COMMITTEE OF EXPERTS ON THE EVALUATION OF ANTI-MONEY LAUNDERING MEASURES AND THE FINANCING OF TERRORISM (MONEYVAL)

MONEYVAL(2012)17

Mutual Evaluation Report

Anti-Money Laundering and Combating the Financing of Terrorism

THE HOLY SEE (INCLUDING VATICAN CITY STATE)

4 July 2012

The Holy See (including Vatican City State) is evaluated by MONEYVAL pursuant to Resolution CM/Res(2011)5 of the Committee of Ministers of 6 April 2011. This evaluation was conducted by MONEYVAL and the report was adopted as a third round mutual evaluation report at its 39th Plenary (Strasbourg, 2-6 July 2012).

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I. PREFACE AND SCOPE OF EVALUATION

1. On 24 February 2011, His Eminence Cardinal Bertone, Secretary of State, wrote to the Secretary General of the Council of Europe, requesting that the Holy See (including Vatican City State) become subject to the evaluation and follow up procedures of MONEYVAL. MONEYVAL is the Council of Europe's primary monitoring arm in anti-money laundering and countering the financing of terrorism (AML/CFT). The Committee of Ministers accepted this application on 6 April 2011. The Holy See (including Vatican City State) became fully engaged with MONEYVAL thereafter and arrangements were made for a MONEYVAL onsite visit in November 2011.
2. The evaluation of the anti-money laundering and combating the financing of terrorism regime of the Holy See (including Vatican City State) was based on the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF)[1] and was prepared using the AML/CFT Methodology 2004[2]. Due to the specific scope of evaluations carried out by the Committee, this evaluation is complemented by coverage of some issues linked to the Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (hereinafter the "Third EU Directive") and Directive 2006/70/EC (the "implementing Directive"). This is in accordance with MONEYVAL's terms of reference and Procedural rules.
3. The evaluation was based on the laws, regulations and other materials supplied by the Holy See (including Vatican City State), and information obtained by the evaluation team during the MONEYVAL on-site visits to the Holy See (including Vatican City State) from 20 to 26 November 2011 and 14 to 16 March 2012. This evaluation report takes into account developments in the two months subsequent to the first on-site visit (i.e. up to 25 January 2012) as is permitted in FATF and MONEYVAL practice. Under the procedures of MONEYVAL, no account can be taken in the text of the report, and for rating purposes, of developments after the 25th January 2012. None-the-less, the HS/VCS has continued to move forward to improve and modernise its laws and practices since the 25th January 2012. Important developments since the 25th January 2012 are referred to by updating footnotes in accordance with MONEYVAL procedure.
4. During the MONEYVAL on-site visits, the evaluation team was greeted by His Holiness Pope Benedict XVI and met with officials and representatives of all relevant Holy See (including Vatican City State) government agencies and the related organisations. A list of the persons and bodies met is set out in Annex I to the mutual evaluation report.
5. This is an evaluation of a unique jurisdiction. The evaluation team had first to establish what areas in the context of the HS/VCS had relevance in AML/CFT terms. Thereafter the 2004 AML/CFT Methodology has been applied in exactly the same way as any other jurisdiction. This report is an evaluation of measures in place to counter money laundering and terrorist financing. It is not an investigation into past or present allegations of money laundering and terrorist financing. It is not concerned directly with the situation before the implementation of AML/CFT legislation. The assessment is also not an audit of any particular financial institution, as this is outside the scope of an evaluation. However, the evaluators have assessed intensively effective implementation of the global standards (in particular by the Institute for Works of Religion - IOR). MONEYVAL's

[1] This report is not based on the revised FATF Recommendations, which were issued in February 2012.

[2] As updated in February 2009.

assessment in this area was based on interviews with IOR management and employees and other documents requested by the evaluation team.

6. The evaluation was conducted by an assessment team, which consisted of MONEYVAL and FATF experts in criminal law, law enforcement and regulatory issues: Professor William C. Gilmore (Professor of International Criminal Law at the University of Edinburgh and Legal Scientific Expert to MONEYVAL) who participated as a legal evaluator; Mr. Philipp Roeser (Executive Officer, Legal and International Affairs, Financial Market Authority, Liechtenstein) and Mr. Andrew Strijker, (Financial Scientific Expert to MONEYVAL) who participated as financial examiners; Mr. Boudewijn Verhelst, (Deputy Director of CTIF-CFI, Belgium and Law Enforcement Scientific Expert to MONEYVAL) and Mr. Vladimir Nechaev (Assistant to the First Vice-Chairman of the Government of the Russian Federation and Chairman of MONEYVAL) who participated as law enforcement evaluators; Mr John Ringguth, (Executive Secretary to MONEYVAL) and Mr John Baker (MONEYVAL Secretariat). The team reviewed the institutional framework, the relevant AML/CFT Laws, regulations, guidelines and other requirements, and the regulatory and other systems in place to deter money laundering (ML) and the financing of terrorism (FT) through financial institutions and Designated Non-Financial Businesses and Professions (DNFBP), as well as examining the capacity, the implementation and the effectiveness of all these systems.

7. This report therefore provides a summary of the AML/CFT measures in place in the Holy See (including Vatican City State) as at the date of the first MONEYVAL on-site visit or, as noted above, immediately thereafter. It describes and analyses these measures, and provides recommendations on how certain aspects of the systems could be strengthened (see Table 2). It also sets out the Holy See's (including Vatican City State) levels of compliance with the FATF 40 + 9 Recommendations (see Table 1). Compliance or non-compliance with the EC Directives has not been considered in the ratings in Table 1.

8. For ease of comprehension a detailed list of acronyms and glossary of terms used in this report is provided in Section VI below.

II. EXECUTIVE SUMMARY

1. Background and scope of the evaluation

1. On 24 February 2011, His Eminence Cardinal Bertone, Secretary of State, wrote to the Secretary General of the Council of Europe, requesting that the Holy See (including Vatican City State) (HS/VCS) become subject to the evaluation and follow up procedures of MONEYVAL. MONEYVAL is the Council of Europe's primary monitoring arm in anti-money laundering and countering the financing of terrorism (AML/CFT). The Committee of Ministers accepted this application on 6 April 2011. The Holy See (including Vatican City State) became fully engaged with MONEYVAL thereafter and arrangements were made for a MONEYVAL on-site visit in November 2011.

2. MONEYVAL is a peer evaluation mechanism. It assesses the compliance with and the effectiveness of the implementation of the legal framework, plus the financial and law enforcement measures in place to combat money laundering and terrorist financing. Its assessments are made against the global standards of the Financial Action Task Force (FATF), and also in respect of some aspects of Directive 2005/60/EC (the 3rd EU Directive). MONEYVAL is a leading Associate Member of the FATF.

3. This report describes and analyses the AML/CFT measures that were in place in the HS/VCS at the time of the first MONEYVAL on-site visit (20-26 November 2011) and takes into account developments in the subsequent two months to 25 January 2012 (as is permitted in FATF and MONEYVAL practice). A second MONEYVAL on-site visit was made between 14-16 March 2012 to clarify certain matters. The MONEYVAL report offers recommendations on how to strengthen aspects of the system. It was prepared on the basis of the FATF 40 Recommendations (2003) and the 9 Special Recommendations of the FATF on Terrorist Financing (2001), as updated. It is not based on the revised FATF Recommendations, which were issued in February 2012.

4. Under the procedures of MONEYVAL, no account can be taken in the text of the report, and for rating purposes, of developments after the 25th January 2012. None-the-less, the HS/VCS has continued to move forward to improve and modernise its laws and practices since the 25th January 2012. Important developments since the 25th January 2012 are referred to by updating footnotes in the body of the mutual evaluation report in accordance with MONEYVAL procedure.

5. This report is an evaluation of measures in place to counter money laundering and terrorist financing. It is not an investigation into past or present allegations of money laundering and terrorist financing. It is not concerned directly with the situation before the implementation of AML/CFT legislation. The assessment is also not an audit of any particular financial institution, as this is outside the scope of an evaluation. However, the evaluators have assessed intensively effective implementation of the global standards (in particular by the Institute for Works of Religion - IOR). MONEYVAL's assessment in this area was based on interviews with IOR management and employees, the analysis of comprehensive internal procedures and other documents requested by the evaluation team.

2. The specific context of the evaluation

6. The Vatican City State is geographically and demographically the smallest country in the world and consequently there is very little domestically generated crime. However, St Peter's Basilica and the Vatican Museums receive more than 18 million pilgrims and tourists each year and this inevitably results in a certain level of petty crime.

7. No independent businesses are established within the HS/VCS, as a public monopoly regime exists in the economic, financial and professional sectors. Thus, unlike other states evaluated

by MONEYVAL, there is no market economy. Given this, the authorities consider that the threat of money laundering and terrorist financing is very low. However, no formal risk assessment has been done as yet. The evaluators consider that such a risk assessment should be undertaken to properly judge the adequacy of this approach, and a process has been initiated to commence one. This is important as the evaluators have identified factors present in the system which could potentially increase the AML/CFT risk situation including: high volumes of cash transactions and wire transfers (although, the evaluators fully appreciate that cash transactions are an important contributor to the funding of the global mission of the church); global spread of financial activities (including with countries that insufficiently apply the FATF Recommendations); and the limited availability of information on the non-profit organisations operating in the HS/VCS.

8. There are only two entities, the Institute for Works of Religion (IOR) and the Administration of the Patrimony of the Holy See (APSA), which have been treated as financial institutions for the purposes of this evaluation. The IOR is the larger of the two financial institutions with 33,404 accounts being operated as at 30 November 2011. Both financial institutions are ultimately controlled by the HS/VCS.

9. There are only a few (foreign domiciled) designated non-financial businesses and professions (DNFBP), notably external accountants, providing relevant services within the HS/VCS.

3. Key findings

10. The HS/VCS authorities have come a long way in a very short period of time and many of the building blocks of an AML/CFT regime are now formally in place. But further important issues still need addressing in order to demonstrate that a fully effective regime has been instituted in practice.

11. In order to bring the legal system of the HS/VCS into line with international standards on AML/CFT matters the Act of the Vatican City State No. CXXVII, concerning the prevention and countering of the laundering of proceeds resulting from criminal activities and financing of terrorism, was enacted on 30th December 2010 and came into force on 1 April 2011. By an Apostolic letter of 30 December 2010, in the form of a '*Motu Proprio,*[3]' His Holiness Pope Benedict XVI also extended this law to the Holy See itself and created the *Autorità di Informazione Finanzaria* (Financial Intelligence Authority (FIA)) as the financial intelligence unit (FIU) for the HS/VCS and AML/CFT supervisor. This original AML/CFT Law was rapidly revised after the first MONEYVAL visit, largely to take into account the evaluators' emerging findings. The first law was wholly supplanted and replaced by Decree No. CLIX of 25 January 2012 making amendments and additions, all of which came into force also on 25 January 2012. The Decree has since been confirmed. The revised AML/CFT Law introduced a significant number of necessary and welcome changes, but due to the timing of its introduction it was not possible for the evaluators to assess the effectiveness of implementation. The amended AML/CFT Law also clearly establishes the Secretariat of State as responsible for the definition of the policies on AML/CFT, and for adhesion to international treaties and agreements.

12. Money laundering has been fully criminalised in accordance with the FATF standards although effectiveness of application has yet to be demonstrated as there have been no investigations, prosecutions or convictions for money laundering. Likewise, financing of terrorism has been criminalised, although the specific criminalisation of financing in respect of certain terrorist acts in relevant UN counter-terrorism conventions is absent. The authorities have the necessary powers to freeze, seize and confiscate criminal funds and assets although effectiveness of implementation has also still to be demonstrated. Detailed legislative provisions have been introduced to give full force and effect to the freezing of funds associated with terrorism and financing of terrorism in accordance with relevant UN

[3] A document issued by the Pope on his own initiative directed to the Roman Catholic Church.

Security Council Resolutions (UNSCRs). However, as of January 2012, they had not been brought into practical effect[4].

13. The VCS has an established Gendarmerie whose responsibilities now include the investigation of financial crime and money laundering offences, though there does not appear to have been enough training provided to them in financial investigation. Both the Gendarmerie and the FIA appear to have adequate legal and material resources.

14. The preventive measures established by the original AML/CFT Law provided a comprehensive framework, including Customer Due Diligence (CDD)[5] and record keeping requirements. These represented a major step forward for the HS/VCS. The legal provisions were augmented by Regulations and Instructions issued by the FIA. However, some elements of the original preventive regime did not clearly meet the FATF standards. The amendments and additions made by the revised AML/CFT Law have filled a considerable number of gaps identified in the original AML/CFT Law. The gaps that remain relate mainly to the requirements for appropriate monitoring and scrutiny of business relationships and transactions and the implementation of the risk based approach established by the Law.

15. The IOR launched a process in November 2010 (in advance of the enactment of AML/CFT legislation) to review its client database. The IOR is committed to complete this process with up to date CDD information by the end of 2012, though this was still at an early stage at the time of the on-site visits. Though there is an IOR bylaw that sets out the categories of persons that may hold accounts in IOR, it is recommended that serious consideration be given to a statutory provision describing the categories of legal and natural persons who are eligible to maintain accounts in the IOR.

16. The AML/CFT Law introduced a suspicious transaction reporting regime and the FIA have issued guidance on indicators of anomalous transactions. But attempted transactions are not clearly covered by the requirements and there are deficiencies in the reporting provisions regarding terrorist financing. In the period under review 2 STRs had been filed under the AML/CFT regime by a financial institution. This appears to be low as the SAR regime has been in effect since 1 April 2011. Even if allowances are made for the small size of the financial sector in the HS/VCS and for the need of the reporting entities to accustom themselves to the new regime and acquire experience, effectiveness of the reporting system is questionable.

17. The FIA is the main supervisor for AML/CFT purposes. Nonetheless, there appeared to be a lack of clarity about the role, responsibility, authority, powers and independence of the FIA as supervisor. The legislative basis for supervision and inspection needs strengthening to ensure that it includes the review of policies, procedures, books and records and, above all, sample testing. The supervisory authorities should have the clear legal right of entry into premises under supervision and the right to demand access to books of account and other information. The FIA does not appear to have adequate powers to carry out its supervisory duties and has no ability to issue sanctions in respect of one of the two identified financial institutions (APSA) as APSA is regarded as a "public authority". Following its formation, the FIA concentrated on preparing and issuing guidance. At the time of the MONEYVAL on-site visits the FIA had not conducted an on-site inspection, notwithstanding the fact that the

[4] On 3 April 2012 the HS/VCS list of designated persons was promulgated by the Secretariat of State which covered, *inter alia*, the 1267 list of designated persons. On the same day the FIA issued an Ordinance giving effect to this list and transmitted it to all obliged persons.

[5] Customer Due Diligence is a cornerstone of a preventive AML/CFT regime. It requires that all customers are clearly identified and that their identity is verified against reliable documentation. This includes the identification and verification of the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted and those persons who exercise ultimate effective control over a legal person or legal arrangement (such as trusts).

primary financial institution, the IOR, had requested that the FIA do so. No specific training had been provided to the FIA for its supervisory tasks.

18. The FIA is not involved in the process of licensing of senior staff in the financial institutions and there is no provision for the financial institutions to be prudentially supervised. It is strongly recommended that IOR is also supervised by a prudential supervisor in the near future. Even if this is not formally required it poses large risks to the stability of the small financial sector of HS/VCS if IOR is not independently supervised.

19. The AML/CFT Law covers lawyers and accountants who are operating within the VCS for STR reporting purposes. There are a number of non-profit organisations (NPO) based within the HS/VCS, all of which are linked to the mission of the Church. However, there is no supervisory regime in place in the NPO sector and no systemic outreach on AML/CFT issues has taken place as yet to the NPO sector.

20. Overall there are adequate arrangements in place to facilitate both national and international cooperation. In January 2012 the HS/VCS became a party to the Vienna, Palermo and Terrorist Financing Conventions of the United Nations which the evaluators warmly welcome as this will facilitate judicial mutual legal assistance. While information provided to the evaluators showed a broadly satisfactory track record in judicial international co-operation, one country indicated that it had encountered some difficulties in mutual legal assistance relationships with the HS/VCS.

21. The FIA is limited in its ability to exchange information with other FIUs by the requirement to have a Memorandum of Understanding (MOU) in place with its counterparts. As no MOUs had been signed at the time of the MONEYVAL on-site visits, the effectiveness of the FIU in international co-operation was not demonstrated[6]. The FIA does not have the explicit authority to share supervisory information.

4. Legal Systems and Related Institutional Measures

22. With regard to criminal law, the HS/VCS relies upon the Italian Penal Code of 1889 and the Italian Code of Criminal Procedure of 1913. It is, however, noted that the AML/CFT Law has introduced various updating amendments to the Penal Code to bring HS/VCS criminalised offences into line with the FATF "designated categories of offences"[7].

23. Prior to the enactment of the original AML/CFT Law, money laundering had not been specifically criminalised in the legal system of the HS/VCS. Before the AML/CFT Law came into force there was reliance on Art. 421 of the Italian Criminal Code of 1889. Subsequent to the MONEYVAL on-site visit of November 2011 and in the light of MONEYVAL's emerging findings, the authorities of the HS/VCS revisited the original AML/CFT Law in order to deal with identified gaps and also as they described it - to place the AML/CFT system on a more secure, long term and sustainable legislative footing. Extensive amendments and additions to the law brought about by this process came into force on 25 January 2012. Under this revised AML/CFT Law, the physical and material elements of money laundering required by the international standards are covered.

24. The offence of money laundering in the HS/VCS applies to natural persons who knowingly engage in proscribed activities. The evaluators were told that under applicable general principles and rules of the legal system the intentional element of the offence can be inferred from objective factual circumstances. A provision on "administrative responsibility of legal persons" was introduced into the amended legislation which came into force on 25 January

[6] The authorities have subsequently reported that they have entered into one MoU with an FIU. In addition they have approached 11 other FIUs receiving formal assent from two.

[7] The offences which are required to be criminalised in order that they can form an underlying basis for money laundering charges and prosecutions.

2012. The application of administrative responsibility of legal persons is based upon the prior securing of a criminal conviction of a natural person with relevant ties to the legal person in question for either money laundering or the financing of terrorism. The evaluators have concerns regarding the effectiveness of the corporate liability provision.

25. Specific offences to cover the financing of terrorism have also been included in the legislation. However, the ability to prosecute the financing of terrorism in respect of certain terrorist acts in some relevant UN counter-terrorism conventions is still missing. The financing of individual terrorists or terrorist organisations for legitimate purposes, which is also required under FATF standards, is not covered.

26. The AML/CFT Law provides for the mandatory confiscation of both proceeds and instrumentalities, including from third parties. Provisional measures, including the freezing and/or seizing of property, to prevent any dealing, transfer or disposal of property subject to confiscation are applied through reliance on the provisions of the Italian Criminal Code. The evaluators are satisfied that law enforcement agencies and the FIA have adequate powers to identify and trace property that is or may become subject to confiscation or is suspected of being the proceeds of crime. The system of confiscation and of provisional measures contains wording designed to protect the interests of *bona fide* third parties, as the standards require.

27. The AML/CFT Law has introduced provisions to allow for the freezing of funds of persons identified under the UNSCRs. However, a system for the application of these provisions in practice had still to be developed at the time of the MONEYVAL visits[8].

28. The Financial Intelligence Unit for the HS/VCS, is the FIA. It has been operational since 1 April 2011. The *Motu Proprio* establishing the FIA identifies the FIA as a public institution of the HS. Its jurisdiction in respect of AML/CFT rules extends to all Dicasteries (Departments) of the Roman Curia and all the organisations and bodies depending on the Holy See that perform financial activities listed in the AML/CFT Law.

29. The FIA is an autonomous administrative authority. It exercises the key FIU functions of receiving and analysing suspicious activity reports (SARs), and of disseminating the results of its analysis to law enforcement. In support of its analytical activity the FIA has a broad power to collect additional data. The AML/CFT Law gives the FIA access, on a timely basis, to the necessary financial, administrative, investigative information and also additional information from the parties that made the disclosure. However, as a result of a regrettable shift between the texts of the original and the revised AML/CFT Law, the legal basis for the FIA enabling it to collect additional information from all entities that are subject to the reporting obligation has become uncertain. The AML/CFT Law guarantees the FIA's operational independence and autonomy and requires that the FIA shall have adequate resources.

30. Whilst the FIA is required to maintain the "highest secrecy", exchange of information in the context of international co-operation or with the judicial authorities is allowed. However, the FIA does not have the authority to autonomously conclude MOUs with its foreign counterparts which potentially limits its effectiveness in international cooperation. The FIA is seriously considering joining the Egmont Group[9] and has already taken steps to initiate the membership procedure which would enable it to co-operate directly with other FIUs in the Egmont Group in accordance with Egmont principles.

[8] See footnote 4 above.

[9] The Egmont Group provides a forum for FIUs around the world to improve cooperation in the fight against money laundering and financing of terrorism. Egmont Group members meet regularly to find ways to cooperate, especially in the areas of information exchange, training and the sharing of expertise.

31. The judicial power in the HS/VCS is exercised by the Courts, i.e. the Single Judge, the Tribunal, the Court of Appeal and the Court of Cassation. The law enforcement authorities in the HS/VCS are comprised of: the Public Prosecutor's Office (the Promoter of Justice), who is nominated by the Pope; the Gendarmerie Corps, whose primary functions, as the only police force in the VCS, are the maintenance of public order and the investigation of offences. Due to the small size of the law enforcement community, there are no law enforcement authorities specialised in investigation and prosecution of ML or TF. The judiciary and law enforcement authorities have not yet been confronted with money laundering or terrorism financing matters, so it is not possible to assess their effectiveness on these issues.

32. The standards require that countries should have measures in place to detect the physical cross-border transportation of currency or bearer negotiable instruments. With the adoption of the AML/CFT Law the HS/VCS authorities established a declaration system for cash and bearer negotiable instruments with legal requirements for all natural persons. However, the declaration requirement does not cover shipment of currency through containerised cargo. The Gendarmerie Corps have the authority to make inquiries and inspections to ensure compliance with the requirements as well as to restrain currency where there is a suspicion of ML/FT. Although the authorities have the power to apply a penalty this is limited and there are doubts as to the ability of the Gendarmerie in practice to restrain currency where there is a suspicion of ML/FT on a timely basis, given that all declarations had been made at financial institutions. The Gendarmerie can co-operate with the Customs authorities of other countries, although there appear to be restrictions on the ability of the FIA to exchange information with counterparts on cross-border transportation.

5. Preventive Measures – Financial Institutions

33. The preventive measures established by the AML/CFT Law prior to the amendments made by Decree No. CLIX of 25 January 2012 provided a comprehensive framework, including CDD and record keeping requirements and were viewed as a major step forward for the HS/VCS. The legal provisions had been augmented by Regulations and Instructions issued by the FIA. However, some elements of the preventive regime did not clearly meet the FATF standards. The amendments and additions promulgated by Decree No. CLIX of 25 January 2012 have filled a considerable number of gaps identified in the previous Law. The gaps that remain relate mainly to the requirements for the monitoring and scrutiny of business relationships and transactions and the implementation of the risk based approach established by the Law.

34. The original AML/CFT Law as amended by Decree No. CLIX of 25 January 2012 applies to all activities and operations carried out by financial institutions as defined in the Glossary to the FATF Methodology. In practice, there are only two entities, notably the IOR and APSA, which have been treated as financial institutions for the purposes of this evaluation. The IOR is the most relevant to this assessment.

35. The revised AML/CFT Law introduced a comprehensive CDD regime and includes a risk-based approach to CDD. Enhanced CDD[10] is required by law for relationships established with politically exposed persons (PEPs), correspondent current accounts and non-face to face relationships. Some deficiencies have been identified with respect to these requirements. For example, the requirement to put in place appropriate risk management systems to determine whether a customer is a PEP does not extend to beneficial owners of accounts. With respect to non-face to face relationships the Law provides for undue exemptions from the full CDD requirements. The only additional requirement for enhanced due diligence, that appears to be

[10] Enhanced CDD measures are required to be applied to certain high risk categories of customers (for example, non-resident customers). These procedures require seeking additional information concerning the background to the customers and their beneficial owners.

designed based on a local risk assessment, is set out in an FIA Instruction and relates to repeated deposits of cash or valuables.

36. The instances for simplified CDD[11] as provided for in the AML/CFT Law are not the result of a specific assessment of the risks and vulnerabilities faced by the HS/VCS. The failure to have undertaken any formal risk assessment implies that there is no basis for determining whether other potential risks are addressed appropriately. As noted earlier, the evaluators have identified additional factors that could increase the risk situation. The evaluators' assessment on these specific risks largely matches with a preliminary threat assessment of the FIA. This preliminary assessment needs completing and formalising.

37. In applying the risk-based approach to simplified due diligence the AML/CFT Law creates blanket exemptions from the CDD requirements. As such these are not "reduced or simplified" CDD measures as the standards allow, but exemptions from any CDD requirements except in those situations when ML or FT are suspected, or when there are reasons to believe that the previous verification is unreliable or insufficient to provide the necessary information. These exemptions need reviewing.

38. The CDD framework also lacks an express requirement to verify that the transactions are consistent with the institution's knowledge of the source of funds. There is also no requirement to give special attention or to examine the background of business relationships and transactions with persons from or in countries that do not or insufficiently apply the FATF Recommendations. Nor are there requirements to examine the background and purpose of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose, as the standards also require.

39. The IOR officials demonstrated clear commitment and high awareness as regards the accurate implementation of the obligations under the AML/CFT Law. The evaluators were pleased to note that the internal procedures established by the IOR went, to some extent, beyond the requirements set out by the Law prior to the amendments and additions introduced in January 2012. Their procedures partly contained requirements that were missing or unclear in the original AML/CFT Law.

40. On the other hand, based on these internal procedures, the evaluators have also identified some deficiencies impacting on the effective implementation of certain CDD measures. For example, the risk categorisation applied by the IOR does not take into account geographic risk, product/service risk, type and frequency of transactions, the activity carried out, business volumes, or behaviour of the client.

41. As a result of the incomplete risk categorisation by the IOR, enhanced due diligence measures appear to be applied to a very limited number of customer categories and the additional measures applied in higher risk situations seem limited. The IT systems to identify unusual and riskier transactions were still in the process of being developed at the time of the MONEYVAL on-site visits. Additionally, some weaknesses were detected in the identification procedures (e.g. with regard to persons purporting to act on behalf of a customer).

42. The APSA representatives demonstrated a good understanding of their obligations under the AML/CFT Law and the requirements appear to be implemented in practice. However, the formalisation of CDD procedures in APSA appears to be at an early stage. Internal procedures in APSA were only adopted after the first MONEYVAL on-site visit.

43. A major concern arises from the fact that there has never been a sample testing of the CDD files maintained by the IOR or a supervisory assessment by the FIA including the scrutiny of

[11] Simplified CDD measures can be applied to certain categories of low risk customers (for example, government institutions or enterprises). This allows institutions to apply reduced measures to identify and verify the identity of the customers and their beneficial owners.

transactions and the origin of funds in transactions carried out by the IOR. While the evaluators took note of the efforts and commitment by the IOR to review its customer database in the light of the new regulatory framework, this process was still at an early stage at the time of the MONEYVAL on-site visits. Though there is an IOR bylaw that sets out the categories of persons that may hold accounts in IOR, the evaluators recommend that serious consideration be given to a statutory provision setting out the categories of legal and natural persons that may hold accounts in the IOR.

44. The AML/CFT Law has introduced a requirement to preserve the documents and records in accordance with the standards. With regard to wire transfers, the FIA has issued Regulations that also appear to be generally in line with the standards. However, there is no explicit requirement in the Regulation that ensures that non-routine transactions are not batched[12], where this would increase the risk of money laundering. The Regulation itself contains weaknesses regarding the verification of identity and too broad an interpretation of the concept of 'domestic transfers'. Furthermore, no requirements for beneficiary financial institutions to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information have been put in place.

45. The AML/CFT Law has introduced a suspicious transaction reporting regime which is basically sound and the FIA have issued guidance on indicators of anomalous transactions. However, attempted transactions are not clearly covered by the requirements. The reporting requirements refer to "transactions" rather than "funds" and there is no reporting obligation covering funds suspected to be linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations. Furthermore, the deficiencies in the terrorist financing offence formally limit the terrorist financing reporting obligation. The level of STRs at the time of the on-site visits raises questions in the minds of the evaluators regarding the effectiveness of the reporting regime in practice. It is noted that no reports were submitted to the prosecutor. The protection for persons reporting a suspicious transaction and the "tipping off" prohibition are largely in line with the standards.

46. The FIA has issued guidance on required internal controls in financial institutions. There are, however, concerns that the scope of the FIA's right to issue guidance is restricted. Neither the law nor guidance provide for timely access by the AML/CFT compliance officer to customer identification data and other CDD information, transaction records, and other relevant information. While neither of the financial institutions operates any foreign branches or subsidiaries, relevant provisions have been established in the AML/CFT Law to cover this, which are largely in line with the standards.

47. The FIA is the main supervisor for AML/CFT purposes. The AML/CFT Law states that the FIA has the power to perform inspections and to impose administrative pecuniary sanctions. The Law does, however, limit supervision to monitoring and verification of certain activities, which focus mainly on internal control measures and selection of employees. Furthermore, it is unclear to what extent the power to carry out inspections includes the review of policies, procedures, books and records, and can be extended to sample testing. It is also unclear whether the FIA's powers include the right of entry into the premises of the institution under supervision, the right to demand books of accounts and other information and the right to make and take copies of documents, with a penalty on the institution if its officers fail to comply. Following its formation, the FIA concentrated on preparing and issuing Regulations and Instructions. As a consequence of this virtually no supervisory activity took place during the period under review and, at the time of the MONEYVAL on-site visits, the FIA had not conducted an on-site inspection. It is recommended that the definition in the AML/CFT Law of supervision and inspection be amended to make it clear that those functions are not restricted only to certain AML/CFT activities but encompass all aspects of AML/CFT, and in

[12] Batch processing groups similar transactions together to facilitate efficient data processing. The standards require that non-routine transactions should be processed individually.

particular the review of policies, procedures, books and records and sample testing. The supervisory authorities should have the legal right of entry into premises under supervision and the right to demand access to books of account and other information.

48. It is strongly recommended that IOR is also supervised by a prudential supervisor in the near future as currently there is no adequate, independent supervision of the IOR. Even if this is not formally required, it poses large risks to the stability of the small financial sector of HS/VCS if IOR is not independently supervised. In addition it would require IOR to implement additional regulatory and supervisory measures which are relevant for AML.

49. No sanctions for breaches of AML/CFT legislation are applicable to APSA as it is regarded as a public authority. This should be reconsidered. Otherwise, legal persons can be sanctioned. There are sanctions available also in respect of all natural persons, but directors and senior management are not specifically addressed in the legislation. Further clarity here would help. There is no power to withdraw, restrict or suspend a financial institution's licence. At the time of the MONEYVAL on-site visits, no sanctions had been applied. With regard to market entry, directors and senior management of IOR and APSA are not specifically evaluated on the basis of "fit and proper" criteria by the FIA and the financial institutions are "licensed" via the Chirograph[13] and the Pastor Bonus[14] but not by the FIA.

50. The AML/CFT Law states that financial secrecy should not obstruct requests for information by competent authorities and also provides for domestic authorities to actively co-operate and exchange information for AML/CFT purposes. The Law further states that official secrecy shall not inhibit the international exchange of information. HS/VCS authorities have demonstrated that information covered by financial and official secrecy is exchanged in practice. However, the Law lacks express exemptions from the secrecy provisions for certain types of information exchange.

6. Preventive Measures – Designated Non-Financial Businesses and Professions (DNFBP)

51. Given the public monopoly regime, no one is entitled to establish businesses or to set up industrial or commercial enterprises without obtaining authorisation from the Governor. No such authorisation has ever been issued. Only those DNFBP services provided by HS/VCS entities, as well as cross-border services provided by foreign domiciled persons (e.g. lawyers, auditors, etc.), are permitted to be conducted within the HS/VCS.

52. The revised AML/CFT Law covers all categories of DNFBP covered by the FATF standards except for casinos (including internet casinos) the establishment of which is expressly prohibited by the Law. DNFBP have to comply with the same obligations as financial institutions, including *inter alia* CDD and record keeping requirements. Despite this broad scope of application, there appear to be only a few (foreign domiciled) DNFBP (notably external accountants) providing services within the HS/VCS that are relevant under the FATF standards. However, those DNFBP have not yet implemented the obligations of the AML/CFT Law.

7. Non-Profit organisations

53. There are a number of non-profit organisations based within the HS/VCS. They are all linked to the support of the mission of the Church. This sector is a significant controller of financial resources within the HS/VCS. No review has been undertaken of this sector to establish the adequacy of the legal and regulatory framework and the potential vulnerabilities to financing of terrorist activities. At the time of MONEYVAL's visits there was no monitoring regime in

[13] A papal document establishing the IOR.

[14] An Apostolic Constitution promulgated by Pope John Paul II which sets out the process of running the central government of the Roman Catholic Church. Both IOR and APSA are established under Pastor Bonus.

place. No written guidance had been prepared and no systemic outreach has taken place to this sector.

8. National and International Cooperation

54. Both the Holy See and the Vatican City State enjoy international legal personality. The HS maintains bilateral diplomatic relations with members of the international community. It is a member of certain international organisations and has observer status in many others, including the UN and the Council of Europe. It has a treaty making capacity in international law and has become a party to a number of multilateral conventions including several negotiated under the auspices of the UN. The evaluators warmly welcomed the decision of the HS/VCS to become a party to the Vienna, Palermo and Terrorist Financing Conventions of the UN in January 2012.

55. In the HS/VCS issues of international legal co-operation are regulated by the relevant provisions of the Italian Code of Criminal Procedure of 1913 as it stood in 1929 (CCP). The CCP stipulates that international conventions and practices regarding letters rogatory and related matters are to be observed. However, at the time of the first MONEYVAL on-site visit, no bilateral mutual legal assistance agreements had been concluded. However, since the HS/VCS is now a party to the Vienna, Palermo and Terrorist Financing Conventions of the UN, their extensive provisions relating to mutual legal assistance now apply as between the HS/VCS and all other state parties.

56. At present the HS/VCS relies on the Letters Rogatory process provided for in the CCP. This is drafted in relatively broad and flexible terms and double criminality is not required. This scheme of co-operation is generally adequate in relation to the provision of assistance for money laundering, terrorist financing and predicate offence investigations and prosecutions. With regard to extradition, two separate regimes operate. With regard to Italy, under the terms of the Lateran Treaty, the HS/VCS enjoys "an enhanced co-operation". With regard to other states the terms of the CCP apply. This means that when a request for extradition is made through diplomatic channels the courts play a decisive role in determining whether the relevant requirements have been satisfied. The final determination is made by the executive branch of government.

57. While information provided to the evaluators showed a broadly satisfactory track record in international co-operation in judicial mutual legal assistance, one country indicated that it had encountered some difficulties in the context of its mutual legal assistance relationship with the HS/VCS.

58. The legal systems of the HS/VCS do not contain any undue restrictions to law enforcement co-operation in fiscal matters. The legal system of the HS-VCS does not contain any particular restrictions or conditions on international co-operation on the basis of the protection of financial secrecy and professional privilege of possible designated non-financial subjects. Competent authorities have powers to carry out inquiries on both the internal and international levels. In particular, the Gendarmerie, in close co-operation with the Judicial Authority, carries out inquiries and investigations and cooperates with authorities of other states within the framework of INTERPOL. It can request, through the competent channels, the co-operation of the equivalent Italian agencies. However, as noted, the FIA is limited in its ability to exchange information by the requirement to have an MOU in place with its counterparts and no MOUs had been signed at the time of the visits[15]. The evaluators were provided with conflicting opinions regarding the ability of the FIA to share information prior to the entry into force of the original AML/CFT Law on 1 April 2011. It was subsequently demonstrated to the evaluators that in practice this did not appear to restrict the ability of the

[15] The authorities have subsequently reported that they have entered into one MoU with an FIU. In addition they have approached 11 other FIUs receiving formal assent from two.

FIA to receive or disseminate information relating to transactions prior to 1 April 2011. The FIA does not have the explicit authority to share supervisory information

9. Resources and Statistics

59. Both the FIA and the Gendarmerie appear to have adequate budgets to carry out their functions and the AML/CFT Law requires that FIA shall have adequate resources. At the time of the MONEYVAL visits, neither the FIA nor the Gendarmerie had yet developed adequate experience of the application of the AML/CFT law. The evaluators noted that the Gendarmerie lacked training and experience in financial investigation and thus there is a reserve on their future effectiveness in this area. The FIA staff had not received any specific training for its supervisory tasks, and this needs to be remedied.

60. The authorities were able to provide statistics on the level of crime in the HS/VCS and related criminal proceedings. The recent introduction of the AML/CFT Law meant that there were as yet relatively few statistics maintained, although a system for recording and analysing STRs was in place. Statistics were also provided on international co-operation.

10. Conclusion

61. Most states in MONEYVAL have had AML/CFT systems in place for 10-15 years and been through 3 evaluation rounds. The HS/VCS have therefore come a long way in a very short period of time and many of the building blocks of an AML/CFT regime are now formally in place. However, further important issues still need addressing in order to demonstrate that a fully effective regime has been instituted, particularly in respect of supervision of the financial institutions to ensure that the CDD measures are being effectively implemented and also in respect of the exchange of information by the FIA.

62. The HS/VCS authorities have co-operated closely with the evaluators and reacted quickly to remedy a number of the deficiencies highlighted during the first on-site visit.

63. The development of the HS/VCS AML/CFT regime is an on-going process. MONEYVAL will continue to monitor progress closely through its comprehensive follow-up procedures.

III. MUTUAL EVALUATION REPORT

1 GENERAL

1.1 General Information on the Holy See (Incorporating the Vatican City State)

The Vatican City State and the Holy See

1. Although the Holy See (HS) is not a state in itself, it has sovereignty over the Vatican City State (VCS) which is the smallest sovereign state in the world, in terms of both size and population. It is a landlocked sovereign city-state whose territory consists of a walled enclave within the city of Rome, Italy. It has an area of approximately 44 hectares (110 acres) on the Vatican hill close to the western bank of the River Tiber. At the time of the MONEYVAL on-site visits, it had a resident population of 595 of which 247 were resident citizens. The HS/VCS jurisdiction also covers some extraterritorial areas, including various buildings owned by the HS/VCS, both within and outside Rome. However, the VCS receives on average 18 million pilgrims and tourists per year.
2. Citizenship of the VCS is determined neither by blood (*ius sanguinis*) nor by birth (*ius soli*). Instead, it is determined on the basis of *ius officii*, meaning that citizenship can be obtained generally only through appointment to work in a specific capacity in the service of the Holy See. Due to its dependence on employment within the HS, citizenship is lost upon the termination of such employment. Law no. CXXXI of 2011 on citizenship, residency and access, further extends citizenship to the citizen's direct family members who live with and are authorised to reside in Vatican City State. At the time of the first MONEYVAL on-site visit, the VCS had 595 citizens, out of which 348 citizens live outside the territory of the State[16].
3. The term the Holy See (or Apostolic See) refers, *stricto sensu*, to the Roman Pontiff as a legal person distinct from that of other legal persons established according to the Canon law (See Canons 113 and 361, 1983 Code of Canon Law (CCL)).
4. While the term Holy See or Apostolic See refers to the Roman Pontiff (the Pope), it also, unless the contrary is clear from the nature of things or from the context, refers to the Roman Curia, which is the complex of Dicasteries and institutions which help the Pope in the exercise of his Supreme Pastoral Office. It thus strengthens the unity of the faith and the communion of the people of God and promotes the religious mission of the Catholic Church in the world (See Canons 360-361 CCL; and Art. 1 of the Apostolic Constitution of June 28, 1988: "Pastor Bonus"). The Holy See is the preeminent episcopal see of the Catholic Church, forming the central government of the Church. As such, diplomatically, the Holy See acts and speaks for the whole Catholic Church. It is also recognised by other subjects of international law as a sovereign entity, headed by the Pope, with which diplomatic relations can be maintained.
5. Although it is often referred to as "the Vatican", the Holy See is not the same entity as the Vatican City State, which came into existence only in 1929. The Holy See, the episcopal see of Rome, dates back to the beginning of Christian times. Ambassadors are officially accredited not to the Vatican City State but to "the Holy See", and papal representatives to states and international organisations are recognised as representing the Holy See, not the Vatican City State. The expression "the Holy See" (without further specification) is normally used in international

[16] As of March 20, 2012, 109 Nuncios (VCS citizens) were living outside the VCS.

relations to refer to the See of Rome viewed as the central government of the Roman Catholic Church.

6. It is important to note that the civil activity of the local Churches (Dioceses), outside of the immediate jurisdiction of the Vatican City State, is subject to the legal system of the countries where they are located, and that, according to the CCL, it is for the Bishop: "to exercise careful vigilance over the administration of all the goods which belong to public legal persons subject to him" (See Can. 1276,1) although the HS exercises some degree of surveillance over the use of goods of canonical legal persons. Moreover, as clarified by the Pontifical Council for the Interpretation of Legislative Texts, the Dicastery of the Roman Curia competent for authentic interpretation of laws and regulations (See Art. 154, Pastor Bonus), the HS: "is not the owner of the goods. is not required to respond for the consequences of acts of economic management posed by the immediate administrator of the assets".

Scope of Mutual Evaluation Report

7. In the context of this report the evaluators have limited themselves to those activities and entities that legally fall within the direct jurisdiction of the Vatican City State and the Holy See. As stated in the previous paragraph, the local Churches (Dioceses), outside the immediate jurisdiction of the Vatican City State, would be expected to be subject to the law and regulations relating to money laundering and the financing of terrorism of the jurisdiction in which they are based and do not, therefore, fall to be considered in this assessment.

History

8. As the imperial Roman capital and the burial place of the apostles Peter and Paul, Rome was established as the seat of the Christian faith in the 1st century AD. During the intervening years the Catholic Church attained control over various territories on the Italian peninsula and around Avignon, France. These territories were known as the Papal States and were under the sovereign rule of the Pope.

9. Territories around Avignon were permanently surrendered to France under the Treaty of Tolentino in 1797. In 1861, the unification of the various city states on the Italian peninsula gave rise to a political conflict between Italy and the papacy. The dispute is generally known as "the Roman Question", and concerned the legal and political status of the Pope and the Catholic Church. The first Italian Parliament declared Rome the capital city on 27 March 1861. In 1870, however, Napoleon III was forced to withdraw the garrison due to the commencement of the Franco-Prussian war. This gave the Italian Army the opportunity to occupy Rome in the same year. Following the capture of Rome, the Popes considered themselves "prisoners in the Vatican", as they refused to leave the Vatican compound.

10. The Roman Question was resolved in 1929 with the signing of the Lateran Treaty (see Annex VII) between the Italian Government and the Holy See.

The Lateran Treaty

11. The Lateran Treaty recognised the international legal personality of the Holy See (Art. 2) and provided for the creation of the Vatican City State (Art. 3) as a means of ensuring the absolute sovereignty of the Holy See. It was signed on 11 February 1929 and ratified on 7 June 1929.

12. Besides the reestablishment of a territorial sovereignty, through the foundation of the VCS (Arts. 3-4), the Lateran Treaty provides for a series of further immunities. Such guarantees take on a particular relevance with respect to the definition of the legal status of the HS in Italy. They can have a functional, personal and real nature.

13. The guarantees that are relevant to the person of the Roman Pontiff are the same that are established for sovereigns and Heads of State to whom a special protection against the criminal jurisdiction of third States is granted. In this regard, the Lateran Treaty establishes that "Italy, considering the person of the Supreme Pontiff sacred and inviolable, declares that any attempt on him and the provocation to commit it are punishable by the same penalties established for any

attempt on the person of the King [now the President of the Republic] and the provocation to commit it". (Art. 8).

14. Among the guarantees having a functional nature, it is noted:

    (a) the pontifical dignitaries and officers are exempted from any personal duty (for example: military service, juror's office, etc.; See Art. 10, §1);

    (b) the clerics participating for any reasons of office whatsoever, outside the VCS and, hence also in Italy, in the issuing of deeds by the HS, are exempted from any impediment, inquiry and control (See Art. 10, §3);

    (c) cardinals and bishops, also if they are foreign nationals, enjoy the freedom of entry and transit in the Italian territory, as well as full personal liberty, in particular during the vacancy of the Apostolic See and on the occasion of Conclaves and Councils (See Arts. 12, §3; 21, §§2; and 4).

15. There are also guarantees, having a functional nature, intended to assure the free exercise of the HS's sovereignty and jurisdiction. For example, according to the Lateran Treaty: "the central bodies" of the HS are exempted from any interference on the part of the Italian State (Art. 11)[17]. This provision essentially reproduces the rule of international law on the exemption of foreign States from local civil, administrative and criminal jurisdiction.

