may take place, there is still room for improvement in more effective interagency cooperation. [Effectiveness Issue] • There is room for more formal increased interagency cooperation particularly between supervisory authorities, the FIU and prosecutors.	LC	• There remains a gap between the policy level and operational level law enforcement work • More refined coordination is needed amongst law enforcement agencies with overlapping jurisdictions.
32. Statistics	PC	• Portugal has not conducted a full, complete and comprehensive review of its AML/CTF regime • There are no comprehensive statistics on ML and TF investigations, prosecutions and convictions. There are no TF statistics on which to judge the effectiveness of the TF legislation as no TF cases have been tried • More detailed statistics should be kept, particularly concerning the nature and disposition of investigations and prosecutions • It is not possible to assess the effectiveness of freezing of terrorist funds under Special Recommendation III as no funds have been identified for freezing action • There are very limited statistics on the number of cases and the amounts of property frozen, seized and confiscated relating to ML, TF and criminal proceeds • There are insufficient statistics upon which to assess the efficiency of the measures in place [issue of effectiveness SR IX].	LC	• Freezing, seizing and confiscation statistics are not specified into ML and TF related seizures and confiscations • No statistics on TF related confiscations • FinCEN collects and maintains substantial valuable statistical BSA data, which can be used to provide a partial picture of the effectiveness of the U.S. AML/CTF regime; however, FinCEN's data would need to be coupled with that of other federal agencies and departments in order to produce a comprehensive view of overall effectiveness of U.S. AML/CTF systems • MLA and extradition statistics are not broken down annually, and do not show the time required to respond to a request.
33. Legal persons – beneficial owners	PC	• The National Register of Legal Persons does not include information on the beneficial ownership and the persons who control a legal person • There is not full transparency of the shareholders of companies that have issued bearer shares.	NC	• While the investigative powers are generally sound and widely used, there are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent

				authorities • There are no measures taken by those jurisdictions which permit the issue of bearer shares to ensure that bearer shares are not misused for money laundering.
34. Legal arrangements – beneficial owners	PC	• Competent authorities have limited powers to have timely access to information on the beneficial ownership and control of trusts.	NC	• While the investigative powers are generally sound and widely used, there is minimal information concerning the beneficial owners of trusts that can be obtained or accessed by the competent authorities in a timely fashion.
	INTERNATIONAL CO-OPERATION			
35. Conventions	C	-	LC	• Not all conduct specified in Article 3 (Vienna) and Article 6 (Palermo) has been criminalized, and there is not a sufficiently comprehensive list of foreign predicates related to organized criminal groups as required by Article 6(2)(c) (Palermo).
36. Mutual legal assistance (MLA)	C	-	LC	• Dual criminality may impede MLA where the request relates to the laundering of proceeds that are derived from a designated predicate offense which is not covered.
37. Dual criminality	C	-	C	-
38. MLA on confiscation and freezing	C	-	LC	• Dual criminality may impede MLA where the request relates to the laundering of proceeds that are derived from a designated predicate offense which is not covered.
39. Extradition	C	-	LC	• Dual criminality may impede extradition where the request relates to the laundering of proceeds that are derived from a designated predicate offense which is not covered • List-based treaties do not cover ML.
40. Other forms of co-operation	C	-	C	-