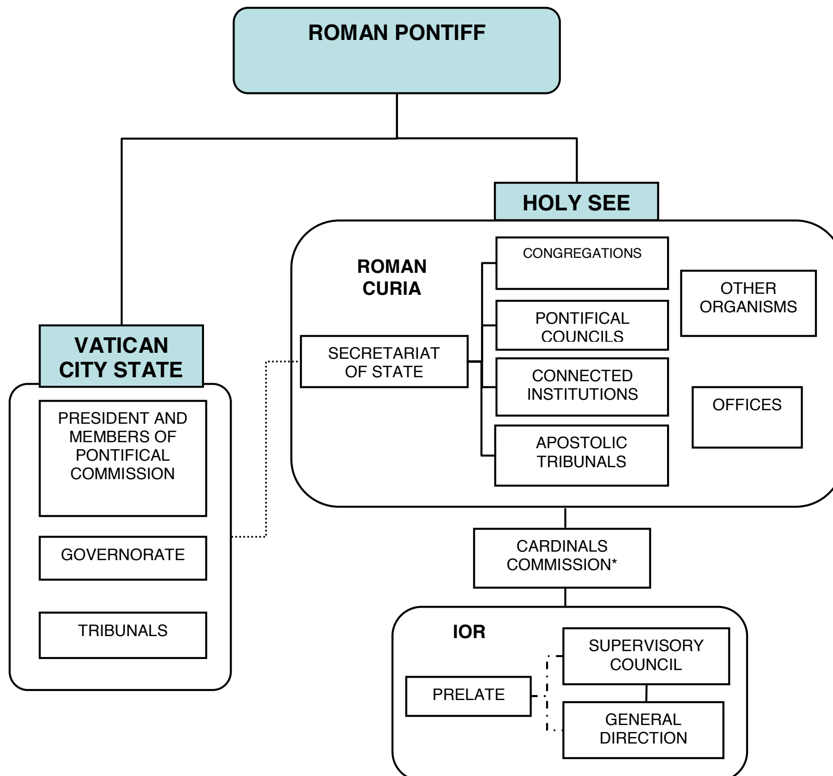
16. Some immunities have a real nature. Considering the narrow boundaries of the VCS, some Dicasteries of the HS are located in the territory of Italy. According to the Lateran Treaty, the areas and property in which the Dicasteries are placed have the same immunities enjoyed by diplomatic embassies (See Arts. 13-15).

17. According to Art. 7 of the Italian Constitution of 1948, the review and modification of the Lateran Treaty do not require proceedings of constitutional review.

Political structure

18. As noted above, when considering the political structure of the HS/VCS, it is recalled that the Holy See and the Vatican City State are, in fact, two separate legal entities although the VCS is functionally dependent on the HS. The following diagram reflects the structural arrangements in both of these entities.

[17] For example, according to the Italian *Court of Cassation* (case No. 3932/1987), the IOR, in the exercise of its institutional activity, is a "Central Body".



*For further details of the role of the Cardinals Commission see under section 1.3 below.

Vatican City State

19. The HS/VCS is an elective monarchy, the structure of which is governed by the Fundamental Law of the Vatican City State of 2000 (the "Fundamental Law") (See Annex X). The status of the VCS was affirmed to the evaluators during the first MONEYVAL on-site visit by the Cardinal Secretary of State, Cardinal Bertone, who stated that the VCS was "established as a guarantee of the visual independence and spiritual liberty of the Holy See so that it may carry out its religious and moral mission"[18].

20. The Fundamental Law contains various provisions which define the nature and character of the HS/VCS. According to Art. 1 the Pope (Supreme Pontiff) has "full legislative, executive and judicial powers." In practice, however, the Pope usually delegates these absolute powers to various entities within the HS/VCS. During a period of a vacant See (i.e. in the absence of a Pope) the powers are vested in the College of Cardinals. The College may issue legislative provisions if urgently required, but the effect of these provisions is limited to the duration of the vacancy unless they are subsequently approved by the Pope.

21. The Pontifical Commission of the Vatican City State exercises the legislative powers of the Pope except for those cases which the Supreme Pontiff intends to reserve to himself or to other entities. It is composed of a Cardinal President and other Cardinals, all named by the Supreme Pontiff for a five-year term. (Fundamental Law, Art. 3.1). The President of the Pontifical Commission is also, ex officio, the President of the Governorate of Vatican City State.

22. The executive power of the Pope within the territory of the VCS is exercised by the President of the Governorate of the VCS, who represents the VCS in legal (but not international) affairs. The President has the authority to issue temporary legislative provisions which remain in force for 90 days only, unless confirmed by the Pontifical Commission (Fundamental Law, Art. 7). The President can also issue orders for the implementation of Acts and Regulations within the territory

[18] Address of His Eminence Cardinal Tarcisio Bertone, Secretary of State, to the evaluation team on 22 November 2011.

of the VCS. The functions of the Governorate are distributed among various departments, including:

- State Accounting Administration,
- General Services Administration,
- Security and Civil Protection Services Department (including the Gendarmerie),
- Department of Health and Hygiene,
- Museums Administration,
- Department of Technical Services,
- Department of Telecommunications,
- Department of Economic Services,
- Department of Pontifical Villas, and
- Vatican Observatory.

23. Matters of greater importance are dealt with together with the Secretariat of State (Fundamental Law, Art. 6). The Fundamental Law sets out the relationship between the VCS and the Roman Curia. Before they can become law, bills must be submitted to the Pope for consideration via the Secretariat of State (Art. 4. §3 of the Fundamental Law). The VCS' budget and final balance must also be submitted to the Pope via the Secretariat of State once they have been approved by the Commission Art. 12).

24. An advisory body of the state is made up of the General Councillor and State Councillors. These entities perform advisory functions in relation to legislation and administration of the VCS.

25. On the basis of the information obtained by the evaluation team on the MONEYVAL on-site visits, it is apparent that the Governorate exercises the functions which are absolutely necessary to ensure the proper functioning of the VCS.

The Holy See

26. According to the HS/VCS authorities, the HS refers to the Pope as an independent moral person distinct from the other entities established under Canon law. In a broader sense, the HS refers to the Roman Curia, which is the administrative body of the Roman Catholic Church. It comprises various departments ("Dicasteries") and institutions, which assist the Pope in the exercise of his office. According to the authorities, the Dicasteries are:

    - the Secretariat of State;
    - Congregations;
    - Tribunals;
    - Pontifical Councils; and
    - Administrative Services:
        - The Apostolic Camera;
        - The Administration of the Patrimony of the Apostolic See (APSA); and
        - The Prefecture for the Economic Affairs of the Holy See.

27. The Dicasteries rank equally among themselves. Nevertheless, the Secretariat of State has been assigned a broad coordinating and directing role. The competences of the Dicasteries are stipulated in the Apostolic Constitution (Pastor Bonus) (see Annex VIII), the constitutional document of the Roman Curia.

International relations

28. The HS is a longstanding member of the international community having full legal personality under international law. It has the capacity to conclude treaties (*ius tractandi*) and to conduct its own policy abroad (*ius legationis*). This capacity is exercised by the Secretariat of State in the name of the Pope, both on behalf of the HS (cf. Pastor bonus, Arts. 41, 45-46) and on behalf of the VCS (Fundamental Law, Art. 2). The HS has established diplomatic relations with 179 States and most international and regional organisations. To maintain these relations, the HS appoints diplomatic representatives, who usually have the rank of Apostolic Nuncios, and other diplomatic personnel.

29. The HS is entitled to sign bilateral and multilateral treaties with States, other regional or international organisations, as well as a range of other international subjects. Within the framework of an international organisation, the HS can be either Member or Observer. In general, as an Observer state, the HS is entitled to participate in the activities of the organisation but lacks the right to vote.

30. The HS enjoys the usual immunities recognised by customary international law. As noted, the Lateran Treaty also provides the HS with various functional, personal and real immunities in its relations with Italy. The Pope enjoys the same protection of the Italian criminal law as does the Italian Head of State (Art. 8). Cardinals and bishops enjoy the freedom of entry and transit in Italy regardless of their nationality, and pontifical officers are exempt from military service, jury service and any other obligation of a personal nature (Art. 10). The central bodies of the HS are exempt from any interference on the part of the Italian state (Art. 11). Furthermore, Art. 20 of the Lateran Treaty provides that goods arriving from abroad and destined for Vatican City or destined for institutions or offices of the Holy See outside its boundaries, will always be admitted from any point of the Italian frontier and in any seaport of Italy for transit through Italian territory, with full exemption from customs fees and duty.

Courts and Tribunals

31. Both the Holy See and Vatican City State operate a system of tribunals in order to consider both civil and criminal matters. For further details see section 1.5 below.

Police force

32. In the HS/VCS, two distinct entities perform police and security functions. The Pontifical Swiss Guard is a department of the HS and is responsible for ensuring the security of the Pope. It has jurisdiction over the Apostolic Palace and all the entry points to the VCS. The Corps of Gendarmerie of the Vatican City State is responsible for performing all the ordinary functions of a police force in the VCS. It is responsible, *inter alia*, for public security, criminal investigations, border control. For further details see section 1.5 below.

Economy

33. As far as the economic and financial system is concerned, Act No. V on the Economic, Commercial and Professional Order of 1929[19] (see Annex XXX), established a public "monopoly regime" in the economic, financial and professional sectors in force in the State. As such, there is no private property or private business within the VCS. Apart from two public legal entities, APSA and the Institute for Works of Religion (IOR) there are no other financial institutions as defined by the FATF methodology.

34. While little economic activity takes place in the VCS, the state generates some revenue by issuing postal stamps and charging museum entrance fees. Since the signing of the Monetary Agreement between the European Union and the Vatican City State on 17 December 2009, the VCS utilises the Euro as its official currency and is entitled to issue a set number of coins each year.

[19] A.A.S. Suppl. 1 (1929), No. 1, June 8, 1929, pp. 25-28.

35. The Prefecture for the Economic Affairs:

    - studies the reports on the patrimonial and economic status of the Holy See as well as the statements of income and expenditure of the previous year inspecting, if necessary, the books and documents;
    - compiles the Holy See's consolidated financial statement of the previous year's expenditures; and
    - prepares the estimates for the following year's expenditures (Pastor Bonus, Art. 178).

    The balance assets of the VCS are partly transferred to the HS, while the liabilities mostly refer to services rendered by the VCS to the HS.

36. As stated by the authorities in their replies to the MEQ, the consolidated accounts of the HS, for the year to 31 December 2010, showed revenues equal to €245,195,561 and expenditures which amount to €235,347,437, with a surplus of €9,848,124. The IOR contributed approximately €55,000,000. Peter's Pence, which comprises the contributions to the Pope's charitable works from churches, foundations, individual believers as well as the Institutes of Consecrated Life and Societies of Apostolic Life, amounted to US$67,704,416 in the year 2010. Expenditures mostly account for ordinary and extraordinary expenditures by the Dicasteries and Institutions of the Roman Curia. On 31 December 2010, the HS employed a total of 2,806 personnel.

37. In relation to the VCS, the budget of the Governorate provides for the management of the territory, institutions and facilities, as well as the performance of activities supporting the HS. The authorities advised the evaluation team that, on the final balance sheet of 2010, revenues amount to €255,890,112 and expenditures to €234,847,011 with a surplus of €21,043,000. On 31 December 2010, the Governorate employed a total of 1,876 personnel. The Governorate operates independently from the Roman Curia, as its administration is able autonomously to cater for its economic needs.

Hierarchy of laws

38. According to Act No. on Sources of Law of 2008 (see Annex XII), the Canonical legal system is the supreme source of law and the first point of reference for statutory interpretation. It consists of the Code of Canon Law, the uncodified Canon law, and the special Canon law. The Code of Canon Law is the codified representation of church theology in legal language. After the Canon law, the main sources (as defined by Art. 1, para 2 of the Act above) are the Fundamental Law (which only the Supreme Pontiff can amend), as well as any Acts promulgated by the Pope, the Pontifical Commission, or by any other entity authorised by the Pope. Furthermore, Art. 3 provides for various additional sources such as the Criminal Code and the Code of Criminal Procedure.

39. As provided by Art. 3.1 of the Act on Sources of Law, Italian law is applied where there are regulatory gaps or where it is impossible to apply the domestic law. By explicit decision expressed from time to time by a competent VCS authority, Italian law is also applied ("received") when no provision is made by domestic law. Art. 4 reserves certain matters to Canon law, including marriage, citizenship and adoption.

40. With regard to criminal law, the VCS relies upon the Italian Penal Code of 22 November 1888 and the Italian Code of Criminal Procedure of 27 February 1913. It is, however, noted that the revised AML/CFT Law (Act of the Vatican City State No. CXXVII, concerning the prevention and countering of the laundering of proceeds resulting from criminal activities and financing of terrorism, 30th December 2010 revised and replaced by Decree No. CLIX promulgating amendments and additions to Law No. CXXVII, On the Prevention and countering of the laundering of the proceeds of criminal activities and the financing of terrorism, of 30 December 2010 of 25 January 2012) has introduced various updating amendments to the Penal Code to bring HS/VCS criminalised offences into line with the FATF designated categories of offences (i.e. those minimum categories of offences which have to be criminalised within the national

legislation and which can be predicate or underlying offences for the offence of money laundering).

41. With regard to civil law, the VCS relies upon the Italian Civil Code of 16 March 1942, as it had been amended by the Italian legislature up to 1st January 2009 (Act on the Sources of law, Art. 4).

42. The Act on Sources of Law also recognises the rules provided for by the Canon Law as the primary source of law and the main interpretation criterion within the HS/VCS framework (Art. 1). Hence, according to the abovementioned Law (Arts. 3 and 4), the Italian Civil Code (dated March 16, 1942) is applicable only in cases where its provisions are not inconsistent with the Code of Canon law, the Lateran Treaty and following Agreements, taking into account the exemptions under Art. 4 of Law no. LXXI on Sources of Law (e.g., Vatican citizenship, marriage, adoption, prescription related to ecclesiastical goods, employment relationships, pious dispositions and pious foundations).

43. Acts and regulations of the VCS are published in the Supplement to the *Acta Apostolicae Sedis* (Acts of the Apostolic See). They enter into force on the seventh day following publication unless otherwise expressly stated.

1.2 General Situation of Money Laundering and Financing of Terrorism

44. According to the statistics provided in a Report of the Promoter of Justice of the Vatican City State[20] for the Opening of the Judicial Year 2010, proceedings in which VCS citizens or inhabitants are involved, are rare. On the criminal side, they do not even account for one percent. In the Vatican (and in particular inside Saint Peter's Basilica and the Vatican Museums) each year there are more than 18 million pilgrims and tourists, who account for some of the crime committed. Moreover, the Vatican, though being an enclave inside the City of Rome, has direct relationships all over the world; for this reason procedures started in the VCS are usually characterised by "international" elements (e.g. parties domiciled abroad, contracts executed or to be executed abroad). Hence, there is a frequent necessity for international forms of judicial assistance.

45. Among the 1,126 civil proceedings pending in 2010 in the VCS, most concerned contracts.

46. Of the criminal proceedings pursued (see table below), over eighty per cent involved property offences, of which the majority concerned theft (most frequently robbery in the Vatican Museums and the Saint Peter's Basilica), but proceedings for embezzlement and fraud were also commenced. Criminal proceedings for offences to the person – particularly assault and battery – have also been brought, including one case in 2009 of assault on the Pope. In 2007, one case of possession and trafficking of narcotics was prosecuted. Thirty percent of criminal proceedings involved imposition of fines. Overall, in excess of ninety percent of reported crime concerned tourists and visitors rather than VCS residents or HS/VCS staff.

47. The following chart provides details of all criminal procedures in Vatican City State for the period 2007 to 2011.

[20] The appointee of the Pope who exercises prosecutorial functions.

Judicial Year From 1 October to 30 September	2007	2008	2009	2010	2011
Gendarmerie					
Complaints submitted to the Single Judge	27	17	11	13	10
Complaints submitted to the Promoter of Justice	115	71	57	48	64
Single Judge					
Complaints received from the Gendarmerie	27	17	11	13	10
Complaints received from the Promoter of Justice for reasons of competence	-	1	2	3	4
Complaints transferred to the Promoter of Justice for reasons of competence	9	10	7	4	4
Sentences	2	-	3	4	4
Cases archived	16	7	4	5	7
Promoter of Justice					
Complaints received from the Gendarmerie	115	71	57	48	64
Complaints received from the Single Judge for reasons of competence	9	10	7	4	4
Complaints transferred to the Single Judge for reasons of competence	-	1	2	3	4
Request made to the Investigative Judge	86	69	52	33	47
Summary instructions	13	13	16	16	11
Cases referred to trial	3	1	-	2	2
Investigation Judge					
Requests from the Promoter of Justice	86	69	52	33	47
Cases archived	86	69	52	33	47
Sentences	2	-	-	-	-
Criminal Tribunal					
Trial Proceedings held	7	4	3	4	1
Sentences Issued	4	1	2	2	-

48. At the time of the MONEYVAL on-site visits there had been no prosecutions under the AML/CFT Law although it should be noted that this law had only been in effect since 1 April 2011. Given the economic situation of the VCS, with no independent businesses operating within the VCS, the authorities consider that the threat of money laundering and terrorist financing is very low; although no formal risk assessment has been undertaken.

49. In order to bring the legal system of the HS/VCS into line with international standards on AML/CFT matters the Act of the Vatican City State No. CXXVII, concerning the prevention and countering of the laundering of proceeds resulting from criminal activities and financing of terrorism, was enacted on 30th December 2010. The Act was introduced by a *Motu Proprio* of His Holiness Pope Benedict XVI and in the introduction the Act was extended to the Holy See itself. The Act *inter alia* established the Autorità di Informazione Finanzaria (Financial Intelligence Authority (FIA)) as the FIU for the HS/VCS. The original law was brought into force on 1 April 2011. Since that date the FIA has been created and is now operational. Following the first MONEYVAL on-site visit and the team's emerging findings, the HS/VCS authorities responded very swiftly to address numerous issues. The original AML/CFT Law was subsequently revised, wholly supplanted and replaced by Decree No. CLIX of 25 January 2012 promulgating amendments and additions to Law no. CXXVII, On the Prevention and countering of the laundering of the proceeds of criminal activities and the financing of terrorism, of 30 December 2010 of 25 January 2012. A significant package of subordinate measures (in the form of Regulations and Instructions from the FIA) was subsequently prepared and brought into force on 15 December 2011. These measures were intended to further develop the law and fill gaps on the preventive side. They include indicators of anomalies for the identification of suspicious transactions and internal control procedures. These Regulations and Instructions have not been replaced since Decree No. CLIX of 25 January 2012. The HS/VCS authorities advised that under Decree No. CLIX of 25 January 2012, they remain in force in so far as they are compatible with the revised AML/CFT Law. The evaluators consider that the Regulations and Instructions constitute "other enforceable means". The reasons for this are set out under the review of SR.VII in Section 3.5 below. The new law applies also to the Holy See as the *Motu Proprio* of His Holiness Pope Benedict XVI applied the law "and its future modifications" to the Holy See. The internal procedures drawn up by the IOR and APSA are not considered to be "other enforceable means" but are taken into account when assessing the effective implementation of the FATF standards.

<u>Transparency, good governance and measures against corruption</u>

50. Art. 1 of Apostolic Constitution Pastor Bonus states that the Roman Curia is the complex of dicasteries and institutes which help the Roman Pontiff in the exercise of his Supreme Pastoral Office for the good and service of the whole Church and of the particular Churches. It thus strengthens the unity of the faith and the communion of the people of God and promotes the mission proper to the Church in the world. Thus the overall function of the VCS is to support the Pope in his universal mission. As such high standards are expected of all persons involved, in particular, the *General Regulation of the Roman Curia* of 1999 requires a high standard, both moral and professional regarding hiring staff and maintenance. In particular, Art. 14 provides that executives shall be chosen 'among those distinguished for virtue, prudence, knowledge, due experience'.

51. As noted under section 1.2 above, criminal proceedings in which VCS citizens or inhabitants are involved are rare.

52. With regard to corruption, although there have been recent unsubstantiated allegations of corruption in the media, there is no empirical evidence of corruption taking place within the VCS.

53. With respect to the prevention of corruption, Arts. 171-174 of the Criminal Code punish both the public officers as well as persons who induce public officers to receive funds. Art. 174 of the Criminal Code provides that those who either fail to comply with, or omit performance of their public duties in exchange for undue favours are punishable. Moreover, Art. 174 provides expressly for the confiscation of the funds used to induce corrupt acts. In addition, the General Regulation of the Roman Curia, as well as the General Regulation of the State of Vatican City, each provide administrative sanctions, including termination of employment, for any conduct recognisable under the Penal Code as corruption. Furthermore, the APSA, which reviews and authorises both employment of persons and authorisations to enter into procurement contracts for

the Roman Curia, has, since 2010, adopted specific regulations and procedures with respect to public procurement and contracts with a view: to ensure greater transparency; to uncover corrupt activities; and to prevent the involvement of criminal activity in the procurement of public services and works. According to the new procedures, in order to participate in the procurement of public service and works, candidates must provide relevant judicial information. Moreover, companies must provide information regarding their nature, activities, organisation, organs of administration, direction and control. Finally, the Code of Canon law, contains provisions requiring proper conduct and honesty in office.

54. A system of criminal investigation and prosecution has been well established and is described below. More recently, the HS/VCS authorities have taken a number of steps to embrace the international standards for the detection and prevention of money laundering and the financing of terrorism through the passing of an AML/CFT Law and the formation of a FIU. As the original AML/CFT Law only came into force on 1 April 2011 it was not possible for the evaluators to form a view on the long-term assimilation of an AML/CFT culture with the HS/VCS. It was, however, noted that the two "financial institutions" (IOR and APSA) visited by the evaluators appeared to be fully aware of their AML/CFT responsibilities and to have embraced an AML/CFT culture. Furthermore the two financial institutions have taken the initiative to review their systems and controls and introduce a numbers of preventive measures including the identification and verification of identity of all account holders.

55. With regard to transparency, the investigative powers of the FIA and Gendarmerie are set out in sections 2.5 and 2.6 below and both the FIA and Gendarmerie appear to have access to relevant documents, books and records. As set out in section 5.1 below the VCS has created what is virtually a public monopoly regime and, as such, there are no independent legal persons registered in the VCS. There are a number of NPOs established within the VCS and details of these are set out in section 5.3 below. The VCS maintains three separate registers for canonical legal persons, Vatican civil legal persons and volunteer organisations.

1.3 Overview of the Financial Sector and Designated Non-Financial Businesses and Professions (DNFBP)

56. The evaluation team was informed by the FIA, that after it became operational on 1 April 2011, it evaluated the activities of the entities located in VCS or connected to the HS in order to assess, whether they have to be considered subjects of the AML/CFT Law. As a starting point for their evaluation, FIA relied on the reference in the *Motu Proprio* of His Holiness Pope Benedict XVI, which establishes that the AML/CFT Law applies to all Dicasteries of the Roman Curia and for each and every dependent institution or entity in which they carry out activities falling under the scope of the AML/CFT Law.

57. The FIA informed the evaluation team that their assessment as to whether an entity was to be considered as an obliged subject under the AML/CFT Law has been carried out on the basis of the following criteria:

   - the performance of activities listed in Art. 2 §1, letters a) to r) of the AML/ACT Act (prior to the amendments promulgated by Decree No. CLIX of 25 January 2012) on a professional basis; and
   - the exercise of these activities in respect of third parties, such as clients or counterparts.

58. Based on this assessment the FIA came to the conclusion that at the time of the MONEYVAL on-site visits only two entities have to be considered as obliged subjects under the AML/CFT Law, namely the IOR and APSA. The FIA engages in ongoing assessment as to the applicability of Art. 2 of the AML/CFT Law to other entities within the HS/VCS.

59. Given the large number of entities operating within HS/VS the evaluation team had to rely to a large extent on the above-mentioned assessment carried out by FIA when identifying entities relevant for the MONEYVAL evaluation. In addition the evaluators have analysed the information provided by the authorities on some of the entities evaluated by the FIA and met with the IOR, APSA, the Pontifical Council "Cor Unum" and the Equestrian order of the Holy Sepulchre. In accordance with FIA's assessment, the evaluators also identified the IOR and APSA to be relevant to this evaluation. In addition, accountants have been identified as DNFBP relevant to this assessment. All other entities would appear to fall under the FATF definition of non-profit organisations[21].

Financial Sector

<u>I. Institute for Works of Religion - IOR</u>

History of the IOR

60. The Institute for Works of Religion ("*Istituto per le Opere di Religione*", (IOR)) was constituted by Chirograph of 27 June 1942 by Pope Pius XII in the Vatican City. The newly-established IOR absorbed the former Administration of the Works of Religion ("*Amministrazione delle Opere di Religione*", (AOR)), which had originated in the Commission for Pious Causes ("*Commissione ad pias causas*") established by Pope Leo XIII on 11 February 1887.

61. The AOR was initially a type of central administration for the Pope's remaining assets after the loss of the Papal States.

62. On 27 July 1942, Pope Pius XII renamed the AOR as the IOR and by a further Chirograph of 24 January 1944 he turned the Institute into an independent financial institution. He also established new rules to regulate the Institute, requesting that the Institute's own Cardinals' Commission propose changes to the By-laws of March 17, 1944 that appeared necessary in order to execute the 1944 Chirograph.

63. The Chirograph of Pope John Paul II on 1 March 1990 (see Annex XXV) gave a new configuration to the IOR "in order to render the structures and the activities of the Institute more adequate to the needs of the times, in particular, by relying upon the collaboration and the responsibility of competent lay Catholics". The name and the purpose were retained.

Purpose of the Institute

64. The purpose of the Institute is determined in Art. 1 of the Chirograph of March 1990 (see also Art. 2 (first sentence) of the IOR By-Laws (See Annex XXVI):

    The purpose of the Institute is to provide for the custody and the administration of moveable and immovable property transferred or entrusted to the Institute by natural or legal persons and destined ("destinati") for religious works or charity.

65. In addition, Art. 2 (second sentence) of the IOR By-Laws sets out:

    The Institute therefore accepts assets whose destination, at least partial or future, is indicated by the preceding paragraph. The Institute can accept deposits of assets from entities or persons of the Holy See and of the State of Vatican City.

66. Based on these provisions, the IOR commits to establish relationships only with a restricted group of customers. The eligible types of clients are now set out in the IOR "Prevention and Countering of the Laundering and Proceeds from Criminal Activities and the Financing of Terrorism Policy" (Annex XXVII; hereinafter referred to as "IOR Internal AML/CFT Policy") which was introduced on 25 February 2011 and subsequently approved on 6 October 2011. In accordance

[21] The term *non-profit organisation* or *NPO* refers to a legal entity or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works".

with the IOR Internal AML/CFT Policy the IOR can operate only with the strictly defined types of customers which are set out in Attachment 1 to the AML/CFT Policy; further details are set out under Customer Structure below.

67. While it is evident that deposits of assets from entities of the Holy See and of the Vatican City State are destined for religious works or charity and therefore meet the above-mentioned requirement, this appears less clear in the case of Holy See employees who can hold a payroll account with the IOR or deposits held by foreign ambassadors to the Holy See.

68. IOR representatives pointed out that the activity performed by Holy See employees is linked to the institutional role and functions carried out by the HS/VCS entities and their employees, whose work serve either directly or derivatively the universal mission of the Holy See, a mission supported by the work of both the Roman Curia and the Vatican City State and its offices. This view is also taken with respect to the ambassadors accredited to the Holy See.

Legal Status

69. The IOR is characterised in the legal commentary as an "atypical" institution because it combines a peculiar set of qualities and activities that do not fit easily into any one category. Its fundamental features are as follows: it is a foundation established as a canonically recognised separate juridical person created by the sovereign to serve the purposes set out for it by the sovereign. The IOR is situated exclusively on the sovereign territory of the VCS.

70. HS/VCS representatives stress that the IOR is a public institution whose nature is public and activity is *iure imperii* (by virtue of its sovereignty), but which also conducts activities comparable with that of a financial institution, which are *iure gestionis* (commercial or private acts) in character. An analysis of the activities of the IOR is set out under paragraph 88 below. In the view of the evaluators, the IOR conducts as a business one or more of the activities or operations for or on behalf of a customer as listed under the definition of "financial institution" in the glossary to the FATF 3rd round Methodology.

71. Due to its legal nature both Italian[22] and US courts[23] have recognised its sovereign immunity from civil suit or criminal prosecution. However, IOR representatives stress that the IOR is not to be considered absolutely immune. Based on the theory of restrictive immunity, exemptions may apply in cases of tort, expropriation or primarily commercial activity.

72. The IOR is not answerable to the Prefecture of Economic Affairs of the Holy See. Instead it functions independently.

Internal organisation of the IOR

73. The organs of the Institute are:

    a. The Cardinals' Commission;

    b. The Prelate;

    c. The Oversight Council;

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[22] Italian Supreme Court of Cassation, Section V, 17 July 1987, n.3932 (acknowledging location of IOR on Vatican City State territory; its formation under the laws of the Holy See and the Vatican City State; and its immunity from the jurisdiction of Italian courts)

[23] *Alperin v. Istituto per le Opere di Religione* (erroneously sued *sub nom.* "Vatican Bank"), No. C-99-04941 MMC, 2007 WL 4570674, at *3-6 (N.D. Cal. Dec. 27, 2007) (holding, upon factual inquiry, that the *Istituto per le Opere di Religione* (IOR) qualifies as a foreign sovereign entity entitled to restrictive immunity pursuant to the United States Foreign Sovereign Immunities Act (Title 28 section 1602-1611) because, *inter alia*, it is (1) a separate legal entity; (2) formed under the laws of the sovereign; (3) created to serve pursue a public purpose; (4) and not a "commercial enterprise"); *decision affirmed by United States Court of Appeals for the Ninth Circuit,* 365 Fed. Appx. 74 (9th Cir. Feb. 10, 2010) (plaintiffs' request for panel rehearing and rehearing en banc *denied*, Feb. 10, 2010).

d. The Directorate;

e. The Auditors.

74. At the time of the MONEYVAL on-site visits, and in accordance with the Chirograph of 1 March 1990, the IOR operated a three-tier board structure. The highest board level is formed by the Cardinals' Commission, which consists of five high-ranking Cardinals, who receive a five year appointment by the Pope (one of the members of the Cardinals' Commission is also the President of the FIA (for further details see under sections 2.5 and 3.10 below)). The Commission is by custom chaired by the Cardinal Secretary of State. The Cardinals' Commission convenes at least bi-annually and oversees the compliance of the IOR with its statutory norms according to the manner provided for in the By-laws. The Cardinal's Commission appoints and removes the members the Oversight Council, which is another supervisory board composed of five (lay) non-executive directors, which is responsible for the "administration and management of the Institute" as well as the "oversight and supervision of its financial, economic and operational activities". The President and the Vice-President can be appointed and removed by the Cardinal's Commission based upon proposals made by the Oversight Council. The legal representation of the Institute is the responsibility of the President of the Oversight Council.

75. Finally, the Directorate is responsible for all operational activities of the Institute and is accountable to the Oversight Council. It is composed of the Director General and the Vice-Director. Both are appointed by the Oversight Council with the approval of the Cardinals' Commission for an indeterminate or determinate period of time. The HS/VCS authorities point out that, in line with the structure of juridical entities constituted by the sovereign and for sovereign purposes, the three tier structure serves to provide sound business direction by lay experts at the level of the Oversight Counsel, as well as Governmental policy direction at the Cardinals Commission level.

76. The Chirograph also foresees the position of a Prelate, who shall be appointed by the Cardinals' Commission and shall oversee the activities of the Institute. He shall also act as Secretary for the Cardinals' Commission meetings and attend the meetings of the Oversight Council. The historical reason for this position seems to be based on protocol. The position provides for a priest of "regular rank" who is the interlocutor between the lay Oversight Council and the Cardinals' Commission. According to the Authorities, the necessity for such interlocutors has diminished over the years as interaction between Cardinals and lay persons has become less formal. According to HS/VSC representatives this position is not always filled. This position was vacant at the time of the first MONEYVAL on-site visit. On 1 December 2011 the Commission of Cardinals approved a nominee to serve in the statutory position of Prelate of the IOR. The nominee has not yet commenced his service.

77. The Oversight Council appoints, for a duration not to exceed three years, three auditors with specific administrative and accounting competence. The Auditors' positions can be renewed. The auditors are directly accountable to the Oversight Council for their activities[24].

Financial activities

78. The following paragraphs will describe the financial activities carried out by the IOR. The IOR accepts deposits and other repayable funds from its customers. The IOR representatives point out that the term "customer" must be understood as a (natural or legal) person who, in accordance with the rules of the governing Chirograph and the IOR By-laws is entitled to participate in the IOR fund. Those persons are listed in the attachment of the "IOR Internal AML/CFT Policy" (see Annex XXVII).

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[24] In addition to the statutory auditors, the IOR is audited by external auditors who are hired by the IOR and are from one of the major four audit firms. The same company is also hired by the IOR, not in its accounting capacity, but in its compliance capacity. In this capacity, the audit firm oversaw and made recommendations to all of the structures related to AML procedures, which have been followed by the IOR.

79. Participation in the IOR fund is hereinafter referred to as "holding an account" because this is the term that is most commonly used. However, the term "holding a position in the fund" appears to describe more accurately the customer relationship than the term "account" does. The IOR representatives stress that the (natural or legal) person, who holds a position has no contractual relationship with the IOR in the nature of a bank and a title to specific funds is not created. However, from a functional point of view, the way this relationship can be used by the customer is very similar to commonly known account services.

80. The IOR provides payment means such as debit cards and cheques for funds deposited with the IOR. Cash can be withdrawn at 13 automated teller machines (ATM) maintained by the IOR within the Vatican City State. The ATM service is only accessible to clients of the IOR. The ATM service is a private network within the VCS, which is not linked to any Italian or international ATM service (Pagobancomat, MAESTRO, CIRRUS etc.). It facilitates the withdrawal of low amounts of cash (daily limit of €550) in order to avoid queues at the cashiers and is particularly used by the Vatican employees to cash their salaries. In addition, the IOR manages 120 Points of Sale, which refer to credit card processing terminals which operate on territory controlled by the HS/VCS (e.g. in order to process cashless payments at the Vatican museums).

81. The IOR also enables customer payments via wire transfers, which is one of the most important services provided by the IOR.

82. Furthermore the IOR invests, administers or manages funds on behalf of its customers and on its own account[25]. The IOR invests mainly in fixed interest securities having low risk and short duration. Few investments are made in equities, cash and cash equivalents, precious metals or foreign currencies.

83. As a result of the above described business activities the revenues of the IOR result from commissions and service fees[26] and earnings from its own proprietary trading activities.

84. The IOR can only invest and transfer assets through foreign banks. At the time of the MONEYVAL on-site visits the IOR used the services of more than 40 correspondent banking relationships in Europe, the US, Australia and Japan to operate those investments and transfers.

85. The IOR provides services through only one establishment, which is located in a government building within the State of Vatican City. According to the IOR representatives, loans do not constitute a source of true revenue or financial activity. As a service to Vatican employees and qualified ecclesiastical institutions, "modest credit" is extended against salaries received and paid out by the IOR. A percentage of the assets committed by the Institute provides guarantees to canonical legal entities to assist them with transitional cash flow/credit needs (i.e. temporary bridging loans).

86. The IOR in general does not provide financial leasing and commitments.

87. The IOR does not engage in the underwriting and placement of life insurance and other investment related insurance.

88. The following table sets out the activities or operations undertaken by the IOR (and APSA) which, if conducted as a business for or on behalf of a customer, would qualify institutions undertaking them to be considered as "financial institutions" within the definition of that term provided in the FATF Methodology. The relevant supervisor is indicated in the table, and whether the institutions concerned have applicable AML/CFT requirements.

[25] The IOR representatives point out that the funds are held in custody and administration together with other funds of the Institute, consistent with the statutory purposes of the Institute itself.

[26] The IOR representatives stress that the terms "commission" and "fee" do not reflect the true legal nature of the relationship between the IOR and fund participants. The amounts retained by the IOR reflect a fund quota which is used for the purpose set forth in the founding documents (Chirograph and by-laws).

Type of financial activity	Legal entity	Subject to AML/CFT requirements	AML/CFT Supervisor/ Regulator
Acceptance of deposits and other repayable funds from the public (including private banking)	IOR/APSA	Yes	FIA
Lending (including consumer credit; mortgage credit; factoring, with or without recourse; and finance of commercial transactions (including forfeiting))			
Financial leasing (other than financial leasing arrangements in relation to consumer products)			
The transfer of money or value (including financial activity in both the formal or informal sector (e.g. alternative remittance activity), but not including any natural or legal person that provides financial institutions solely with message or other support systems for transmitting funds)	IOR/APSA	Yes	FIA
Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money)	IOR/APSA	Yes	FIA
Financial guarantees and commitments			
Trading in: (a) money market instruments (cheques, bills, CDs, derivatives etc.); (b) foreign exchange; (c) exchange, interest rate and index instruments; (d) transferable securities; (e) commodity futures trading.	IOR/APSA	Yes	FIA
Participation in securities issues and the provision of financial services related to such issues	IOR/APSA	Yes	FIA
Individual and collective portfolio management	IOR/APSA	Yes	FIA
Safekeeping and administration of cash or liquid securities on behalf of other persons	IOR/APSA	Yes	FIA

Otherwise investing, administering or managing funds or money on behalf of other persons	IOR/APSA	Yes	FIA
Underwriting and placement of life insurance and other investment related insurance (including insurance undertakings and to insurance intermediaries (agents and brokers))			
Money and currency changing	IOR/APSA	Yes	FIA

89. IOR representatives stated that several years ago the IOR determined to dispose of any remaining stakes in other financial institutions. IOR representatives confirmed that the IOR presently has no holdings greater than one percent in any financial institution either held solely by the IOR or when aggregated with other HS/VCS bodies.

90. Pursuant to Art. 8 a) of the IOR By-Laws the Cardinals' Commission "deliberates, having become acquainted with the year's budget and with the exception of the Institute's minimum liquidity standards for the distribution of funds". In the first trimester of each year the Directorate has to compile the balance sheet (Profits, Losses and statements of Assets and Liabilities, according to generally accepted accounting principles) relative to the activities of the preceding year (Art. 23 IOR By-Laws). The balance sheet of the IOR is not publicly available (and has not been made available to the evaluators). HS/VCS authorities stress however that the IOR balance sheet has been certified by an independent external auditor of international repute since 1990. During the first onsite visit, HS/VCS authorities made available to the evaluators the auditor's management letters for the years 2009-2010.

91. In 2010 the IOR made available €55 million to the apostolic and charitable works of the Pope. The fund is simply available to the Holy See, as directed by the Holy Father, or by his delegates to exercise its universal mission. As a general rule, the IOR informs the Holy Father about amounts available, after which the Holy Father may choose to use all, part, or none of these amounts. At the same time, HS/VCS representatives stress that it is important to understand that amounts made available are not "owned" by the Pope. They are available for the use of the Pope to pursue the universal mission of the church. This is considered by the HS/VCS representatives as part of the exercise of governmental authority.

92. It should be noted that the global regulatory standard of the Basel Committee on Banking Supervision regarding bank capital adequacy and market liquidity risk are applied as "best practices". It was stressed however, that the IOR is not legally required to do so.

Customer structure

93. Pursuant to the IOR Internal AML/CFT Policy the IOR commits in accordance with Art. 2 and 3 of the IOR By-Laws to establish relationships only with the following types of clients:

	Legal Person*	Natural Person*
Clergy	– Canonical Foundations; – Beatification Causes; – Vatican Congregations; – Secular and Religious Congregations (female); – Secular and Religious Congregations (male); – Apostolic Delegations and Nunciatures; – Monasteries, Convents, Abbeys; – Bishops' Conferences, Dioceses and Representative Departments; – Parishes, Churches and Pertinent Departments; – Seminaries, Colleges, Various Entities; – HS Departments.	– Cardinals; – Bishops; – Nuncio, Permanent Observer; – Employee/Secretary/Board member or officer of the Nunciature; – Religious and Secular Clergy; – Nuns.
Clergy and Laymen		– Church staff and Secretary of State; – Pontifical Household.
Laymen		– HS Employees; – HS Retired Employees and Assimilated; – I.O.R. Employees; – I.O.R. Retired Employees; – Other Vatican Employees; – Diplomatic corps accredited to the HS; – Embassy to the Holy See; – Ex relations with Holy See.

*A description of each of the customer types is set out in Annex XXXIV.

94. According to the IOR representatives, the abovementioned policy allows the IOR to operate accounts for Holy See, Vatican or IOR employees only as long as salaries or pensions are received.

95. The types of transactions which may be carried out for persons who do not have a pre-existing business relationship with the IOR are listed below. Those persons must however belong to the above-mentioned categories of customers permissible pursuant to the IOR Internal AML/CFT Policy. The permissible occasional transactions are:

    1) cheque cashing;
    2) currency exchange;
    3) wire transfers;
    4) cheque shipping/delivery.

96. The breakdown and distribution of accounts operated by the IOR by industry code as at 30 November 2011, is set out as follows:

DESCRIPTION	NO.OF CLIENTS
Canonical Foundation	50
Beatification Causes	322
Vatican Congregations	23

Secular and Religious Congregations (Female)	1,935
Secular and Religious Congregations (Male)	989
Apostolic Delegations and Nunciatures	143
Monasteries, Convents and Abbeys	128
Bishops' Conferences, Dioceses and Repres. Depts	1,617
Parishes, Churches and Pertinent Departments	465
Seminaries, Colleges, Various Entities	837
Holy See Departments	134
Cardinals	236
Bishops	1,604
Secular Clergy and Religious Men	15,420
Nuns	1,529
Holy See Employees	4,594
Holy See Retired Employees	642
IOR Employees	144
IOR Retired Employees	66
Pontifical Family	37
Former Vatican Employees and Diplomatic Staff of the HS	1,065
Legal Persons Without Canonical Recognition	995
Diplomatic Corps Accredited To The Holy See	392
Embassy To The Holy See	37
	5667,764

97. Geographically, the accounts are broken down as follows:

DESCRIPTION	NO.OF CLIENTS
Europe	29,271
Asia	665
Middle America	246
South America	1,184
North America	345
Other	51
Oceania	47
Africa	1,595
	1386,05

98. The IOR has no central banks functions. In accordance with the Monetary Agreement with the EU See Annex XXXII) the Vatican City State may use the Euro as its official currency and grants legal tender status to Euro banknotes and coins. Based on this Agreement the Vatican City State may issue Euro coins. The annual ceiling for coin issuance is determined by a Joint Committee composed of representatives of the Vatican City State, the Italian Republic, the European Commission and the European Central Bank (ECB) in accordance with the provisions of the Agreement.

99. However, this agreement does not impose any obligation on the ECB and national Central Banks to include Vatican City State's financial instruments in the list(s) of securities eligible for monetary policy operations of the European System of Central Banks.

100. Pursuant to Art. 9 of the Monetary Agreement the financial institutions located in the Vatican City State may have access to interbank settlement and payment and securities settlement systems within the Euro area under appropriate terms and conditions determined by the Bank of Italy, in agreement with the European Central Bank. These terms and conditions have not been determined yet.

II. Administration of the Patrimony of the Apostolic See (APSA)

History of APSA

101. His Holiness Pope Paul VI, in accordance with the Apostolic Constitution *Regimini Ecclesiae Universae* of August 15th, 1967 established the "*Amministrazione del Patrimonio della Sede Apostolica*", that consists of two sections: The Ordinary Section ("*Sezione Ordinaria*") and the Extraordinary Section ("*Sezione Straordinaria*").

The Ordinary Section

102. The Ordinary Section continues the work of the Administration of the Property of the Holy See ("*Amministrazione dei Beni della Santa Sede*"). The Administration of the Property of the Holy See has its origins in a Commission of Cardinals that His Holiness Pope Leo XIII set up by a *Motu Proprio* dated December 11th, 1880 and May 23rd, 1883, to supervise, as an advisory body, the Administration of the Peter´s Pence and the Patrimony still belonging to the Holy See after occupation of the ancient Pontifical State by the Italian Army in 1870.

103. By another *Motu Proprio* of April 30th, 1891 the Commission was given direct responsibility for the management of the Patrimony of the Holy See and the Commission's powers were also extended to all the other related branches and economic affairs.

104. His Holiness Pope Pio XI by a *Motu Proprio* of December 16th, 1926, decided to merge the Prefecture of the Apostolic Palaces and the Ecclesiastical Ministry Unit Administrative Offices into the general Administration of the Property of the Holy See.

The Extraordinary Section

105. The "*Administrazione Speciale della Santa Sede*" was established by His Holiness Pope Pio XI, by a *Motu Proprio* of June 7th, 1929, to manage the funds given to the Holy See by the Italian Government, deriving from the financial convention attached to the Lateran Treaty of February 11th, 1929 (see Annex VII). In compensation for the properties confiscated by the Italian Government, the Holy See received the amount of one billion and 750 million Liras, which represents the historical patrimony of the Administration.

Legal status

106. The APSA is a Dicastery of the Holy See. It represents one of the three Offices of the Roman Curia. The APSA is subject to the supervision of the Prefecture for the Economic Affairs of the Holy See.

Internal organisation of the APSA

107. The Internal organisation of APSA is determined by Art. 173 to 175 of the Apostolic Constitution "Pastor Bonus" and the APSA Regulation (see Annex XXVIII). The latest version of the APSA Regulation which contains details of the staff organisation was approved on November 23rd, 2010 by His Holiness Pope Benedict XVI. The new rules aim to improve the office organisation and management and the service to the Curia Romana.

108. Pursuant to Art. 173 of the Apostolic Constitution "Pastor Bonus" APSA is presided over by a Cardinal assisted by a Board of Cardinals. The two sections, the Ordinary Section and the Extraordinary Section, are under the control of the Prelate Secretary assisted by two Deputies, one for each section. (Art. 2 § 2 APSA Regulation).

109. The APSA relies on the consultancy of international clergy and lay experts. The consultants, who usually work for free, express their views on issues of financial, real estate, legal, tax and

business issues. The consultants are appointed by His Holiness the Pope on the proposal of the President Cardinal for a period of five years.

Financial Activities

110. Based on Art. 174 of the Constitution Pastor Bonus and Art. 8 §1 of the APSA Regulation the Ordinary Section administers the real estate entrusted to its care. It is also responsible for the legal and administrative requirements concerning employees of the Holy See; it supervises institutions under its fiscal responsibility[27]; it ensures the purchasing of goods and services required to carry out the ordinary business and specific aims of the dicasteries; and it maintains records of income and expenditures, prepares the accounts of the money received and paid out for the past year, and draws up the estimates for the year to come.

111. Based on Art. 175 of the Constitution Pastor Bonus and Art. 8 §2 of the APSA Regulation, the Extraordinary Section administers the moveable goods resulting from the financial Convention annexed to the Lateran Treaty of February 11th, 1929 and those acquired later and manages those entrusted to it by other institutions of the Holy See, including the Roman Curia, Vatican Radio, the Apostolic Library and some foundations constituted under Vatican Law.

112. The movable goods administered by the Section consist of cash, financial instruments and other values. The Extraordinary Section may exceptionally carry out financial transactions on behalf of individuals, with the approval of the President Cardinal, but never for the staff of the APSA.

113. According to the APSA representatives APSA holds accounts and deposits (exclusively managed by the Extraordinary Section) with many Central Banks in the world, such as: Bank for International Settlements, Bank of Italy, Federal Reserve Bank, Bank of England, Deutsche Bundesbank and others.

114. The Extraordinary Section is responsible for executing payment orders on behalf of various institutions of the Holy See. It manages the entrusted patrimony, having relationships with banks around the world, investing either in financial markets (deposits, equities, bonds), or in real estate in France, England and Switzerland. The properties in those countries are managed by APSA's wholly owned real estate companies. The members of the APSA management are also board members of the real estate companies.

115. The Extraordinary Section of APSA also manages the salaries payments for around 2,400 HS employees. On behalf of the Pension Fund, APSA manages the payment of pensions for 1,600 former HS and VCS employees. The Italian bank requires a tax identification code (*"codice fiscale"*) to carry out such operations. APSA (including both Ordinary and Extraordinary Sections) is the only institution within the Holy See which has an Italian tax identification code. The code is used either by the Ordinary Section for real estate purposes (owning properties in Italy), or by the Extraordinary Section for financial purposes (owning bank accounts in Italian banks).

Customer structure

116. As outlined above the APSA is a dicastery of the Holy See. All services carried out by the Ordinary Section and the main services carried out by the Extraordinary Section are provided for the Holy See and its institutions.

117. In addition, the Extraordinary Section is allowed – in accordance with the Constitution Pastor Bonus and the APSA Regulation – to provide some financial services to natural persons (clerical and lay) that are not organs or bodies of the HS/VCS with the approval of the President Cardinal. It was noted that these services were limited to 23 persons (15 clergy and 8 laymen accounts) at

[27] This supervisory function is shared with the Prefecture for the Economic Affairs.

the time of the MONEYVAL on-site visits[28]. The assets deposited in those accounts amount together to approximately €10 million.

Extraordinary Section			
Natural/ Legal	**Cleric/Laymen**	**No. of accounts**	**Assets (€)**
Legal persons	Clergy (e.g. Holy See Institutions, Religious Orders)	79	670.0 million
Natural persons	Clergy (e.g. Cardinals, Bishops)	15	7.2 million
	Laymen	8	2.8 million
Total		**102**	**680.0 million**

118. The accounts held for 15 individual clerical persons (e.g. Cardinals, Bishops) typically serve the purpose of depositing charitable contributions made on their behalf, or in favour of the Roman Curia or their own diocese of origin. The 8 lay persons holding accounts with the APSA have typically donated moveable or immovable goods to the Holy See and in return receive a life annuity which is accredited to their account with APSA.

119. The APSA representatives stated that in 2001 the Board of Cardinals took the decision to gradually limit the provision of financial services to individual persons (both clerical and lay) that are not organs or bodies of the HS/VCS. Finally, on 27 January 2006, the Board of Cardinals decided to start the process of closing all remaining accounts with those persons as far as possible (copies of the minutes recording these decisions were shown to the evaluation team). The representatives of APSA also stressed that since 2001 no deposits have been accepted for the remaining 23 accounts of natural persons. APSA only managed the assets deposited within those accounts and only the yields of the assets managed were reinvested.

120. The APSA representatives advised that there are no profits earned by providing financial services to the remaining persons that are not organs or bodies of the HS/VCS. Only APSA's expenses for administering those accounts are charged to the account holders. (There are also no profits earned with respect to services provided for organs or bodies of the HS/VCS, as costs are directly absorbed by the APSA itself.)

Main differences between IOR and APSA

121. APSA, in contrast with the IOR, is a dicastery which is headed by a Cardinal President who has a particular ecclesiastical relationship to the sovereign. In fact, this dicastery has special duties of a canonical nature to the Roman Curia. Thus, while the IOR may perform certain analogous activities, it is a separate legal person not headed by a Cardinal President.

122. APSA is a department of the Roman Curia. As such, it is part of the core administrative structure of the Curia and, according to Pastor Bonus, must serve the Curia according to the provisions of Pastor Bonus. This is referred to in canonical administrative law as a "competence." The IOR does not have a "competence" in the administrative sense within the Roman Curia because it is not part of the core administrative structure of dicasteries. As a dicastery, APSA serves the Roman Curia (and the departments of the VCS (See Pastor Bonus)). With the exception of the above-mentioned residual accounts which arise from a period prior to 2000 its account structure and functions are exclusively governmental.

123. The IOR, by contrast, is a separate legal person which administers a different patrimony of different origin and which has a "mission". In Canon Law, a foundation (unlike a dicastery) is

[28] APSA representatives informed the evaluators that following the first MONEYVAL on-site visit the holders of the 8 lay accounts have been contacted. Three of those accounts have already been closed, two further accounts are in the process of being closed and the assets of the three remaining accounts will become property of APSA upon the death of their respective beneficiaries. APSA also informed that the remaining 15 clergy accounts are difficult to close, given that they are related to long-standing account holders of APSA and it would be delicate to explain to them that they have to terminate this relationship with APSA.

assigned a "mission" in its founding documents, as is consistent with the creation of any legal person. That mission, stated in the Chirograph and by-laws of the IOR – is to receive and take custody of patrimony, obtain fruits from that patrimony, and facilitate its use and distribution on behalf of the Universal Church. In this regard, rather than being a dicastery, legally equal with other dicasteries, but assigned a different competence, the IOR is a creature of the Sovereign which interacts primarily with the Secretary of State under a Cardinal's Commission, which is presided over by the Cardinal Secretary of State. Finally, the custody of the patrimony held serves the Universal Mission of the Church by serving Nunciatures, Dioceses and religious orders in the promotion of religious works and charity.

124. The following table provides an overview of assets under management and organisation of the IOR. Figures for APSA are also provided for ease of comparison.

As of November 2011	IOR	APSA (Extraordinary Section)
Assets under management	€6.3 billion	€680.7 million[29]
Number of customers	20,772	102
Natural persons	75%	23 (20%)
- Clergy accounts	68%	15 (65%)
- Laymen accounts	32%	8 (35%)
Legal persons	25%	79 (80%)
Number of employees	104	13
Internal audit	Yes	Yes
External audit	Yes	No
Financial statements audited by Prefecture for the Economic Affairs of the HS	No	Yes
Number of dormant accounts	4,494	None

Categorisation as financial institution

125. In consideration of the foregoing description of the financial activities and customer structure of the IOR and the APSA the evaluation team concluded that both entities conduct as a business one or more of the activities or operations for or on behalf of a customer as listed under the definition of "financial institution" in the glossary to the FATF 3rd round Methodology. It should also be recalled that the FIA, the competent supervisory authority, has also identified both the IOR and APSA as entities conducting professionally activities as listed in Art. 2 a) of the revised AML/CFT Law which have been taken from the glossary definition of "financial institutions". An "activity conducted professionally" is defined in Art. 1 §1 of the revised

[29] Data includes both the funds managed on behalf of organs or bodies of the HS/VCS and on behalf of selected natural and legal persons.

AML/CFT Law as an organised economic activity, conducted regularly, for the production or exchange of goods and services, for and on behalf of a third party.

126. HS/VCS representatives agreed that the IOR and APSA must be treated as a "financial institutions" for the purposes of this evaluation, as this is the closest analogous category under the FATF Recommendations. However, HS/VCS representatives would like to reiterate that the IOR is a public institution whose nature is public and activity is *iure imperii* (by virtue of its sovereignty), but which also conducts activities comparable with that of a financial institution, which are *iure gestionis* (commercial or private acts) in character. Concerning the APSA, it has to be reiterated that this entity, being part of the core governmental structure of dicasteries, mainly performs an institutional activity with the exception of the 23 above-mentioned residual accounts held on behalf of natural persons.

Designated Non-Financial Businesses and Professions (DNFBP)

127. As an introductory remark, it should be noted that pursuant to Art. 7. of Act No. V on the economic, commercial and professional order of 1929, no one is entitled to open shops, businesses or workshops, even for the exercise of simple trades, nor set up industrial or commercial enterprises of any kind, nor open offices, studios, agencies or fixed places of delivery for the exercise of any profession, without obtaining authorisation from the Governor (see also sections 5.1 and 5.1 of this report). Accordingly, all services and activities that would fall under the category of DNFBP activities within AML/CFT evaluations are, in the context of the evaluation of the HS/VCS, subject to the above-mentioned authorisation regime.

Casinos (including internet casinos)

128. The establishment of casinos is expressly prohibited. This prohibition comprises land based and internet casinos.

Real estate agents, dealers in precious metals or stones, trust and company service providers

129. HS/VCS authorities state that no real estate agents operate within HS/VCS (as no real estate transactions take place in the territory of the VCS). As far as the HS is involved in real estate operations located on foreign territory and to the extent that real estate agents are involved in such transactions, foreign law would be applicable according to the principle of territoriality.

130. Furthermore, there are neither dealers in precious metals nor dealers in precious stones providing services in HS/VCS. Nor are there any trust and company service providers active within HS/VCS.

131. Nevertheless, all of the abovementioned DNFBP categories are listed in the AML/CFT Law as subjects obliged to fulfil the requirements set out in the AML/CFT Law (to the same extent as financial institutions). DNFBP were primarily included in the AML/CFT Law because the legislator wanted to replicate European and FATF standards. It was also intended as a safeguard to cover any possible future activities or activities of which the authorities are possibly not yet aware.

Lawyers, notaries and other independent legal professionals and accountants

132. There are a few foreign domiciled lawyers operating within the HS/VCS (also within its tribunals) and there is one public notary. There are also several foreign domiciled external accountants operating for different entities within the HS/VCS. While HS/VCS authorities acknowledge that such professionals are active within the HS/VCS, they stress that they do not prepare for or carry out transactions for their client concerning the activities mentioned under Recommendation 12 (d):

- buying and selling of real estate;
- managing of client money, securities or other assets;
- management of bank, savings or securities accounts;

- organisation of contributions for the creation, operation or management of companies;
- creation, operation or management of legal persons or arrangements, and buying and
- selling of business entities.

133. It appears that no relevant services are provided by lawyers and the public notary. However, the evaluation team takes the view that there are accountants preparing and carrying out transactions for clients in relation to the managing of client moneys, securities or other assets as well as in relation to the management of bank, savings or securities accounts. This refers in particular to the examination of the financial statements of the IOR. Therefore the evaluation team concludes that relevant services under Rec. 12 (d) are provided in practice.

1.4 Overview of Commercial Laws and Mechanisms Governing Legal Persons and Arrangements

134. Art. 4 of Act No. LXXI of 2008 on Sources of the Law (see Annex XII) applies the Italian Civil Code of 16 March 1942, as adapted until the entry into force of the Act (1 October 2008) and adopts it as the Civil Code of the VCS. Art. 4 then sets out a number of reservations which adapt the Civil Code to the special situation of the VCS.

135. At present the Vatican commercial law is governed by Book V of the Italian Civil Code, and in particular by: a) Arts. 2082 ff., concerning enterprises; b) and Arts. 2247 ff., concerning companies.

136. With regard to independent legal persons, Law No. V on the economic, commercial and professional order of 7 June 1929 (see Annex XXX) appears to create what is in effect a public monopoly regime within the territorial jurisdiction of the VCS. In particular, Art. 4 states "The purchase of goods or commodities of any kind and origin, meant for resale, and their sale are reserved to the State monopoly, according to provisions to be established by regulations."

137. Furthermore Art. 2 states that "The Governor's authorisation shall be necessary for the alienation of real property located within the territory of Vatican City by deeds *inter vivos* with or without payment, for the establishment of rights of long lease, surface, use, interest *in rem* limited in time, easement, mortgage or any other real interest, as well as for the lease and sublease, even partial, of the same property and for any duration." Art. 2 also provides that "The deeds foreseen in this paragraph shall be void and null if they lack said authorisation.".

138. In these circumstances it has been concluded that, at the time of the MONEYVAL on-site visits, it was not possible to establish an independent legal person within VCS and the evaluators did not observe any indications to the contrary. This is considered further in section 5.1 below.

1.5 Overview of Strategy to Prevent Money Laundering and Terrorist Financing

a. AML/CFT Strategies and Priorities

139. In the preamble to the Original AML/CFT Law the HS/VCS set out their understanding of the threat posed by money laundering and the financing of terrorists and state that "laundering of proceeds resulting from illicit activities and, likewise, exploiting the financial system to transfer assets deriving from criminal activities or also money of licit origin to finance terrorism, undermine the very foundations of civil societies, thus representing a threat for the integrity, regular functioning, reputation and stability of financial systems."

140. The preamble also states that "any State and jurisdiction, by reasons of the cross-border peculiarities of the phenomena of money laundering and financing of terrorism, must offer their contributions by introducing into their respective domestic legislations rules and measures consistent with the principles and standards agreed upon on the international and Community levels to fight against money laundering and financing of terrorism".

141. Furthermore, the HS/VCS commitment to supporting the proper use of the economy and financial markets was set out in Pope Benedict XVI's Encyclical Letter *Caritas in veritate*, which stated "Efforts are needed - and it is essential to say this - not only to create "ethical" sectors or segments of the economy or the world of finance, but to ensure that the whole economy - the whole of finance - is ethical, not merely by virtue of an external label, but by its respect for requirements intrinsic to its very nature".

142. The HS/VCS authorities have therefore taken a number of steps to introduce measures to counter the threat to the financial systems of HS/VCS being utilised for the purposes of money laundering and the financing of terrorism, notably:

a. On December 17, 2009, the VCS signed the Monetary Convention with the European Union (2010/C 28/05), undertaking: «to adopt any appropriate measures, by direct reception or equivalent actions, to implement the legal instruments and rules of the EU … in matters of: … prevention of money laundering» (Art. 8, § b)).

b. On December 30, 2010, the Pontifical Commission for the VCS adopted Act No. CXXVII concerning the prevention and countering of the laundering of proceeds of criminal activities and financing of terrorism.

c. On the same day, Pope Benedict XVI promulgated the Apostolic Letter in the form of a *Motu Proprio* on the prevention and countering of illegal activities in the financial sector. The *Motu Proprio* established the Financial Intelligence Authority (FIA) as the financial intelligence unit (FIU) for the VCS.

d. In his *Motu Proprio*, Pope Benedict XVI extended the application of Act No. CXXVII/2010 to the dicasteries of the Roman Curia and for each and every dependent institution or entity in which they carry out their activities (i.e. within the legal framework of the HS), after expressing his concern that: "in our time, inside an ever more globalised society, peace is always threatened by different causes, among which an improper use of markets and economy, and the terrible and destructive cause of violence perpetrated by terrorism, thus causing death, pain, hatred and social instability".

e. On 24 January 2012, the Holy See mandated a decision to take all necessary steps to apply for membership of the Egmont Group (of financial intelligence units).

f. On January 25, 2012, the President of the Governorate of the Vatican City State signed a Decree which modified and integrates Law No. CXXVII/2010 in order to introduce further provisions to remedy deficiencies in the application of international standards.

g. Also on January 25, 2012, the Holy See, acting also on behalf of the VCS, deposited before the Secretary-General of the United Nations the instrument of ratification of the *1988 UN Convention against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances*, as well as the accession instruments to the *1999 International Convention for the Suppression of the Financing of Terrorism*, and to the *2000 UN Convention against Transnational Organised Crime*[30].

[30] Subsequent to the second MONEYVAL on-site visit, the HS/VCS authorities informed the evaluators that an in-depth analysis of the substantive provisions of the VCS Criminal Code had been initiated, in order to introduce modifications to the Criminal Code to fully state in the municipal law treaty terms, including, *inter*

143. As stated above, Act No. CXXVII concerning the prevention and countering of the laundering of proceeds of criminal activities and financing of terrorism was enacted on 30 December 2010 (the original AML/CFT Law) and came into force on 1 April 2011. This law was introduced in order to implement an AML/CFT regime within the HS/VCS and also to implement the Monetary Convention between the Vatican City State and European Union. The evaluators considered the effectiveness of the implementation of this act during the first MONEYVAL on-site visit in November 2012. Following the first MONEYVAL on-site visit the President of the Governorate using his powers under Art. 7 of the Fundamental Law of VCS (see Annex X) to issue dispositions having the force of law in cases of urgent necessity, enacted Decree No. CLIX – Decree of the President of the Governorate of the Vatican City State promulgating amendments and additions to Law n. CXXVII, On the Prevention and countering of the laundering of the proceeds of criminal activities and the financing of terrorism, of 30 December 2010 (the revised AML/CFT Law) which came into immediate effect on 25 January 2012. This Decree substantially amended and supplanted the original law. The Decree was guided by the need to better allocate AML/CFT responsibilities amongst the competent authorities in order to make the HS/VCS, as a whole, more effective in preventing and countering ML and FT. The Decree clarifies the responsibilities of competent authorities and confirms and clarifies the FIA's fundamental powers both as a supervisor and as the FIU of the HS/VCS. The aim of the Decree was also to implement the international standards, and adapt the international standards to the context of the HS/VCS, in order to make the AML/CFT system effective. The Decree introduced new provisions in the fields of crimes and sanctions, international cooperation, customer due diligence, registration and record keeping, reporting of suspicious transactions. In the field of measures to counter financing of terrorism and the activities that threaten international peace and security, the Decree clarified the mechanisms according to which the HS/VCS adopts a domestic list of designated persons, also to implement the relevant Resolutions of the UN Security Council. This Decree loses its force if it is not confirmed by the Pontifical Commission within 90 days[31].

144. Following the formation of the FIA, regulations and instructions were prepared and issued to relevant bodies within the VCS. These regulations and instructions seek to provide detailed guidance and direction on the various AML/CFT measures that need to be in place to facilitate the development of a comprehensive AML/CFT regime within HS/VCS. The evaluators consider that the Regulations and Instructions constitute "other enforceable means". The reasons for this are set out under SR.VII in Section 3.5 below.

145. The HS/VCS authorities have stated that their medium and long-term strategy in the prevention and countering of money laundering and financing of terrorism, may be summarised as follows:

a. to *continue* their efforts in the ethical foundation of economic and financial activities;
b. to *continue* their efforts towards the conformity with the international and European-regional standards;
c. to *improve* the effectiveness of the implementation of the internal laws, regulations and other imperative measures;
d. to *increase* institutional co-operation between the internal authorities;
e. to improve and increase the international co-operation.

146. This strategy will be continued under five "pillars" or fundamental principles:

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alia, articles 8 and 9 of the United Nations Convention against Transnational Organised Crime (Palermo Convention). The Holy See furthermore notes that, according to the terms of its internal law, to the extent possible, treaty terms are directly incorporated into the legal system. Finally, HS/VCS authorities are actively considering ratification of the 2003 United Nations Convention against Corruption (the Merida Convention).

[31] The Pontifical Commission for the Vatican City State confirmed the Decree No. CLIX of 25th January 2012 without modification on 24th April 2012.

h. *Human dignity and common good:* the fundamental principle is that finance cannot be contrary to human dignity and must contribute to the realisation of the common good;

i. *Subsidiarity:* prevention and countering mechanisms tend to make the different decision-making and operational levels of subjects involved and responsible in the prevention and countering of money laundering and financing of terrorism;

j. *Proportionality:* prevention and countering mechanisms intervene following an accurate assessment of the suspect property and transactions and risks;

k. *Effectiveness:* prevention and countering mechanisms must be adequate to the realisation of the objectives set;

l. *Co-operation:* activities of preventing and countering the laundering of proceeds of criminal activities and financing of terrorism are carried out by ensuring maximum communication and co-operation between the internal, international and regional authorities competent in this matter.

b. The institutional framework for combating money laundering and terrorist financing

147. The following are the main bodies and authorities involved in combating money laundering or financing of terrorism:

Governorate

148. The legislative power within VCS is exerted by the Pontifical Commission for the VCS, whose members are appointed by the Pope for five years (Art. 3, §1 of the Fundamental Law (see Annex X).

149. The executive power is exerted by the President of the Governorate of the VCS, an office held by the same Cardinal heading the Pontifical Commission, assisted by a Secretary General and a Vice-Secretary General (Art. 5).

150. In the Governorate different functions are established (see 1.1 above), which are normally distributed among various departments (commercial, legal, technical, artistic, general maintenance, etc.). Relations with foreign states is the competence assigned to the Secretariat of State.

151. The President of the Governorate is in charge of the legal representation of the State, but not its international representation (Art. 8); he can issue orders for the implementation of acts and regulations (Art. 7, §1); he can avail himself of law-enforcing bodies for security reasons, and of the State's police as well (Art. 14), represented by the Corps of Gendarmes of VCS; in case of emergency, he can issue provisions having the force of law, though, as noted above in the context of the AML/CFT Law, they must be confirmed by the Pontifical Commission within ninety days, otherwise they become ineffective (Art. 7, §2).

152. As far as the executive power is concerned, there are forms of supervision and control by the Secretariat of State. To this end, the Fundamental Law establishes that "in matters of greater importance it is necessary to proceed in agreement with the Secretariat of State" (Art. 6), and in any case it is established that the VCS' budget and final balance, once they are approved by the Pontifical Commission, "are submitted to the Supreme Pontiff through the Secretariat of State" (Art. 12).

153. The Governorate is composed of operational bodies:

a. Departments. There are nine (State Accountancy, General Services, Security Services and Civil Protection, Health and Hygiene, Museums, Telecommunications, Economic Services, Pontifical Villas); the activities they carry out are of an institutional nature, related to buildings and facilities, culture and scientific research, trade and marketing, public utility, also in favour of other Vatican organisations, natural persons or third parties.

b. Directors. They head Departments, taking on the relevant responsibilities and co-ordinating their functions and activities; they are directly accountable to the President.

c. Council of Directors. This is an advisory and auxiliary body to the President. It is more than a traditional Board. The directors are the departmental heads of the Governorate and form the Council which generally meets on a bimonthly basis to discuss common governance or management issues.

d. Office Managers and Service Managers. They are directly accountable to the directors.

e. Central Offices. There are seven of them (Legal Office, Personnel Office, Registry Office, Philately and Numismatics, Information Systems, State Archives, Pilgrim and Tourist Office); they are in charge of carrying out particular activities related to the exercise of the executive power and depend directly on the President.

f. Scientific Body. It is made up by the "*Specola Vaticana*" (Vatican Observatory) having an autonomy status and operating in the sector of astronomic research.

154. Recently, the President's Office, has created new bodies that directly depend on the Secretary General: the Goods and Services Purchase Office and the Internal Control Office.

155. As far as the institutional tasks of departments and offices are concerned, reference is made to Act No. CCCLXXXIV of 2002 on The Government of the Vatican City State (see Annex XI). According to the AML/CFT Law, in matters of combating the laundering of proceeds of criminal activities and financing of terrorism, as far as the Governorate is concerned, the Department of State Accountancy plays a supervisory role over the financial flows of the State and of more general protection of the principles established in the same Act.

<u>The Department of VCS Accounting</u>

156. The Department of VCS Accounting is a section of the Governorate of the VCS. According to the Act on the Government of the VCS No. CCCLXXXIV of 2002, the Department of State Accounting takes care of the general and analytical accounting of State Bodies, carrying out audits, preparation of reports relating to all economic and financial operations and management of the State Treasury (Art. 11). The Department carries out audits and verification of the correct use of accounting processes and their economic integration with the administrative procedures, operating under a centralised form.

157. The State Accountancy Office is headed by a Director and is made up of the Administrative Office and the Management planning and control Office. It has a staff of 27 people. The Accountancy Office is responsible for the keeping of the general and detailed accountancy records of all the bodies of the Governorate, on the basis of the accountancy principles indicated by the Prefecture for the Economic Affairs of the HS (see below) and generally acknowledged international accountancy principles. It carries out activities of accountancy control and draws up the Governorate's budget and final balance sheet. It manages the positions of all the suppliers of the Governorate, by dealing with the input and keeping of the operational system of sensible data communicated by the companies supplying goods and services to the State. The keeping and maintenance of the panel of suppliers is part of the responsibility and competence of the Goods and Services Purchase Office depending directly upon the Secretary General.

158. The State Accountancy Office furnishes expert opinions on fiscal, financial and economic topics, and, to assure the full integration of administrative-accounting processes with the operational ones, co-ordinates and supervises the ongoing standardisation of managerial procedures of the Governorate's Departments and Offices.

<u>The Prefecture for the Economic Affairs of the Holy See</u>

159. The Prefecture for the Economic Affairs of the HS is a dicastery of the HS. According to Pastor Bonus, the Prefecture has the function of revising and governing the goods of the administrations that are dependent on the HS, or of which the HS has charge (Art. 176). The

Prefecture is presided over by a Cardinal assisted by a board of Cardinals, with the collaboration of the Secretary and the General Accountant (Art. 177).

160. The Prefecture studies the reports on the patrimonial and economic status of the HS, as well as the statements of income and expenditures for the previous year and the budget estimates for the following year of the administrations, by inspecting books and documents, if required. The Prefecture compiles the HS's consolidated financial statement of the previous year's expenditures as well as the consolidated estimates of the next year's expenditures, and submits these at specific times to higher authority for approval (Art. 178).

161. Furthermore, the Prefecture supervises the financial undertakings of the administrations (including APSA) and expresses its opinion concerning projects of major importance. Finally, it inquires into damages inflicted in whatever manner on the patrimony of the HS, and, if needed, lodges penal or civil actions to the competent tribunals (Art. 179).

Secretariat of State - the Section for Relations with States

162. As previously stated, as far as international representation is concerned in accordance with Art. 2 of the Fundamental Law, "the representation of the State in the relations with foreign States and other subjects of international law, for the diplomatic relations and the stipulation of treaties, is reserved to the Supreme Pontiff who exerts it through the Secretariat of State".

163. Within the Secretariat of State, the Section for Relations with States or Second Section is responsible for the diplomatic relations of the HS with States, including the signing of treaties and similar agreements and the representation of the HS in international organisations and conferences. The Second Section of the Secretariat of State is headed by an Archbishop, the Secretary for Relations with States, assisted by a Prelate, the Under-Secretary for Relations with States (Pastor Bonus Arts. 45-47).

164. The Secretariat of State concludes international agreements, and also has regard to matters concerning the prevention and countering of laundering of unlawful money and financing of terrorism, and deals with the relevant compliance with and ratification of such agreements. Furthermore, it co-operates with the competent State or international authorities through its own diplomatic channels.

Tribunals

Tribunals of the Vatican City State

165. The court system of the VCS is a department of the Governorate. According to Law No. CXIX – Law that approves the Judiciary system of the State of Vatican City (see Annex XVI), the following tribunals exercise judicial powers in the name of the Supreme Pontiff:

- Single Judge (*Giudice Unico*);
- Tribunal (*Tribunale*);
- Court of Appeal (*Corte d'Appello*);
- Court of Cassation (*Corte di Cassazione*).

166. The Single Judge handles simple cases such as small claims and traffic violations. The Tribunal is composed of three judges appointed by the Pope and is the court of first instance in criminal and civil cases which do not fall under the jurisdiction of the Single Judge. The Court of Appeal serves as a disciplinary body for VCS lawyers, hears appeals from the VCS Disciplinary Commission, and handles employment issues from the Office of Work of the Apostolic See. It comprises a President and the three other judges who are appointed by the Pope and serve a term of five years. The Court of Cassation is the highest court of the VCS. It hears appeals from the Court of Appeal as well as penal matters against Cardinals and bishops which the Pope does not handle personally.

167. Criminal jurisdiction over the offences described in the AML/CFT Law is vested in the tribunals of the VCS by Act No. CXXVII of 2010. However, criminal cases may be transferred to

be prosecuted by the Italian authorities, as this is authorised by Art. 22 of the Lateran Treaty. The number of cases considered in the period 2009-2011 are set out below.

Year	Cases where violators of public safety norms were detained by Vatican police and handed over to the Italian authorities	Cases where Art. 22 of the Lateran Treaty between the Holy See and Italy was applied
2009	1	1
2010	7	0
2011	5	4

168. The functions of the prosecutor, in both civil and criminal cases, are performed by the Promoter of Justice (*promotore di giustizia*) (see below).

Tribunals of the Roman Curia (Holy See)

169. The Holy See has a distinct court system which deals with religious affairs, violations of Canon Law and cases related to the functions of the Holy See. Details of the tribunals are set out in Arts. 117-130 of Pastor Bonus (see Annex VIII) There are 3 tribunals:

- Apostolic Penitentiary is responsible for the internal church forum and granting and use of indulgences (Arts. 117-120);
- Supreme Tribunal of the Apostolic Signatura functions as the supreme tribunal and also ensures that justice in the Church is correctly administered (Arts. 121-125); and
- Tribunal of the Roman Rota is a court of higher instance at the Apostolic See, usually at the appellate stage, with the aim of safeguarding rights within the Church; it fosters unity of jurisprudence, and, by virtue of its own decisions, provides assistance to lower tribunals (Arts. 126-130).

170. The tribunals of the Roman Curia have no jurisdiction over ordinary civil and criminal cases. However, the Supreme Tribunal of the Apostolic Signatura exerts disciplinary powers over judges of the VCS. The President of the Court of Cassation is also the Prefect of the Apostolic Signatura, and most judges of the Court of Appeal also serve as judges of the Roman Rota.

The Promoter of Justice

171. The Promoter of Justice of the VCS exerts a prosecutor's functions, both on the civil and criminal side, before the Tribunal and the Single Judge of the VCS (Law no. CXIX Art. 5). The Promoter of Justice is appointed by the Pope (Law no. CXIX Art 7). Judges are selected among persons with high standards of morality and professional skills. The Prosecutor exercises his functions with autonomy and independence and subject to the law.

172. According to the rules established by the internal legal system, the Promoter of Justice performs his criminal law responsibilities by promoting and instigating inquiries and possibly criminal prosecutions on the basis of circumstances or facts related to goods or natural and legal persons, about which he is informed.

173. As far as the activities of prevention and countering of ML and FT are concerned, the AML/CFT Law provides that the FIA carries out the financial examination of the reports received by analysing and thoroughly investigating suspicious transactions and communicates to the Promoter of Justice at the Tribunal the facts that, on the basis of their features, entity, nature and other known circumstances, possibly indicate offences of money laundering, self-laundering or financing of terrorism (Art. 33). Should the FIA suspend transactions, for a maximum of five working days, it must give immediate notice to the Promoter of Justice at the Tribunal. The Promoter of Justice, should inform the FIA about the reports of suspicious transactions on which no further investigation has been carried out (Art. 36).

174. The criminal jurisdiction for the offences provided for in the AML/CFT Law is assigned to the Tribunals of the VCS.

Gendarmerie Corps of VCS

175. The Gendarmerie Corps of VCS is part of the Department of Security Services and Civil Protection of the Governorate.

176. The Department is in charge of the security and public order in close co-operation with the Pontifical Swiss Guard[32] and the competent Vatican bodies. In accordance with the Lateran Treaty, it can ask, through the institutional channels, for the co-operation of the equivalent entities of the Italian State and other States. Relations between the Gendarmerie and the Italian Police are conducted through the General Inspectorate of Public Security for the Vatican City (an Italian state institution), which is the liaison body between the two countries.

177. The Gendarmerie's primary goal is the protection and security of the Pope when he is within the VCS, when he is on pastoral visits in Italy and on his Apostolic journeys in other States. The tasks assigned to it are the same institutional tasks as other national police forces, i.e. judicial police, frontier police, fiscal police, etc., with the aim of assuring the security of places and persons, keeping public order and preventing and repressing offences. However, because of the peculiar character of the VCS, such as its territorial size and limited number of citizens, the Gendarmerie is a police force *sui generis*. The Gendarmerie Corps is the only security agency and police force of the VCS and it also acts as a road patrol, and in this context, it deals with the prevention of road accidents and related interventions.

178. The Gendarmerie is covered by Act No. CCCLXXXIV of 2002 on The Government of the Vatican City State (Art. 13) (see Annex XI), which provides the legislative basis for the goals and competences of the Gendarmerie.

179. The Gendarmerie Corps co-operates, within the limits of its competence, with the Judicial Authority of the VCS and the competent authorities of the HS. In particular, in the course of investigative activities it co-operates with the Promoter of Justice and Single Judge who have the power to impose coercive measures.

180. Gendarmerie activities include frontier controls, prevention of criminal activities and investigations.

181. Furthermore, the Gendarmerie Corps has the power to enforce laws and regulations in matters of trade and finance; in cases of necessity, it avails itself of all the legislative and sub-legislative instruments, in order to be in a position to carry out the tasks of supervision, implementation of investigative techniques, checks, confiscation, *flagrante delicto* procedures, inquiries and other criminal procedural actions assigned by law or delegated to the Gendarmerie.

182. The Gendarmerie Corps, in co-ordination with the Secretariat of State and the Governatorate, also has responsibility for maintaining contacts with foreign bodies and organisations, in order to assure international co-operation in the fields of money laundering and fight against terrorism. In strategic terms, one of the priorities in countering money laundering and fighting against terrorism consists of reinforcing international mutual legal assistance and co-operation with the equivalent foreign legal entities on the level of both bilateral relations and main international organisations, such as INTERPOL.

183. The headquarters of the Gendarmerie is located in the premises of the Department of Security Services and Civil Protection, where all the different functional police divisions are based.

[32] The Pontifical Swiss Guard is a small force maintained by the Holy See and is responsible for the safety of the Pope, including the security of the Apostolic Palace. It serves as the *de facto* military of Vatican City.

184. The structure of the Gendarmerie Corps is centralised and made up of offices specialised in terms of technical-professional capabilities. It is entrusted with the prevention of, and fight against, criminal activities. As far as fiscal crimes, economic crimes, prevention of terrorism and organised crime are concerned, it is noted that:

Financial crimes. The Gendarmerie has jurisdiction over the whole territory of the VCS. The officer in charge of the inquiries has competence over the whole territory of the State, and is directly responsible to the Director of Security Services and Civil Protection. This activity consists of detecting, documenting and investigating cases of economic and financial crimes, and corruption. The investigating unit monitors and analyses unlawful or suspicious financial operations and various kinds of economic crimes which have been committed.

Prevention of terrorism and organised crime. The Gendarmerie has the competence over the whole territory of the VCS, with the exception of the Apostolic Palace. The officer in charge is directly responsible to the Director of Security Services and Civil Protection. This activity consists of monitoring, documenting and preventing unlawful or suspicious activities, adopting preventive and repressive measures on the basis of intelligence information, detecting possible terrorists and delivering them to the court.

Frontier and customs control unit. This unit is in charge of fiscal crimes, border security and any other related type of financial crime, including financing of terrorism.

185. There are two more specialised units, directly reporting to the Director of Security Services and Civil Protection, for extremely serious or urgent interventions:

Anti-sabotage unit, in charge of dealing with threats connected to sabotage actions or explosive devices. This special unit intervenes, for instance, in cases of locating parcels, envelopes or other suspicious objects. Its actions consist of implementing all the security measures aimed at recognising and neutralising such threats. Furthermore, it acts as a support unit for judicial police activities.

Swift intervention squad, which was recently created with the goal of dealing with emergencies outside the scope of ordinary police activities (e.g. subversive activities, analysis and technical logistic support for investigative activities). Furthermore, it can intervene immediately in high-risk situations.

Police authority of Italy

186. Art. 3 of the Lateran Treaty also provides:

"It remains understood that St. Peter's Square, although forming part of Vatican City, will continue to be normally open to the public and to be subject to the police power of the Italian authorities, who will stop at the foot of the steps leading to the Basilica, although the latter will continue to be used for public worship, and they will, therefore, abstain from mounting the steps and entering the said Basilica, unless they are asked to intervene by the competent authority".

187. Art. 15 provides that certain designated properties, even if they form part of the territory of the Italian State, will enjoy the immunities granted by International Law to the headquarters of the diplomatic agents of foreign States. The same immunities apply also with regard to other churches (even if situated outside Rome) during such time in which, without such churches being open to the public, religious ceremonies are celebrated in them with the participation of the Supreme Pontiff. However, Art. 22 does provide that:

"the Holy See will hand over to the Italian State persons who may have taken refuge within Vatican City and who have been accused of acts, committed within Italian territory, which are considered to be criminal by the laws of both States. The same provisions will apply with regard to persons accused of crimes who may have taken refuge within the buildings declared

to be immune under Art. 15, unless the persons in charge of such buildings prefer to invite the Italian police agents to enter them in order to arrest such persons".

Financial Intelligence Authority (FIA)

188. Pope Benedict XVI established the FIA by the *Motu Proprio* of December 30, 2010, in order effectively to prevent and counter money laundering and financing of terrorism (See letter c, *Motu Proprio*; and Art. 2 *septies* of the revised AML/CFT Law). The FIA has public canonical legal personality and Vatican civil personality and has its headquarters in the VCS. The FIA supervises the observance of the duties established in matters of prevention and countering of ML and FT and receives reports of suspicious transactions which it analyses (Art. 2 *septies* of the revised AML/CFT Law). The FIA monitors obligors' compliance with the requirements set out in the AML/CFT Law to prevent and counter money laundering and the financing of terrorism and verifies, including through inspections, the suitability and effectiveness of the policies, organisation, measures and procedures adopted by them to prevent and counter money laundering and the financing of terrorism. (Art. 2 *septies* §2). The FIA has powers to impose administrative sanctions (Art. 42). Full details of the FIA's functions are set out under section 2.5.1 below.

189. The FIA operates in close co-operation with the Judicial Authority. It can suspend, for a maximum of five working days, transactions suspected to involve money laundering, self-laundering or financing of terrorism, giving immediate notice to the Promoter of Justice at the Tribunal (Art. 33 §5 k)). It informs the Promoter of Justice about facts indicating money laundering, self-laundering or financing of terrorism (Art. 33 §3 & §5 c)).

190. Furthermore, the FIA, independently of the provisions adopted by Judges on the criminal level, can order the freezing of assets and economic resources by its ruling, in order to counter or repress financing of terrorism and the activity of countries threatening peace and international security (Art. 24 §1). This is covered in detail under SR.III (see Section 2.4 below).

c. The approach concerning risk

191. There is a clear need for a comprehensive risk assessment to properly judge the adequacy of the current risk based approach. The Secretariat of State has confirmed that, as a consequence of the evaluation process, it has become aware of the importance of conducting a detailed risk assessment in order to develop a comprehensive AML/CFT regime. As a consequence of this the evaluators were informed that the process for conducting a risk assessment has been initiated. This process will involve actively seeking recommendations from the FIA and more generally gathering information necessary for the completion of the risk assessment including the recommendations of the evaluators on this issue. Furthermore, the Secretariat of State has taken into account an initial view from the FIA, indicating those areas of inquiry which typically present possible areas of weakness in many jurisdictions, including: use of cash transactions; the adequacy and availability of information from non-profit organisations; receipt of donations; and placing of external contracts.

192. The AML/CFT Law has introduced elements of a risk based approach and details of this are set out in section 3.1 below.

2 LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES

Laws and Regulations

2.1 Criminalisation of Money Laundering (R.1 and 2)

2.1.1 Description and analysis

Recommendation 1

193. Prior to the enactment of Act No. CXXVII of 30 December 2010 and its extension to the Holy See by His Holiness Pope Benedict XVI in the introduction to the *Motu Proprio* of the same date money laundering had not been specifically criminalised in the legal system of the HS/VCS. In theory reliance could have been placed on the procedure provided by Art. 9 of Act No. LXXI on the sources of law of 1 October 2008; (see Annex XII) designed to address lacuna in the system of criminal law. While this had been utilised in the drugs area its application in the context of money laundering was never tested.

194. In the period prior to the entry into force of the new law reliance had to be placed on Art. 421 of the Italian Criminal Code of 1889 which, failing specific HS/VCS legislative action, applies by virtue of Art. 7 of the Act on the sources of law mentioned in the previous paragraph. This sets out the offence of receiving stolen property and is worded thus:

> Except in the cases provided in Art. 225, whomever acquires, receives or hides money or things resulting from a crime, or is involved in any way with the acquisition, receiving or hiding of them, without participating in the underlying crime, is punished with imprisonment for up to two years or with a fine of up to three thousand lira. If the money or things proceed from a crime which is subject to a term of imprisonment for more than five years, the guilty party is punished with imprisonment from one to four years.
>
> In both cases provided for in the preceding provisions, the imprisonment should not be more than half of the penalty established for the underlying crime from which the things proceed. Where it regards a fine, the amount is determined according to the norms established in Art. 19.
>
> If the guilty person is a habitual receiver of stolen property, the term of imprisonment is from three to seven years in the case provided in the first paragraph of this article, and from five to ten years, in the case provided in the second paragraph and the fine between three hundred and three thousand lira is always added.

The fine level has been adjusted upwards on several occasions to take account of inflation and of the introduction of the Euro.

195. Those responsible for the drafting of the new law had two primary goals. First, to achieve consistency with relevant international and European standards in this sphere. Second, to do this in a manner broadly harmonised with Italian criminal law. The latter goal was, in turn, dictated by considerations of geography and practicality. It was also influenced by Art. 22 of the Lateran Treaty of 1929 (see Annex VII) which subjects aspects of an enhanced regime of criminal co-operation with Italy to the condition of double criminality. This is examined in greater depth below in the context of Recommendations 36-39 and Special Recommendation V. It is also

worthy of note for present purposes that in the FATF third round mutual evaluation of Italy in 2006 that country received a compliant rating for R.1.

196. As with Italy, Act No. CXXVII of 2010 adopted a drafting technique in relation to the criminalisation of money laundering which had the receiving offence (above) at its foundation. Art. 3, headed 'Money Laundering' is of primary importance. It was worded, in full, as follows:

> In book II of "About offences in particular" Title X "About offences against property" Chapter V after the section "About handling stolen goods" follows "about laundering and self-laundering". In the same Chapter, after Art. 421 follows Art. 421 *bis*, that reads:
>
> 421 *bis*
>
> He who, except for the cases foreseen in Art. 421, replaces or transfers money, goods or other utilities resulting from a serious offence, or performs other operations linked to them, in such a way as to hinder the identification of their criminal source, or uses, in economic or financial activities, money, goods or other utilities resulting from a serious offence, is punished with a detention of four to twelve years and a fine of one to fifteen thousand Euro.
>
> In the cases foreseen by the preceding paragraph, the penalty consist of a detention penalty of two to six years and a fine of one to ten thousand Euro, if the monies, goods or other utilities result from a serious offence for which a penalty of detention inferior to the maximum of five years is foreseen.
>
> The person who committed the serious offence, shall be sentenced to a detention period of two to six years and a fine of one to ten thousand Euro.
>
> In the cases foreseen by the first paragraph, the sanction is increased if the fact is committed within the exertion of a professional activity.
>
> The offence occurs even when the activities that generated such monies, goods or other utilities to be laundered, are performed in another state.
>
> In the case of condemnation, the confiscation of the goods representing the product or profit of the criminal activity is mandatory, except for the case that they belong to persons alien to the offence. The judge, if it is not possible to proceed to the confiscation, shall order the confiscation of money, goods or other utilities available to the convict, even through a third person, for an amount equivalent to the value of the product, profit or price of the offence.