	PORTUGAL		UNITED STATES OF AMERICA	
Special Recommendation No.	Rating	Summary of Factors Underlying Rating	Rating	Summary of Factors Underlying Rating
I. Implement UN instruments	PC	• S/RES/1267 has been implemented but S/RES/1373 (2001) is not yet comprehensively implemented • There is no system for effectively communicating action taken by the authorities under the freezing mechanisms to some designated non-financial business and professions • Designated non-financial businesses and professions are not adequately monitored for compliance with measures taken under the Resolutions.	LC	• Not all UN1267 designations are transposed in the OFAC list.
II. Criminalize TF	LC	• The TF offence does not extend to the provision or collection of funds for the benefit of a single terrorist • It is too early to assess the effective implementation of the TF offence provisions.	C	-
III. Freeze and confiscate terrorist assets	PC	• Portugal has a limited ability to freeze funds in accordance with S/RES/1373 (2001) of designated terrorists outside the EU listing system • Communication mechanisms to some DNFBPs are limited • Portugal does not adequately monitor DNFBPs for compliance with the relevant laws for freezing of terrorist funds.	LC	• Compliance monitoring in non-federally regulated sectors (e.g. insurance, MSBs) is ineffective • Not all S/RES/1267(1999) designations are transposed in the OFAC list.
IV. Suspicious transaction reporting	LC	• As the reporting obligation relates to suspected TF offences, the evaluation team had concerns regarding the scope of the TF offence (as discussed in section 2.2). This could limit the reporting obligation.	LC	• The existence of a USD 5,000 threshold for reporting suspicious activity • No measures have been applied to investment and commodity trading advisers • The effectiveness of measures in the insurance and mutual funds sectors cannot yet be assessed.
V. International co-operation	LC	• Since dual criminality may be required in for international cooperation it is not clear how Portugal would execute requests	LC	• List-based treaties do not cover FT.

		for MLA or extradition involving the collection/provision of funds/assets to be used by an individual terrorist.		
VI. AML requirements for money/value transfer services	LC	• There is an absence of STRs coming from exchange offices [Effectiveness issue in relation to application of Recommendations 11 and 13] • As with other financial institutions overall implementation of related FATF Recommendations, in particular Special Recommendation VII, negatively impacts on the effectiveness of AML/CTF measures for money transmission services.	LC	• The limitations identified under Recommendation 5, 8, 13 and SR.IV with respect to the MSB sector also affect compliance with Special Recommendation VI • Major concerns with respect to resources of the IRS for monitoring of this sector.
VII. Wire transfer rules	NC	• Portugal has not implemented the full range of requirements of SR VII. There is no legal obligation to include full originator information in the message or payment form that accompanies a cross-border or domestic wire transfer • There are no obligations on intermediary reporting financial institutions in the payment chain to maintain all of the required originator information with the accompanying wire transfer • There are no obligations on beneficiary reporting financial institutions to adopt risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information • There is no obligation to verify that the originator information is accurate and meaningful • There are no obligations to require financial institutions to apply risk-based procedures when originator information is incomplete • There are no sanctions for breaching many of the obligations under SR VII because many of the obligations themselves have not been implemented.	LC	• Threshold of USD 3,000 instead of USD 1,000 as is required by the revised Interpretative Note • It is not mandatory to include all required originator information on batch transfers.

VIII. Non-profit organizations	LC	• NPOs in Portugal should be required to maintain information on (2) the identity of the person(s) who own, control or direct their activities, including senior officers, board members and trustees. This information should be publicly available either directly from the NPO or through appropriate authorities • NPOs should have appropriate controls in place to ensure that all funds are fully accounted for and are spent in a manner that is consistent with the purpose and objectives of the NPO's stated activities. • NPOs should follow a "know your beneficiaries and associate NPOs" rule, maintain, for a period of at least five years, and make available to appropriate authorities, records of domestic and international transactions • Appropriate authorities should monitor the compliance of NPOs with applicable rules and regulations.	C	-
IX. Cash couriers	LC	• There are insufficient statistics upon which to assess the efficiency of the measures in place [issue of effectiveness].	C	-

Source: FATF Third Mutual Evaluation for Portugal (2006); Id. for the USA (2006)

Appendix 3: Number of Reports Filled In For Each Country – Evolution

Table 6 - **PORTUGAL - Total Number of Reports**					
	2006	2007	2008	2009	2010
FE	855	1.036	870	928	2.282
DNFBP	15.180	11.438	21.157	12.865	6.188
Casinos	15.108	11.402	21.142	12.852	6.142
DNFBP (excluding casinos)	72	36	15	13	46
Other	445	500	706	1.406	2.153
Customs	426	493	698	1.390	2.150
Total	16.480	12.974	22.733	15.199	10.623
Total (excluding casinos)	1.372	1.572	1.591	2.347	4.481

Source: UIF (2006); UIF (2007); UIF (2008) ; UIF (2009) ; UIF (2010) (adap.)