197. One of the consequences of this approach was that the language used differed substantially from that found in the Vienna and Palermo Conventions of the UN (both of which have very recently been ratified by the HS/VCS).

198. For the avoidance of doubt it should be stressed that though influenced by the Italian provisions the articles addressing criminalisation were not identical to those which apply in that country. There were differences in structure (two provisions in the HS/VCS rather than three) and some departures in wording. However, the authorities confirmed to the evaluation team that the only significant departure from the Italian precedent which was intended to be achieved was that of the specific criminalisation in the legal system of the HS/VCS of self-laundering (criterion 1.6).

199. As was noted previously (see above), subsequent to the MONEYVAL on-site visit of November 2011 the authorities of the HS/VCS decided to revisit the Act of December 2010 in order to place the AML/CFT system on a more secure, long term and sustainable legislative footing. The extensive amendments and additions to the law brought about by this process entered into force on 25 January 2012. The text, which now exclusively occupies the field and thus replaces the former law, is reproduced in full at Annex V for ease of reference.

200. In the course of this review process the relevant authorities took the decision to revisit the approach originally adopted to the criminalisation of money laundering in order to more directly embrace the concepts and the wording utilised in the relevant international standards. The 2005

Warsaw Convention of the Council of Europe and the UN Palermo Convention of 2000 were particularly influential.

201. Art. 1(4) of the Law of January 2012 defines "money laundering" as follows:

a) the acts referred to in Art. 421 *bis* of the Criminal Code.

b) participation in one of the acts referred to in Art. 421 *bis* of the Criminal Code, association to commit, attempt to commit, and aiding, inciting, or counselling someone to commit such act, or abetting its execution;

202. Art. 421 *bis* is, in turn, inserted by Art. 3 of the Act headed "money laundering and self-laundering". This is the first of two articles in Chapter II of the Act entitled "criminal provisions on money laundering". Paragraph 1 is central to the new approach which has been adopted. Drawing its inspiration primarily from Art. 9(1) of the Warsaw Convention, it is worded thus:

1. Whomever, outside the cases foreseen in Art. 421:

a) replaces, converts or transfers currency, funds or other assets, knowing that they proceed from a predicate offence or from the participation in a predicate offence, for the purpose of concealing or disguising their illicit origin or of assisting any person who is involved in the commission of such criminal activity to evade the legal consequences of his actions;

b) conceals or disguises the true nature, source, location, disposition, movement, ownership of, or the rights with respect to currency, funds or other asses, knowing that they proceed from a predicate offences or from the participation in a predicate offence;

c) acquires, possesses, holds, or uses to currency, funds or other assets, knowing, at the time of their receipt, that they proceed from a predicate offence or from the participation in a predicate offence;

shall be punished with four to twelve years of imprisonment and with a fine ranging from €1,000 to €15,000.

203. The physical and material elements of the offence are consistent with the relevant international standards. Criterion 1.1 is thus satisfied.

204. Several of the key concepts utilised in 421 *bis* (1) are defined in Art. 1 of the 2012 Act including "currency", "funds" and "other assets" (Art. 1(10), (11) and (12)). All are broadly cast. In addition Art. 421 *bis* (2) provides as follows:

The crime of money laundering exists regardless of the value of the currency, funds or other assets that proceed from the predicate offence, even when there has been no conviction for that offence.

In the view of the evaluators the interaction of these features of the Act are sufficient to satisfy the expectations of criterion 1.2 of the methodology.

205. As noted above, in the 2012 Act money laundering is defined in relation to the concept of predicate offences. This concept is defined, in Art. 1(5) by reference to a list of specific offences in the Criminal Code "as well as any other criminal acts punishable …. with a minimum penalty of six months or more of imprisonment or detention; or with a maximum penalty of one year or more of imprisonment or detention". The term thus combines the approaches permitted by R.1.

206. As was noted earlier, by virtue of Art. 7 of Act No. LXXI on the sources of law of 1 October 2008 (see Annex XII) the Italian Criminal Code, as it stood at the time of the Lateran Treaty in 1929, applies within the HS/VCS unless modified by a subsequent enactment. It was confirmed in the course of the November MONEYVAL on-site visit that changes to the Italian Criminal Code are not automatically adopted. Developments in Italian law, and more widely, are monitored and modernising legislation is enacted in the HS/VCS on an ad hoc basis.

207. For this reason those responsible for drafting Chapter II of Act No. CXXVII of December 2010, entitled "criminal provisions in matters of money laundering", also had to address gaps in the CC as revealed by a comparison with, *inter alia*, the designated categories of offences contained in the Glossary to the FATF Recommendations. A substantial modernising effort was required in this regard the fruits of which were included in Chapter III (entitled 'other offences'). As was stated in the mutual evaluation questionnaire "The reform of the Vatican criminal law was also an opportunity to introduce criminal offences and sanctions according to the relevant international and regional standards". Further progress in this regard was recorded in Chapter III of the January 2012 Law.

208. The HS/VCS authorities have compiled a compliance table in which they indicate the offences in domestic legislation which relate to the FATF categories as set out in the Glossary. This is reproduced at Annex II. As will be seen there is now substance coverage within the HS/VCS legal system of all the categories in question. Given the context set out above this is a substantial achievement.

209. Art. 421 *bis* (4) directly addresses the issue of extraterritoriality. It is worded as follows: "The crime of money laundering exists even when the currency, funds or other assets that proceed from the predicate offence committed in another State". Criterion 1.5 is therefore satisfied.

210. As noted earlier, one of the goals of the December 2010 approach to money laundering criminalisation was that, unlike the situation in Italy, it should be extended to self-laundering. This policy was retained in the revisions introduced in January 2012. Art. 421 *bis* (3) states, in a manner consistent with criterion 1.6, that: "The crime of money laundering exists even when its author is the same person who committed the predicate offence".

211. The CC applicable within the HS/VCS makes provision for a range of ancillary offences. The mutual evaluation questionnaire notes, *inter alia*, aiding and abetting (Art. 225) and attempt (Arts. 61-62). Subsequently the attention of the evaluators was also drawn to Arts. 63-66 (complicity) and Arts. 248-251 (criminal association). As noted previously Art. 1(4)(b) of the Law of January 2012 specifically defines money laundering by reference to a broad range of ancillary offences. The drafting of this provision was inspired by Art. 9(1)(d) of the Warsaw Convention. It should be noted that while Article 1(4)(b) does not refer to conspiracy it does address association. This is consistent with criterion 1.7. Similarly, the formulation used does not directly list facilitation as an ancillary offence. However, the evaluators are satisfied that the relevant ground is appropriately covered by, *inter alia*, the concepts of aiding, inciting, counselling and abetting.

212. Paragraphs 5 to 8 of Art. 421 *bis* address issues of confiscation, provisional measures and like matters. These provisions are treated, in the main in the analysis of R.3 below.

213. The second and final provision in Chapter II on "criminal provisions on money laundering" is Art. 3 *bis*. This is headed "use of proceeds from criminal activities". It creates a new Art. 421 *ter* of the Criminal Code and is worded in full as follows:

1. Whomever uses in economic or financial activities currency, funds, or other assets, that proceed from a crime; shall be punished with four to twelve years of imprisonment and with a fine ranging from €1,000 to €15,000.

2. In case of a conviction, paragraphs 5, 6, 7 and 8 of the preceding article apply.

214. Motivated in part by the close relationship with Italy the scope of this Article overlaps but does not fully coincide with that on money laundering. Importantly it does not require proof of any specific intent or purpose. It thus goes beyond the requirements contained in the relevant FATF standards.

Recommendation 2

215. The offence of money laundering in the HS/VCS applies to natural persons who knowingly engage in proscribed activities**.** The evaluators were informed that under applicable general principles and rules of the legal system the intentional element of the offence can be inferred from objective factual circumstances.

216. At the time of the MONEYVAL on-site visit in November 2011 there was no criminal liability for legal persons as, in the view of the authorities, this appeared to be inconsistent with fundamental principles of domestic law. The authorities pointed, in particular, to the centrality of this concept in Canon Law (see e.g. Canon 1311). It is of importance to note that in the legal system of the HS/VCS that this is the first nominative order and first criterion of interpretive reference (see Acts on Sources of the Law Art 1(1)). At that stage, the evaluators voiced their concerns that the Act of December 2010 did not appropriately provide for civil or administrative liability of legal persons for money laundering as required by criterion 2.3. In this regard they noted that while Art. 42 of that Act specifically provided for the imposition of administrative sanctions for violations of various provisions, these did not apply to money laundering as such. This was a significant deficiency in terms of the satisfaction of R.2.

217. In the immediately subsequent period the authorities of the HS/VCS reconsidered this approach. As a consequence the decision was taken to insert a provision on "administrative responsibility of legal persons" in the amended legislation which entered into force on 25 January 2012. This applies to money laundering (Art. 421 *bis*) and the financing of terrorism (Art. 138 *ter*). Paragraph 1 of Art. 42 *bis* is central to the approach adopted and is worded thus:

1. In case of a conviction for one of the crimes set forth in Arts. 421 *bis and* 138 *ter* of the Criminal Code, the judicial authority shall impose a pecuniary administrative sanction ranging from €20,000 to €2,000,000 to the legal person involved if:

    a) the person convicted exercised its legal representation, administration, direction, or a similar role;
    b) the person convicted was under the direct responsibility, supervision or control of one on the persons referred to in paragraph a);
    c) the crime was committed in favour of the legal person.

218. Paragraph 2 of Art. 42 *bis* articulates various grounds which act so as to exclude liability. Paragraph 3 sets out the aggravating circumstances which will give rise to the additional sanction of "a temporary interdict to exercise its functions". Paragraph 4 clarifies that relevant financial sanctions shall be acquired by the Holy See and be utilised for the charitable and religious works of the Roman Pontiff.

219. Art. 42 *bis* (5) states that this form of liability does not apply, *inter alia*, to domestic public authorities. The term public authority is defined in Art. 1(2) as "an organism or entity that, on the basis of the domestic legal system, performs, directly or indirectly, an institutional activity inherent to the sovereign authority". A legal person is then defined (Art. 1(3)) as "any legal person, regardless of its nature and activity, including foundation and trusts, that do not fall within the definition of Public Authority".

220. Given that a public monopoly regime is said to prevail within the VCS the evaluators, when they returned in March 2012, sought clarification of the nature and extent of the exemption afforded by Art. 42 *bis* (5). It was explained that in effect the distinction drawn between "legal persons" and "public authorities" in this context was a functional one broadly similar in character to that made between sovereign and non-sovereign acts in the modern international law of State immunity. The evaluators drew comfort from the oft repeated assurance by the authorities of the HS/VCS – and its specific reassertion by the President of the Tribunal – that the exemption in question would not apply to an obligated financial institution such as the IOR.

221. While the insertion of Art. 42 *bis* in the Law of January 2012 represents progress in the satisfaction of the requirement of R. 2 it should be stressed that the liability in question is strictly

circumscribed. In particular it is predicated upon the prior securing of a criminal conviction of a natural person with relevant ties to the legal person in question for either money laundering or the financing of terrorism. While such a precondition is technically consistent with R.2 it does severely limit the possibilities of having recourse to this provision in practice.

222. As noted above the basic sanction set by Art. 42 *bis* (1) is a pecuniary one of between €20,000 and €2,000,000. In so far as natural persons are concerned Art. 421 *bis* stipulates that money laundering shall be punished with four to twelve years of imprisonment and with a fine ranging from €1,000 to €15,000. As will be seen in relation to R3 confiscation of proceeds in such cases is mandatory. The evaluation team is of the view that within the circumstances prevailing in the VCS these penalties can be regarded as effective, proportionate and dissuasive.

Recommendation 32 (money laundering investigation/prosecution data)

223. As of the date of the conclusion of the MONEYVAL on-site visits there had been no investigations, prosecutions or convictions for money laundering. However, the Tribunal of the HS/VCS is charged with keeping comprehensive statistical data on all criminal matters and the Promoter of Justice reports and comments on the same at the commencement of every judicial year. This system applies in the current context.

Additional elements

224. As noted above, paragraph 4 of Art. 421 *bis* criminalises money laundering even where the predicate activities are performed in another country. Double criminality is not included in the text as a specific restriction on the operation of this provision. In the view of the President of the Tribunal, this provision, properly construed, applies even in the circumstances set out in criterion 1.8.

Effectiveness and efficiency

225. In the course of their discussions with the relevant authorities of the HS/VCS at the time of the MONEYVAL on-site visits the evaluators noted a generally high level of awareness of the new Act and of the criminalisation provisions for money laundering contained in it. However, in the absence of any investigations, prosecutions or convictions since its entry into force the team is not in a position to conclude that it is effective in practice.

2.1.2 Recommendations and comments

226. The legislative drafting technique used in January 2012 to give effect to the criminalisation of money laundering has brought added clarity to the formal satisfaction of the requirements of R.1 by the HS/VCS. Furthermore, by virtue of the definition of money laundering in Art. 1(4) it is clear that it is an autonomous offence separate and distinct from Art. 421 on receiving. Indeed the latter is listed as a money laundering predicate offence (Art. 1(5)). That said in the view of the evaluators the authorities should consider how best to further clarify the relationship between these two Arts. of the Criminal Code where the scope of coverage overlaps.

227. In so far as R.2 is concerned the evaluators have concerns as to the manner in which Art. 42 *bis* on administrative responsibility of legal persons has been made contingent on securing a prior criminal conviction of a natural person for money laundering. They urge the appropriate authorities to revisit this issue in the light of experience with the functioning of the legislation and to reassess at that time whether an appropriate balance of interests has been struck.

2.1.3 Compliance with Recommendations 1 and 2

	Rating	Summary of factors underlying rating
R.1	**LC**	• Effectiveness concerns.

R.2	LC	• The evaluators have concerns regarding the effectiveness of the corporate liability provisions.

2.2 Criminalisation of Terrorist Financing (SR.II)

2.2.1 Description and analysis

Special Recommendation II

228. As was noted in the analysis of R.1 above, the drafters of Act No. CXXVII of December 2010 in addition to crafting a provision on the criminalisation of money laundering also took advantage of the opportunity to modernise the criminal law of the HS/VCS in order to better reflect international and regional standards and expectations. One such area was that of terrorism including terrorist financing.

229. Arts. 4 to 7 of the original AML/CFT Law added new provisions to the Criminal Code in a Chapter entitled "Other measures to prevent and counter the financing of terrorism". Art. 1 of the Act included several definitions of relevance in this context. Paragraphs 8 and 9 are particularly worthy of note for present purposes. They define "financing of terrorism" and "misconduct for terrorist purposes" respectively.

230. It will be noted that Art. 1(9) defined "misconduct for terrorist purposes" in part by reference to "conventions or other regulations of international law binding for the state". However, and for the reasons discussed in the treatment of R.35 and SR.I at a later stage of this report, the HS/VCS was not, at the time of the MONEYVAL on-site visit, a party to the UN Terrorist Financing Convention. This deficiency was cured in January 2012, within two months of the end of the MONEYVAL on-site visit, when the HS/VCS deposited its instrument of accession to this important multilateral treaty. However it is still not a party to any of the counter-terrorism Conventions listed in the annex to that instrument. The authorities accordingly formulated a declaration pursuant to Art. 2(2) of the Convention. By virtue of this declaration its "accession does not constitute consent to be bound by or to become a party to any of the treaties listed in the Annex to the Convention. …. [F]or the purposes of Art. 2.2(a) of the Convention, none of them should be deemed to be included within the scope of Art. 2.2(a) of the Convention".

231. Notwithstanding that this is entirely in line with the Convention, this raises difficulties in the context of the interpretive note to SR.II. This defines "terrorist act" in part by reference to offences within the scope of, and as defined in, those treaties[33].

232. While the HS/VCS was not at the relevant time formally bound by the Terrorist Financing Convention its influence can be seen in the drafting of certain provisions of Act No. CXXVII of 2010. For instance, the definitions of "funds" and "assets" in Art. 1(31) and (32) resonate with the approach taken in Art. 1(1) of the Convention.

233. While the relevant definitions within the Act could be seen to have paved the way for the domestic implementation of a terrorist financing offence broadly reflective of Art. 2(1)(b) of the

[33] Subsequent to the second MONEYVAL on-site visit, the HS/VCS Authorities informed the evaluators that an in-depth analysis of the substantive provisions of the VCS Criminal Code had been initiated with the view to identify areas where the VCS substantive Criminal Law requires amendment. As part of this process, it had been decided to incorporate into the Criminal Code a set of definitions of crimes, including those crimes described in the various conventions referred to in the annex to the 1999 Terrorist Financing Convention. Moreover, HS/VCS authorities are actively considering ratification of some of the aforementioned treaties.

Terrorist Financing Convention the evaluators harboured concerns that this goal may not have been adequately achieved by the substantive provisions as drafted. Among other problematic issues the evaluators noted the absence of a sufficiently focused treatment of the extraterritorial aspects of terrorist financing and the lack of treatment of criminal, civil or administrative liability for terrorist financing by legal persons.

234. Following the end of the November 2011 MONEYVAL on-site visit the HS/VCS authorities decided to review the adequacy of the legislative approach which had been taken to terrorist financing. The outcome of this consideration was the introduction of a range of relevant amendments in the Law of January 2012 designed to better reflect the expectations of SR. II.

235. Central to the approach adopted in the revised legislative scheme is Art. 4 *bis* entitled "financing of terrorism". This inserts into the Criminal Code Art. 138 *ter*, paragraphs 1 and 2 of which are worded as follows:

1. Whomever by any means, unlawfully and wilfully, directly or indirectly, collects, provides, deposits or holds currency, funds or other assets, however obtained, 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 commit one or more acts for a terrorist purpose or to abet the commission of one or more acts for a terrorist purpose, regardless of whether those funds or assets are used to commit or to attempt to commit those acts, shall be punished with five to fifteen years of imprisonment.
2. The crime exists whether the acts are directed to finance associations or whether they are directed to finance one or more natural persons.

236. According to Art. 1(6) "acts performed for a terrorist purpose" means:

> … acts intended to cause death or serious bodily injury to civilians or to persons not taking active part in hostilities in cases of armed conflict, when the act, by its nature or context, is carried out with the intent to:
>
> a) intimidate a population;
>
> b) compel the public authorities or an international organisation to do or to abstain from doing any act.

237. It is of importance to note that for the purposes of the Law of January 2012 the concept of "terrorist financing" extends beyond those matters provided for in Art. 138 *ter*. In particular, the concept includes, by virtue of Art. 1(8)(b) "participation in one of the acts referred to in Art. 138 *bis* of the Criminal Code, association to commit, attempt to commit, and aiding, inciting, or counselling the commission of such act, or abetting its execution.". This provision of the Criminal Code is inserted by Art. 4 of the 2012 Act and is headed "associations for terrorist purposes or subversion". Paragraph 1 reads:

> Whomever promotes, creates, organises, or directs associations that intend to commit acts for a terrorist purpose or for the purpose of subversion, shall be punished with five to fifteen years of imprisonment.

238. These provisions, inspired by the Terrorist Financing Convention, are generally consistent with some of the exacting expectations of criterion II. 1(a). However, as noted above the HS/VCS has not yet become a party to any of the treaties listed in the Annex to the Convention and has not, as such criminalised on a systematic basis offences within the scope of and as defined in those instruments (though Art. 8 on acts of terrorism with explosives or other lethal weapons or devices was inspired by the Terrorist Bombings Convention). To that extent the law of the VCS does not as yet fully reflect the definition of "terrorist Act" contained in the Interpretative Note to FATF SRII.

239. However, the HS/VCS authorities advised that reliance can be placed on the procedure provided by Art. 9 of Act No. LXXI on the Sources of Law of 1 October 2008 which states "Should any penal provision be lacking, and an act has been committed that offends the principles of religion or morals, public order, personal security or safety of things, the judge may refer to the general principles of the legislation to inflict pecuniary penalties up to €3,000, or detention penalties up to six months, and apply, as the case may be, the alternative sanctions indicated in Law of 14 December 1994, No. CCXXVII". While this has been utilised in the drugs area its application in the context of terrorist financing has never been tested.

240. Art. 138 *ter* (1), as we have seen, utilises the terminology "currency, funds or other assets, however obtained …". This wording thus catches funds etc. whether of legitimate or illegitimate provenance as required by criterion II.1(b). Furthermore, the terms currency, funds, and other assets are specifically and appropriately defined in Art. 1(10), (11) and (12) respectively.

241. The terrorist financing offence as embodied in Art. 138 *ter* (1) of the Criminal Code does not require that the currency, funds or other assets were actually used to carry out or attempt a terrorist act or be linked to a specific terrorist act. This conclusion flows from the specific wording utilised ("regardless of whether those funds or assets are used to commit or attempt to commit those acts"). The expectations of criterion II. 1(c) are therefore satisfied. It is also an offence to attempt to commit the offence of terrorist financing. This conclusion is confirmed as accurate by the HS/VCS authorities, and is reinforced by Arts. 61 and 62 of the Criminal Code (see also Canon 1328). However, financing of individual terrorists or terrorist organisations for legitimate purposes is not covered by the legislation.

242. As was noted in the context of R.1 above the Criminal Code of the VCS makes provision for a range of other ancillary offences including Arts. 63-66 (complicity) and Arts. 248-251 (criminal association). Also of relevance in this context is the fact, as noted previously, that under Art. 1(8)(b) of the January 2012 Law "terrorist financing" is extended to include participation in one of the acts covered by Art. 138 *bis* ("associations for terrorist purposes or subversion") as well as "association to commit, attempt to commit, and aiding, inciting, or counselling the commission of such act, or abetting its execution".

243. By virtue of Art. 1(5) of the Law of January 2012 all of the offences relating to terrorism which it addresses, including Arts. 138 *bis* and *ter* on terrorist financing, are specifically listed as predicate offences for money laundering. This satisfies the requirement of criterion II.2.

244. Similarly the Act directly addresses issues of extraterritoriality in a terrorist financing context. Art. 138 *ter* (3) is worded as follows:

> 3. The terrorist purpose is present even when the violent acts are directed against another State, or an international institution or organisation, or when they are committed in another State.

The evaluators were informed that under applicable general principles and rules of the legal system the content and element of these offences can be inferred from objective factual circumstances (see, e.g., Canon 1321(3)).

245. Art. 138 *bis* (2) is to the same effect.

246. As was noted in the earlier discussion of R. 2, the Law of January 2012 introduced, in Art. 42 *bis*, a provision on administrative responsibility of legal persons for both money laundering and the financing of terrorism. This liability is predicated upon the securing of a prior criminal conviction of a natural person for, in this context, a terrorist financing offence. Such an exacting precondition is not, however, explicitly prohibited by the relevant international standards.

Recommendation 32 (terrorist financing investigation/prosecution data)

247. As of the time of the MONEYVAL on-site visits there had been no investigations, prosecutions or convictions for terrorist financing within the HS/VCS. However, the Tribunal is

charged with keeping comprehensive data on all criminal matters, and the Promoter of Justice has an annual reporting obligation in respect of the same.

Effectiveness and efficiency

248. In the absence of relevant investigations, prosecutions and convictions the evaluation team is unable to conclude that the system introduced by the Act in December 2010 and amended in January 2012 is effective in this sphere.

2.2.2 Recommendations and comments

249. The HS/VCS is to be commended in having taken significant legislative steps to address the complex criminal justice issues which arise in the context of the financing of terrorism. However, some work remains to be done in order to ensure full, clear and effective compliance with the requirements of FATF SR.II. As mentioned above the major issue, arises from the current stance of non-participation in the global counter-terrorism Conventions listed in the Annex to the UN Terrorist Financing Convention. Even if reliance can be placed on Art. 9 of Act No. LXXI on the Sources of Law of 1 October 2008 designed to address lacuna in the system of criminal law it would in the view of the evaluators be better for these matters to be addressed directly in the Criminal Code and for appropriate sanctions to be specified therein. Furthermore, the financing of individual terrorists or terrorist organisations for legitimate purposes is not explicitly covered in the current legislation[34].

250. As noted above, the evaluators have concerns as to the manner in which Art. 42 *bis* on administrative responsibility of legal persons has been made contingent on securing a prior criminal conviction of a natural person for money laundering. This provision also applies in a terrorist financing context. Notwithstanding Art. 5 (1) of the Terrorist Financing Convention the evaluators urge the appropriate authorities to revisit this issue in the light of experience with the functioning of the legislation and to reassess at that time whether an appropriate balance has been struck.

2.2.3 Compliance with Special Recommendation II

	Rating	Summary of factors underlying rating
SR.II	**LC**	• Absence of specific criminalisation of financing in respect of certain terrorist acts in the relevant UN counter-terrorism conventions annexed to the Terrorist Financing Convention. • Financing of individual terrorists or terrorist organisations for legitimate purposes not covered.

2.3 Confiscation, Freezing and Seizing of Proceeds of Crime (R.3)

[34] In the plenary meeting the HS/VCS authorities expressed their commitment to incorporate explicitly in the Criminal Code each of the crimes set forth in the UN counter-terrorist conventions and will address the issue of financing of individual terrorists or terrorist organisations for legitimate purposes within the meaning of the FATF standards.

2.3.1 Description and analysis

Recommendation 3

251. As was seen in the analysis of R1 above, Art. 3 of the Law of January 2012 inserts a somewhat revised provision on money laundering into the Criminal Code as Art. 421 *bis*. This includes specific coverage of mandatory confiscation of both proceeds and instrumentalities in that context. Paragraphs 5 and 6 are central to the approach adopted and are worded thus:

> 5. In the case of conviction, the judge shall order the confiscation of:
>
> a) The proceeds of the money laundering, including the instrumentalities used or destined for that purpose;
>
> b) The profits or other earnings originating, directly or indirectly, from the proceeds of the predicate offence.
>
> 6. Whenever it is not possible to confiscate the goods referred to in paragraph 5, subparagraphs a) and b), the judge shall order the confiscation of currency, funds or other assets of an equivalent value among those owned or possessed, directly or indirectly, exclusively or jointly with others, by the convict, without prejudice to the *bona fide* rights of third parties.

252. Paragraph 2 of Art. 421 *ter* on use of proceeds from criminal activities explicitly adopts these provisions. This wording is crafted in such a way as to satisfy, within this context, the requirements of criterion 3.1.

253. The Law of January 2012 similarly makes provision for mandatory confiscation following upon conviction for terrorist financing. Paragraphs 4 and 5 of Art. 138 *ter* reads as follows:

> 4. Regarding the person convicted, the confiscation of the goods used or intended to be used to commit the offence, their value, proceeds, profits, and other earnings, is always mandatory, without prejudice to the *bone fide* rights of third parties.
>
> 5. Whenever it is not possible to confiscate the goods referred to in paragraph 4, the judge shall order the confiscation of currency, funds or other assets of an equivalent value among those owned or possessed, directly or indirectly, exclusively or jointly with others, by the convict, without prejudice to the *bona fide* rights of third parties

254. Art. 138 *bis* (3) and (4) adopt the same approach.

255. The position in respect of the confiscation of the proceeds and instrumentalities of other predicate offences other than piracy (see, Law of January 2012, Art. 23 *bis*) is somewhat less clear cut.

256. Art. 3 of the 2010 AML/CFT Law was the sole provision of Chapter II entitled "criminal provisions in matters of money laundering". Art. 421 *bis* came under the heading in the Criminal Code "about laundering and self-laundering". Notwithstanding the possible restrictive inferences to which such language might give rise the authorities of the HS/VCS with whom the team met in November 2011, including the Promoter of Justice and the President of the Tribunal of the HS/VCS, were unanimous in the view that paragraph 6 on confiscation was not confined in its scope to mandating the confiscation of the proceeds of money laundering. Under this view confiscation was also provided for in respect of predicate offences. In their view this interpretation was reinforced and placed beyond doubt by the wording of paragraph three of the same article. This interpretation had not been formally confirmed by the judiciary in practice. The attention of the evaluators was not at that time drawn to any pre-existing provisions of the law of the HS/VCS governing the confiscation of criminal proceeds as such.

257. It is relevant to note in this context that the final paragraph of Criminal Code Art. 138 *bis*, inserted by Art. 4 of the original AML/CFT Law, also makes explicit mention of mandatory confiscation in, *inter alia*, the financing of terrorism context. On the basis of the interpretation advanced in the previous paragraph one assumes that this was explicitly stipulated for other reasons.

258. A very similar analysis of this issue was advanced by the authorities of the HS/VCS in relation to the amended version of Art. 421 *bis*. In this regard particular stress was placed on the wording of paragraph 5(b) reproduced above. It also appeared to the evaluators that Art. 421 *ter* might facilitate the confiscation of the proceeds of predicate offences in instances where these are used "in economic or financial activities". Given the concerns expressed by the evaluators as to the lack of clarity of the legal system of the HS/VCS over the availability of confiscation in several areas of relevance to Recommendation 3, including its extension to indirect proceeds, to laundered proceeds and to the proceeds of predicate offences other than those for which specific provision had been made in the January 2012 Law, the authorities requested that the Pontifical Commission for the VCS address the matter and issue an authentic interpretation concerning the powers of confiscation held by the judge in criminal matters. This was issued in May 2012 and is reproduced in full at Annex XXXV. The Pontifical Commission concluded as follows: "*Considering Articles 166, par. 1; 237, par. 1; and 612, par. 1, of the Code of Criminal Procedure; as well as Article 421 bis, §§. 5, 6, 7 and 8 of the Criminal Code; the judge possesses the power to order confiscation of the proceeds, direct and indirect, of all predicate offences of money laundering, and likewise the power to order confiscation of currency, property and other assets which are the object of laundering in a criminal process dealing with the crime of laundering. The power to order confiscation extends to the currency, property and other assets of equivalent value, whenever the currency, property and assets are owned or possessed, exclusively or jointly with others, directly or indirectly, by the convict, without prejudice to the* bona fide *rights of third parties*."

259. Provisional measures, including the freezing and/or seizing of property, to prevent any dealing, transfer or disposal of property subject to confiscation were not addressed in Act No. CXXVII of 2010 (save in relation to certain measures relevant to Security Council Resolutions in a SR.III context). For such matters reliance had to be placed on various provision of the Italian Code of Criminal Procedure of 1913 which, as noted elsewhere, applies by virtue of Art. 8 of the Act on the Sources of Law of 2008.

260. In this regard the HS/VCS authorities pointed to the following provisions of the CCP: Arts. 166, 170, 233-234, and 606-617. These are reproduced, for ease of reference, at Annex XV Broadly speaking these, in combination, can be regarded as creating a system for the sequestration of goods used to commit a crime and those which are the product of crime. None explicitly empowers the courts or other competent authorities to order that bank and financial records be made available or be seized.

261. The Law of January 2012 introduced some welcome assistance in this area. In particular according to paragraph 8 of Art. 421 *bis* "The judge shall adopt precautionary measures, including the seizure of the currency, funds or other assets likely to be confiscated, to prevent their sale, transfer or disposition, as well as other measures to enable the competent authorities to identify, trace, and freeze the currency, funds or other assets likely to be confiscated without prejudice to the *bona fid*e rights of third parties." This provision also applies to the use of the proceeds of crime (Art. 421 *ter* (2)). The Act also introduces specific coverage to like effect in the area of the financing of terrorism (Art. 138 *bis* (6) and Art. 138 *ter* (7)).

262. In the course of the evaluation process the HS/VCS authorities confirmed that the general principles and rules of the legal system allow the initial application to freeze or seize property subject to confiscation to be made ex-parte and without prior notice. Art. 24(2) of the January 2012 Law makes specific provision of this kind but only in a SRIII context**.**

263. The evaluators are satisfied that law enforcement agencies and the FIU have adequate powers to identify and trace property that is or may become subject to confiscation or is suspected of being the proceeds of crime.

264. The system of confiscation and of provisional measures outlined above contain wording designed to protect the interests of *bona fide* third parties.

265. In so far as criterion 3.6 is concerned the authorities of the HS/VCS informed the evaluation team that the Promoter of Justice may, under Art. 11(1) of the Code of Civil Procedure request the court to cancel a contract "in the public interest". The evaluators are not aware of any use of this provision in practice. The authorities did not, however, point to any authority to prevent or void actions outside of the contractual sphere where the persons involved knew or should have known that as a result of those actions the authorities would be prejudiced in their ability to recover property subject to confiscation.

Additional elements

266. The evaluators were advised that by virtue of interaction of Arts 248 & 249 of the CC and Art. 612 of the CCP there is some limited capacity within the legal system of the HS/VCS to confiscate the property of organisations that are found to be primarily criminal in nature. However at the present time the legal system of the VCS does not address the criteria of Additional Elements 3.7 b 7 c.

Recommendation 32 (confiscation investigation/prosecution data)

267. No provisional measures had been applied and thus no statistics were available.

Effectiveness and efficiency

268. The authorities of the HS/VCS provided the evaluators with data on judicial practice on freezing & confiscation from 1984 to the present date. The greater part reveals an ability & willingness to use provisional measures in appropriate cases. However, insofar as confiscation is concerned the practice prior to the new law related to instrumentalities. The confiscation regime as amended by the Law of January 2012 has not been in place for a sufficient period of time in the VCS to generate judicial practice.

269. As the revised AML/CFT Law was only adopted on 25 January 2012, it was not possible for the evaluators to assess the effectiveness of its application.

2.3.2 Recommendations and comments

270. While the evaluators welcome the clarification of the nature and scope of the powers of confiscation provided by the Pontifical Commission they are of the view that there would be substantial merit in enacting a detailed, comprehensive and modern legislative scheme to address the range of issues, including provisional measures, which arise in the context of this important international standard. They urge the authorities of the HS/VCS to consider this possibility in due course.

271. Steps should also be taken in a timely manner to ensure that the requirements of criterion 3.6 on the authority to take steps to prevent or void actions are more fully satisfied.

2.3.3 Compliance with Recommendation 3

	Rating	Summary of factors underlying rating
R.3	**LC**	• Lack of comprehensive authority to prevent or void actions (c.3.6). • Effectiveness concerns.

2.4 Freezing of Funds Used for Terrorist Financing (SR.III)

2.4.1 Description and analysis

Special Recommendation III

272. Chapter IV of Act No. CXXVII of 30 December 2010 was entitled "measures to prevent the financing of terrorism and implement the freezing of funds and assets". Its three substantive Arts. create a framework through which the HS/VCS would seek to give effect to the terms of SR.III. The FIA lay at the heart of the system so created.

273. Art. 24(1) of the Act, was central to the approach adopted to freezing under relevant UN Security Council Resolutions. It was worded thus:

> In order to enforce measures of freezing of funds and assets for the purposes of countering and repressing the financing of terrorism and the activities of countries that threaten international peace and security, the Financial Intelligence Authority, except for the provisions adopted by the judiciary authority in criminal matters, orders by its own provision the freezing of funds and assets held by natural and legal persons, groups or entities, designated according to the principles and rules in force within the European legal system. By the same provision, exemptions from such freezing are identified on the basis of the principles and rules in force within the European legal system.

274. Several of the terms utilised in Art. 24(1), including the "financing of terrorism", "funds", "assets", "freezing of funds" and "freezing of assets" were defined in Art. 1.

275. As can be seen clearly from its wording, the approach favoured by the drafters of Art. 24(1) for the satisfaction of this dimension of SR.III was an indirect one intended to incorporate "the principles and rules in force within the European legal system". It was confirmed during the MONEYVAL on-site visit in November 2011 that by "European legal system" was meant that of the European Union. The authorities also confirmed that this critical provision required subordinate implementing legislation to give it full force and effect. This was in preparation at the time of the MONEYVAL on-site visit.

276. The effects of the freezing of funds and assets pursuant to Art. 24(1) were set out in some detail in Art. 25. The reporting obligations of obligated entities were set out in Art. 26. At the time of the MONEYVAL on-site visits, however, the FIA was in the process of drafting a specific regulation which would be designed to create an effective system through which it could communicate relevant freezing actions to the financial sector. In this regard it should be noted that Art. 3(3) of FIA Regulation No. 5 (see Annex XXI) is based on a list of designated persons being available for consultation on its website. Guidance to the financial sector concerning their obligations was also said to be under development.

277. Following the November 2011 MONEYVAL on-site visit the authorities of the HS/VCS decided to reconsider the nature of the above approach to the satisfaction of the relevant international standards in this important area of concern. Those deliberations were to result in the introduction of significant legislative amendments in the Law of January 2012. These are set out, in the main, in Chapter IV of the Act entitled "measures to prevent and counter the financing of terrorism". This consists of four detailed substantive provisions: namely, measures to counter the financing of terrorism and the activities that threaten international peace and security (Art. 24); the effects of the freezing of funds and assets (Art. 25); reporting requirements (Art. 26); and, the custody, administration and management of the frozen assets (Art. 27). Several relevant terms, including "to freeze" and "designated persons" are defined in Art. 1.

278. The first point to note about the revised legislative scheme is that, while the FIA retains a significant role, responsibility for SR III issues is now shared among a broader group of actors. In particular, the Secretariat of State is afforded a position of some centrality. This is reflective of its long established general responsibility for the conduct of international affairs and its new responsibilities for anti-money laundering and terrorist financing policy embodied in Art. 2 *quinquies* of the January 2012 Law. This new reality is clearly illustrated in Art. 24 of that Act. It reads as follows:

1. In order to prevent and counter the financing of terrorism and the activities that threaten peace and international security, the Secretariat of State shall draw up a list of designated persons subject to the freeze of funds and economic assets on the basis, *inter alia*, of the relevant United National Security Council resolutions.

   The Secretariat of State shall update the list of designated persons, and possibly remove persons from that list, on the basis, *inter alia*, of the relevant United Nations Security Council resolutions.

2. The Financial Intelligence Authority, by its own provision, without delay and without giving previous notice, orders the freeze of the funds and other assets owned or possessed, exclusively or jointly, directly or indirectly, by the persons designated by the Secretariat of State.

   The ordered freeze shall be communicated without delay to the subject referred to in Art. 2, paragraph 1, and has immediate effect.

   The Financial Intelligence Authority's order shall define the terms, conditions and limit of the freeze of funds, also to protect the *bona fide* rights of third parties.

3. The Secretariat of State shall:

   a) acquire, both from domestic and international competent authorities, any information that might be useful to fulfil the tasks set forth in paragraph 1;

   b) maintain contacts with foreign and international authorities with the view to enhance the indispensable international co-ordination;

   c) propose to the competent international authorities the designation of additional persons.

      Whenever there are, on the basis of the information gathered pursuant to subparagraphs a) and b), sufficient elements to propose to the international authorities the designation of additional persons, and there is a risk that the funds and other assets subject to the freeze might be concealed or used to finance terrorism, the Secretariat of State shall inform the Promoter of Justice and the Financial Intelligence Authority for the adoption of precautionary measures.

   d) propose to the International Authorities the delisting of designated persons, even on the basis of the recourses filed by the entitled persons pursuant to paragraph 4.

4. The Tribunal shall receive and assess the applications for exemption from the freezing of funds and other assets filed by the entitled persons, also to protect the *bona fide* rights of third parties.

279. It is clear from the above that the primary point of reference for the new legislative approach is the practice of the UN Security Council rather than that of the European Union. However, the use of the terminology "*inter alia*" in Art. 24(1) leaves open the possibility of taking account of designations carried out by other authorities including the EU. This possibility was confirmed in discussions held with colleagues in the HS/VCS in March 2012.

280. Pursuant to paragraph 1 the responsibility to draw up a list of designated persons falls to the Secretariat of State. Within the time frame relevant to this evaluation no such list had been

finalised. The evaluators were, however, informed that it was in the course of preparation[35]. Upon the finalisation of a list of designated persons by the Secretariat of State it is provided to the FIA. Under paragraph 2 that authority "by its own provision, without delay and without giving previous notice" orders the freezing of the funds and other assets in question. This order is then to be communicated by the FIA to all obligated entities listed in Art. 2(1). This is to be done "without delay". The freezing order has "immediate effect".

281. While the scheme has yet to be activated in practice, the framework provided by the interaction of paragraphs 1 and 2 of Art. 24 appear to be sufficient to satisfy the expectations of criterion III.1 which relates to UN Security Council Resolution 1267 (1999) and its successor resolutions.

282. Art. 24 (1) provides the legal authority for the creation of an autonomous HS/VCS list. Given the drafting style adopted in Art. 24(1) and (2) it appears to the evaluators that they also form a basis upon which the HS/VCS could give effect to the freezing of funds or other assets of persons designated by "international" bodies such as the EU and by third states pursuant to UN Security Council Resolution 1373 (2001).

283. The freezing actions authorised by Chapter IV of the January 2012 Law are extensive in nature. They extend to "the funds and other assets owned or possessed, exclusively or jointly, directly or indirectly" by a designated person (Art. 24(2)). As noted at an earlier stage of this report the terms "funds" and "other assets" are broadly defined in paragraph 11 and 12 of Art. 1. Furthermore, under Art. 25(4) it is "forbidden to provide, directly or indirectly, funds or other assets to the designated persons, or to devote those funds and assets to their benefit".

284. As was noted above, under Art. 24(2) the FIA is required to bring all freezing orders in respect of designated persons to the attention of obligated entities without delay. The exact technical manner in which this obligation will be discharged in practice was still under consideration at the end of the time frame relevant to the preparation of this report. It is of relevance to note in this regard that under Art. 26 obligated entities are required to report, within 30 days, to the FIA on measures taken by them pursuant to the freezing order. This extends to:

b) any available information regarding the relationship, services and transactions, as well as any other intelligence available, related to the designated persons or to those persons who, on the basis of the indications that may have been received, are in the process of being designated.

285. Guidance to financial institutions and other relevant entities concerning their obligations in taking action under freezing measures is under preparation by the FIA.

286. The Secretariat of State is given the responsibility to propose to the competent "international authorities" both the designation of additional persons and the delisting of such persons (Art. 24(3)(c) and (d)). It should also be noted that Art. 24(4) provides that "The Tribunal shall receive and assess the applications for exemption from the freezing of funds and other assets filed by the entitled persons, also to protect the *bona fide* rights of third parties". (See also, Art. 27(6)).

287. As was seen in relation to R.3, the HS/VCS legal system also contains general provisions to permit the seizure and confiscation of assets in other circumstances. The drafters of Chapter IV of Act No. CXXVII have taken care to ensure that these processes are not disturbed. Importantly this is explicitly acknowledged in the wording of Art. 25(6).

288. As was also noted in the context of the analysis of R.3 the legal system of the HS/VCS provides for several measures to protect the interests of *bona fide* third parties affected by the

[35] On 3 April 2012 the HS/VCS list of designated persons was promulgated by the Secretariat of State which covered, *inter alia*, the 1267 list of designated persons. On the same day the FIA issued an Ordinance giving effect to this list and transmitted it to all obliged persons.

operation of the confiscation regime. A specific regulation to address such matters under Chapter IV of the AML/CFT Law was, the evaluators were informed, in the process of being drafted[36].

289. Finally, it will be recalled that under the January 2012 Law the FIA is charged with the supervision of the observance of the duties established in the area of the prevention of the financing of terrorism. Art. 42 creates an administrative pecuniary sanctions system. This applies, *inter alia*, to infringements of Arts. 26 and 27 of Chapter IV.

Additional elements

290. As has been seen, the system of measures to prevent the financing of terrorism and implement the freezing of funds and assets provided by Chapter IV of the AML/CFT Law has still to be perfected and to be put in place in practice. It is uncertain at the time of writing the extent to which the final scheme will address the issues raised in criteria III.14 and III.15.

Recommendation 32 (terrorist financing freezing data)

291. There have been no listing measures taken to date to implement the relevant UN Security Council Resolutions. There have similarly been no instances to date in which the general criminal justice system in relation to the confiscation of terrorist assets or associated provisional measures has been utilised in practice.

Effectiveness and efficiency

292. As the system contemplated by Chapter IV of the Law of January 2012 has not yet been brought into full practical force and effect it is, by definition, ineffective at this time. Given the absence of practice under the general criminal justice provisions reviewed in relation to R.3 the evaluators are also unable to conclude that it is effective in this context.

2.4.2 Recommendations and comments

293. The detailed legislative provisions found in Chapter IV of the January 2012 Law provide a much improved basis from which the HS/VCS can seek to give full force and effect to the freezing of funds and other assets in accordance with the relevant Resolutions of the UN Security Council passed under Chapter VII of the UN Charter. This is particularly so in relation to the listing process established by Resolution 1267 (1999) and its successor resolutions. While the differences in approach to designation embodied in Resolution 1373 (2001) may not have been so fully in focus the wording utilised in Art. 24 appears to form a basis for the HS/VCS to give effect to “designations” made by the EU and other “international” bodies and by third states. It is recommended, however, that an appropriate opportunity is sought to place this beyond doubt. It should be noted in this context that if reliance is placed on the European Union lists then procedures will need to be in place to cover the so called “EU internals” which are not subject to designation as such by the European Union.

294. At the end of the evaluation period certain facilitation initiatives, including the issuing of appropriate guidance to obligated entities, had still to be finalised. These should be completed as a matter of priority[37].

[36] The HS/VCS authorities subsequently informed evaluators during the pre-meeting that an Ordinance was adopted by the FIA on 3 April 2012 which addresses this matter.

[37] At the time of the pre-meeting the HS/VCS authorities indicated that such guidance had been provided by the FIA on 3 April 2012.

295. Finally, although Chapter IV contains limited treatment of delisting, exemptions and like matters more needs to be done in order to create a system which is more comprehensive and potentially effective. This is particularly the case in respect to the authorisation of access to funds needed for basic expenses or for extraordinary expenses in accordance with Security Council Resolutions 1452 (2002).

2.4.3 Compliance with Special Recommendation SR.III

	Rating	Summary of factors underlying rating
SR.III	**NC**	• No designations under UNSCR 1267 or 1373 within the evaluation period. • Communication systems for designation were not tested within the evaluation period. • Lack of guidance for obligated entities. • Lack of comprehensive coverage of delisting procedures and exemption procedures. • Lack of publicly known procedures for unfreezing in a timely manner of the funds or other assets of persons inadvertently affected by a freezing order. • No procedures for authorising access to funds frozen pursuant to UNSCR 1267 that have been determined to be necessary for basic expenses. • Recent adoption of AML/CFT Law meant that it was not possible to assess effectiveness of implementation.

Authorities

2.5 The Financial Intelligence Unit and its functions (R.26)

2.5.1 Description and analysis

Recommendation 26

296. The Financial Intelligence Unit for the HS/VCS, is the FIA - Financial Intelligence Authority (Autorità di Informazione Finanzaria – AIF), which has been operational since 1 April 2011. The unit was established by His Holiness Benedict XVI in his Apostolic letter dated 30 December 2010 in the form of a *Motu proprio* on preventing and countering illegal activities in the financial and monetary field (see Annex III), giving effect to the original AML/CFT Law No. CXXVII concerning the prevention and countering of the laundering of proceeds from criminal activities and of the financing of terrorism Dated 30 December 2010, substituted by Decree 159 since 25 January 2012. The *Motu Proprio* identifies the FIA as a public institution within the HS, endowed with the public canonical judicial personality and a Vatican civil legal personality. Its jurisdiction in respect of AML/CFT rules extends to all Dicasteries of the Roman Curia and all the organisations and bodies depending on the Holy See that perform the (financial) activities listed in Art. 2 of the AML/CFT Law.

297. In addition to the key assignment of an FIU in relation to the processing of the suspicious activity reports (SARs), the FIA has an important regulatory and supervisory role as set out in Art. 2 *septies* 2 a), b) & c) of the revised AML/CFT Law.

298. The FIA is an autonomous administrative authority, whose functions and responsibilities are governed by the revised AML/CFT Law (in particular Art. 2 *septies* and 36 *bis*) and its Statute (Art. 2) (see Annex VI) as approved by the *Motu proprio* of 30/12/2010. Beside supervisory and regulatory duties it exercises the key FIU functions of receiving and analysing the information it receives in the form of a suspicious transaction report, and of disseminating the results of its analysis:

- Receiving: all reporting entities are under the obligation to report promptly to the FIA their suspicions on transactions ("*transazione*")[38] that might be related to money laundering or financing of terrorism (Art. 2 *septies* 3.a) & 34.1 of the revised AML/CFT Law).
- Analysing: on reception, the FIA processes the STR, basically by performing financial analysis and using its powers of collection of relevant information, to determine if the STRs are sufficiently founded and indicative of ML/FT (Art. 2 *septies* 3.b) & 36 *bis* 1 a) & b))
- Disseminating: once the FIA judges there are sufficient elements indicative of ML/FT, it communicates these "facts" to the Promoter of Justice, who then decides whether to initiate a police investigation (Art.2 *septies* 3.c & 36 *bis* 1.d).

299. The FIA takes a broad view on what triggers the intervention and analysis of the FIU, as provided for in Art. 2 *septies* & 36 *bis* of the revised AML/CFT Law. In the Italian version of both provisions the process starts with *"segnalazioni"*, translated as Suspicious Transaction Reports. Yet, as the statistics show, they have opened 12 cases applying their analytical and inquisitive powers, whereas only 1 SAR had been filed[39]. The FIA indeed puts foreign requests and other sources of information on a par with a STR.

300. On 14 November 2011, the FIA issued Regulation n° 5 (see Annex XXI) in implementation of Art. 34.3 of the original AML/CFT Law. This Regulation comprehensively specifies the structure of the STR report and the manner of reporting by means of a model form, which can be forwarded by fax or e-mail. Emphasis is laid on the timeliness of the communication and the completeness qua identification and relevant information. There are plans to establish an on-line reporting system.

301. The report is structured to include :

a) identification data (the reporting person remains anonymous);
b) information concerning operations, subjects, relationships and the links between them;
c) description of the operations and suspicion grounds;
d) attached documents.

302. In support of its analytical activity the FIA has a broad power to collect additional data. To that end the revised AML/CFT Law gives the FIA access, on a timely basis, to "the necessary financial, administrative, investigative information" (Art. 2 *septies* 3.d) and "additional information from the parties that have made the disclosure" (Art. 36 *bis* 1. b)[40]. There is an overarching condition of the FIA requiring the information in order to perform its AML/CFT assignment.

303. The inquisitive power of the FIU is very generally formulated, ensuring the authority of the FIA covering all relevant sectors. However, compared to the previous Act, the new text raises some issues that call for clarification and even rectification.

[38] Incorrectly translated in the heading of Art. 34 as "operations" in the English version.

[39] At the time of the 2nd MONEYVAL on-site visit the total amounted to 2 STR + 8 foreign requests + approximately 3,000 cash declarations.

[40] The Italian original "… ai soggetti che hanno effettuato la segnalazione;" was incorrectly translated in English as "…from the reporting parties".

304. First of all the absence of a clear delineation of this power may lead to controversy as to its scope. Whilst "investigative information" commonly refers to the data managed by the investigative authorities (i.e. the Gendarmerie), it is regrettable that the reference in the old Act to "judicial information" was dropped[41]. Furthermore, it is not clear what exactly is covered by the notion of "financial" and "administrative" information and, more specifically, to what databases the FIA has access or from what entities the FIA may request additional information. At least for the interpretation of administrative information there was guidance from the specific reference to the "Organs of the State" in the old Art. 33.3.

305. According to the VCS authorities, the intentionally broad language allows the FIA to determine the range of additional information depending on the specific case and the analytical needs of the FIA. In concreto, the FIA has the power to request following information:

- Financial information held by all subjects obliged by the AML/CFT Law and all relevant dicasteries, institutions and entities of the Roman Curia (e.g. APSA, Prefecture for Economic Affairs, Pontifical Council "Cor Unum" etc.). The authorities state that this would also include information held by all legal persons and entities (including foundations) dependent from the HS/VCS. This last assertion is however based on an overly broad interpretation of Art. 2 *septies*, §3, d.
- Administrative information held by all dicasteries, institutions and entities of the Roman Curia (e.g. Prefecture for Economic Affairs, Pontifical Council "Cor Unum" etc.).
- Investigative information held by the Gendarmerie in its databases. This category would also include information held by the Judicial Authority, including, *inter alia*, investigative records, penal cases records, rogatory letters, etc.

306. A regrettable shift between the old and new text happened to the FIA access to additional information held by the reporting parties. Whilst the previous Art. 33.3 left no doubt that the power to obtain additional information also related to "other subjects", i.e. to all entities subjected to the obligation to disclose, this authority is now limited to the subjects who actually made the STR *("soggetti che hanno effettuato la segnalazione"* – Art. 36 *bis* 1.b). This appears to deviate from Art. 2 *septies* 3 d) which gives the FIA the general power to collect financial information and which the authorities consider grants them access to information held by all entities subject to the reporting obligation[42].

307. Furthermore, the FIA has the power to suspend suspect operations for a period of up to five working days if it finds the transactions could be related to money laundering or terrorism financing, on condition such freezing action does not jeopardise ongoing investigations. The Promoter of Justice (PoJ) must then be informed immediately (Art. 2 *septies* 3.h) of the revised AML/CFT Law).

308. If on the basis of its analysis of the reports the FIA finds sufficient indications, it must communicate to the PoJ the "information" leading to a presumption of ML or TF (Art. 2 *septies* 3. d) of the revised AML/CFT Law). From the tenor of the provision it appears that this power of decision is not a discretionary one, so communication to the PoJ is mandatory as soon as the FIA finds the information to be relevant in respect of suspected ML/TF. Furthermore, on account of the scope of the ML offence being limited it follows that, in order to establish its jurisdiction, the FIA needs to identify the probable predicate offence as a serious offence according to Art. 3 of the revised AML/CFT Law – Art. 421bis PC. The PoJ informs the FIA whenever he does not pursue the FIA report (Art. 36 *bis* 2. of the revised AML/CFT Law). Once the case has been forwarded to the Promoter of Justice, the analytical role of the FIA ends there, although it can still support the investigation or prosecution with its financial expertise in an advisory capacity.

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[41] The wording of the old provision was considered too generic.

[42] The FIA confirmed to evaluators that they have used their power under the revised AML/CFT Law to request information from entities other than the one that reported.

309. Great attention is given to the autonomy of the FIA in its operational functions as a FIU within the HS/VCS preventive AML/CFT system. This principle is expressly stated in Art. 2 *septies* 1. of the revised AML/CFT Law and Art.2§2 of the FIA Statute. The operational independence is emphasised by the circumstance that the FIA is a stand-alone legal personality unrelated to any Dicastery or Department. Also the financial provision (€900.000 for 2012) and human resources should be sufficient to avoid the FIA being dependent on outside support to be able to function. The VCS authorities do not perceive a possible conflict of interest arising from the fact that the President of the FIA is also a member of the Cardinal Committee overseeing the activities of the IOR. There are indeed no indications that this dual position affects the FIA operational independence. On the other hand, the authority to decide on the conclusion of its own MOUs with its counterparts has been taken away from the FIA, although the whole process is still initiated and managed by the FIA (Art. 2 *septies §*7 of the revised AML/CFT Law).

310. Art. 2 *septies* 5. and 37 of the revised AML/CFT Law mandate a confidentiality and security regime for all data and documents held by the FIA. Also, Art.7 of the FIA Statute imposes the "highest secrecy" on the Organs of the FIA and its staff in respect of all matters ("anything") concerning the Authority and its relation with third parties (§1). The provisions are quite stringent, but make an exception for exchange of information in the context of international co-operation or with the judicial authorities. In practice the FIA restricts access to its database to its own staff. At the moment the reports are kept in a safe, awaiting the creation of a secured IT system allowing for direct electronic reporting.

311. Dissemination of FIA held information, particularly the STR based reports, is regulated as to its destination (PoJ and foreign counterparts), whilst protecting the confidentiality and security (Art. 37. 2 & Art. 41 of the revised AML/CFT Law). The operative relationship and confidentiality requirements between the FIA, the PoJ and the Gendarmerie can be further developed through MOUs (Art. 37.3).

312. As well as being called to develop typologies and trends and periodically publicise non-confidential statistics and activity information (Art. 2 *septies* 4a & b of the revised AML/CFT Law), the FIA must forward an annual report of its activities to the Secretary of State by 31 March of each year (Art. 2 *septies* 8).

313. The FIA is seriously considering joining the Egmont Group and has already taken steps to initiate the membership procedure.

314. The principles and modalities of mutual co-operation and exchange of information between the FIA and its counterpart FIUs are laid down in MOUs. In all cases the co-operation is governed by the principles of information exchange of the Egmont Group (free exchange, prior consent, confidentiality and reciprocity)[43].

Recommendation 30 (FIU)

315. The FIA is composed of a Cardinal President, a Board of 4 Directors (chaired by the President) and the FIA Director and his staff. The Supreme Pontiff appoints the President for a period of 5 years (extendable) and the Board of Directors. They are responsible for and supervise the organisation and functioning of the FIA (Art. 4 & 5 FIA Statute).

316. The FIA Director is appointed by the President, subject to the approval of the Secretary of State, for a three year period (extendable). He is responsible for the operational aspects of the unit (Art. 6 FIA Statute). His personnel are also hired by the President and numbers 7 in total (including 3 temporary/contract staff). The IT system is being developed using the software application of Italian banks (OASI), and is made ready for on-line reporting.

[43] The authorities have subsequently reported that they have entered into one MoU with an FIU. In addition they have approached 11 other FIUs receiving formal assent from two.

317. The budget is prepared by the Director and approved by the Board of Directors. The budget is then submitted to the Prefecture for the Economic Affairs of the Holy See, according to Art. 178 of Pastor Bonus. In 2011 the operational budget for the FIA was €600,000. This was augmented to €900,000 for 2012. All in all, in the present circumstances the financial, technical and human resources appear adequate. The system is gradually coming out of its development phase and steadily becoming fully operational. Taking into account the significant workload that comes with the extra functions assigned to the FIA, it remains to be seen if these resources will prove to be sufficient for the FIA to perform its task effectively once the preventive system generates more reports.

318. The members of the Board are required to be of proven reliability, competence and professional skills (Art. 5 §1 FIA Statutes). At the time of the MONEYVAL on-site visits all Board members had a highly qualified background and expertise in canonical, financial/economic, academic and/or judicial/legal matters.

319. The professional requirements for the operational Director of the FIA are high in terms of qualifications and capability. Art. 6 1. of the Statute requires that the Director is adequately qualified and is to have proven competence and professional skills in legal-financial matters and computer science, acquired in the institutional matters of the Authority. The present Director was previously active for a long time in the higher echelons of the Italian FIU. Equally Art. 6 3. of the Statute requires that the FIA staff have the necessary professional skills in legal, financial or technical (IT) matters to ensure an effective functioning of the unit.

320. The FIA personnel has undergone the following AML/CFT training activities in 2011 and early 2012 (in man/training days):

- conferences and seminars: 6 days[44].
- International issues: 8 days[45].
- IT: 20 days[46].

Recommendation 32 (FIU)

321. The authorities supplied the following statistics on the FIA activities in 2011:

- Requests for information to other units during 2011: 1.
- Requests for information to subjects (Art. 2 AML/CFT Law) in 2011: 7.
- Requests for information from other units in 2011: 7.
- Number of cases opened: 12[47].

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[44] "*La nuova funzione antiriciclaggio e il responsabile antiriciclaggio*", organised by AIRA (Associazione Italiana Responsabili Antiriciclaggio), 3 May 2011

"*Aspetti giuridici del contrasto del riciclaggio finanziario: problematiche applicative e prospettive di riforma normativa",* during this seminar it has been established *the* Osservatorio Permanente Antiriciclaggio, 14 November 2011, University of *Roma tre*.

"Antiriciclaggio e Charity Crime nel terzo settore", organised by the *Associazione Ricerca Governance Impresa Sociale* (ARGIS) and *Alta Scuola Impresa e Società* (ALTIS), 25 January 2012, at *the Università Cattolica del Sacro Cuore*

[45] *MONEYVAL training seminar for mutual evaluation assessors on the revised FATF 40 + 9 Recommendations and the 2004 AML/CFT Methodology*, 25 – 29 July 2011, Strasbourg, France.

10th Experts' MONEYVAL Meeting on Money Laundering and Terrorist Financing Typologies (subjects: trade based money laundering in cash intensive economies and the postponement of financial transactions and the monitoring of bank accounts) 31 October – 2 November 2011, Tel Aviv, Israel.

[46] 2 members of FIA have followed 10 days of specific training (each), organised by the OASI company, at the Vatican City State.

322. It is underlined that of the 12 cases opened in 2011, only one case was triggered by an STR. Furthermore, the relatively high number of incoming requests from counterpart FIUs (7) is noteworthy. All in all, the figures indicate a level of operational activity commensurate with the starting phase of an FIU operating in a jurisdiction with a small financial sector.

Effectiveness and efficiency

323. The FIA clearly holds a key and independent position within the AML/CFT system, as the legislator intended. The effectiveness of the whole system will very much depend on the level of efficiency and performance of the FIU as a support and expert information source to the law enforcement community. With the introduction of the revised AML/CFT Law by Decree CLIX the FIA is still firmly embedded in the centre of the preventive system and is legally endowed with a range of powers to perform its duties in an adequate way.

324. Compared to the Law no. CXXVII, however, the position and legal capacities of the FIA have been weakened:

- the FIA no longer has an advisory function (Art. 34.2 old);
- the power to query additional information no longer includes judicial information (Art. 33.2 old);
- more seriously, the FIA appears to only be able to request additional information from the entity that has actually reported (Art. 33.3 old – Art. 36 *bis* 1.b new);
- while not a unique case, the FIA no longer has the authority to conclude autonomously MOUs with its foreign counterparts (Art. 2 *septies* 7 & 41 new).

325. With the exception of the new Art. 36 *bis* 1.b, these changes remain within the limits of the international standards. Nonetheless it appears to the evaluators that these changes could have an adverse impact in practice in terms of efficiency of the FIA as the centrepiece of the AML/CFT system. However, as the AML/CFT Law as amended was only adopted on 25 January 2012, it was not possible for the evaluators to assess the effectiveness of its application.

326. It is understood that the final implementation of the legal framework is still an ongoing process, but it is important that some uncertainties and deficiencies be cleared away to enhance the effectiveness of the FIU:

- It is still unclear how far the FIA's authority reaches in querying financial and administrative data, particularly in relation to the foundations. Logically that would entail direct access to information held by all Dicasteries, but it is still an open question if that also extends to foundations located in and/or dependent from the Holy See. As these foundations play a significant role in the financing of the VCS activities and the social and religious works of the Holy See, and as such must be above all suspicion, the FIA should, as a matter of principle and out of effectiveness considerations, have undisputable access to all relevant information held by these foundations.
- Beside the extent of the authority of the FIU, there is also the question where exactly its "jurisdiction" starts. The Law refers to *"segnalazioni"* (i.e. disclosures or SARs) as the starting point for any FIU operational activity, but in reality the FIA has considered itself legally competent to deal with foreign requests and other sources of information. Mutual co-operation with foreign counterparts is indeed provided for in Art. 41 of the AML/CFT Law, but from a legal point of view this does not explicitly empower the FIA to conduct enquiries on behalf of a foreign counterpart. As for other triggers of the FIU's analytical function there is no formal legal basis to be found in the Law. Any legal challenge on this point could be pre-empted by explicitly putting counterpart requests and other sources (to be specified) on a same legal footing as a SAR, or by formally introducing the possibility for the FIA to act on

[47] See footnote 20.

their own initiative.

- Art. 36 *bis* 1.b unduly restricts the power of the FIA to query additional information from the reporting entities to the entity that has filed the STR. This is not only contrary to the standards, it also raises effectiveness concerns.
- The FIA freezing capacity is a powerful and effective tool promoting recovery of criminal assets; it could, however, profit from some fine-tuning. The text of Art. 2 *septies* §3 h seems to limit this power to halting specific suspect operations, nor is it specified within what time-limit the FIA has to react to an SAR. Efficiency would be increased if the freezing measure would also apply to accounts generally. Also, the obligation to immediately hand over the case to the Promoter of Justice excludes the possibility to freeze in order to give the FIA more time to conduct or deepen its analysis to determine if there are sufficient indications or not.

2.5.2 Recommendations and comments

Recommendation 26

327. Of the cases treated by the FIA, only one[48] had been initiated by an STR during the relevant period; the rest were initiated through other sources such as foreign requests. There has been no dissemination to the Promoter of Justice as yet. Although at this point any assessment of the effectiveness would be premature, these findings give rise to an assumption that the majority of the cases will be triggered by external sources and not be generated by the HS/VCS STR system. It will be important to develop the HS/VCS AML/CFT system to become more self-supporting in order not to leave the initiative to outside sources and for the FIU not to become over-dependent on foreign input.

328. In this initial phase the deficiencies and uncertainties in the legal framework, which is basically sound, should be remedied by:

- expressly extending the power of enquiry of the FIA to the information held by all entities subjected to the reporting duty;
- clarifying to what additional sources the FIA has access and to include explicitly the foundations located in and/or dependent from the HS;
- specifying the instances triggering the authority and intervention of the FIA, beside the receipt of SARs;
- reinforce the autonomy of the FIA by restoring its decision power to conclude mutual co-operation agreements with its counterparts.
- as an effectiveness consideration, strengthening the freezing capacity of the FIA to include accounts and revisit the obligation of immediate handover to the Promoter of Justice.

Recommendation 30

329. In the present circumstances the FIA is sufficiently resourced and staffed with expert and honourable people with the appropriate level of experience to be able to cope with an increased inflow of reports and other forms of information.

Recommendation 32

[48] See footnote 20.

330. The FIA statistics appear to be adequate.

2.5.3 Compliance with Recommendation 26

	Rating	Summary of underlying rating

R.26	**LC**	• Power to query additional information does not appear to extend to all entities subject to the reporting obligation.
		• Effectiveness considerations:
		  • No access to information held by HS foundations.
		  • Recent adoption of AML/CFT Law meant that it was not possible to assess effectiveness of implementation.

2.6 Law enforcement, prosecution and other competent authorities – the framework for the investigation and prosecution of offences, and for confiscation and freezing (R.27 and 28)

331. The judiciary power in the HS/VCS is exercised by the Courts, i.e. the Single Judge, the Tribunal, the Court of Appeal and the Court of Cassation (Law CXIX approving the judiciary system in the HS/VCS (see Annex XVI)). The law enforcement segment of the HS/VCS comprises the Public Prosecutor's Office (aptly named the Promoter of Justice), nominated by the Pope; and the Gendarmerie Corps, whose primary functions as the only police force in the VCS, are the maintenance of the public order and the investigation of offences. The Swiss Guard has military status and is not involved in any law enforcement activity.

2.6.1 Description and analysis

Recommendation 27

332. Mainly due to the small size of the law enforcement community, there are no law enforcement authorities specifically and exclusively specialised in the prosecution and investigation of ML or TF.

333. Promoter of Justice: according to Art. 15 of the Fundamental Law of the HS/VCS (see Annex X) the judicial power is exercised in the name of the Supreme Pontiff by the organs within the judicial structure of the State, in which the Promoter of Justice operates. Among other things he is responsible for prosecuting offences, which would include ML & TF. He is the authority responsible for receiving reports from the FIA about probable ML & FT, and he decides on whether to pursue the case and allocate it to the Gendarmerie for a further investigation, which would be carried out under his authority. If need be, particularly when special powers are required to conduct an investigation, a single judge can act as an investigating judge.

334. Until now the Promoter of Justice has not received any reports from the FIA, nor have there been any ML or FT prosecutions. The Promoter of Justice is, however, aware of the legal issues which any successful prosecution entails, particularly in respect of the proof of the predicate offence.

335. According to Art. 16 of the Fundamental Law the Supreme Pontiff can defer the investigation and the decision in respect of a particular subject (*istanza*). This power includes pronouncing a decision according to equity and the exclusion of any further appeal (*gravamen*). This is

considered to be consistent with the powers (legislative, executive and judicial) of the Supreme Pontiff as sovereign of the VCS. On the other hand Art. 15 of the Fundamental Law establishes that the judicial power is ordinarily exercised in the name of the Supreme Pontiff by the organs constituted in accordance to the legal system of the State. The Vatican magistrates (prosecutors) are therefore invested with this ordinary delegated authority. This means that the judges are nominated by the Supreme Pontiff but they decide and formulate the sentences independently and subject only to the observance of Canon Laws and laws issued by the VCS legislator.

336. Gendarmerie: Except for Art. 13.3 Law CCCXXXIV on Government of the HS/VCS, the rules and provisions governing the organisation, function, and powers of the Gendarmerie are not found in any HS/VCS Statute, but find their base in internal regulations, such as the Regulations of the Corps of the Gendarmerie (see Annex XXXIII) the applicable (Italian) Criminal Procedure Code (arrest, investigative police, searches, sequestration) and specific provisions in diverse laws or regulations. The Gendarmerie Corps carries out the police tasks, including border, criminal and fiscal police investigations, maintaining security and public order, and prevention and repression of offences. They perform the tasks of judiciary police when investigating criminal offences under the authority of the Promoter of Justice. Although art 2 *octies* §1 of the revised AML/CFT Law now specifically entrusts the investigation of money laundering and terrorism financing to the Gendarmerie, the Corps has no specialised financial department and is likely to rely on the contribution of the FIA to assist in ML/TF investigations. If necessary, they see no problem in creating a special section to deal with financial criminal activity. As yet they have not been involved in any domestic ML/FT investigations.

337. Considering the geographical position of the VCS, interaction with the Italian police is obviously very frequent and occurs practically on a daily basis, mostly in the form of exchange of intelligence and public order maintenance support. Art. *2 octies* §3 of the revised AML/CFT Law now provides for the possibility for the Gendarmerie to enter into MOUs with their counterparts, subject to the *nihil obstat* of the Secretary of the State. The Gendarmerie is presently considering the advisability of entering into such an agreement with the Italian police.

338. HS/VCS judicial authorities do have the option to waive their jurisdiction and hand over the case to the Italian (see Art. 3 & 22 Lateran Treaty) or other foreign authorities, which the HS/VCS authorities could consider if there is no particular interest for the State (e.g. no HS/VCS citizen involved). The relation and liaison with the Italian police services is not organised in a structural way, but happens rather on an *ad hoc* basis.

339. There are no explicit texts referring to the possibility to defer arrests or seizures for investigative effectiveness purposes (*Licet*). On the other hand there are no prohibitive provisions either (*Non Licet*). The HS/VCS has not formally considered expressly providing for this possibility in their legislation. Such an operational decision is indeed within the normal powers and prerogatives of the Promoter of Justice or the Investigating Judge, under whose responsibility and authority the investigation is conducted, so no other (legislative or other) measures need to be considered.

Additional elements

340. The use of other special investigating techniques, such as undercover operations, telephone tapping and infiltration, is not expressly provided for in the VCS legislation, except for the possibility of telephone interception (Art. 170 CCP). However, according to the authorities, other techniques can also be applied when instructed or sanctioned by the investigating magistrate.

Recommendation 28

341. The procedures regulating the law enforcement actions in this field are the norms of the Italian Criminal Procedure Code of 1913 with subsequent amendments as integrated by Vatican law. The power to order production of documents, searches or seizure rests with the judicial authorities.

The Gendarmerie (with functions of investigative police) has the power to search persons or premises under the direction and authority of the Promoter of Justice (Public Prosecutor). Art. 233 of the CPC states: "If there are substantial indications that someone is concealing goods subject to an order of sequestration, or that those goods can be found in a certain place, or that it would be possible to arrest the accused or a fugitive person for which there is an arrest warrant, the preliminary investigating judge may order the search of the person or home, and proceed with the assistance of officers or agents of the investigating police, and, if necessary of security forces. In urgent cases it is possible to delegate an investigative police officer to proceed, observing the following rules". According to Art. 234 of the CPC "the search of a house or in closed places adjacent to it cannot begin before sunrise nor after sunset. Nevertheless, in urgent cases the judge can issue a decree that permits the search to begin during the night".

342. The term "funds" is defined in Art. 1.11 of the revised AML/CFT Law as "assets of every kind, whether tangible or intangible, movable or immovable, as well as legal documents or instruments in any form, including electronic or digital, evidencing title to or interest in such assets" and serves for the definition of "goods" (the term in Italian is "*beni*").

343. Consequently, searches have to be authorised by the judicial authorities except in cases of flagrant crime and in urgent cases when the Gendarmerie can search on their own initiative without having to request a prior authorisation.

344. Financial information held by financial institutions, including the data collected in the context of CDD and other information covered by financial secrecy is accessible through the intervention of judicial authorities (the order of the single judge). According to Art.166 of the CPC "officials of the investigating police should sequester any goods that were used to commit a crime, those which were the product of the crime, and all which could be used to ascertain the truth". The only limitation upon the investigative police seems to be related to sealed documents because, as it is set out in Art. 170, "during sequestration, officials of the investigative police cannot open letters under seal, other letters, folders, packages, letters of credit, telegrams, or documents, but must instead transmit them intact to the judicial authority". That refers only to the period of sequestration because sealed documents can be opened by the judge.

345. There is no specific mention in the law of the possibility of seizing computerised data. The only provision the evaluators found in the CPC (dating from 1913) that could indirectly be used to demonstrate this facility for the police and judiciary authorities was the provision of Art. 166 of the CPC on seizure of anything "which could be used to ascertain the truth" and of Art. 162 on obligation of the investigative police "to investigate crimes, collect evidence". On the other hand, Art.32 of the revised AML/CFT Law states that financial institutions and other obliged entities are required to preserve "the documents, data and information obtained while fulfilling the customer due diligence requirements, so as to permit the Judicial Authorities to reconstruct the relationships, services and transactions even in case of a criminal proceeding. In the original version of the AML/CFT Law (Art. 40) there was a provision stating that "any news, information and data possessed, by reasons of their activity, by the subjects referred to in Art. 2, their managers, employees, consultants and collaborators, bound by whatever relationship, are covered by secrecy in respect of everyone, except for the Financial Intelligence Authority and the Judiciary Authority, both inquiring and adjudicatory, if, for the latter, the information requested is necessary for investigation purposes or proceedings relevant to violations subject to criminal punishment"; however, the same article in the amended law refers the lifting of secrecy for those authorities only in relation to the information held by competent authorities. At the same time a new Art. 37 *bis* was introduced which states in its paragraph 2 that "financial secrecy shall not obstruct the activities and the requests for information from the authorities competent for the prevention and countering of money laundering and the financing of terrorism". And Art. 37.6 mentions now the possibility of sequestering records or documents indirectly providing for a mandate for the seizing of computerised data.

346. Failure to comply with the obligations mentioned in the previous paragraph is subject to sanctions by the FIA from €10,000 to €250,000 for the natural persons and from €10,000 to €1,000,000 (Art. 42.1 of the revised AML/CFT Law).

347. The Gendarmerie is able to seize assets. The seizure can be ordered in the course of a judicial investigation and it remains in force until the end of the criminal proceedings. Art. 612 of the CPC states that "those goods that are the proceeds of crime or that are somehow related to it, are held under sequester until the procedure so requires". In cases of necessity and urgency, the Gendarmerie can seize the *corpus delicti* and any relevant items. This seizure has to be notified in writing within 48 hours to the judicial authorities.

Power to take witness statements

348. Statements in connection with any investigation are taken by the judicial authorities. Statements and testimonies made to the investigating judge may be used both during investigation and legal proceedings. In flagrant crime cases or urgent cases these and cross-examination of witnesses can be taken by the investigative police (Art. 169 of the CPC). The use of statements and testimonies made to the investigative judge is regulated in Art. 245 of the CPC. All the acts of the preliminary stage may be used for the final sentence. Giving false or hostile evidence before a Judicial Authority is punished by terms of imprisonment from 1 to 30 months, if done to the prejudice of an accused person or during a criminal trial, then the punishment is from 1 to 10 years (up to 20 years in a specific case of aggravating consequences) (Art. 214 of the CC).

Recommendation 30 (law enforcement and prosecution)

349. There are 2 Promoters of Justice exercising their function, both in civil and criminal cases, with the HS/VCS Courts. This is a fully independent function. In the judicial year 2010 they conducted 200 criminal procedures in total, including 1 mutual legal assistance procedure. Although quite heavy, the work burden is deemed manageable. As previously noted, they have not yet been confronted with ML/FT cases.

350. The Gendarmerie forms part of the HS/VCS administration. It counts 137 officers (15 commissars, 68 inspectors, 49 gendarmes apart from the leadership of the Corps). The Gendarmerie Commander is the Director of the whole Security and Public Order Department which includes additionally to the mentioned police staff the Fire Command and Technical Service**.**

351. The Gendarmerie Corps has a budgeted headcount of 197, which leaves 60 vacancies unfilled. This is of course a restraint in terms of human resources, but does not appear to hinder the normal functioning of the service. The Gendarmerie conducts its investigations under the authority of the Promoter of Justice or the Single (Investigation) Judge, who can issue instructions to the investigators. The table below demonstrates the number of investigations in the previous years (none of them were related to ML or TF).

Statistics on criminal investigations conducted by the Criminal Police Department of the Corps of Gendarmerie

Year	Number of Investigations
2008	38
2009	58
2010	66
2011	92

352. In accordance with Art. 7 and 13 of Law No. CXIX Law that approves the Judiciary system of the State of Vatican City, the Promoters of Justice are appointed by the Pope from the Italian legal community. The conditions include high standards of irreproachable morality and legal expertise and experience.

353. The personnel of the Gendarmerie must also comply with moral and professional standards. The Regulations of the Safety and Civil Protection Department define the procedure for enlisting and appointment of the police corps. There are specific criteria in addition to the usual requirements set by the General Regulations for the Personnel of the Vatican City State Governorate, including specific competition tests.

354. The Promoters of Justice have not been specifically prepared for dealing with ML or TF cases and basically rely on their extensive legal background and experience.

355. The HS/VCS authorities indicated that the Gendarmerie officers are recruited, selected and trained on the basis of the relevant criteria and professional standards (including moral and religious criteria). Besides the general law enforcement training all members of the Gendarmerie receive, a number of officers have followed specialised courses and training on financial crime and terrorism with their Italian colleagues of the Carabinieri and other bodies (see the list below). However, on the basis of information provided, there does not appear to be enough training provided to the Gendarmerie staff in the financial investigation field. The skill level of the law enforcement personnel regarding ML and FT issues clearly needs to be enhanced.

Training courses followed by the personnel of the Corps of the Gendarmerie

- Since 2007, every year, three officials of the Corps of the Gendarmerie take professional courses for officers organised by the *Arma dei Carabinieri* (of Italy). Each course lasts one academic year (October to June) and covers various specialised subjects for officials in the sectors of public safety and general international law enforcement for police.
- Training course for the staff of the Central National Offices of INTERPOL, headquarters in Lyon France of the General Secretariat of INTERPOL, 11-13 March 2009, attended by one chief officer and one functionary officer.
- Course organised by The European Police College (CEPOL) on the trafficking of stolen art works, Rome, 15-18 June 2010, attended by one functionary officer.
- Course organised by CEPOL on the trafficking of stolen art works, Rome, 24-27 May 2011, attended by one functionary officer.
- Training course of international cooperation with INTERPOL and the Italian Police on "*UN Security Council Sanctions and their Implementation at National and International Level*", Rome, 5-9 March 2012, one officer attended.
- The European Anti-Fraud Office (OLAF) – training course on Euro currency bank notes organised by the "Italian Office on False Currency", Rome, 24-26 November 2009, attended by two officers.
- Seminar on the crime of counterfeiting, Ostia (Rome), 16-20 November 2009, attended by one officer.

Additional elements

356. No special training or educational programs are provided for the judicial authorities regarding ML and FT offences and the seizure, freezing and confiscation[49].

Effectiveness and efficiency

357. Since Law No. CXXVII came into effect as of 1 April 2011, the judiciary and law enforcement authorities have not yet been confronted with money laundering or terrorism financing matters, be it in the form of FIA reports or otherwise, but they feel capable of handling such cases. The synergies with the FIA are being developed and that should translate itself into higher performance of the system as a whole. Although the fundamentals are already in place, the system is still very much under construction, so any attempt to assess the effectiveness of the implementation by the law enforcement community would be too speculative.

358. There appears to be a risk of underestimating the challenge to law enforcement capacity here. Specialisation at court and police level may indeed be difficult to achieve in view of the limited human resources. The Gendarmerie statistics give no indication of any experience in serious financial crimes (petty theft and attempted illegal entry into Vatican City State seem to be predominant crimes). The reported financial loss due to crime was €5,200 in 2011, €8,600 in 2010, and €4,900 in 2009. ML/TF cases present particular challenges, especially in terms of the burden of proof, and require a particular know-how, both by the judiciary and the law enforcement authorities, which comes from targeted education and case experience. Although the Gendarmerie has already participated in some training with its Italian and EU counterparts, in the present circumstances it is doubtful if the Gendarmerie has sufficient resources and expertise to handle complicated ML/TF cases. Of course, there is always the option for the HS/VCS to waive its own jurisdiction and hand the case over to their Italian counterparts, but it is imperative that the HS/VCS law enforcement authorities develop their own efficiency so not to be overly dependent upon foreign goodwill.

359. The provision on the conclusion of MOUs with "similar" counterparts (Art. 2 *octies* 3 of the revised AML/CFT Law) is puzzling, as it does not make any sense in the present law enforcement environment with its established communication systems and traditions, such as INTERPOL. As such MOU requires the approval of the Secretary of State, this may be perceived as an undue restriction of the operational margins of the Gendarmerie. The VCS authorities maintain that the provision does not introduce an obligation, but is meant to streamline the cooperative interaction with law enforcement counterparts in AML/CFT matters. In any case, the evaluators consider this provision redundant and needlessly confusing.

360. The statistics do not indicate any financial investigations having been undertaken, although some crimes that could have been regarded as predicate offences were registered. There might be a tendency to transfer the cases to the Italian investigative authorities, rather than taking up the prosecution in HS/VCS. That is why it is important for the HS/VCS authorities to develop their own experience and jurisprudence in stand-alone money laundering prosecutions, and take matters more in their own hands, even where the transfer of prosecution under the Italian jurisdiction is likely to be an appropriate approach.

361. In view of the above, the evaluators have reservations on the effectiveness and efficiency of the framework for the investigation and prosecution of ML offences even if the risk of serious ML crime on the HS/VCS territory or relating to the interests of the Holy See or HS/VCS is considered low. Simple cases of fraud and other offences are investigated and prosecuted. When the case does not relate to the HS/VCS the case is passed to the Italian law enforcement authorities. It is strongly advised that the HS/VCS law enforcement authorities start playing a more active role in AML/CFT investigations and prosecutions. So far the involvement of the

[49] Subsequent to the second MONEYVAL on-site visit, an investigative officer whose official duties include anti-money laundering of the Gendarmerie attended the "Seminar on Money laundering" organised by the Italian CEPOL unit, Rome, 17-20 April 2012.

Gendarmerie has been limited to looking into several cash declarations following requests from the FIA. The evaluators feel that the MOU between the law enforcement and the FIA that is being developed will provide a good basis for a more active role of the Gendarmerie The absence of practical experience calls into question the capabilities of the Gendarmerie in investigating ML offences.

2.6.2 Recommendations and comments

362. The law enforcement and judicial authorities' competencies in AML/CFT should be strengthened, in particular through training with regards to the specifics of the HS/VCS and the use of existing tools and investigative and computer techniques. The authorities could consider establishing a joint committee comprising all those concerned in AML/CFT matters to discuss and evaluate AML/CFT effectiveness and reviewing the system to detect and eliminate shortcomings, develop and implement policies and legislation, thus improving results.

363. In light of the above it is recommended to:

- intensify the training of the law enforcement authorities, especially in the area of financial investigation, in view of the expected effects of the recently introduced reporting system.
- as for the judiciary, to participate in such training and develop its own expertise to be able to deal with the legal challenges inherent in the prosecution of ML/FT.
- further interact and coordinate with the FIA to develop the necessary know-how underpinning the effectiveness of the system.

364. The statistics do not indicate that any financial investigations have been undertaken, although some crimes that could have been regarded as predicate offences were registered. There might be a tendency to transfer the cases to the Italian investigative authorities, rather than taking up the prosecution in HS/VCS. That is why it is important for the HS/VCS authorities to develop their own experience and jurisprudence in stand-alone money laundering prosecutions, and thus take matters more into their own hands.

2.6.3 Compliance with FATF Recommendations

	Rating	**Summary of factors underlying rating**
R.27	**LC**	• Effectiveness not demonstrated. • Lack of experience and training in financial investigations (effectiveness issue).
R.28	**C**	

2.7 Cross Border Declaration or Disclosure (SR.IX)

2.7.1 Description and analysis

Mechanisms to monitor cross-border physical transportation of currency)

365. With the adoption of the original AML/CFT Law the HS/VCS authorities established a declaration system for cash and bearer negotiable instruments with legal requirements for all natural persons. According to Art. 39 of the revised AML/CFT Law all persons entering the HS/VCS are to declare currency "equal or exceeding the pre-set maximum threshold established

by the Pontifical Commission for the Vatican City State, on the basis, *inter alia*, of the European norms in force on this matter". The original AML/CFT Law of 30 December, 2010 provided for the direct application of the threshold established by regulations in force in the (European) Community. FIA Regulation No. 2 "Concerning the Transportation of Cash and Financial Instruments Entering or Leaving Vatican City State" (see Annex XVIII) establishes specifically the threshold above which the currency is to be declared in writing as the amount equivalent to €10,000. But the amended Act introduced Art. 39 *bis* that says that "the Pontifical Commission for the Vatican City State shall pre-set, through a regulation, a maximum threshold for the amount of currency that may be used, on the basis, *inter alia*, of the European legislation in force in this regard". Although Art. 1 of the same Act mentions that "the adoption of this Decree is without prejudice to the provisions contained in the regulations and instructions adopted by the Financial Intelligence Authority before 25 January 2012, in so far as they are compatible with it". There might be a conflict in this regard because the Act instructs specifically the Pontifical Commission to establish the threshold and not the FIA.

366. It should be noted that Art. 1.10 of the revised AML/CFT Law introduces the definition of *«currency»* which meets the requirements set out in SR.IX:

a) currency (banknotes and coins circulating as means of exchange); b) instruments issued or negotiable to the bearer, including traveller's cheques, cheques, money orders and promissory notes issued or made out without restrictions to a fictitious payee or otherwise issued or made out in such a form that the title passes upon delivery; as well as incomplete instruments, signed but with the payee's name omitted.

367. The AML/CFT Law states that the completed declaration forms have to be recorded and preserved for five years by the FIA. Art. 2.1. of FIA Regulation No.2 specifies that the forms are to be submitted at the offices of the Gendarmerie Corps where they will be accepted after having identified the declaring person by a valid document. Art. 4 1. of the Regulation requires that the originals of the statements be sent within 48 hours to the FIA. At the same time the Regulation allows for the possibility to file a declaration at the offices of the bodies and organisations subjected to the requirements pursuant to the AML/CFT Law, operating in the Vatican City State, "where the said operation takes place". The requirement declare currency also covers transfers of cash and similar instruments made by post, in which case the statement must be submitted at the moment of consignment to the offices of the Vatican Post Office, or within 48 hours of receipt at the offices of the Gendarmerie Corps. The requirement to file a declaration does not apply to documents of title and negotiable instruments issued with the indication of the beneficiary's name and corporate name and the clause of non-transferability. The declaration requirement applies to movement of values by cash transportation vans. This obligation does not, however, extend to containerised cargo. The obligation to file a declaration applies only to natural persons. Legal persons are bound by customs duties requirements which cover the need to declare goods for customs duties. The authorities have provided the following statistics with respect to the total number of declarations received: for the period from 1 April 2011 till 31 December 2011 – declarations at entry – 658, declarations at leaving the state – 1,896. Almost all declarations were submitted at the IOR (2,551 out of total 2,554), while none were submitted to the Gendarmerie. The statistics also contain the amounts and types of declared currency.

368. Art. 2 7. of FIA Regulation No. 2 states that the duty of declaration is not considered to be fulfilled if the information provided is incorrect or incomplete. According to the AML/CFT Law, the FIA has the power, and obligation to perform inspections for the observance of declaration duties and to impose administrative pecuniary sanctions in cases of infringement.

369. The agents of the Gendarmerie Corps have the authority to make inquiries and inspections of the luggage and any other objects carried by the persons entering or leaving the territory of Vatican City State on a targeted basis in case of justified grounds for suspicion. It should be noted that according to the Lateran Treaty with Italy of 1929, all goods arriving from abroad and destined for Vatican City or destined for institutions or offices of the Holy See outside its

boundaries, will always be admitted from any point of the Italian border and in any seaport of Italy for transit through Italian territory, with full exemption from customs fees and duty (Art. 20). So the customs functions belong solely to the Vatican City authorities. With transportation of cash the situation is different because the customs controls are additionally performed at the Italian border control points as the Vatican City State has no entrance points other than from Italian territory. The Gendarmerie provided statistics for the last years on checks of persons and goods entering or leaving the state (this seems to refer to normal customs checks and not under the declaration system).

Year	2009	2010	2011
Persons	600	628	628
Goods	957	968	968

370. No checks resulted in reports.

Requesting Information on Origin and Use of Cash

371. The AML/CFT Law and FIA Regulation No. 2 (see Annex XVIII) specify that the declaring person has to include into the declaration information on himself, the owner and the recipient of the values concerned as well as on their origin and itinerary and intended use. The law establishes in Art. 39.4 that "the Gendarmerie Corps shall make inquiries and inspections to ensure the compliance of the requirements set forth in paragraph 1, within its own competences and the limits established by the laws in force". Taking into account that no declarations are submitted to the Gendarmerie it is doubtful that this provision can be used. At the same time the Regulation states that in case of suspicion the Gendarmerie Corps officers may inspect the luggage or means of transportation and order a search of the person, and in case of infringement they shall draw up an assessment report and inform the FIA within 48 hours. Those actions can be challenged by the person concerned. Cases of infringement include false or incomplete declaration. The AML/CFT Law and the Regulation mention suspicion on infringement of the obligation to declare but not suspicion on money laundering or terrorist financing. The declaration form is very detailed and contains fields for the origin and intended use of the currency. The evaluation team had been provided not only with the form template but also with completed declarations.