Table 7 - **PORTUGAL - Reports of Each Area as a % of Total Reports**					
	2006	2007	2008	2009	2010
FE	5,19%	7,99%	3,83%	6,11%	21,48%
DNFBP	92,11%	88,16%	93,07%	84,64%	58,25%
Other	2,70%	3,85%	3,11%	9,25%	20,27%

Table 8 **- USA - Total Number of Reports**					
	2006	2007	2008	2009	2010
FE	1.071.609	1.240.496	1.279.428	1.269.212	1.312.641
Depository Institutions	567.080	649.176	732.563	720.309	697.389
MSB's	496.400	578.439	531.761	530.518	596.494
Securities & Futures Institutions	8.129	12.881	15.104	18.385	18.758
DNFBP	7.285	9.943	11.162	12.093	13.987
Total	1.078.894	1.250.439	1.290.590	1.281.305	1.326.628

Source: FinCEN (2011) (adap.)

Table 9 - **USA - Reports of Each Area as a % of Total Reports**					
	2006	2007	2008	2009	2010
FE	99,32%	99,20%	99,14%	99,06%	98,95%
DNFBP	0,68%	0,80%	0,86%	0,94%	1,05%

Table 10 - **Total Reports Variation: Portugal vs. USA**				
	06-07	07-08	08-09	09-10
Total - PT	-21,27%	75,22%	-33,14%	-30,11%
Total - USA	15,90%	3,21%	-0,72%	3,54%

Appendix 4: Quality Measures Calculations For Each Country

Table 11 – **PORTUGAL – Report Quality Ratio**					
	2006	2007	2008	2009	2010
Investigations	584	724	568	634	703
Reports	16.480	12.974	22.733	15.199	10.623
Ratio	3,54%	5,58%	2,50%	4,17%	6,62%

Source: UIF (2006); UIF (2007); UIF (2008); UIF (2009); UIF (2010) (adap.)

Table 12 - **USA – Report Quality Ratio**[17]					
	2006	2007	2008	2009	2010
Investigations	n/a	n/a	3.749	4.121	4.706
Reports	1.078.894	1.250.439	1.290.590	1.281.305	1.326.628
Ratio	n/a	n/a	0,29%	0,32%	0,35%

Source: http://www.irs.gov/compliance/enforcement/article/0,,id=107484,00.html (adap.)

[17] The data presented for the USA corresponds to North American Fiscal Years, which begins on October 1st and ends in September 30th, while in Portugal it starts in January 1st and ends in December 31st.

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VIII. ACRONYMS

AML – Anti-Money Laundering

ASAE – Autoridade de Segurança Alimentar e Económica

BCP – Banco Comercial Português

BdP - Banco de Portugal

BES – Banco Espírito Santo

BPI – Banco Português de Investimento

BSA – Bank Secrecy Act

C – Totally Compliant

CDD – Customer Due Diligence

CGD – Caixa Geral de Depósitos

CMVM - Comissão de Mercado de Valores Mobiliários

CTF – Counter Terrorism Financing

DCIAP – Departamento Central de Investigação e Acção Penal

DNFBP – Designated Non-Financial Businesses and Professions

ESCB – European System of Central Banks

EU – European Union

FATF – Financial Action Task Force

FE – Financial Entities

FinCEN – Financial Crime Enforcement Network

FIU – Financial Intelligence Unit

IGAE – Inspecção Geral das Actividades Económicas

IGJ – Inspecção-Geral de Jogos

IMF – International Monetary Fund

InCI – Institute for Contruction and Real Estate

IRS – Internal Revenue Service

ISP - Instituto de Seguros de Portugal

LC – Largely Compliant

MSB – Money Services Business

NC – Non-compliant

NCCT - Non-Compliant Countries and Territories

NPO – Non-Profit Organization

OECD - Organization for Economic Co-operation and Development

PC – Partially Compliant

PEP – Politically Exposed Person

PJ – Polícia Judiciária

R – FATF Recommendation

ROC – Revisor Oficial de Contas

SAR – Suspicious Activity Report

SR – FATF Special Recommendation

STR – Suspicious Transaction Report

TOC – Técnico Oficial de Contas

UIF – Unidade de Informação Financeira

UK – United Kingdom

UN – United Nations

UNODC – United Nations Office on Drugs and Crime

USA – United States of America

USC – United States Code

USD – United States Dollars