Restraint of Currency

372. Art. 5 of the Regulation allows that, in circumstances where there is an infringement of the obligation to declare the values exceeding the limit (€10,000), the authorities have the power to apply an administrative restraint (the Regulation uses the term "administrative attachment"). However, this restraint is limited to the extent of 40% of those values and a minimum amount of €10,000. The attachment is made for the whole amount if: the object is indivisible; its author is unknown; or the nature and amount of values or its equivalent in Euro is not immediately assessable when the attachment is performed. This has not yet been tested in practice.

373. The purpose for such action is only to secure pecuniary administrative sanctions imposed by the FIA. Moreover Art. 5.6 of the Regulation states that the values shall be restored to the title holders in any case upon payment of the custody fees, provided that:

a) the party concerned demonstrates the case falls under the provisions of Art. 1.3 of this Regulation;

b) the party who committed the infringement is deceased;

c) an order of discharge has been issued or the confiscation has not been ordered;

d) the values have not been allocated for the payment of the administrative sanction.

Furthermore, Art. 5.8 of the Regulation states that "the Financial Intelligence Authority shall provide for the restitution of attached values which have not been used for the payment of the pecuniary administrative sanction imposed, to parties concerned who have claimed it within 5 (five) years from the date of attachment". Art. 5.5 (c) has the only mentioning of "discharge or confiscation".

374. In any case the law or the Regulation do not explicitly cover the authority by law enforcement officials to be able to stop or restrain currency or bearer negotiable instruments in order to enable them to ascertain whether there is a suspicion of ML or TF. The wording of the law implies that "suspicion" is only non-declaration or incomplete or inaccurate declaration. The law mentions the right of the customs authorities (i.e. Gendarmerie) to search persons and to submit the report on the search to the Promoter of Justice, but this refers to cases of smuggling of goods, and belongs to normal customs duties.

Retention of information of currency and identification data by authorities when appropriate

375. The declaration form contains data to be filled in, which includes, *inter alia*, the identifying data of the person submitting the declaration, the owner and the recipient of the values concerned, the amount as well as information on the origin and destination. All declarations received are sent, within 48 hours, to the FIA. The information is recorded and kept for a period of 5 years. Furthermore, Art. 4 of the Regulation states that the Gendarmerie forwards to the FIA assessment reports on infringements of the declaration regime. Consequently, the information in the declaration forms shall be retained for use by the appropriate authorities in instances when: (a) a declaration which exceeds the prescribed threshold is made; and (b) where there is a false declaration. The legislation is silent on the cases when there is a suspicion of money laundering or terrorist financing related to transportation of cash.

Access of information to FIU

376. It is to be noted that the declaration form itself is developed by the FIA. As mentioned previously, all declarations are to be submitted to the FIA. And all assessment reports on infringements of the declaration obligations are forwarded to the FIA.

Domestic co-operation between Customs, Immigration and related authorities

377. The relevant articles in the AML/CFT Law or FIA Regulations do not mention any additional provisions relating to domestic co-operation, including regarding cross-border cash movements apart from the declaration forms' information being forwarded to the FIA by the Gendarmerie and relevant information on any actions by the Promoter of Justice. The authorities indicated that an MOU between the FIA and the law enforcement authorities in the AML/CFT field is being developed. There were no examples of any financial analysis results submitted to the Promoter of Justice on the basis of declaration system.

International co-operation between competent authorities relating to cross-border physical transportation of currency

378. The revised AML/CFT Law contains Art. 41 "International Exchange of Information" that refers only to the powers of the FIA to exchange information. While the article establishes that "financial secrecy and any eventual restrictions on the communications shall not inhibit the international exchange of intelligence" it restricts the powers of the FIA to the exchange information only "with analogous Authorities in other States, on the condition of reciprocity and on the basis of Memoranda of Understanding". The authorities indicated that the Gendarmerie can cooperate with the customs authorities of other countries on the basis of general rules. No examples were given to the evaluators. The Gendarmerie may also exchange information through INTERPOL channels (there is an officer responsible for that). It was also reported that the Gendarmerie can exchange information with the Guardia di Finanza of Italy regarding the import/export of goods as well as on individual cases. It would appear that the possibility to set up investigation groups and conduct joint search operations seems purely theoretical.

Sanctions for making false declarations/disclosures & Sanctions for cross-border physical transportation of currency for purposes of ML or FT

379. As mentioned earlier, pursuant to Art. 42 of the revised AML/CFT Law the FIA shall impose administrative pecuniary sanctions in cases of infringement of the declaration of cash obligations (i.e. when the information is not provided or is incorrect or incomplete). Making a false declaration or failing to file the declaration or providing inaccurate or incomplete information constitutes an administrative violation and is punished by an administrative sanction of up to 40% of the amount concerned, exceeding the equivalent value of €10,000, with the range of sanctions between the minimum of €10,000 and maximum of €250,000. This provision had not been yet applied in practice. Art. 6 of FIA Regulation No. 2 allows for a specific procedure of voluntary settlement, which consists in depositing a sum calculated as follows, and in any case at least €200: 5% if the amount exceeding the limit of €10,000 is not higher than €15,000; and 20% in all other cases. Voluntary payments are not permitted if the amount exceeding the limit is higher than €250,000 (or if the person concerned avails himself/herself of said option within 365 days before the date of notification of the assessment report. In such cases, the FIA orders the return of money or similar instruments within 10 days following receipt of the proof of payment. The evaluators have come to the conclusion that the voluntary payment rules enable a person to immediately pay 5% or 20%, of the money exceeding the established threshold, with a minimum of €200, which might not be an adequate or dissuasive sanction. The authorities have not provided detailed statistics on the controls carried out by the Gendarmerie or the FIA, the violations ascertained and the sanctions applied.

380. It seems that these sanctions apply only in case of incomplete or incorrect declarations but not in case of suspicions of money laundering or terrorist financing.

Confiscation of currency related to ML/FT and pursuant to UNSCRs

381. According to Art. 24 of the AML law "the Financial Intelligence Authority, by its own provision, without delay and without giving previous notice, orders the freeze of the funds and other assets owned or possessed, exclusively or jointly, directly or indirectly, by the persons designated by the Secretariat of State" (on the basis, *inter alia,* of the relevant United Nations Security Council resolutions). Because practically all cash declarations (with cross-border movement) are done at the IOR, the criteria of SR.III seem to be met.

Notification of foreign agency of unusual movement of precious metal and stones

382. The competence for detecting any unusual movement of precious metals and precious stones belongs to the Gendarmerie Corps in the ordinary exercise of its tasks. Within the Gendarmerie Corps there is a frontier and customs control unit which is in charge of performing these functions at frontiers. The Gendarmerie Corps in principle is able to exchange information with foreign law enforcement agencies and can refer a case to Italian law enforcement authorities although in this particular case there might be a conflict of jurisdiction because under the Lateran Treaty the Italian authorities are excluded from any customs functions for the goods to or from the VCS. But in practice such a possibility has never been used. The Law does not explicitly cover aspects arising from the discovery of unusual cross-border movement of gold, precious metals and precious stones (they can be considered to be included in the term "goods"), and those are not covered as such by any declaration requirements. The authorities indicate that without prejudice to the provisions concerning cross-border movements of cash, the Gendarmerie, in the framework of ordinary control customs activities on the import and export of any goods, may detect gold, precious metals and stones.

Safeguards for proper use of information

383. Art. 37 *bis* of the revised AML/CFT Law states that "all notices, information and data held by the subjects referred to in Art. 2, §1, their legal representatives, administrators, directors, employees, consultants, and collaborators on any grounds, by virtue of the exercise of the activities referred to in the same Art. 2, §1, shall be protected by financial secrecy. Financial

secrecy shall not obstruct the activities and the requests for information from the authorities competent for the prevention and countering of money laundering and the financing of terrorism". And for the competent authorities Art. 40 of the same act states that "all information held by the competent authorities shall be subject to official secrecy, without prejudice to the activities of the Judicial Authorities in case of criminal proceedings". As the authorities stated that is valid for the information on cross-border transportation as well.

384. Furthermore, Art 7 of the FIA Statute (see Annex VI) states:

1. The subjects mentioned in the Articles of this Chapter are obliged to keep the highest secrecy about anything concerning the Authority and its relationships with third parties.
2. The secrecy is not a restriction for the implementation of duties in matters of international co-operation and towards Judicial Authorities, both inquiring and adjudicatory, when the information requested is necessary for inquiries or proceedings concerning offences subject to criminal sanctions.

Training, Data Collection, Enforcement and Targeting Programs

385. The information available, did not demonstrate that the Gendarmerie had received adequate training in this particular field.

Supra-National Approach: Timely Access to Information

386. Not applicable to the HS/VCS.

Additional elements

387. Reports are maintained in a computerised data base of the FIA and of the Gendarmerie.

Recommendation 30 (Customs authorities)

388. The authorities stated that they have involved staff with experience in inspections on persons and means of transport in the customs control function. The requirements for the officers are the same requirements as for all Gendarmerie staff. The information provided to the evaluation team on training did not contain any training in issues related to detecting illegal cross-border transportation of currency.

Recommendation 32

389. Statistics maintained by the authorities are adequate.

Effectiveness and efficiency

390. The introduction of the declaration requirements is relatively recent, and the authorities have already introduced amendments to clarify the requirements. The introduction of such a declaration system and forwarding of the completed declarations to the FIA and the subsequent storage of the data contained in the declaration allows the FIA and the other competent authorities to monitor the flows of cash and other instruments in and out of Vatican City State. The effectiveness of the implementation of the declaration obligation needs to be further enhanced especially as the Gendarmerie, with its customs powers, seems to be distanced from that. That might also influence the ability of the authorities to exchange information on cross-border transportation because of limitations for the FIA where all the information is kept. Specifically the authorities have to look at how the provision for voluntary depositing influences the system of sanctioning.

2.7.2 Recommendations and comments

Special Recommendation IX

391. Authorities should take stock of the sanctions applied and analyse whether the voluntary settlement provisions undermine the effectiveness and deterrent scope of the sanctions, and if appropriate, reconsider the statutory sanctions to ensure that these are proportionate. Authorities should consider introduction of a clearer indication on powers to act on suspicion of money laundering or financing of terrorism into the provisions of Art. 39 of the AML/CFT Law.

392. As all declarations have so far been submitted at the IOR, Governorate or APSA, the authorities should review the existing provisions and find a better way to facilitate involvement of the Gendarmerie with its law enforcement powers of restraining currency. The existing delay in the processing of the declarations might influence the effectiveness.

Recommendation 30

393. Comprehensive training should be provided regularly to the Gendarmerie on detection of cash couriers.

2.7.3 Compliance with Special Recommendation IX

	Rating	**Summary of factors underlying rating**
SR.IX	**PC**	• The declaration requirement does not cover shipment of currency through containerised cargo. • Doubts on the ability of the Gendarmerie to restrain currency where there is a suspicion of ML/FT as all declarations have been made at financial institutions. • Restrictions on the ability of the FIA to exchange information with counterparts on cross-border transportation. • The voluntary payment rule substantially reduces the level of sanctions and may undermine the deterrent scope of the sanctions. • It was not demonstrated that the relevant authorities were provided with sufficient training to effectively perform their functions (Effectiveness issue).

3 PREVENTIVE MEASURES - FINANCIAL INSTITUTIONS

394. Pursuant to Art. 2 §1 letter a of the revised AML/CFT Law all persons, either natural or legal, that conduct professionally one of the following activities are bound to observe the measures regarding CDD, registration, and record-keeping, as well as the reporting of suspicious transactions.

i. the acceptance of deposits and other repayable funds from the public;
ii. lending;
iii. financial leasing;
iv. transfer of funds;
v. issuing and managing means of payment;
vi. issuing financial guarantees and commitments;
vii. trading in any kind of financial instruments, exchange rate and interest contracts;
viii. participation in issuing securities and the provision of related financial services;
ix. management of individual or collective portfolios;
x. safekeeping and management of currency and other securities;
xi. any other form of investing, administering or managing currency, funds or other assets;
xii. underwriting and placing life insurance and other investments related to insurance;
xiii. currency exchange.

395. Accordingly, the AML/CFT Law applies to all activities and operations carried out by financial institutions as defined in the Glossary to the FATF Methodology. The table under Section 1.3 above sets out which of the above-mentioned activities or operations are in practice undertaken by the IOR and APSA, if conducted as a business for or on behalf of a customer. Overall the IOR is the most relevant financial institution for the purposes of this evaluation report.

<u>Customer Due Diligence and Record Keeping</u>

3.1 Risk of money laundering / financing of terrorism:

396. The Vatican City State is geographically and demographically the smallest country in the world and consequently there is very little domestically generated crime. However, St Peter's Basilica and the Vatican Museums receive more than 18 million pilgrims and tourists each year and this inevitably results in a certain level of petty crime. No independent businesses are established within the HS/VCS, as a public monopoly regime exists in the economic, financial and professional sectors. Thus, unlike other states evaluated by MONEYVAL, there is no market economy. Given this the authorities consider that the threat of money laundering and terrorist financing is very low. However, no formal risk assessment has been done as yet.

397. The AML/CFT Law as amended by Decree No. CLIX of 25 January 2012 applies to all activities and operations carried out by financial institutions and DNFBP as defined in the Glossary to the FATF Methodology. The revised AML/CFT Law includes a risk-based approach to CDD. Enhanced CDD is required by law for non-face to face relationships (see Recommendation 8 below), correspondent current accounts (see Recommendation 7 below) and relationships established with politically exposed persons (see Recommendation 6 below). The only additional requirement for enhanced due diligence that appears to be designed based on a local risk assessment is the one set out in the FIA Instruction No. 2 and relates to repeated transactions of deposit of cash or valuables. However, as a result of an incomplete risk categorisation, enhanced due diligence measures appear to be applied to a very limited number of customers.

398. The instances for simplified CDD as provided for in the AML/CFT Law are designed largely on the basis of the risk-sensitive elements set out in the Third EU AML Directive and are not the result of a specific assessment of the risks and vulnerabilities faced by the HS/VCS. The failure to have undertaken any formal risk assessment implies that there is no basis for determining whether other potential risks are addressed appropriately. The evaluators have identified other factors which could increase the risk situation; these include: high volumes of cash transactions and wire transfers (although, the evaluators fully appreciate that cash transactions are an important contributor to the funding of the global mission of the church); global spread of financial activities (including with countries that insufficiently apply the FATF Recommendations); and the limited availability of information on the non-profit organisations operating in the HS/VCS. The evaluators' assessment largely matches with a preliminary threat assessment of the FIA. This preliminary assessment needs completing and formalising.

399. In applying the risk-based approach to simplified due diligence the AML/CFT Law creates blanket exemptions from the CDD requirements. As such these are not reduced or simplified CDD measures as suggested by the essential criteria, but an exemption from any CDD except in those situations when ML or FT are suspected, or when there are reasons to believe that the previous verification is unreliable or insufficient to provide the necessary information. Obliged subjects are exempted from observing CDD requirements with respect to life insurance policies, complementary pension schemes, obligatory and complementary pensions and similar schemes, beneficial owners of pooled accounts and electronic money which meet certain conditions.

400. In addition, the FIA may authorise the obliged subjects not to apply CDD requirements regarding particular categories of counterparts and typologies of relationships, services and transactions of low risk of money laundering or financing of terrorism (see under essential criteria 5.8 below for details). The products and services mentioned above are again taken from the Third EU AML Directive. The authorities have not set out the basis upon which they have taken the decision to allow for simplified due diligence in those cases. It should be highlighted that most of the above-mentioned products and services are not provided by subjects within the HS/VCS and are therefore not relevant for the local financial environment.

401. There is a clear need for a comprehensive risk assessment to properly judge the adequacy of the current risk based approach. The Secretariat of State has confirmed that, as a consequence of the evaluation process, it has become aware of the importance of conducting a detailed risk assessment in order to develop a comprehensive AML/CFT regime. As a consequence of this the evaluators were informed that the process for conducting a risk assessment has been initiated. This process will involve actively seeking recommendations from the FIA and more generally gathering information necessary for the completion of the risk assessment including the recommendations of the evaluators on this issue. Furthermore, the Secretariat of State has taken into account an initial view from the FIA, indicating those areas of inquiry which typically present possible areas of weakness in many jurisdictions, including: use of cash transactions; the adequacy and availability of information from non-profit organisations; receipt of donations; and placing of external contracts.

3.2 Customer due diligence, including enhanced or reduced measures (R.5 to R.8)

3.2.1 <u>Description and analysis</u>

Recommendation 5

Anonymous accounts and accounts in fictitious names

402. In order to protect and promote the integrity and transparency of the economic, financial and professional sectors, Art. 1 *bis* a) of the revised AML/CFT Law prohibits the opening or holding

of anonymous or ciphered accounts, deposit, savings accounts or similar relationships, or accounts under fantasy or fictitious names.

403. Representatives of the IOR and APSA assured the evaluation team that all accounts are opened and kept in the official name of the respective customer, taking into account the differences between natural and legal entities. The IOR employee responsible for account opening procedures confirmed that all customer CDD details are accessible to those involved in AML-relevant operations (including, in particular, front office staff and compliance officers) In addition, IOR representatives emphasise that the core banking solution used by the IOR since 1996 does not technically allow the use of anonymous or ciphered accounts.

404. IOR and APSA representatives stated that they have no evidence of the use of anonymous, accounts in fictitious names or numbered accounts in the time prior to the coming into force of the AML/CFT Law (see also c. 5.18).

405. Safe custody services are provided to very few clients (less than 100) of particular categories of customers. While not set out in written form, in practice the express approval of the General Manager is requested before providing such services. The IOR representatives assured the evaluation team that all of the customers requiring safe custody services have been subject to the standard CDD procedures in accordance with the AML/CFT Law and that these relationships are not kept in an anonymous way or under fictitious names.

Customer due diligence

When CDD is required

406. Following the amendments and additions to the revised AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012, financial institutions are required, pursuant to Art. 28 of the revised AML/CFT Law, to apply CDD measures:

a) when they establish a relationship;

b) when they carry out occasional transactions equal to or in excess of €15,000, regardless of whether it is conducted in a single transaction or in various transactions connected one to the other;

c) when they transfer funds for an amount equivalent to or in excess of €1,000;

d) when there exists a suspicion of money laundering or financing of terrorism, regardless of any derogations, exemptions, or applicable thresholds;

e) when there are doubts about the veracity or adequacy of the data previously obtained for identification of the counterpart.

407. Prior to the amendments and additions to the revised AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012, there was no requirement in Law or Regulation to undertake CDD measures when carrying out occasional transactions that are wire transfers in the circumstances covered by the Interpretative Note to SR VII.

408. Pursuant to the definition provided in Art. 1 §28 of the revised AML/CFT Law only transactions executed within a period of seven days have to be considered as "linked transactions". This is not in line with the Standard, which does not provide for such a limitation of the time elapsed between transactions. Given that this time period is published in the Law and therefore publicly known, it would be possible for criminals to circumvent identification requirements by taking into account the threshold of €15,000 and the given time period when requesting financial transactions.

Identification measures and verification sources

409. According to Art. 29 §3 of the revised AML/CFT Law, the obliged subjects are required to "identify the counterpart, be it a natural or legal person, and they shall verify the identity based upon, *inter alia*, documents, data, and information obtained from an independent and reliable

source." The obliged subjects have to request from the counterpart those documents, data and information necessary to fulfil the CDD requirements. Such information is required to include the purpose of the relationship.

410. Examples of reliable and independent source documents are provided in Part 2 Section IV of FIA Instruction No. 2[50]. Accordingly the data furnished concerning the client, executor[51] and beneficial owner shall be verified by examining the following documentation:

a) valid identity documents;

b) public deeds, certified private documents[52], qualified certificates used to produce a digital signature;

c) declarations of the diplomatic mission of the Holy See;

d) records and lists of authorised subjects, articles of incorporation, statutes, balance sheets;

e) websites of public organisations and authorities, also of foreign States, provided that the latter have an equivalent regime. (Note: according to authorities the term " equivalent regime" refers to an equivalent AML/CFT regime).

411. The attachment to the IOR "CDD Procedures" specifies in detail the documentation standard for each client category (see excerpt in the section regarding effectiveness and efficiency below). For example, for all natural persons (e.g. Cardinals, Bishops, Nuncio, Secular Clergy/ Religious Men, Nuns, Holy See employees, Ambassadors to the Holy See etc.) the verification of the client identity has to be carried out through passport, identity card, diplomatic identity card or driving licence.

412. With regard to legal persons (e.g. secular and religious congregations, canonical foundations, Beatification Causes, Monasteries, Convents, Abbeys, etc.) the documentation standards set by the IOR "CDD Procedures" vary slightly between the different customer categories. It typically consists of the Statute (or Foundation-Boards), the Superior and Legal Representative appointments decree and proof of any legal recognition in Italy[53]. The natural person ultimately controlling or owning the legal person have to be identified on the basis of identity card, diplomatic identity card, driving licence or passport. In the case of Apostolic Delegations and Nunciatures or Vatican Congregations the verification of the client identity can also be carried out by checking the Pontifical Yearbook (*Annuario Pontificio*)[54].

413. Additionally, according to the IOR procedures, the Italian Fiscal code has to be acquired for both, natural and legal persons residing in Italy. This is due to a requirement by the competent Italian authority when executing transactions in the Italian monetary area.

Identification of legal persons or other arrangements

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[50] The FIA Instructions are considered to be other enforceable means as set out under SR.VII in Section 3.5 below.

[51] According to the authorities this includes the authorised signatory on the account as well as the person who actually performs the financial operation.

[52] According to the authorities this term refers to documents certified by a public notary.

[53] The legal recognition is considered as an alternative or supplementary verification source. The canonical recognition remains a mandatory verification source. The procedures have been recently modified in order to also take into account legal recognition in countries other than Italy.

[54] The Pontifical Yearbook is the official annual directory of the Holy See. It lists all the popes to date and all officials of the Holy See's departments. It also gives complete lists, with contact information, of the Cardinals and Catholic bishops throughout the world, the dioceses, the departments of the Roman Curia, the Holy See's diplomatic missions abroad, the embassies accredited to the Holy See, the headquarters of religious institutes, certain academic institutions, and other similar information. Regular updates are issued throughout the year.

414. Prior to the amendments and additions to the revised AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012 there was no requirement in Law or Regulation to verify that any person purporting to act on behalf of the customer was so authorised, and to identify and verify the identity of that person. Neither was there a requirement in Law or Regulation to verify the legal status of the legal person or legal arrangement, as required by the Standard.

415. However, Art. 29 *ter* of the revised AML/CFT Law requires obliged subjects to ascertain whether those who intend to represent or to act in the name and on behalf of the legal person are duly authorised. Obliged subjects are required to identify them and verify their identity on the basis, *inter alia*, of documents, data, and information obtained from an independent and reliable source.

416. In addition, Art. 29 §3 of the revised AML/CFT Law requires that the due diligence shall include establishing the legal status, legal denomination and registered office, as well as the identity of those persons who perform the functions of legal representatives, administrators or directors.

Identification of Beneficial Owners

417. Prior to the amendments and additions to the revised AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012 there was (due to the wording of the Law) no clear requirement to take reasonable measures to verify the identity of the beneficial owner using relevant information or data obtained from a reliable source such that the financial institution is satisfied that it knows who the beneficial owner is[55].

418. Pursuant to Art. 29 *bis* of the revised AML/CFT Law the obliged subjects are required to determine and identify the beneficial owner and verify their identity on the basis, *inter alia*, of documents, data, and information obtained from a reliable and independent source.

419. The beneficial owner is defined in Art. 1 §15 of the revised AML/CFT Law as the natural person or persons on whose behalf a service or a transaction is conducted or, in the case of a corporation or legal person, the natural person or persons who are the ultimate owners or exercise ultimate control of such corporations or legal persons, or who are its beneficiaries according to the criteria set out in the Annex to the revised AML/CFT law (see further below for further details).

420. Given that the definition of "beneficial owner" includes persons on whose behalf a service is conducted, the evaluators take the view that the requirement for financial institutions according to essential criterion 5.5.1, to determine whether a person is acting on behalf of another person, is met by Art. 29 *bis* AML/CFT Law. This is complemented by FIA Instruction No. 2, Part 2, Section III setting out that "at the moment of the identification, the client must state whether the relationship is being entered into on behalf of another party."

421. In the case of corporations or legal persons, in order to identify the beneficial owner, the obliged subjects are also required to ascertain the ownership and control of such corporations or legal persons. Such a requirement was not set out prior to the amendments and additions to the revised AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012.

422. Furthermore, the revised AML/CFT Law requires obliged subjects to identify and verify the natural person or persons who are the ultimate owners or exercise ultimate control of such legal person, or who are its beneficiaries according to the criteria set out in the Annex to the law. The criteria are largely modelled on the EU 3rd AML Directive.

423. Pursuant to Art. 1 §2 of the Annex to the revised AML/CFT Law the beneficial owner of corporations is defined as follows:

a) the natural person or persons who ultimately owns or controls a corporation through direct or indirect possession or control of shares in the joint stock, or of voting rights in such corporation, through bearer shares;

[55] See former Art. 29 §1 letter b of the AML/CFT Law.

b) the natural person or persons who otherwise exercise control over the management of a corporation.

424. Pursuant to Art. 1 §3 of the Annex to the revised AML/CFT Law the beneficial owner of other legal persons[56] that manage or distribute funds is defined as follows:

a) if the beneficiaries have already been determined, the natural person or persons who are the beneficiaries of the patrimony of the legal person;

b) if the beneficiaries have not yet been determined, the natural person or persons on whose primary interest the legal person was created;

c) the natural person or persons who exercise control over the patrimony of the legal person.

425. In the attachment to the IOR "CDD Procedures" the IOR has specified who the IOR considers to be the beneficial owner with respect to their different categories of eligible customers (legal persons) as follows:

Subject typologies	**Beneficial owner**
Canonical Foundations	President, General Manager, Treasurer, Government members if required by the Statute
Causes of Beatification	*Postulatore*
Male and female religious and secular orders	Religious orders: Supreme Moderator or Superior who governs the institute, the province or the single House to which the relation refers (e.g. prior, father guardian, mother superior) and its bursar. Secular orders: Grand Master and bursar or Head of single House and its bursar to which the relation refers.
Monasteries - convents and Abbeys	The Superior who governs the institute, the province or the single House to which the relation refers (e.g. prior, father guardian, mother superior) and its bursar.
Bishops Conference, Dioceses and representative offices	Bishops Conference: president, bursar, Economic Affairs Council. Dioceses: bishop; vicar general; episcopal vicars, if any; bursar.
Parishes, churches and relevant offices	Parish priest
Seminaries, colleges, various entities	Rector, bursar/treasurer

426. This attachment to the IOR "CDD Procedures" indicates, that the identification of the beneficial owner applied by the IOR is limited to the natural person or persons who exercise control over the patrimony of the legal person, but does not include the identification of beneficiaries or persons in whose primary interest the legal person was created. IOR representatives stress however, that the beneficiaries are, as a rule, mentioned in the statutes of the different entities mentioned above, which are normally part of the CDD documentation.

Information on purpose and nature of business relationship

427. Pursuant to Art. 29 §3 of the revised AML/CFT Law, the obliged subjects also have to request from the counterpart information regarding the purpose of the relationship.

428. In addition, pursuant to FIA Instruction No. 2, the obliged subjects are required to acquire information about the motivations and goals of the customer for establishing a relationship or accomplishing an operation; the relationship between the client and the executor, as well as

[56] The term legal person refers to any legal person, regardless of its nature and activity, including foundation and trusts, that do not fall within the definition of the Public Authority (Art. 1 §3 AML/CFT Law).

between the latter and the beneficial owner of the relationship or the operation; the working and economic activities performed; and finally the customer's business relationships in general.

Ongoing due diligence on business relationship

429. Prior to the amendments and additions to the AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012 there was no clear requirement that the "ongoing supervision" should include scrutiny of transactions undertaken.

430. Pursuant to Art. 28 §3 of the revised AML/CFT Law the CDD requirements continue throughout the relationship, and include the monitoring of the transactions conducted during the same relationship in order to verify, *inter alia*, that the transactions are consistent with the typology and risk level of the counterpart and the counterpart's activities. There is no express requirement to verify that the transactions are consistent with the institution's knowledge of the source of funds, if necessary.

431. Pursuant to Art. 33 §6 of the revised AML/CFT Law, the obliged subjects are required to adopt record-keeping mechanisms that ensure that the customer data and information remains updated and information gathered while observing the customer identification and verification requirements, regarding particularly those categories of counterparts and those typologies of relationships, services and transactions that involve high level risks.

Risk – enhanced due diligence for higher risk customers

432. Pursuant to Art.31 §1 of the revised AML/CFT Law obliged subjects are required to reinforce the customer due diligence requirements in those situations which, by their own nature, involve a greater risk of money laundering or financing of terrorism, including:

- non-face to face relationships (see Recommendation 8 below);
- correspondent current accounts (see Recommendation 7 below); and
- relationships established with politically exposed persons (see Recommendation 6 below).

433. The additional measures to be taken to compensate for the increased risk in the latter three instances (non-face to face, correspondent current account and PEP) are expressly specified in the revised AML/CFT Law (see Recommendations 6, 7, and 8 below). In addition, there is the above-mentioned general requirement of Art. 31 §1 of the revised AML/CFT Law to apply additional measures to situations which involve a higher risk of ML or TF. In this case however, the type of additional measures that the obliged subjects should take has not been defined in the law or in guidance. It is therefore left to the discretion of the obliged subjects to decide what type of additional measures they deem reasonable and sufficient to mitigate the higher risk. Furthermore, Part 4 Section I of FIA Instruction No. 2 defines three further situations, where enhanced due diligence has to be applied on a mandatory basis[57]. These situations are described under essential criterion 5.12.

Risk – application of simplified/reduced CDD measures when appropriate

434. Pursuant to Art. 30 §1 of the revised AML/CFT Law the obliged subjects are exempted from observing the CDD requirements if the counterpart is a credit or financial institution located in a State that observes requirements equivalent to those set out in the revised AML/CFT Law (such equivalence implies that those institutions are also supervised for compliance with those requirements). The States that observe equivalent requirements shall be identified by the Secretariat of State through its own decision.

435. Prior to the amendments and additions to the AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012 this task was assigned to the FIA. Accordingly, at the time of the

[57] FIA Instructions are considered to be other enforceable means. For a full analysis see Section 3.5 under SR.VII.

MONEYVAL on-site visits the equivalent countries were listed in FIA Instruction No. 3[58]. The list corresponds to the list agreed by EU Common Understanding between Member States on third country equivalence under the Anti-Money Laundering Directive (Directive 2005/60/EC). In FIA Instruction No. 3 it is mentioned that the list was drawn up on the basis of the information available at the international level, and of information taken from assessment reports of national systems for preventing and countering money laundering and financing of terrorism, adopted by the FATF, any FSRB, the IMF or the World Bank, as well as other updated information provided by the States concerned. The Secretariat of State has not issued a corresponding list so far.

436. In addition, the obliged subjects are exempted from observing the customer due diligence requirements if the counterpart is a domestic Public Authority[59] (Art. 30 §3 of the revised AML/CFT Law).

437. Furthermore, pursuant to Art. 30 §6 of the revised AML/CFT Law, the obliged subjects are exempted from observing the CDD requirements in relation to:

a) life insurance policies where the annual premium is not in excess of €1,000 or a single premium of no more than €2,500;

b) complementary pension schemes, provided that there is no surrender clause and that they cannot be used as collateral for a loan;

c) obligatory and complementary pensions and similar schemes that provide retirement benefits, when the contributions are made through deductions from the wages and whose rules do not permit the beneficiaries to transfer their own rights until after the death of the title holder;

d) beneficial owners of pooled accounts managed by foreign notaries or professionals that conduct similar activities in another State, provided that they are subject to requirements regarding the prevention and countering of ML and FT equivalent to those set forth in the revised AML/CFT Law;

e) electronic money, if no more than €150 can memorised in the device, if it is not rechargeable; or, if it is rechargeable, if no more than €2,500 can be deducted in a legal year, unless €1,000 or more is reimbursed to the account holder in the same legal year.

438. The above-mentioned instances are taken from Art. 11 of the Directive. Art. 3 of Commission Directive 2006/70/EC[60] provides criteria which the above-mentioned customers and products must meet so that they can be considered as customers or products representing a low risk of money laundering or terrorist financing. This concept has not been adopted in the AML/CFT Law. The AML/CFT Law allows for simplified due diligence irrespective of whether those criteria are met or not.

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[58] At the time of the first MONEYVAL on-site visit the list included the following states and territories: Member states of the European Community and the European economic area (Iceland, Liechtenstein and Norway), Australia, Brazil, Canada, Japan, Hong Kong, India, Republic of Korea, Mexico, Russian Federation, Singapore, United States of America, Republic of South Africa, Switzerland, Mayotte, New Caledonia, French Polynesia, Saint-Pierre and Miquelon, Wallis and Futuna, Aruba, Curaçao, Sint Maarten, Bonaire, Sint Eustatius and Saba.

[59] A Public Authority is defined as an organism or entity that, on the basis of the domestic legal system, performs, directly or indirectly, an institutional activity inherent to the sovereign authority (Art. 1 §2 AML/CFT Law). According to the authorities this would include in particular the Vatican Congregations, Apostolic Delegations and Nunciatures, the Apostolic Camera, APSA and Prefecture of the Economic Affairs, Governorate of the VCS, but does not include Bishop's Conferences, Dioceses, Parishes, Churches or canonical foundations. Notwithstanding the legal provision of Art. 3 §1 of the Annex of the revised AML/CFT Law the IOR maintains that CDD is also conducted on all public authorities.

[60] Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of politically exposed person and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis.

439. Departing from the concept of the Directive, the AML/CFT Law implemented Art. 3 of the Commission Directive in order to provide for additional instances of simplified due diligence to those mentioned in Art. 11 of the Directive. The FIA may authorise the obliged subjects not to apply CDD requirements regarding particular categories of counterparts and typologies of relationships, services and transactions of low risk of money laundering or financing of terrorism (Art. 30 §7 of the revised AML/CFT Law). Such authorisation has to be granted pursuant to criteria set out to in the Annex to the revised AML/CFT Law, which are largely taken from Art. 3 of the European Commission Directive 2006/70/EC.

440. Based on Art. 3 §1 of the Annex to the revised AML/CFT Law, the FIA may authorise obliged subjects not to apply CDD requirements with respect to:

a) public institutions and corporations as well as concessionaries of public activities that fulfil specific requirements (in particular: where identity is publicly verifiable and certain; where activity and accounting procedures are transparent; where they are subject to the monitoring and control of a Public Authority established by the domestic law)[61];

b) corporations or legal persons that conduct financial activities outside the scope of Art. 2 §1 AML/CFT Law but which have been subjected to this law and which fulfil the abovementioned criteria required for public institutions. (This provision has no scope of application given that no such corporations or legal persons have been subjected to the AML/CFT Law)**;**

c) companies listed on a regulated stock exchange[62];

d) transactions and related products that fulfil specific requirements (in particular: a transaction or product which has a written contractual basis; where the transaction is conducted through an account of the counterpart at a credit or financial institution based in a State that imposes equivalent CDD requirements; where the transaction or product is not anonymous and its nature permits fulfilling the CDD requirements; where the product has a pre-set maximum value**;** etc.).

441. While assessing whether the above-mentioned instances present a low risk of ML or FT, the FIA is required to consider carefully whether the counterpart, transaction or product is particularly susceptible, due to its nature, to be used for ML or FT. They shall not be presumed to present a low risk of money laundering or of financing of terrorism if there is no data or information that furnishes sufficient certainty of the low risk. The FIA has not authorised any exemptions to apply CDD based on Art. 3 §1 of the Annex to the revised AML/CFT Law.

442. The list of exemptions mentioned under Art. 30 §6 of the revised AML/CFT Law has been taken directly from the Third EC Money Laundering Directive. The HS/VCS authorities have not undertaken any formal risk analysis to determine whether for these exemptions the circumstances are appropriate to the local environment and peculiarities.

443. Furthermore, rather than providing for simplified due diligence measures, Art. 30 of Act. CXXVII creates blanket exemptions from the CDD requirements. These customers and products are exempt from the CDD provisions that address the key CDD components of identifying and verifying the customer's identity, identifying the beneficial owner and verifying its identity, determining the purpose and intended nature of the business relationship, and conducting ongoing monitoring of the relationship. Therefore, these are not reduced or simplified CDD measures as suggested by the essential criteria, but an exemption from any CDD except in those situations

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61 According to HS/VCS authorities this would include *inter alia*, the Vatican Press, the Vatican Publishing House, the Vatican Radio, the Vatican Television Centre. These institutes, according to their own regulations, come within the competence of the Secretariat of State or of other agencies of the Roman Curia (see Art. 191 Pastor Bonus).

62 There is no express requirement that the listed company has to be subject to regulatory disclosure requirements.

when ML or FT are suspected, or when there are reasons to believe that the previous verification is unreliable or insufficient to provide the necessary information. (Art. 30 §5 of the revised AML/CFT Law).

444. For both, credit/financial institutions and public authorities the obliged subjects are required to gather enough information to determine that the counterpart falls within one of these categories (Art. 30 §4 of the revised AML/CFT Law). However, there is no further clarification on what "enough data" means and the provision's scope seems limited to the process of determining whether the customer qualifies for the exemption. Furthermore, there is no requirement to gather sufficient information for the exemptions according to Art. 30 §6 and 7 of the revised AML/CFT Law.

445. Further exemptions from CDD obligations are provided by Art. 31 §3 of the revised AML/CFT Law. Accordingly, the CDD requirements shall be deemed to be fulfilled, even in the case of non-face to face transactions, in the following cases:

a) when the due identification has been previously made regarding an already existing relationship, insofar as the information is updated;

b) for the transactions made at electronic points of sale or ATM machines, through the post, or through subjects that transfer funds through banking cards. Such transactions shall be ascribed to the person behind the relevant relationship;

c) when the counterpart's identifying data and other necessary information are found in a public document, in an authenticated private deed, or in any other legal instruments that provide legal certainty;

d) when the counterpart's identifying data and other necessary information are found in a declaration of a Pontifical Representation of the Holy See.

446. The rationale of Art. 31 §3 of the revised AML/CFT Law remains unclear and the wording appears to be unfortunate. It is in line with the Standard to use public documents, authenticated private deeds, legal instruments that provide legal certainty or the declaration of a Pontifical Representation of the Holy See to identify and verify the customer and beneficial owner. However, the simple fact that such information is available should not lead to the conclusion that the CDD obligations may be deemed to be fulfilled.

447. According to Art. 28 §3 of the revised AML/CFT Law the duties related to the CDD requirements ("*gli obblighi di adeguata verifica*") include the monitoring of the transactions conducted during the same relationship. Due to Art. 31 §3 revised AML/CFT Law, obliged subjects would be exempted from the obligation of ongoing monitoring for the situations outlined in the paragraph above, even in the case of non-face to face transactions.

Risk – simplification/ reduction of CDD measures relating to overseas residents

448. Where obliged subjects are permitted to apply simplified CDD measures to customers resident in another country (see c.5.9), this is not always limited to countries that impose equivalent requirements to those of the HS/VCS. As described above, FIA may authorise obliged subjects not to apply CDD requirements with respect to listed companies, irrespective of whether the company is located in a country that the HS/VCS is satisfied to be in compliance with and to have effectively implemented the FATF Recommendations.

Risk – simplified/reduced CDD measures not to apply when suspicions of ML/FT or other risk scenarios exist

449. Pursuant to Art. 30 §5 of the revised AML/CFT Law the simplified CDD requirements are not to be used when money laundering or the financing of terrorism are suspected, or when there are reasons to believe that the previous verification is unreliable or insufficient to provide the necessary information. However, this provision falls short of meeting criterion 5.11, whereupon simplified CDD measures shall not be acceptable whenever higher risk scenarios apply.

Risk Based application of CDD to be consistent with guidelines

450. The FIA issued Instruction No. 2 (see Annex XVIII) in matters of assessment of risk factors and CDD on 14th of November 2011 (shortly before the first MONEYVAL on-site visit). Pursuant to Part I Section I of Instruction No. 2, obliged subjects may modify the intensity and extent of CDD duties according to the degree of risk of ML and FT. The Instruction lists risk factors that have to be taken into account for this modification. Examples provided in the Instruction are the types of activity performed; operative volumes; nature and characteristics of the client; activity performed; client behaviour; geographic risk; amount and frequency of operations and duration of business relationship; geographic destination or origin of assets; and cash transactions without apparent reasons to justify them.

451. According to FIA Instruction No. 2 the obliged subjects have to define a risk profile to be attributed to each client entity on the basis of information collected and analysis carried out, using both the above-mentioned criteria and any other criteria deemed appropriate (Part I Section II). Subsequently each client has to be attributed a risk class defined in advance by the subjects. The Instruction also mentions occasions where the assessment of this attribution shall be repeated at a minimum.

452. Pursuant to the Instruction No. 2 each risk class has to be attributed with a coherent level of depth and extent of performance of the duties laid down in the AML/CFT regulations (customer due diligence and assessment of suspect operations). Obliged subjects are required to define the modes and frequency of assessment in order to keep information and data updated on the basis of the risk profile.

453. In addition to the mandatory instances for enhanced due diligence laid out in Art. 31 of the revised AML/CFT Law, Part 4 Section I of FIA Instruction No. 2 also requires that obliged subjects apply enhanced due diligence in the following situations:

a) repeated transactions of deposit of cash or valuables;

b) when an assessment process has been started in view of reporting a suspect operation to the FIA; and

c) in relation to products, operations and technologies that could increase the risk of money laundering or financing of terrorism.

Instruction No. 2 does not provide examples for such products, operations or technologies.

454. While FIA Instruction No. 2 mainly repeats the obligations already set out in the Law and does not provide examples of a risk-based application of those obligations for different risk categories, no consistency gaps could be identified between the risk-based approach permissible according to the AML/CFT Law and the FIA Instruction No. 2.

Timing of verification of identity – general rule

455. Pursuant to Art. 29, §1 of the revised AML/CFT Law, the obliged subjects are required to fulfil the CDD requirements before entering into a relationship, providing a service or conducting a transaction.

Timing of verification of identity – treatment of exceptional circumstances

456. While the AML/CFT Law does not provide for exceptions to the above-mentioned obligation to perform CDD measures before entering into a relationship, providing a service or conducting a transaction, Part 2 Section IV of FIA Instruction No. 2 creates exemptions to the general rule provided by the Law.

457. According to the essential criteria for financial institutions, the verification of the identity of the customer and beneficial owner may be completed after the establishment of the business relationship only, provided that all of the following criteria are met cumulatively:

(a) The verification occurs as soon as reasonably practicable;

(b) The postponement is essential not to interrupt the normal conduct of business; and

(c) The money laundering risks are effectively managed (including the adoption of risk management procedures).

458. In contrast with the essential criteria, the FIA Instruction No. 2 does not require that all the above-mentioned conditions are met cumulatively but allows for completing CDD measures after establishing a relationship simply when either condition (b) or (c) is met. This is considered as a deficiency in the technical compliance with the essential criterion 5.14.

459. HS/VCS authorities stress that pursuant to Art. 2 of the Decree No. CLIX the adoption of this Decree is without prejudice to the provisions contained in the regulations and instructions adopted by FIA before 25 January 2012, in so far as they are compatible with it. According to the authorities, the abovementioned provisions of FIA Instruction No. 2 are incompatible with the revised AML/CFT Law and are therefore - based on the abovementioned principle contained in Art. 2 of the Decree N. CLIX - not applicable.

460. However, given that the provisions contained in the regulations and instructions that are not considered to be compatible with the Decree No. CLIX are nowhere expressly identified as such, this is considered at least as an impediment to the proper application of the regulations and instructions.

Failure to satisfactorily complete CDD before commencing the business relationship and after commencing the business relationship

461. Prior to the amendments and additions to the AML/CFT Law promulgated by Decree No. CLIX the obligation to examine the need to report an STR was limited to situations where a business relationship was already established but did not cover situations where no relationship was established following failure to satisfactorily complete CDD.

462. Pursuant to Art. 29 §4 of the revised AML/CFT Law it is forbidden to enter into the relationship, provide the service, or conduct the transaction in question, whenever it is not possible to fulfil the CDD requirements. Whenever the relationship is already ongoing, the obliged subjects must terminate the said relationship. In all of these cases, the obliged subjects are required to consider reporting the suspicious transaction to the FIA.

Existing customers

463. Prior to the amendments and additions to the AML/CFT Law promulgated by Decree No. CLIX of 25 January 2012 there was no clear requirement in Law or Regulation or other enforceable mean to apply CDD requirements to existing customers on the basis of materiality and risk and to CDD on such existing relationships at appropriate times.

464. Under the revised AML/CFT Law, obliged subjects are clearly required to fulfil CDD requirements as well for those relationships already in existence when the law entered into force (Art. 28 §3 of the revised AML/CFT Law).

465. The IOR representatives met by the evaluators reported that a process of client database review and update was commenced in November 2010. By the close of 2011, the Institute had updated its client database module (Sintacs) with respect to approximately 50% of natural persons and 11% of legal persons. The IOR representative are confident that they will conclude this task by the close of 2012. Legal entities should be fully updated by December 2012, as well.

466. The evaluators were also informed that, as of 30 November 2011, there were 4,494 dormant accounts (which correspond roughly to 18% of all accounts held) representing assets of €30.8 million. The term "dormant accounts" refers to accounts whose balances have been inactive for more than five years and whose respective account holders could not be contacted. According to the statistics provided to the evaluation team the dormant accounts are mainly related to Congregations, Secular Clergy and Religious Men, Seminaries/Colleges, Bishops and Foundations without Canonical Recognition.

467. According to the IOR Procedure "Customers account's status change" of October 2002, no assets can be deposited in or withdrawn from these accounts before having received a written request from the account's owner and the proper authorisation of the General Manager. In addition, full customer due diligence must have been applied previously in accordance with the revised AML/CFT Law. According to the representatives met, the IT system provides for automatic constraints regarding the withdrawals and deposits on dormant accounts.

468. As laid out under essential criterion 5.1 above, it is prohibited to keep anonymous or ciphered deposits or passbooks, or open accounts with fictitious or fantasy names. In addition, IOR representatives emphasised that the IBIS core banking solution used by the IOR since 1996 does not technically allow the use of anonymous or ciphered accounts. IOR and APSA representatives stated that they have no evidence of the use of anonymous, accounts in fictitious names or numbered accounts in the period prior to the coming into force of the AML/CFT Law.

Effectiveness and efficiency

469. As outlined in the overview of the financial sector there are two entities, namely the IOR and APSA, which are of relevance under this part of this report. Considering the different scale and nature of their financial activities (for further details please refer to the description in the overview of the financial sector above) the evaluation team focused its effectiveness assessment primarily on the IOR. A few remarks with respect to APSA can be found at the end of this section.

470. The IOR representatives met by the evaluation team demonstrated a high level of awareness and a good understanding of the obligations under the AML/CFT requirements. Furthermore, the internal procedures drafted by the IOR, with the assistance of a major international accountancy firm, specify in great detail the roles and responsibilities of IOR employees. Under Recommendation 5 the "IOR-CDD Procedures" are of particular relevance. These procedures were adopted shortly before the coming into force of the original AML/CFT Law on April 1, 2011.

471. The IOR-CDD procedures go, to some extent, beyond the requirements set out by the Law in force prior to the amendments and additions promulgated by Decree No. CLIX. The procedures partly contain requirements which were missing or unclear in the original version of the AML/CFT Law. This mitigates to some extent the negative impact on effectiveness due to the fact that a significant number of elements in the legal framework were introduced only after the first MONEYVAL on-site visit (see comments on very recent implementation below).

472. Parts of the IOR-CDD procedures are portrayed in the description and analysis section above. As mentioned previously, they contain clearly defined documentation standards with respect to each client category, which are considered to have a positive impact on effective implementation.

473. As an example, the documentary standards required for CDD taken from the IOR "CDD Procedures" are set out below.

Documentation – Standard Legal Person Customer Due Diligence					
Subject typologies	**Documentation to be acquired in order to verify that the client is compliant for establishing a client relationship with the Institute**	**Documentation to be acquired in order to verify client identity**	**Authorised subjects**	**Documentation to be acquired in order to verify authorised subjects**	**Preventive approvals**
Canonical Foundations	- Canonical acknowledgement - Client relationship establishment requested by Statutory Bodies	- Statute - Statutory Bodies and Legal Representatives appointment decree - Any legal recognition in Italy - ID card, diplomatic ID card, driving licence or passport	- Subjects foreseen by Statute	- ID card, diplomatic ID card, driving licence or passport - Delegation conferment by Statutory Bodies	- Preventive General Manage-ment approval

Vatican Congregations	- Control in Pontifical - Yearbook - Client relationship establishment requested by Bodies foreseen	- Control in Pontifical Yearbook - Client relationship establishment requested by Bodies foreseen - ID card, diplomatic ID card, driving licence or passport	- Subjects foreseen by Statute	- ID card, diplomatic ID card, driving licence or passport - delegation conferment	-
Bishops' Conferences, Dioceses and Representative Departments	- Establishment decree or control in Pontifical - Yearbook - Canonical acknowledgement - Client relationship establishment requested by President /Ordinary/Legal Representative	- Statute - ID card, diplomatic ID card, driving licence or passport	- Bishops' Conferences - President - Dioceses' Ordinary - Institution Legal Representative	- ID card, diplomatic ID card, driving licence or passport - Delegation conferment by Statutory Bodies	-

474. The evaluators received a demonstration of the account opening procedures, which overall appeared to be effectively implemented. The documents acquired in the CDD process are scanned into the electronic customer database (Sintacs). The customer data is gathered by means of account opening forms, which are predefined in the IOR CDD procedures. The completed form is entered into another IT system (IBIS[2]) which automatically produces a form with the data input that is verified and signed by the client. Upon satisfactory receipt of all client data the account is deemed open but the funds are blocked until all the documents are verified and authorised by the Deputy General Director and the General Director.

475. The evaluators reviewed two customer files chosen and presented by the IOR Administrative Secretariat (Registry Function). They contained all the identification and verification documents with respect to the customer, the beneficial owner and authorised subjects ("*delegati*") as required by law and by the above-mentioned IOR documentation standard.

476. As mentioned in the description and analysis section, the IOR launched a process of client database review and update in November 2010. The IOR demonstrated clear commitment and dedication to complete this process by the end of 2012. Six persons are involved in this project and are actively approaching clients to receive updated information. By the close of 2011, the Institute had updated its client database module (Sintacs) with respect to approximately 50% of natural persons and 11% of legal persons. The overall quality of the documentation held with respect to those customers could not be established.

477. The evaluation team has also been informed that as of 30 November 2011 there were 4,494 dormant accounts representing assets of €30.8 million, the accounts of which have been inactive for more than five years and whose respective account holders could not be contacted so far. However, the procedures in place (see under essential criteria 5.17 above for details) appear to be effective to prevent withdrawals or deposits before CDD procedures in accordance with the AML/CFT Law have been applied.

478. A significant concern to the evaluators is the risk categorisation currently applied by the IOR, which appears to be inadequate. The risk categorisation applied by the IOR is purely based on the client category to which the customer belongs. The different types of client category accepted by the IOR have been classified into five different risk categories. Diplomatic Staff and Legal persons without canonical recognition are considered to present the highest risk.

Risk category	Client category	% total position
0	Vatican Congregations, Apostolic Delegations and Nunciatures, Holy See Departments and Assimilated	10.1%
1	Canonical Foundations, Beatification Causes, Securla and Religious Congregations (Male and Female), Monasteries, Convents and Abbeys, Bishops' Conferences, Dioceses and Repres. Depts, Parishes, Churches and Pertinent Departments, Seminaries, Colleges, Various Entities,	80.1%

	Cardinals, Bishops, Secular Clergy and Religious Men, Nuns	
2	Embassy to the Holy See	0.1%
3	Holy See Employees and Assimilated, Holy See Retired Employees and Assimilated, IOR Employees, IOR Retired Employees	4.2%
4	Lay Master of Ceremonies of the Holy See, Former Vatican Employee and Former Diplomatic Staff to the Holy See	3.4%
5	Diplomatic Staff Accredited to The Holy See, Legal persons without canonical recognition [63]	2.1%

479. The current approach does not take into account geographic risk, product/service risk, type and frequency of transactions, activity carried out, operative volumes, behaviour of the client, or others. This is a particular concern having in mind the large volumes of cash transactions (although, the evaluators fully appreciate that cash transactions are an important contributor to the funding of the global mission of the Church) and wire transfers operated on behalf of several IOR customers. For example, the client categories generating the highest volumes of cash transactions are currently assigned the lowest risk levels; it was noted that these were mainly Roman Curia and Governorate entities. The global spread of their customers' activities presents another risk factor, which is hardly reflected in the risk categorisation. In addition, the gaps identified under SR. VIII with respect to information available for NPOs present risks that are not appropriately mitigated by the IOR risk categorisation.

480. The evaluation team has noted positively that the IOR has endeavoured to supplement its risk categorisation with the above-mentioned risk factors. Moreover, to formalise these procedures, the IOR is designing an algorithm to identify and assign a risk value for each client and will then continuously monitor them. This algorithm will be used in all data systems of the IOR to automatically manage risk assignments for every client[64].

481. As a result of the inadequate risk categorisation enhanced due diligence measures appear to be applied to a very limited number of customers. Furthermore, additional measures which are currently applied, when it comes to the scrutiny of transactions and the origin of funds, seem limited.

482. The requirement to apply enhanced due diligence for repeated transactions of deposit of cash or valuables as set out in FIA Instruction No. 2 appears to be essential given the relevance of such transactions within the IOR. However, this requirement is not yet implemented.

483. Furthermore, the exemption from any CDD (including ongoing monitoring) rather than reduced or simplified CDD measures as suggested by the essential criteria, raises concerns with respect to effective implementation. Particularly in the light of the CDD exemption regarding public authorities, which account for an important share of IOR customers, this shortcoming appears to be significant.

484. IOR representatives stress that, in the case of natural persons, an IOR account can only be opened and held in the name of the beneficial owner of the account[65]. Accordingly, the IOR

[63] Legal persons recognised under civil law but without canonical recognition. According to the IOR Internal AML/CFT Policy legal persons without canonical recognition may not be accepted as customers. IOR representatives stress that as of 2007 the IOR has not established relations with such a category. Such legal persons are regarded as "legacy customers". According to the Overview "Clients by Industry Code distribution" there are 995 clients falling under this category as of November 30, 2011; 51 of these accounts are qualified as dormant accounts.

[64] The HS/VCS authorities informed the evaluators that, on 27 April 2012, pursuant to Art. 28 *bis* of Decree no. CLIX, the IOR approved a new procedure for AML risk profile attribution. The current procedure takes into account, geographic risk, kind of transaction and type of the client. The algorithm is expressed into the updated "Procedure for AML risk profile attribution".

[65] IOR representatives state that joint tenancy accounts are not permitted. Hence in a case an employee dies, his reversionary pension is paid on a new account in the name of the widower/widow.

"CDD Procedures" (p. 54) maintain: "In case the client is a natural person, the beneficial owner corresponds to the client, therefore it is not necessary to autonomously identify said subject." This *per se* assumption does not appear not to be in line with the Standard. In general, it can probably be assumed, that the client is the beneficial owner of the assets deposited with his account. However, there may be exceptions to this rule, which will not be identified as such if the obliged subject relies on the automatic assumption described above[66].

485. The IOR CDD procedures set out that the Institute does not apply CDD to national public entities, which includes institutions listed in the "*Annuario Pontificio*" under section "Roman Curia", "Pontifical Representations" and "Institutions connected to the Holy See".

486. The proper identification and verification of persons purporting to act on behalf of a customer is essential to prevent the illegitimate use of customer relationships. In the light of this, it raises significant concerns that according to the IOR CDD procedures, no CDD has to be applied to "unempowered presenters" (persons who, with reference to a specific transaction, express only the intentions of the subject to whom the client relationship refers and do not exercise any will or take part in the execution process); the IOR representatives state that normally, it is verified by telephone or mail whether the unempowered presenter expresses the intention of the subject to whom the client relationship refers. However, this is not explicitly required by the IOR procedures and the identity of the unempowered presenter should nevertheless be identified and verified, as required by the AML/CFT Law and the FATF standard[67].

487. The evaluators have taken note of this strengthening of the legal CDD framework. From an effectiveness point of view it has to be noted that those requirements have been introduced or clarified very recently. However, the evaluators have taken into account, that some of those requirements had at least been set out in the internal procedures adopted by the IOR shortly before the original AML/CFT Law came into force on April 1, 2011.

488. Effective implementation may also be challenged given that the FIA Regulations and Instructions are not yet aligned with the AML/CFT Law although Art. 2 of Decree CLIX does clearly state that its adoption is without prejudice to the FIA's Regulations and Instructions. The HS authorities and obliged subjects reported that they are in the process of examining and determining the extent to which the FIA instructions and regulations are applicable.

489. A major concern relates to the fact that no on-site inspections have been carried out by the supervisory authority. In particular, there has never been a sample testing of the CDD files maintained by the IOR or an assessment of the scrutiny of transactions and the origin of funds carried out by the IOR. Therefore, it is not possible to establish the effectiveness of the implementation of the IOR CDD procedures. Furthermore, the supervisory authority appeared to have a limited insight into the important IOR project of updating and reviewing existing customers.

490. At the time of the first MONEYVAL on-site visit APSA had no internal procedures in place with respect to the application of CDD requirements. After the second MONEYVAL on-site visit the evaluation team was informed that, as of January 25, 2012 *inter alia*, a procedure for the prevention and countering of the laundering of proceeds resulting from Criminal activities and financing of terrorism has been adopted. Given the different scope of financial activities the procedures are not as detailed as the respective procedures of the IOR. In essence, the APSA internal procedures mainly reiterate the obligations set out by the AML/CFT Law and provide for an assignment of the individual responsibilities within APSA. The procedures also foresee the

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[66] The HS/VCS authorities informed that on 26 May 2012, the IOR adopted a new form for the opening of business relationships where it is mandatory that the client "declares, under his personal responsibility, (that) all the money moved into the account belongs to himself and (that) there are not any other beneficial owners."

[67] The HS/VCS authorities informed the evaluators that, on 21 May 2012, the IOR adopted a directive eliminating the "unpowered presenter". Consequently, the only persons now authorised to perform transactions are: the owner, the delegate, and the person encharged, all of whom are subject to CDD.

establishment of an AML Office under the Extraordinary Section and a newly appointed Head of AML is tasked *inter alia* with monitoring the functionality of procedures, structures and systems, and providing support and advice on managerial decision-making. It must be stressed that the APSA representatives demonstrated a good understanding of their obligations under the AML/CFT Law. However, the formalisation of CDD procedures appears to be at a rather early stage.

Recommendation 6

Risk management systems, senior management approval, requirement to determine source of wealth and funds and on-going monitoring

491. Prior to the amendments and additions to the original AML/CFT Law promulgated by Decree No. CLIX the above-mentioned measures had to be applied only to politically exposed persons residing in a foreign State, while the essential criteria refers to persons entrusted with prominent public functions in a foreign country irrespective of the residence. Furthermore, the procedure to determine a politically exposed person had to be applied "in risky situations" only, while the Essential criteria do not provide for a risk based approach. Finally, there was no requirement to obtain senior management approval, where a customer has been accepted and the customer or beneficial owner is subsequently found to be, or subsequently becomes a PEP.

492. "Politically exposed persons" are defined in Art. 1 §18 of the revised AML/CFT Law as persons who are or who have been entrusted with prominent public functions, as well as their immediate family members and those with whom they publicly maintain a close association.

493. Persons entrusted with prominent public functions are according to Art. 2 of the Annex to the revised AML/CFT Law:

a) the Heads of State, Heads of Government, Ministers, Vice-ministers, Under-Secretaries, and persons who exercise similar functions;

b) the Members of Parliament;

c) the members of the Supreme Courts, the Constitutional Courts and other high ranking judicial organs, whose decisions are generally not subject to further appeal, and the persons who exercise similar functions;

d) the members of State Auditors' Courts and of the Board of Directors of the Central Banks, and the persons who exercise similar functions;

e) the Ambassadors, Chargés d'affaires, and the High-ranking Officers of the Armed Forces, and the persons who exercise similar functions;

f) the members of the Boards of Directors, management or supervisory organs of State-owned enterprises, and the persons who exercise similar functions.

494. Middle ranking or more junior individuals do not fall within any of the foregoing categories. The categories referred to in subparagraphs a) and f) include, if applicable, the functions exercised at the international and European levels.

495. The term "family members" comprises the spouse, the offspring and their spouses, those who during the last five years cohabited with the politically exposed person, as well as the parents.

496. The term "persons with whom they publicly maintain close relationships" is specified as any natural person who publicly shares with a politically exposed person the role of beneficial owner of legal persons or who has with him/her any other close business relationship. In addition, it comprises any natural person who is the sole beneficial owner of a legal person publicly created for the benefit of a politically exposed person.

497. A person no longer holding prominent public offices for a period of at least one year is not to be considered as a PEP. However, it is clearly stated in the same provision that this is without

prejudice to the general obligation to apply enhanced due diligence on the basis of the assessment of the existing risk (Art. 2 §4 of the Annex of the revised AML/CFT Law).

498. The FATF plenary has considered the one-year limit in the context of an EU member state's mutual evaluation report, and has concluded that such a threshold is not a material deficiency when there is a general obligation to apply enhanced due diligence to customers (including PEPs) who still present a higher risk of ML or TF regardless of any timeframe. Such an obligation is provided in Art. 31 (1) of the revised AML/CFT Law.

499. Regarding the relationships established with politically exposed persons, as well as the services and transactions conducted in their name and on their behalf, the obliged subjects are required pursuant to Art. 31 §5 of the revised AML/CFT Law to:

a) put in place appropriate procedures to determine whether the counterpart is a politically exposed person;

b) before establishing a relationship, providing a service, or conducting a transaction, obtain the approval of the responsible superior or director or from his delegate. If the counterpart subsequently acquires the status of a politically exposed person, such an approval shall be required in order to maintain the relationship;

c) adopt every reasonable measure to establish the source of the currency, funds and other assets used;

d) conduct enhanced and ongoing monitoring[68].

500. The above-mentioned obligation to put in place appropriate procedures to determine whether the counterpart is a politically exposed person, does not extend to the case of the beneficial owner. Furthermore, the FATF standard does not provide for the possibility of delegating the senior management approval for establishing business relationships with a PEP. While the HS/VCS authorities take the view that the requirement to establish the source of funds implies establishing the source of wealth (as required by criterion 6.3), this requirement should be expressly stipulated.

Additional elements

Domestic PEP-s – Requirements

501. Prior to the amendments and additions to the original AML/CFT Law promulgated by Decree N. CLIX the obligations regarding PEPs had to be applied only to PEPs residing in a foreign state. Given that most persons holding prominent functions domestically do reside in VCS, the clear majority of persons holding prominent functions domestically was not covered by the former provision. This former limitation has been eliminated by Decree N. CLIX which does not distinguish between persons who hold prominent functions domestically and those holding prominent functions in another country.

Ratification of the Merida Convention

502. The HS has not yet signed the 2003 United Nations Convention against Corruption.

Effectiveness and efficiency

503. In 2004, the IOR entered into licence agreements with an internationally renowned PEP database provider. As part of its initial customer due diligence the IOR checks all potential customers against this database. In addition, the client database is scanned against the database on a daily basis. The IOR was able to demonstrate recent examples where the system has identified persons who became a PEP after the customer relationship has been established. Transactions are also scanned against the PEP database. Apart from these IT assisted procedures, the customer has to indicate in the form applied for the account opening procedure whether he qualifies as a PEP.

[68] HS/VCS authorities have clarified that delegates of the responsible superior of both the IOR and APSA are part of the senior management.

504. The requirement to determine whether the counterpart is a PEP as set out in the IOR CDD procedures goes beyond the requirement of the AML/CFT Law, as it is extended to authorised persons (but not to the beneficial owner). However, the procedures are based on the PEP definition contained in the AML/CFT Law prior to the amendments promulgated by Decree No. CLIX, which is limited to customers residing in a foreign country and therefore not fully in line with the standard. Persons who perform institutional activities abroad (e.g. Apostolic Nuncios) are not considered by the IOR to be resident in a foreign country. Accordingly, based on the former PEP definition only very few customers have been identified as PEPs.

505. As outlined in the description and analysis section, the PEP requirements now have to be applied to all PEPs, irrespective of their residence. This extended requirement has not been implemented yet.

506. The approval for establishing or continuing a relationship with a counterpart identified as a PEP has to be requested form the General Management in the case of the IOR. The Administrative Secretariat (Registry Function) is required to obtain information on the source of funds (e.g. earned income, inheritance) of a PEP and to collect support documentation. In the case of ecclesiastic customers the IOR considers a self-statement regarding the funds to be sufficient. With respect to laymen a self-statement and suitable support documentation (e.g. income tax return or other documentations indicating earned income, copy of last will, embassy's letter, etc.) has to be requested.

507. APSA's internal procedures do not contain provisions with respect to the application of PEP requirements. Effective implementation (in particular in the light of the extended PEP requirement) could not therefore be fully established.

Recommendation 7

Requirement to obtain information on respondent institutions & Assessment of AML/CFT controls in Respondent institutions

508. In the case of correspondent current accounts of foreign banks or credit or financial institutions, the obliged subjects are, pursuant to Art. 31 §4 a) of the revised AML/CFT Law, required to gather sufficient information regarding the correspondent institution to understand fully the nature of its activities and to determine – from publicly available registries, lists, records and documents – its reputation and the quality of the supervision to which it is subject.

509. In addition, they are required to assess the soundness of the legal system, requirements and controls in force in the foreign State regarding the prevention and countering of ML and FT (Art. 31 §4 b) of the revised AML/CFT Law). However, there is neither an explicit requirement to assess whether a correspondent body has been subject to a ML/TF investigation or regulatory action nor to assess the respondent institution's AML/CFT controls, and to ascertain that they are adequate and effective.

Approval of establishing correspondent relationships

510. Pursuant to Art. 31 §4 c) of the revised AML/CFT Law the obliged subjects are required to obtain, before opening an account, the approval of the responsible superior or director or from his delegate[69].

Documentation of AML/CFT responsibilities for each institution

511. Pursuant to Art. 31 §4 letter d) of the revised AML/CFT Law the obliged subjects are required to define in written form the terms of the contract with the corresponding institution, including their respective rights and duties.

Payable through Accounts

[69] HS/VCS authorities have clarified that delegates of the responsible superior of both the IOR and APSA are part of the senior management.

512. Pursuant to Art. 31 §4 e) of the revised AML/CFT Law the obliged subjects have to be certain that the correspondent institution has verified the identity of and performed ongoing due diligence of any counterpart having direct access to payable-through accounts, and that it is able to provide, upon request, the relevant data obtained while fulfilling those same requirements.

Effectiveness and efficiency

513. The IOR operates only as a respondent institution, and as such the IOR is only a customer of correspondent banks but does not itself provide correspondent banking services. At the time of the MONEYVAL on-site visits the IOR used the correspondent bank services of more than 40 correspondent banks. Given that the IOR only acts as a respondent institution, most of the above-mentioned obligations do not have to be applied by the IOR. However, the IOR is obliged to define in written form the terms of the contract with the corresponding institution, including their respective rights and duties. The evaluation team has been provided with several examples of such contracts, which clearly defined the responsibilities and rights of the correspondent and the respondent institution.

514. Moreover, the IOR Internal AML/CFT Policy sets out that the IOR commits to operate directly, and to establish commercial relations of any kind, only with correspondent institutions that have equivalent requirements, and were previously approved by the Board of Superintendence. As far as "payable-through accounts" are concerned, it has to be stressed that neither the IOR nor APSA maintain such accounts. The only persons entitled to operate accounts held by those entities in a correspondent bank are the members of the top management (the authorised persons are listed in a book of signatures). No other persons are authorised to use these accounts.

515. The evaluation team did not find any indications of an inadequate implementation of the relevant requirements und Rec. 7.

Recommendation 8

Misuse of new technology for ML/FT

516. Prior to the amendments and additions to the original AML/CFT Law promulgated by Decree N. CLIX the requirements of Recommendation 8 were not contained in Law or Regulation or "other enforceable means".

517. Pursuant to Art. 2 *ter* §1 of the revised AML/CFT Law, the obliged subjects are required to adopt adequate policies, organisation, measures and procedures to prevent and counter ML and FT, on the basis of the development of new technologies and of the phenomena of money laundering and the financing of terrorism.

518. Furthermore, the obliged parties are required, pursuant to FIA Instruction No. 1, to take into account technological progress and financial innovation when preparing effective organisational and computerised tools in order to guarantee an adequate protective scheme against ML and FT risks. Furthermore, FIA Instruction No. 1 (see Annex XXII) requires that the staff training is reviewed regularly and should take into account progress made in the fields of technology and financial innovation.

Risk of non-face-to-face business relationships

519. In non-face to face relationship, the obliged subjects are, pursuant to Art. 31 §2 of the revised AML/CFT Law, required to apply one or more of the following measures:

a) verify the identity of the counterpart in the relationship through additional information, including documents, data, and information obtained from a reliable and independent source;

b) adopt additional measures to verify and certify the documents provided, or require for those documents a confirming certification by a credit or financial institution subject to customer due diligence requirements equivalent to those set forth in this law;

c) require that the transaction's first payment be carried out through an account in the counterpart's name in a credit or financial institution subject to customer identification and verification requirements equivalent to those set forth in this law.

520. For remote operations implemented by systems of telephone or computerised communication FIA Instruction No. 2 requires specific attention on the part of obliged parties. In cases of remote operations, the obliged parties are required to acquire an appropriate identification document delivered by fax, by post or a scanned copy and to acquire and analyse one or more of the following documents, from which it is possible to draw identifying data and further information required for the purposes of customer due diligence:

- public deeds, certified private documents;
- certificates used to produce a digital signature associated with computerised documents;
- declaration of the diplomatic mission of the Holy See.

521. The exemptions from CDD provided by Art. 31 §3 of the revised AML/CFT Law (in particular with respect to ongoing monitoring), which are described under criterion 5.9 are even applicable for non-face-to-face transactions, as expressly stated in the AML/CFT Law. Therefore, the same concerns as raised above apply.

Effectiveness and efficiency

522. Given that a substantial number of IOR customers are located in foreign countries, business relationships established without physical presence are of importance. Such relationships are concluded through the post. The IOR does not provide Internet banking services. Non-face to face transactions provided by IOR include the use of ATM machines, telephone banking, transmission of instructions via fax and making payments as part of electronic point of sale transactions using account-linked bank cards. IOR officials stress that these instruments are considered as new technologies as mentioned under Art. 2 *ter* §1 of the revised AML/CFT Law. The measures and procedures to address the risks related to these technologies overlap largely with the procedures mentioned below for non-face to face transactions. Transactions conducted through the use of those technologies are particularly monitored.

523. Where business relationships are established without a physical presence, the IOR usually requires a confirming certification (e.g. the identities of bishops or priests have to be certified by the relevant Apostolic Nunciature or Dioceses).

524. Security procedures have been established for non-face to face transactions such as the supply of access codes for confirming transactions, signature verification procedures for orders made by telephone and use of call-backs to confirm transactions.

525. Staff training and the internal procedures are being reviewed regularly to take into account ML threats that may arise from new technologies.

526. APSA's internal procedures do not contain provisions with respect to non-face to face transactions and business relationships. Effective implementation could not therefore be fully established.

3.2.2 Recommendations and comments

527. The AML/CFT Law needs to be amended to specifically require that financial institutions should determine whether the customer is acting on behalf of another person.

528. The AML/CFT Law needs to be amended to specifically require that financial institutions should verify that the transactions are consistent with the institution's knowledge of the source of funds, if necessary.

529. HS/VCS authorities should undertake a formal risk assessment and should in particular review if the circumstances for simplified and enhanced due diligence are appropriate for the local environment/peculiarities.

530. It is recommended that serious consideration should be given to a statutory provision describing the types of legal and natural persons eligible to maintain accounts in the IOR and APSA.

531. HS/VCS authorities should amend the exemptions for low-risk customers, products and transactions as adopted from the Third EU AML Directive by clarifying that minimum CDD (i.e. less detailed CDD) should nevertheless be accomplished.

532. HS/VCS should set out that simplified CDD measures are not permissible where higher risk scenarios apply.

533. HS/VCS authorities should clarify in the AML/CFT Law that the FIA may authorise simplified CDD measures with respect to listed companies only if they are subject to regulatory disclosure requirements.

534. HS/VCS authorities should amend FIA Instruction No. 2 to clarify that the verification of the identity of the customer and beneficial owner, following the establishment of the business relationship, should only be permissible where all conditions mentioned under criterion 5.14 are met cumulatively.

535. HS/VCS authorities should abolish the exemptions to CDD provided under Art. 31 §3 of the revised AML/CFT Law.

536. Where the Law allows for simplified or reduced CDD measures to customers resident in another country, HS/VCS authorities should limit this in all cases to countries that the HS/VCS is satisfied are in compliance with and have effectively implemented the FATF Recommendations.

537. The FIA Instructions should be amended to require that verification should occur as soon as possible in situations where verification occurs after establishment of a business relationship.

538. The provision that only transactions executed within a period of seven days have to be considered as “linked transactions” should be abolished.

539. HS/VCS should introduce an express requirement to verify that the transactions are consistent with the institution’s knowledge of the source of funds where necessary.

540. HS/VCS should extend the requirement to put in place appropriate risk management systems to determine whether the counterpart is a politically exposed person to the case of the beneficial owner.

541. HS/VCS authorities should extend the requirement to establish the source of funds of customers and beneficial owners identified as PEPs to expressly include the establishment of their wealth.

542. The AML/CFT Law should be amended to introduce an express requirement to assess whether a correspondent body has been subject to a ML/TF investigation or regulatory action or to assess the respondent institution’s AML/CFT controls, and to ascertain that they are adequate and effective.

543. HS/VCS authorities should eliminate the exemptions from CDD provided by Art. 31 §3 of the revised AML/CFT Law (in particular with respect to ongoing monitoring).

544. FIA should raise awareness with respect to the obligations that have been introduced or clarified in the AML/CFT Law after the MONEYVAL on-site visits to ensure effective implementation.

545. Most importantly, FIA should put in place appropriate arrangements to monitor and ensure compliance with the requirements under R. 5 to 8 (including adequate sample testing).

3.2.3 Compliance with Recommendations 5 to 8

	Rating	Summary of factors underlying rating

R.5	**PC**	• No requirement to verify that the transactions are consistent with the institution's knowledge of the source of funds, if necessary.
		• Failure to have undertaken any formal risk assessment implies that there is no basis for determining whether potential risks are addressed appropriately by the current risk based approach in place.
		• Rather than providing for simplified due diligence measures, the AML/CFT Law creates blanket exemptions from the CDD requirements.
		• The AML/CFT Law allows for simplified CDD measures even where higher risk scenarios apply.
		• Where obliged subjects are permitted to apply simplified or reduced CDD measures to customers resident in another country, this is not always limited to countries that the HS/VCS is satisfied are in compliance with and have effectively implemented the FATF Recommendations.
		• The FIA Instruction allows for the verification of the identity of the customer and beneficial owner following the establishment of the business relationship without all conditions mentioned under criterion 5.14 being met cumulatively.
		• The definition of "linked transactions" is not in line with the Standard, which does not provide for a limitation in respect of the time elapsing between transactions.
		
		Effectiveness
		
		• The following requirements have been introduced or clarified too recently to be considered fully effective[70]:
		  • The requirement to undertake CDD measures when carrying out occasional transactions that are wire transfers in the circumstances covered by the Interpretative Note to SR VII.
		  • The requirement to verify that any person purporting to act on behalf of the customer is so authorised, and to identify and verify the identity of that person.
		  • The requirement to verify the legal status of the legal person or legal arrangement as required by the Standard.
		  • The clarification of the requirement to verify the identity of the beneficial owner as required by the Standard.
		  • The requirement to understand the ownership and control structure of the customer.

[70] However, it has to be taken into account, that some of those requirements had been incorporated earlier in the IOR internal procedures.

		• The requirement to perform scrutiny of transactions undertaken. • The requirement to apply CDD requirements to existing customers on the basis of materiality and risk and to CDD on such existing relationships at appropriate times. • The requirement to examine the need to report an STR in situations where no relationship was established following failure to satisfactorily complete CDD. • Further effectiveness concerns with respect to some criteria (see shortcomings identified under "Effectiveness and efficiency")
R.6	**PC**	• The requirement to put in place appropriate risk management systems to determine whether the counterpart is a politically exposed person does not extend to the case of the beneficial owner. • Beyond the requirement to establish the source of funds of customers and beneficial owners identified as PEPs there is no express requirement to establish the source of their wealth. <u>Effectiveness</u> • The following requirements have been introduced or clarified too recently to be considered fully effective: • the requirement to apply PEP requirements irrespective of the residence. • the requirement to obtain senior management approval, where a customer has been accepted and the customer or beneficial owner is subsequently found to be, or subsequently becomes a PEP. • the requirement to determine a PEP in all instances, irrespective of "risky situations".
R.7	**LC**	• No express requirement to assess whether a correspondent body has been subject to a ML/TF investigation or regulatory action nor to assess the respondent institution's AML/CFT controls, and to ascertain that they are adequate and effective.
R.8	**PC**	• Undue exemptions from the CDD requirements, in particular with respect to ongoing monitoring (due to Art. 31 §3 of the revised AML/CFT Law). <u>Effectiveness</u> • The following requirements have been introduced or clarified too recently to be considered fully effective: • The requirement to have policies in place or take such measures as may be needed to prevent the misuse of technological developments in ML or TF schemes. • The measures to be applied to manage risks related to non-face to face relationships were not fully appropriate to do so.

3.3 Third Parties and Introduced Business (R. 9)

3.3.1 Description and analysis

546. The original AML/CFT Act did not permit reliance on intermediaries or other third parties to perform elements of the CDD process or to introduce business. The CDD and record-requirements described under Recommendations 5 and 10 have to be performed by the obliged subjects themselves. In jurisdictions where third party reliance is permitted financial institutions are (pursuant to R. 9) only required to satisfy themselves that copies of identification data and other relevant documentation relating to CDD requirements will be made available from the third party upon request. In contrast to this privilege, the subjects obliged under the AML/CFT Law have to preserve themselves the documents, data and information obtained while fulfilling CDD requirements. The Law does not provide for exceptions to this rule. Violations of this requirement are sanctionable pursuant to Art. 42 of the revised AML/CFT Law. The evaluation team has not found any evidence that obliged subjects do not comply with the AML/CFT Law by relying on third parties to perform elements of the CDD process.

3.3.2 Recommendation and comments

547. No comments or recommendations are necessary.

3.3.3 Compliance with Recommendation 9

	Rating	Summary of factors underlying rating
R.9	**N/A**	

3.4 Financial institution secrecy or confidentiality (R.4)

3.4.1 Description and analysis

Inhibition of Implementation of FATF Recommendations

Legal Framework

548. As set out below, there exist three different levels of secrecy rules. The HS/VCS Authorities state that these three levels are in fact the same three levels which generally exist in any other legal orders: The *first level* is that of "financial secrecy", which presumptively protects the confidentiality of a person's private financial data from access by unauthorised third parties. The *second level*, is that of the office secret, or "official secrecy", which is likened to the kind of secrecy which obtains for public offices and public officials and protects against the disclosure of information related to a matter being handled by a governmental office and whose release to third parties is unauthorised, which protects the unauthorised disclosure of information held by public offices where not authorised by law. The *third level* is that of State Secrecy and the Pontifical Secret.

549. The HS/VCS authorities stress that the revised AML/CFT law has addressed the question of how the law relating to secrecy is expressed in the legal system by an explanation of the

confidentiality and secrecy rules. The authorities contend that this has introduced more transparency to all of the relevant rules operating within the legal system.

550. The HS/VCS authorities further explain that these various forms of secrecy are not set out in the AML/CFT law to present barriers to the operation of the AML/CFT law. This was intended to identify those levels of secrecy to be clear that their existence cannot inhibit the legitimate exercise of the powers of any of the competent authorities to access information necessary to any AML/CFT inquiry. This is also indicated by the legislative intent expressed in the preamble to the law to create a properly functioning AML/CFT system.

Financial secrecy

551. Pursuant to Art. 37 *bis*, §1 of the revised AML/CFT Law all notices, information and data held by the obliged subjects, their legal representatives, administrators, directors, employees, consultants, and collaborators on any grounds, by virtue of the exercise of the activities that are subject to the AML/CFT Law, shall be protected by financial secrecy. Violations of this obligation are subject to administrative sanctions ranging from €10,000 to €250,000 for natural persons, and from €10,000 to €1,000,000 for legal persons (Art. 42 of the revised AML/CFT Law). It has to be highlighted that only the obliged subjects are bound by this financial secrecy provision but not the competent authorities which may be in the possession of such information.

552. The HS/VCS authorities explain that the purpose of this provision of the revised AML/CFT Law is to afford the ordinary level of protection of financial information, that is typically afforded to customers of financial institutions[71].

Official secrecy

553. Art. 40 §1 of the revised AML/CFT Law: "All information held by the competent authorities shall be subject to official secrecy without prejudice to the activities of the Judicial Authorities in case of criminal proceedings".

554. The concept of official secrecy is defined by Art. 36, §1 of the General Regulation of the Roman Curia (see Annex IX) according to which all members and employees of the Roman Curia "are obliged to strictly observe official secret. They cannot therefore give to those who are not entitled information regarding documents and news that they have gained as a result of their work". This rule protects confidentiality in a manner consistent with governmental confidentiality rules for all members of the Roman Curia, which includes the authorities competent in matters of prevention and countering of the laundering of proceeds from criminal activities and financing of terrorism.

555. Violations of the official secrecy are prohibited according to the general norms of the legal system and, in particular, by Arts. 70-85 of the General Regulations of the Roman Curia, by Arts. 50-69 of the General Regulations for the personnel of the VCS and, as to the IOR, Arts. 43-50 of the General Regulations of the personnel of the IOR. These sanctions do not exclude other civil or criminal sanctions.

Ability to access information

556. According to Essential Criterion 4.1 countries should ensure that financial institution secrecy laws do not inhibit the implementation of the FATF Recommendations. An area where this may be of particular concern is the ability of the competent authorities to access information they require to properly perform their functions in combating ML or FT.

[71] According to the authorities this is also reflected by Art. 37, §2 AML/CFT Law, according to which: "(…) exchanges of information between the FIA and the Judicial Authority, shall be conducted (…) so as to safeguard the security and integrity of the information".

557. According to Art. 37 *bis*, §2 of the revised AML/CFT Law financial secrecy "shall not obstruct the activities and the requests for information from the authorities competent for the prevention and countering of money laundering and the financing of terrorism".

558. With respect to the authorities that would fall under this provision Chapter I *bis* of the revised AML/CFT Law, entitled "Competent authorities" gives an important indication. It mentions the following authorities:

- Secretariat of State;
- Pontifical Commission of the VCS;
- Financial Intelligence Authority;
- Gendarmerie.

559. The evaluators conclude that there is a clear legal exemption from the obligation to observe financial secrecy with respect to those authorities.

560. The Judicial Authority (that is, the Promoter of Justice, the Single Judge, the Tribunal, etc.) is not explicitly mentioned as a "competent authority" under Chapter I *bis* of the revised AML/CFT Law. However, it has to be taken into account that in the revised AML/CFT Law a clear responsibility has been assigned to the Judicial Authority as regards the sanctioning of money laundering and the financing of terrorism. Moreover, the Judicial Authority is explicitly mentioned by Arts. 37 §3 and 40 §1 of the revised AML/CFT Law. Therefore, it can be argued that the Judicial Authority represents an "authority competent for the … countering of ML and FT" as required by Art. 37 *bis* §2 of the revised AML/CFT Law. As a consequence, financial secrecy cannot be opposed in respect of requests for information by the Judicial Authority. In addition, it is noted that the Gendarmerie is empowered to conduct investigations on behalf of the Promoter of Justice. Notwithstanding this, the HS/VCS authorities should consider adding the Judicial Authority to the list of competent authorities in Chapter I *bis* of the revised AML/CFT Law in order to eradicate any potential doubts.

Domestic exchange of information between competent authorities

561. The legal framework for the exchange of information is governed by Art. 40 of the revised AML/CFT Law. This information exchange mechanism is analysed under Rec. 31.

562. All information held by the competent authorities shall be subject to official secrecy, without prejudice to the activities of the Judicial Authority in case of criminal proceedings (Art. 40 §1 of the revised AML/CFT Law). At the same time, the competent (domestic) authorities shall co-operate actively and exchange relevant information for the prevention and countering of money laundering and the financing of terrorism (Art. 40 §2 of the revised AML/CFT Law).

563. As outlined above, the concept of official secrecy is defined by Art. 36, §1 of the General Regulation and only prohibits giving information to those who are "not entitled". HS/VCS authorities argue that the competent authorities are "entitled" to such information based on the empowerments established by the AML/CFT Law, which are described under Rec. 26 (FIU), R.28 (Powers of competent authorities) and R.29 (Supervisors) and can therefore be shared amongst "entitled authorities". Accordingly, the exchange of information amongst competent domestic authorities appears not to be inhibited.

564. Furthermore, Art. 40, § 4 of the revised AML/CFT Law, establishes that provisions related to the exchange of information "shall be applied without prejudice to the norms in force regarding Pontifical Secret and State Secret". With respect to confidentiality rules established under the Pontifical Secret, it is observed that this does not cover financial matters. It does cover information related to the institutional activity of the universal Church, like the identity of Cardinals or the identity of Bishops the Supreme Pontiff is going to appoint. Therefore, the Pontifical Secret appears not to limit the power of competent authorities to exchange information relevant to the prevention and countering of ML and FT. The Pontifical Secret might be considered, *mutatis mutandis*, as the Holy See's "State Secret" (see below).

565. With regard to "State Secret", Art. 107 §1 of the CC establishes a definition consistent with the common understanding and practice of States, focused on domestic public order and security[72].

International exchange of information between competent authorities

566. The legal framework for the international exchange of information is governed by Art. 41 of the revised AML/CFT Law. This information exchange mechanism is analysed under Rec. 40 and allows for the exchange of information regarding suspicious transactions in matters of money laundering and the financing of terrorism with similar authorities in other states, on the condition of reciprocity and on the basis of Memoranda of Understanding.

567. Art. 41 §2 of the revised AML/CFT Law sets out that official secrecy and any eventual restrictions on the communications shall not inhibit the "international exchange of information". HS/VCS authorities stress that the term "any eventual restrictions" also comprises Art. 36, §1 of the General Regulation of the Roman Curia. Accordingly, official secrecy and Art. 36, §1 of the General Regulation of the Roman Curia appear not to inhibit the international exchange of information regarding suspicious transactions as provided for by Art. 41 §1 of the revised AML/CFT Law. However, Art. 41 §1 of the revised AML/CFT Law does not allow for the exchange of supervisory information. Accordingly, the exemption from official secrecy in §2 of the same Article appears to be expressly provided with respect to the exchange of information with other FIUs but not with other supervisors.

568. However, considering that neither the IOR nor APSA have branches or subsidiaries in foreign countries, the need for international exchange of supervisory information appears to have a limited scope. HS/VCS authorities informed the evaluators that the FIA already has established contacts with foreign supervisors.

Exchange of information between regulated financial entities where required by R.7, R.9 and SR VII

569. *R.7:* In practice, significant exchange of information takes place between IOR/APSA and foreign financial institutions with whom they hold correspondent accounts. Those correspondent accounts are used to transfer funds of IOR and APSA customers internationally. In addition, cheques are issued on Italian correspondent banks.

570. However, there is no express exemption from the obligation to observe financial secrecy where such exchange of information is required in this context.

571. As far as "payable-through accounts" are concerned it has to be stressed that neither the IOR nor APSA maintain payable-through accounts. The only persons entitled to operate accounts held by the IOR in foreign banks are the members of the IOR top management (the authorised persons are listed in a book of signatures). No other persons are authorised to use these accounts.

572. R.9: Recommendation 9 is not applicable within HS/VCS given that the AML/CFT Law does not provide for reliance on intermediaries or other third parties to perform elements of the CDD process or to introduce business. The CDD requirements described under Recommendation 5 have to be performed by the obliged subjects themselves.

573. SR.VII: Special Recommendation VII requires that a set of information relating to the originator is included in the message or payment form accompanying the wire transfer. According to the standard beneficiary institutions are required to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator

[72] „Anyone who reveals political or military secrets, relating the security of the State, *either*, communicating or publishing documents or facts, drawings or other information related to military materials, fortifications or operations; *or* facilitating in any way their knowledge, is punished by imprisonment of one to three years and a fine of more than 2.000 Italian lire.

information. In EU member states wire transfers with missing or incomplete originator information must be either rejected or complete originator information must be requested pursuant to Art. 9 of Regulation (EC) 1781/2006. Therefore, in practice, the IOR and APSA would not be able to order cross-border wire transfers on a continuous basis without providing full originator information. The IOR has also provided evidence that information relevant under SR. VII (name of the originator, the originator's account number and the originator's address) is exchanged in practice. However, there is no express exemption from the obligation to observe financial secrecy where the exchange of information is required by SR. VII.

Effectiveness and efficiency

574. There appears to be an area of tension between, on the one hand the increasing demand of foreign correspondent banks for background information on financial operations[73], which they carry out on behalf of IOR clients, and on the other hand, the considerable interest on the part of HS/VCS institutions for a high level of protection of their client's data. The IOR reports that in particular Italian banks request increasingly detailed background information with respect to operations carried out on behalf of IOR clients. According to HS/VCS authorities this increased demand for information appears to be related to the instruction of the Bank of Italy to apply enhanced due diligence to business relationships with the IOR. The information regularly requested by Italian banks from the IOR includes, for example, additional details with respect to the originator or beneficiary, the beneficial owner of the account for which the order was placed, the source of funds, the purpose of the transaction, and other data.

575. The IOR representatives informed the evaluators that at an initial stage some of those requests have been referred to the FIA, due to the fact that the information requested was beyond the scope of what has contractually been agreed to be shared with those correspondent institutions. However, most contracts of the IOR and APSA with correspondent financial institutions have been amended in order to extend the scope of information that can be shared.

576. Evidence was provided to the evaluation team that comprehensive information (including information covered by financial secrecy) has in fact been exchanged with foreign financial institutions. However, in some cases there still appear to be differing views with respect to the necessary extent and detail of information to be exchanged. IOR representatives stress that in some instances correspondent banks request additional information on a systemic basis rather than on a case to case basis. It appears that these differing views on the necessary extent and detail of information contributed in some instances to the termination of business relationships either at the initiative of the IOR or at the initiative of Italian correspondent banks.

577. It has to be reiterated that information protected by financial secrecy is in fact exchanged with foreign financial institutions. However, in the light of above-mentioned considerations the absence of a clear exemption from the financial secrecy obligation with respect to the exchange of information with foreign correspondent banks raises concerns.

Recommendations and comments

578. HS/VCS should introduce an express exemption from the obligation to observe financial secrecy with respect to the exchange of information with foreign financial institutions where this is required to implement FATF Recommendations.

579. HS/VCS authorities should clarify FIA's powers to request information as recommended under R. 26 and R. 29 to ensure that obliged subjects cannot refuse to comply with a request for information based on the financial secrecy obligation.

[73] Correspondent accounts are used to transfer funds of IOR and APSA customers internationally. In addition, cheques are issued on Italian correspondent banks

580. HS/VCS authorities should clarify the FIA´s power to exchange information with foreign supervisory authorities to make sure that official secrecy cannot inhibit such information exchange.

581. HS/VCS authorities should consider to add the Judicial Authority to the list of all competent authorities in Chapter I *bis* of the revised AML/CFT Law in order to eradicate any potential doubts.

3.4.2 Compliance with Recommendation 4

	Rating	Summary of factors underlying rating
R.4	**LC**	• While in practice information covered by financial secrecy appears to be exchanged with foreign financial institutions where this is required to implement FATF Recommendations, there is no express exemption from the obligation to observe financial secrecy with respect to such information exchange and could therefore be challenged before the court. • Given that there is no clear empowerment for FIA to exchange information with foreign supervisory authorities, it remains unclear whether official secrecy could inhibit the information exchange with other foreign supervisors.

3.5 Record Keeping and Wire Transfer Rules (R.10 and SR. VII)

3.5.1 Description and analysis

Recommendation 10

Record keeping & Reconstruction of Transaction Records

582. Prior to the amendments and additions to the original AML/CFT Law promulgated by Decree N. CLIX the law did not empower a competent authority to request the obliged subjects to keep those records for more than five years in specific cases and upon proper authority.

583. Pursuant to Art. 32 of the revised AML/CFT Law the obliged persons are required to preserve the documents, data and information obtained while fulfilling the customer due diligence requirements, so as to permit the Judicial Authorities to reconstruct the relationships, services and transaction even in case of a criminal proceeding.

584. Regarding the relationships, services and transactions, the obliged subjects are required to record and preserve for five years from the date of the termination of the relationship, of the provision of the service or of the transaction: the identifying data of the counterpart, of the beneficial owner, and of their delegates, the date of the transaction; its amount, the kind of relationship, service or transaction; and the means of payment used. Regarding relationships, the obliged subjects shall record also the purpose (Art. 33 §2 of the revised AML/CFT Law). The five year period may be extended upon request of the Judicial Authorities.

585. The information has to be recorded without delay and, in any case, within 48 hours of the provision of the service, the conduct of the transaction, or the establishment, change or termination of the relationship.

586. FIA Instruction No. 2 Part 2 Section VII (see annex XXIII) specifies that obliged persons shall keep the documents acquired in the course of customer due diligence in order to:

- show FIA the procedures followed and measures adopted in order to comply with legal duties;
- allow FIA to carry out analyses and in-depth checks;
- allow them to be used for inquiries by the FIA, the Gendarmerie Corps and the Judicial Authority.

Record keeping of identification data, files and correspondence

587. Prior to the amendments and additions to the original AML/CFT Law promulgated by Decree N. CLIX there was no empowerment and no clear requirement to maintain records of the business correspondence.

588. Regarding the customer identification and verification requirements, the obliged subjects are required to preserve for five years from the date of the termination of the relationship, of the provision of the service or of the transaction, any information and documents obtained, including the correspondence, deeds and annotations made (Art. 33 §1 of the revised AML/CFT Law). The AML/CFT Law does not explicitly mention that account files have to be recorded. The five year period may be extended upon request of the Judicial Authorities.

Availability of Records to competent authorities in a timely manner

589. Pursuant to Art. 33 §5 of the revised AML/CFT Law the obliged subjects are required to adopt record-keeping mechanisms that allow them to respond promptly and effectively to the inquiries of the competent authorities within the 5 year retention period.

Effectiveness and efficiency

590. At the IOR the record-keeping process is supported by a computerised system. The IOR has operated an electronic client registry and transaction recording system since 1996. In 2005, the IOR created a customised client profile and data module used for all customers. This module is used to maintain data for both natural and legal persons. The documents acquired in the CDD process are scanned into the electronic customer database (Sintacs). The customer data is gathered by means of account opening forms, which are entered into another IT system (NSII). The two IT systems in use (NSII and Sintacs) work in parallel and any information is available online for the whole front office.

591. It has to be stressed that the CDD details of authorised signatories and "encharged" persons (persons entitled to execute a single ad hoc transaction, without a general proxy) are only recorded in physical form. A project has been initiated in order to migrate this information to the teller module of the IT system. The evaluators consider this measure to be essential to facilitate a prompt response to inquiries by the competent authorities and in order to enhance the monitoring of unusual transactions.

592. The IOR has a detailed internal procedure on clients' relationship and transactions registration (see Annex XXVII) in place since March 2011. The requirement to record correspondence, deeds and annotations, as newly introduced by Decree No. CLIX, is not yet reflected in the internal procedures.

593. With respect to the recording of transactions the internal procedure requires the recording of the same data as specified in the AML/CFT Law. According to the operating procedures adopted by the IOR transactions above a minimum threshold of €9,999 must be maintained in a data warehouse (*archivio unico informatico*). The data warehouse is used to monitor the transactions executed by the clients and to identify potentially suspicious transactions. The database moreover allows the compilation of elaborate statistics both for internal use or for the FIA, if requested. All transactions executed are recorded and stored in the information systems for 10 years.

594. The transaction records appear to be sufficient to permit reconstruction of individual transactions. There have been several requests for information by the FIA to IOR with respect to specific transactions. No shortcomings have been brought to light in the process of those requests. Authorities confirmed that the IOR was able to provide all necessary record details.

595. A modern electronic client registry and transaction recording system, sound internal procedures and a clear organisational structure for record-keeping functions combined with a thorough understanding of their duties by IOR representatives suggest an adequate implementation of the record-keeping obligations within the IOR. On the other hand, the absolute lack of any on-site inspections with respect to record keeping obligations, including sample testing, raises concerns.

596. APSA representatives demonstrated awareness and understanding of the record-keeping obligations under the AML/CFT Law. APSA also maintains a modern IT system for client and transaction recording. As regards record keeping the internal AML/CFT procedures, adopted on 2 January 2012 by APSA after the first MONEYVAL on-site visit, mainly contain a reference to the respective obligations of the AML/CFT Law without specifying the internal processes and assigning clear responsibilities. The formalisation of record keeping procedures appears to be at an early stage. Nonetheless the legal requirements appear to be implemented in practice.

SR.VII

597. Chapter VIII of Act No. CXXVII of 2010 deals with *Data related to money transfers*. According to Art. 38:

a) The provisions of this Chapter, established by having regard to the principles and rules in force in the European legal system, apply to the transfers of funds in any currency, transmitted or received, by a provider of payment services. They aim to prevent, investigate and identify cases of money laundering and financing of terrorism.

b) Rules are established in matters of duties of providers of payment services on the ordering person and beneficiary, and the intermediary providers of payment services as well.

c) With regard to the transfer of funds, the customer due diligence concerning the completeness of the ordering person information data, recording and keeping remain in force.

d) The FIA, in compliance with the principles set out in Regulation (EC) No. 1781/2006 of November 15, 2006, on information on the payer accompanying transfers of funds, issues provisions concerning the implementation of the provisions contained in this Chapter.

598. While this article in the original AML/CFT Law itself does not give much clarity on the obligations, letter d is of particular importance. The FIU has issued provisions on November 14th 2011, just before the first MONEYVAL on-site visit.

599. On the 25th of January 2012 a new decree came into force promulgating amendments and additions to the existing AML Law. The new Art. 38, dealing with Wire Transfers stipulates:

1. In the case of wire transfers, without prejudice to the thresholds and exemptions set forth in Art. 28, §1 c (€1,000), the payment services providers of both the originator and the beneficiary, as well as the intermediate payment services providers, *shall observe* the customer identification, verification, registration, and conservation requirements regarding originators:

    a) name and surname;

    b) date and place of birth;

    c) address;

d) account number.

2. The FIA shall issue guidelines and implementation norms regarding wire transfers, on the basis, *inter alia*, of the International and European norms in force.

600. The provisions in the guidance given by the FIU have not changed.

601. It is important to note here that the new Art. 38 stipulates 'that payment service providers *shall observe* the requirements'. This way it practically requires payment service providers to observe the more detailed requirements as set out in the guidance of the FIU, which will be discussed below.

Other enforceable means

602. In general the provisions that the FIU has issued in Regulation No.4 (see Annex XX) appear to be in line with the criteria as stipulated by the essential criteria of SR VII on several points. For certain Recommendations, including SR VII, the FATF Methodology allows for the use of "other enforceable means" rather than law or regulation to require the standards domestically, as long as certain conditions have been met.

603. Those conditions are broadly that the language used in the document requiring the application of the standard should be of a mandatory nature, that the document is issued by a competent authority and that there are sanctions for non-compliance, which should be effective, proportionate and dissuasive.

604. In order to assess this last condition, consideration should be given to the range of sanctions available for legal and natural persons, the applicability in the case of breach of an AML/CFT requirement, availability of evidence that sanctions have been applied in practice and the possibility of an appeal if sanctions are applied.

605. Based on the original AML/CFT Law it was the sanctionability that was not fully satisfactory. Art. 42 of the original AML/CFT Law gave the FIU the power to apply sanctions for certain specified articles, which includes Art. 38 which is related to data on money transfers. So there are administrative sanctions available. The available pecuniary administrative sanctions range from €10,000 up to €250,000 for natural persons. This appears to be rather low in comparison with other jurisdictions. There are no other administrative and disciplinary sanctions available.

606. In Art 42 of the revised AML/CFT Law the pecuniary administrative sanctions for natural persons did not change and were retained in the same range (from €10,000 up to €250,000). No other administrative sanctions are added. For legal persons though there were pecuniary administrative sanctions added, ranging from €10,000 up to €1,000,000.

607. In the VCS there was no criminal or administrative liability for legal persons until the 25th of January of 2012 as in the view of the authorities, this would be inconsistent with the fundamental principles of domestic law. With the enactment of the revised AML/CFT Law Art. 42 *bis* creates administrative responsibility for legal persons for the crimes set out in Articles. 412 *bis* and 138 *ter* of the Penal Code.

608. In such cases administrative sanctions ranging from €20,000 to €2,000,000 can be imposed on a legal person. In addition to the pecuniary administrative sanctions a temporary interdict to exercise its activities shall be imposed if certain conditions have been met. Letter 5 stipulates that this norm does not apply to domestic, foreign or international public authorities. Therefore, although IOR is included, APSA, as a public authority, is not.

609. The revised AML/CFT Law creates the possibility for appeals in Art. 42.4 stipulating that 'the person sanctioned may object to the decision of the FIA resorting to a single judge. If it is a legal person, the entity sanctioned may resort against the natural person responsible for the violation'.

610. So far, the FIA has not imposed any administrative sanctions. Criminal sanctions are not specifically provided for in the AML/CFT Law in cases of infringement of the several articles of

the original and revised AML/CFT Laws relating to Chapters other than II and III for natural persons. Art. 9 of the Act on Sources of Law (see Annex XII) does however provide that:

> Should any penal provision be lacking, and an act has been committed that offends the principles of religion or morals, public order, personal security or safety of things, the judge may refer to the general principles of the legislation to inflict pecuniary penalties up to €3,000, or detention penalties up to six months, and apply, as the case may be, the alternative sanctions indicated in Law of 14 December 1994, No. CCXXVII.

This is a unique solution which introduces the possibility of criminal sanctions in the most egregious cases.

611. Although the new law is a substantial improvement by adding sanctionability for legal persons, it still raises concerns regarding the effective, proportionate and dissuasive criminal, civil or administrative sanctions for the following reasons:

a) as APSA is regarded as a public authority the newly introduced administrative sanctions appear not to apply to it;

b) the existence of additional disciplinary sanctions for natural and legal persons is not explicitly clear and not shown in practice;

c) sanctions are not available for directors and senior management; and

d) no sanctions have been applied so far.

612. In conclusion, the Regulations and Instructions:

- address the underlying requirements necessary to establish an effective AML/CFT regime clearly;
- use language that underpins the stated requirements;
- are issued by the FIA as the designated competent authority;
- are established by the original AML/CFT Act and further endorsed by Art. 2 of Decree No. CLIX which introduced the revised AML/CFT Law; and
- carry sanctions (apart from the public authority exemption on sanctions, which means that sanctions do not apply to APSA) although there are no explicit sanctions available for directors and senior management.

613. Although the conditions for sufficient "effective, proportionate and dissuasive criminal, civil or administrative sanctions" are not fully met, the evaluators consider that there are sufficient grounds for considering the guidance issued by the FIU as "other enforceable means". In practice the Regulations and Instructions are accepted by the relevant institutions as being binding and carrying sanctions that would be applied, particularly within the unique constitution and institutional framework of the HS/VCS. This means that the provisions in the guidance can be taken into account for rating purposes.

FIU provisions as enacted on November 14th 2011 in Regulation No.4

614. FIA Regulation No 4 regarding the transfer of funds is set out in Annex XX. This Regulation clearly describes the obligations on payers, payees, payments service providers and intermediary payment service providers regarding cross-border and domestic transfers above €1,000.

615. The regulation does not apply to funds carried out by using credit or debit cards provided that such transfers are accompanied by a unique identifier allowing the transaction not to be traced back to the payer. It also does not apply to transactions below €1,000 or for payer withdrawals of cash from their own account or where payer and payee are both payment service providers acting on their own behalf.

616. In addition the Regulation stipulates in Art. 3.4 that it does not apply where debits between both parties are authorised, enabling them to carry out payments using their accounts, provided that the transfer of funds is accompanied by a unique identifier, which enables the natural or legal person to be traced where truncated cheques are used or where funds are transferred to public authorities for the payment of taxes, sanctions or other levies.

617. Art. 4 of the Regulation sets out a requirement to complete informative data concerning the payer. Complete information is then defined as name, surname, address and account number. The address may be replaced by date and place of birth of the payer, the customer identification number or the national identity number. In the absence of the payer's account number, it should be replaced with a unique identifier so as to enable tracing of the transaction back to its payer.

618. Art. 5 obliges the payment service provider of the payer to 'verify the completeness' of the informative data before transferring the funds. Essential criterion 1 of SR.VII nevertheless requires that financial institutions should verify the 'identity' of the originator. Verification of completeness might be interpreted as ensuring that all the different types of information are available, while the essential criteria requires ensuring that the identity is verified. This verification obligation is therefore not entirely correct.

619. The standard under essential criterion 3 accepts that domestic transfers can include only the originator's account number or a unique identifier. Art. 6 of the Regulation chooses the same approach for all transfers of funds involving States having equivalent legislative schemes under the condition that the information on request can be made available within three working days. While the European Union is qualified as domestic for the purposes of this Special Recommendation, the HS/VCS is not a part of the EU. The concept 'states with equivalent legislative schemes' even broadens this approach[74]. For both reasons this means that the Regulation is not in line with the requirement that for cross-border wire transfers of €1,000 or more the ordering financial institution should be required to include full originator information in the message or payment form accompanying the wire transfer.

620. Each intermediary and beneficiary financial institution is required to ensure that all originator information is transmitted with the transfer. Art. 13 describes what to do when there are technical limitations. While the standard refers to technical limitations for cross-border transfers, the Regulation unfortunately chooses the same approach regarding states with 'no equivalent legislation'.

621. There is no explicit requirement in the Regulation that ensures that non-routine transactions are not batched where this would increase the risk of money laundering.

622. Art. 10 obliges the payment service provider of the payee to consider the lack or incompleteness of informative data as a risk factor and whether this provides a reason for submitting a report to the FIA.

623. Art. 33, para 5, letter a) of the original AML/CFT Law states that the FIA supervises the observance of the duties established in matters of prevention and countering of money laundering and financing of terrorism and issues provisions for the implementation of the rules contained in this Act, including Art. 38. These responsibilities are reiterated in Art. 2 *septies* of the revised AML/CFT Act.

624. Art. 42 (old) and Art 42 and 42 *bis* (new) of the AML/CFT Law provide for a range of sanctions. Overall, as described earlier, there is still a lack of effective, proportionate and dissuasive criminal, civil or administrative sanctions.

[74] Instruction No. 3 regulates the identification of states considered as having an equivalent regime. It consists of the member states of the EU and EEA, Australia, Brazil, Canada, Japan, Hong Kong, India, Republic of Korea, Mexico, Russian Federation, Singapore, USA, Republic of South Africa, Switzerland, Mayotte, New Caledonia, French Polynesia, Saint-Pierre and Miquelon, Wallis and Futuna, Aruba, Curacao, St Maarten, Bonaire, St Eustatius and Saba.

625. The provisions in the Regulation are in line with the requirements of SR VII on several points. In accordance with Art. 2 *septies* §9, the Regulation was published in *Acta Apostolicae Sedis* on 1 January 2012.

626. There are two areas where it appears that the Regulation is not in line with the standard. There is no explicit requirement in the Regulation that ensures that non-routine transactions are not batched where this would increase the risk of money laundering. In addition, beneficiary financial institutions are not required to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information. In some cases, the beneficiary financial institution should consider restricting or even terminating its business relationship with financial institutions that fail to meet SR VII standards.

627. As the date of publication was immediately after the first MONEYVAL on-site visit the effectiveness of implementation could not be assessed.

Internal procedures of IOR

628. Since 20 June 2011 the IOR has detailed procedures in place regarding the transfer of funds which are largely in line with the criteria of SR VII. Given the special circumstances within HS/VCS, which mean that the financial sector, to a large extent, consists of IOR and APSA, the existence of these procedures is therefore of particular relevance to the overall picture.

629. Furthermore, in the internal procedure of IOR, there is a procedural difference between domestic transfers and international transfers. The IOR explained that domestic transfers concerned wire transfers with Italian banks executed through the Italian corporate banking files transmission system (CBI). International transfers were concerned as 'foreign, being not Italian' for which the SWIFT message 103 was used. IOR states that currently all IOR wire transfers concern international transfers. Also in the case of domestic transfers, the internal procedures in place since 20 June 2011 require that transfers of funds must be accompanied by the following information on the payer:

a) name and surname;

b) address (or substituted by date and place of birth);

c) relationship identification number.

630. In the context of the lack of provisions before November 14th 2011, the fact that the guidance is not in line with the standard regarding 'domestic transfers' and the remaining concerns regarding their sanctionability, the internal procedures of the IOR are to be qualified as voluntary behaviour from the private sector and not as "other enforceable means".

631. Effective implementation of those internal procedures is nevertheless important. An international firm of accountants[75] has audited the Financial Statements of IOR and in that context also looked at the internal control system, but not for the purpose of expressing an opinion on the effectiveness of the internal control system regarding AML/CFT policies. Moreover, in particular, it was noted by the auditors in their draft management letter that IOR started a project to comply with the AML/CFT Law also taking into account international anti-money laundering rules and best practices during 2010 focussing on CDD, data recording, STR Reporting and AML/CFT governance. The auditors were informed by the IOR that the project was expected to be finalised in December 2012. In conclusion the external auditors have not evaluated the effectiveness of the AML/CFT procedures since 2010.

632. The Management Letter regarding 2010 was not published because the auditors had executed an IT audit in October 2010 following a specific requirement coming from the Board of Superintendence. The management agreed with the auditors to report on this matter in the

[75] Auditor to the IOR at the time of the MONEYVAL on-site visits.

Management Letter for the year 2011, which is scheduled to be submitted to the Board of Superintendence in July 2011.

Effectiveness

633. In September 2010, an investigation was opened in Italy to determine whether one or more violations of Italian money laundering regulations had occurred with respect to requests by the IOR made to an Italian bank that the Italian bank in question perform two wire transfers. The transfers, which were not completed, were reported to be in the amounts of €20 million to a bank in Frankfurt and €3 million to another Italian Bank. The funds sought to be transferred were provisionally frozen but such funds were subsequently released by the Italian Authorities. At the time of the evaluation visits, the related judicial proceedings had not been concluded. One of the presumed issues at stake is the question of whether information regarding the identification of the clients and their beneficial owners accompanied the transfers or not.

634. Related to this issue, Italy's FIU was requested by Italian judicial authorities to acquire information on the use of various bank accounts opened at IOR. Italy's FIU forwarded its requests to FIA. The information that was received by the Italian authorities was, according to them, very generic as to the identification of the beneficial owners on whose behalf the accounts were held.

635. In the context of the assessment of this Recommendation it is as yet unclear to the assessors if, in these particular cases, the ordering financial institution (IOR) included full originator information in the message or payment form accompanying the wire transfer. The assessment team could not pursue this matter in further detail as this evaluation is an assessment of the effectiveness of the implementation of international standards and not an investigation.

636. On 23 May 2011 IOR issued a letter to its customers stating that it would no longer be possible to use the cheques in their possession issued in respect of funds maintained at the IOR. The letter stated that an Italian bank wanted to honour payment of the cheques only upon receipt of all personal and fiscal data of the drawer and, where appropriate, the entity or congregation with which the drawer was affiliated. The IOR explained that it would defend the autonomy and privacy of its clients against any interference on the part of institutions and organisations outside the Holy See. IOR officials explained to the assessment team that they were willing, and in practice provided, all the required information on the basis of international standards, but that this particular demand of the Italian bank went far beyond the international requirements (by requesting a full client list of the IOR as a condition of doing any further business with the Institute). The FIA asked the IOR for further details on the issue. The IOR explained that all requested information had been provided to the FIA.

637. As a consequence of the fact that cross-border transactions are frequently taking place in HS/VCS and are qualified as high risk by the authorities, effective implementation of this Recommendation is of particular importance.

638. The internal procedures of IOR are largely in line with the criteria of SR VII. On the issue of 'domestic transfers' (transfers to Italy) the internal procedures require more than the provisions of the FIU guidance in this respect. Regarding the impact of using the Italian corporate banking files transmission system (CBI) instead of SWIFT messages in the recent past (June 2011 – March 2012), the authorities explained that there is no practical difference between CBI and SWIFT messages. Because of the recent implementation of the changes full effectiveness of the implementation could not be assessed.

639. The disputed issues with the Italian prosecutors and the issue as described in the letter of 23 May 2011 raise concerns regarding the overall effectiveness. In the context of the assessment of this Recommendation it is, as yet, unclear to the assessors if, in these particular cases, the ordering financial institution (IOR) included full originator information in the message or payment form accompanying the wire transfer. The assessment team could not pursue this matter in further detail because, as noted, this is an assessment and not an investigation

640. The APSA had issued internal anti-money laundering procedures on 13 March 2012 more than two months after the first MONEYVAL on-site visit). No specific written procedures are in place regarding wire transfers. In practice the wire transfers executed by APSA are mainly related to salary and pensions. APSA operates under SWIFT codes.

641. The FIA has not inspected IOR and APSA yet in its supervisory role. That is remarkable knowing the issues at stake between IOR and foreign authorities and the small size of the financial sector in VCS and does not give the impression that there are measures in place to effectively monitor compliance.

Additional elements

642. So far the following statistics regarding cross border transactions were received:

Cross border transfers (from 01/04/2011 to 11/10/2011)

Currency	Total amount when entering	Number of entries	Total amount when leaving	Number of exits
Swiss franc	104,600,00	6	20,000,00	1
Singapore dollar	105,579,00	2	0,00	0
Euro	11,168,519,21	405	25,501,751,88	1,148
Yen	5,968,000,00	4	0,00	0
Pound	35,400,00	4	2,525,00	2
US dollar	1,438,559,00	71	5,797,402,03	194
Canadian dollar	70,297,00	4	36,400,00	3
Other	0,00	0	33,050,00	2
Total		496		1,350

currency	Total amount when entering and leaving	Total entries and exits	Total amount in entering (Euro)	Total amount in leaving (Euro)	Total amount in entering and leaving (Euro)
Swiss franc	124,600,00	7	85,442,51	16,337,00	101,779,51
Singapore dollar	105,579,00	2	59,683,81	0,00	59,683,81
Euro	36,670,271,09	1,553	11,168,519,21	25,501,751,88	36,670,271,09
Yen	5,968,000,00	4	55,502,40	0,00	55,502,40
Pound	37,925,00	6	40,072,80	2,858,30	42,931,10
US dollar	7,235,961,03	265	1,014,327,95	4,087,748,17	5,102,076,12
Canadian dollar	106,697,00	7	49,805,42	25,789,40	75,594,82
Other	33,050,00	2			
total		1,846	12,473,354,10	29,634,484,75	42,107,838,86

3.5.2 Recommendation and comments

R.10

643. FIA should put in place appropriate arrangements to monitor and ensure effective implementation of the record-keeping requirements (including adequate sample testing).

644. Effective implementation by APSA should be enhanced by the adoption of internal procedures clearly specifying the duties and responsibilities of APSA staff.[76]

SR.VII

645. It is recommended to establish a clearer basis for requirements regarding the obligations of payment service providers in the law instead of in guidance, particularly as it is unclear what the legal expectations are for financial institutions such as IOR.

646. It is recommended to establish an explicit requirement that ensures that non-routine transactions are not batched where this would increase the risk of money laundering. It is also recommended to establish for beneficiary financial institutions effective risk-based procedures for identifying and handling wire transfers from beneficiary financial institutions which are not accompanied by complete originator information.

647. So far there is no evidence of applied sanctions in practice. It is recommended to effectively apply the powers of sanctions by the FIA, where appropriate.

648. The guidance in place is unclear when it comes to the verification obligation. Art. 5 obliges the payment service provider of the payer to 'verify the completeness' of the informative data before transferring the funds. Essential criterion 1 of SR.VII nevertheless requires that financial institutions should verify the 'identity' of the originator. Verification of completeness, as noted earlier, might be interpreted as ensuring that all the different types of information are available, while the essential criteria requires ensuring that the identity is verified. It is recommended to amend Art. 5 in this respect.

649. The standard under essential criterion 3 accepts that domestic transfers include only the originator's account number or a unique identifier. Art. 6 of the Regulation chooses the same approach for all transfers of funds involving States having equivalent legislative schemes under the condition that the information on request can be made available within three working days. While the European Union is qualified as domestic for the purposes of this Special Recommendation, the HS/VCS is not part of the EU. The concept 'states with equivalent legislative schemes' even broadens this approach[77]. For both reasons this means that the Regulation is not in line with the requirement that for cross-border wire transfers of €1,000 or more the ordering financial institution should be required to include full originator information in the message or payment form accompanying the wire transfer.

650. Each intermediary and beneficiary financial institution is required to ensure that all originator information is transmitted with the transfer. Art. 13 describes what to do when there are technical limitations. While the standard refers to technical limitations for cross-border transfers, the Regulation unfortunately chooses the same approach regarding states with 'no equivalent legislation'. This should be reviewed.

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[76] The evaluation team has been informed that APSA has adopted internal procedures. The procedures provided to the evaluation team were dated 13 March 2012.

[77] Instruction No. 3 regulates the identification of states considered as having an equivalent regime. It consists of the member states of the EU and EEA, Australia, Brazil, Canada, Japan, Hong Kong, India, Republic of Korea, Mexico, Russian Federation, Singapore, USA, Republic of South Africa, Switzerland, Mayotte, New Caledonia, French Polynesia, Saint-Pierre and Miquelon, Wallis and Futuna, Aruba, Curacao, Sint Maarten, Bonaire, Sint Eustatius and Saba.

3.5.3 Compliance with Recommendation 10 and Special Recommendation VII

	Rating	Summary of factors underlying rating
R.10	**LC**	Effectiveness • The requirement to maintain records of the business correspondence has been introduced too recently to be considered fully effective. • The lack of on-site inspections (including sample testing) with respect to the implementation of record keeping duties raises concerns. Furthermore, APSA has no internal procedures in place with regard to record-keeping obligations.
SR.VII	**NC**	• No explicit requirement in the Regulation that ensures that non-routine transactions are not batched where this would increase the risk of money laundering. • No effective risk-based procedures have been required from beneficiary financial institutions for identifying and handling wire transfers that are not accompanied by complete originator information. • The Regulation itself contains weaknesses regarding the verification of identity and too broad an interpretation of the concept of 'domestic transfers'. • APSA had no written internal procedures in place at the time of the MONEYVAL on-site visits. • The FIA has not inspected IOR and APSA yet in its supervisory role. This does not give the impression that there are measures in place to effectively monitor the compliance. • Overall the requirements have been introduced too recently to be considered fully effective and the evaluators were unable to assess the effectiveness of implementation.

Unusual and Suspicious Transactions

3.6 Monitoring of Transactions and Relationships (R.11 and 21)

3.6.1 Description and analysis

Recommendation 11

Special Attention to Complex, Unusual Large Transactions

651. The obliged subjects are required to be particularly attentive to complex transactions, of notable import, or unusual for the counterpart, or otherwise difficult to connect to a legitimate scope, as determined, *inter alia*, on the basis of FIA guidelines (Art. 34 §2 of the revised AML/CFT Law). FIA Instruction No. 4 requires obliged subjects to pay attention *inter alia* to operations lacking plausible economical or financial justification. In combination, the provisions

meet the elements of essential criterion 11.1 (i.e. complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose).

652. It is noted that, prior to the amendments and additions to the original AML/CFT Law promulgated by Decree N. CLIX there was no such requirement.

Examination of Complex & Unusual Transactions

653. The standard requires that obliged subjects should be required to examine as far as possible the background and purpose of transactions mentioned in the previous paragraph and to set out their findings in writing. There is no such requirement in the AML/CFT Law.

Record-Keeping of Findings of Examination

654. As a consequence of the fact that there is no requirement for examinations as described in the previous paragraph, there is no specific requirement to keep the resulting findings available for competent authorities and auditors for at least five years. The authorities refer to the general requirement under Art. 33 §1 of the revised AML/CFT Law to preserve information and documents obtained. However, this requirement does not cover findings of examinations carried out by the obliged subject.

Recommendation 21

Special Attention to Countries not Sufficiently Applying FATF Recommendations; Examinations of Transactions with no Apparent Economic or Visible Lawful Purpose from Countries Not Sufficiently Applying FATF Recommendations

655. While FIA Instruction No. 2 (see Annex XXIII) mentions geographic risk as a risk factor that has to be taken into account when applying a risk-based approach, there is no express requirement for obliged subjects to pay special attention to business relationships and transactions with persons (including legal persons and other financial institutions) from or in countries, which do not or insufficiently apply the FATF Recommendations.

656. Furthermore, there are no effective measures in place to ensure that financial institutions are advised of concerns about weaknesses in the AML/CFT systems of other countries. The authorities state that such information will be disseminated in the future based on the new empowerment according to Art. 2 *septies* §3 g) of the revised AML/CFT Law. However, this empowerment refers to the dissemination of updated intelligence on ML and FT activities, rather than information about weaknesses of countries in applying FATF Recommendations.

657. In addition, there are no requirements to examine the background and purpose of those transactions that have no apparent economic or visible lawful purpose, as far as possible and to have respective written findings which shall assist competent authorities (e.g. supervisors, law enforcement agencies and the FIU) and auditors.

Ability to Apply Counter Measures with Regard to Countries Not Sufficiently Applying FATF Recommendations

658. There is no empowerment to apply appropriate counter-measures where a country continues not to apply or insufficiently applies the FATF Recommendations.

Effectiveness and efficiency

659. The IOR relies on an IT solution (Discovery Day) for monitoring the unusual operations of a customer. This IT tool is designed to scan the IOR transaction data warehouse (*archivio unico informatico*; mentioned under Recommendation 10 for the following unusual customer transactions:

1) significant transactions by description and risk categories;
2) significant cash transactions by description and risk categories;
3) wire transfers with a correspondent bank located in a risky country;

4) beneficial owner or their representative residing in a risky country;

5) transactions executed by encharged persons[78].

660. However, the system was not fully implemented, at the time of the MONEYVAL on-site visits, given that the risk categorisation has not been finalised yet (as mentioned under Recommendation 5). Furthermore, it has not been determined which transactions are considered to be significant or which countries are regarded as risky[79].

661. The evaluation team concludes, that neither the IOR nor APSA have implemented adequate procedures which ensure that special attention is paid to relationships and transactions as described under Recommendations 11 and 21 and which provide that their background and purpose is examined and recorded as far as is required under Recommendations 11 and 21.

662. So far, obliged subjects have never been informed by the competent authorities about weaknesses in the AML/CFT systems of other countries.

3.6.2 Recommendations and comments

663. Given the global spread of the IOR's customers and its activities, the above-mentioned gaps under Recommendation 21 present important deficiencies.

664. HS/VCS should introduce a requirement in law, regulation or "other enforceable means" to examine as far as possible the background and purpose of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose and to set out their findings in writing.

665. HS/VCS should introduce a requirement in law, regulation or "other enforceable means" to keep such findings available for competent authorities and auditors for at least five years.

666. HS/VCS should introduce a requirement to give special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF Recommendations.

667. HS/VCS should introduce a requirement to examine transactions, the background and purpose of such transactions as far as possible, and to keep written findings available, if they have no apparent economic or visible lawful purpose.

668. HS/VCS should put in place effective measures to ensure that obliged subjects are advised of concerns about weaknesses in the AML/CFT systems of other countries.

669. HS/VCS should introduce a clear empowerment to apply appropriate counter-measures where countries continue not to apply or insufficiently apply the FATF Recommendations.

3.6.3 Compliance with Recommendations 11 and 21

	Rating	Summary of factors underlying rating
R.11	**PC**	• No requirement to examine as far as possible the background and purpose of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose and to set forth their findings in writing.

[78] "Encharged persons" are persons entitled to execute a single ad hoc transaction, without a general proxy.

[79] After the MONEYVAL on-site visits, the IOR representatives informed the evaluation team that the system has become operational as far as wire transfers are concerned.

		• No express requirement to keep such findings available for competent authorities and auditors for at least five years. Effectiveness • The requirement to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose had not been fully implemented at the time of the MONEYVAL on-site visits.
R.21	**NC**	• No requirement to give special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF Recommendations. • No requirement to examine transactions, the background and purpose of such transactions, as far as possible, and to keep written findings available, if they have no apparent economic or visible lawful purpose. • No effective measures in place to ensure that obliged subjects are advised of concerns about weaknesses in the AML/CFT systems of other countries. • There is no empowerment to apply appropriate counter-measures where countries continue not to apply or insufficiently apply the FATF Recommendations.

3.7 Suspicious Transaction Reports and Other Reporting (R. 13, 14, 19, 25 and SR.IV)

3.7.1 Description and analysis

670. The HS/VCS has opted for a reporting system based on a subjective assessment of the relevant financial institutions. The reporting obligation, as originally laid down in the Act CXXVII of 30 December 2011, has been effective since 1 April 2011. The revised AML/CFT Law basically follows the same line.

Recommendation 13

671. Pursuant to Art. 34.1 of the revised AML/CFT Law, the entities performing on a professional basis an activity listed in Art.2.1.a) of the same Law, together with the professionals set out in Art. 2.1.b) and c), are under an obligation, on their own initiative, to inform the FIA of any suspicious transaction, when they know, suspect or have reasons to suspect that the relevant funds are the proceeds of criminal activities or when ML or FT has been or is being committed or has been attempted[80]. As noted above, within the HS/VCS only the APSA and the IOR can be

[80] The specific reference in the original Art. 34.2 and 35 to "self-laundering" was removed, as it rightfully was considered redundant.

regarded as financial institutions falling under the reporting obligation. The revised AML/CFT Law introduced a similar reporting obligation for public authorities (Art. 2 §2).

672. Art. 34.1 of the revised AML/CFT Law also applies when there is a suspicion or knowledge "when the financing of terrorism has been committed". The international standards however impose broader reporting obligations, *i.e.* (reasonable grounds to) a suspicion of the funds being linked to or related to or to be used for terrorism, terrorist acts or by a terrorist organisation. These suspicions should also trigger a STR, even when unrelated to any financing aspects. Furthermore, there is a cascading effect from the reference to the offence of terrorism financing, as defined in Art. 38 *ter* Criminal Code, which scope (as noted in part 2.2 above) gives rise to concerns.

673. Art. 34.1 further explains the basic reasons for suspicion by referring *inter alia* to the financial, economical and professional profile of the operator and the characteristics of the operation. The notion of "suspicion" is further specified in Regulation n° 5 of the FIA "governing the content, modes of identification, also through indicators of anomaly and forwarding reports"[81] (see Annex XXI). This is supported by a series of indicators listed in FIA Instruction no. 4 "of Indicators of Anomalies for the reporting of suspicious transactions" (see Annex XXIV). The grounds for suspicion for the 2 STRs filed were taken from this objective list.

674. As in the old Law, whatever the circumstances or grounds prompting the disclosure, the reporting obligation only arises from a suspect "transaction" being performed, and consequently it is legally limited to an active financial transaction or similar activity. Such a restrictive approach is not in line with the FATF essential criteria which only requires the existence of funds related to criminal activity, not necessarily in the context of an active conduct. The provision is also narrower than the EU Directive standard, which also imposes the reporting obligation in respect of "facts", within the context of a financial transaction or not.

675. According to Art. 34.2 of the original AML/CFT Law, the FIA had to be informed "promptly", whilst Art. 35.1 of the revised AML/CFT Law sets the rule of *a priori* reporting. In the present Art. 34.1 the word "promptly" has been removed, which makes it more consistent with Art. 34.3 and Art. 35, specifying that the disclosure has to be made as soon as the suspicion arises and prohibiting the reporting entities from carrying out operations they consider suspect, unless they have filed a SAR. This enables the FIA to intervene in a timely manner, if necessary with a freezing action. Deviating from this rule is only allowed if it is impossible to abstain from executing the transaction or if by doing so it would jeopardise an investigation. In those cases the report must be filed immediately after execution (Art.35.2 revised AML/CFT Law).

676. Only suspicious operations relating to money laundering or terrorism financing should trigger a SAR. Bearing in mind that the ML offence in the HS/VCS is not an all crimes offence, this could be understood as requiring the reporting entities to disclose only in cases where they can identify a relevant predicate offence and relieving them from the reporting obligation when they find that the underlying offence is not included in the list.

677. Compared to Art. 34.2 of the original AML/CFT Law, the reference to attempted transactions has been dropped. Instead Art. 34.1 of the revised Act now refers to the circumstance that "money laundering or financing of terrorism …… or has been attempted". The attempt now relates to the ML or TF as ground for the disclosure, not to the transaction itself, which is not entirely correct. In any case, if it was the legislator's intention to include attempted transactions, it is highly questionable that the reporting entities understand the present formulation in that sense.

678. Art. 34.3 §2 now specifically states that the amount involved makes no difference in terms of the obligation to report.

679. As there is no tax system in the VCS, tax offences are not included in the list of predicate offences. Consequently, the reporting entities are legally under no obligation to disclose if the

[81] The FIA Regulations are considered to be other enforceable means as set out under SR.VII in Section 3.5 above.

proceeds are the result of a fiscal evasion. The fact that the case presents fiscal aspects does not invalidate the reporting requirement (Art. 34.3 §2).

Additional Elements

680. The reporting duty also applies when the financial institutions suspect that the transaction relates to funds that are the proceeds of whatever criminal activity that would constitute a predicate offence for ML domestically.

Special Recommendation IV

681. As stated above, Art. 34.1 of the revised AML/CFT Law also expressly applies to the financing of terrorism, so the related reporting obligation follows the same regime as the ML one. The scope of the reporting obligation should, however, be broader (see consideration of 13.2 above).

682. As in the ML context, the reporting obligation does not depend on any threshold amount involved in the suspect transaction. Possible fiscal aspects do not pre-empt any disclosure under Art. 34.1 of the revised AML/CFT Law. As for the inclusion of attempted transactions, the same comment as above for ML applies.

Safe Harbour Provisions (Recommendation 14)

Protection for Persons Making STRs)

683. Art. 34 §4 of the revised AML/CFT Law establishes that a report in good faith of a suspicious transaction, including any information related to it, shall not give rise to any form of liability for the subjects who make the report, or their legal representatives, administrators, directors, employees, consultants, and collaborators on any grounds, nor it shall constitute a breach of banking or professional secret, nor of any possible restrictions on the disclosure of information imposed by legal, administrative or contractual provisions.

684. According to the authorities "good faith" also include cases where the reporting person did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

Tipping off (Recommendation 14)

Prohibition against Tipping-Off

685. Pursuant to Art. 26 of the revised AML/CFT Law the obliged subjects, their legal representatives, administrators, directors, employees, consultants, and collaborators of whatever nature, as well as anyone else who is aware of it, shall not disclose to the entitled person or to third parties the report of suspicious transactions, including correlative information, nor that there is in course, or could be in course an investigation regarding money laundering or the financing of terrorism.

686. The tipping off prohibition only appears to cover STRs that have already been submitted, but not the fact that a STR has been identified and is in the process of being prepared/reported.

Additional elements

Additional Element—Confidentiality of Reporting Staff

687. Art. 37 of the revised AML/CFT Law, concerning Protection measures, provides that the FIA shall adopt, also on the basis of agreement protocols with the Judiciary Authority, both inquiring and adjudicatory, and with any authority whatsoever, adequate measures to assure the maximum confidentiality with regard to the identity of the subjects that report suspect operations.

688. The Memorandum of Understanding on the exchange of information within the cooperation between Vatican authorities provides that in the event that FIA forwards a suspicious transaction report to the Promoter of Justice, the identity of the reporter shall not be mentioned, unless this element is required by a justified decree.

Recommendation 25 (feedback and guidance relating to STRs)

689. According to Art. 33 §5 of the of the revised AML/CFT Law, the FIA shall:

b) issue and periodically update indicators of anomalies in order to facilitate the identification of suspect operations;

h) draw up statistics concerning the application and effectiveness of the administrative and organisational measures of prevention and repression of money laundering and financing of terrorism;

i) carry out studies in matters of prevention and countering of money laundering and financing of terrorism and develop and disseminate models and format descriptive about unusual behaviours on the economic and financial level, referable to possible activities of money laundering or financing of terrorism.

690. In addition to the forgoing, Art. 36 §4 provides that upon the dismissal of a suspicious transaction report, this fact shall be communicated to the reporting subject by the FIA.

691. The FIA issued on the 14 November 2011 Regulation No. 5 governing the means of identification (also through anomaly indicators) and forwarding of reports of suspicious transactions (see Annex XXI).

692. On the same date the FIA issued Instruction No. 4 on Indicators of Anomalies for the Reporting of Suspicious Transactions (see Annex XXIV).

693. The revised AML/CFT Law gives the FIA the obligation in Art. 2 *septies* §3 e to issue guidelines to facilitate the reporting of suspicious transactions and provides the subjects listed in Art. 2 §1, with guidance regarding the manner of reporting, including the specification of reporting forms and the procedures to be followed when reporting.

694. While the Regulations and Instructions all refer to and mention the old law as the basis for their existence, the question arises if those are still valid. At the very least, effectiveness issues arise as the guidance is harder to understand in certain cases.

695. One of the financial institutions complained that it had never received any further explanation on the issued guidelines or feedback on the internal procedures that were sent to the FIA.

Recommendation 19

Consideration of Reporting of Currency Transactions above a Threshold

696. No evidence was provided that the authorities have considered the feasibility and utility of implementing a system where financial institutions report all transactions in currency above a fixed threshold to a national central agency with a computerised data base.

<u>Additional elements</u>

Additional Element—Computerised Database for Currency Transactions Above a Threshold and Access by Competent Authorities

697. Not to be assessed, given that the reporting of currency transactions above a threshold has not been implemented.

Additional Element—Proper Use of Reports of Currency Transactions Above a Threshold

698. Not to be assessed, given that the reporting of currency transactions above a threshold has not been implemented.

Recommendation 32

699. The low number of STRs submitted to the FIA together with the novelty of the regime meant that it was not possible to assess the effectiveness of the gathering of statistics. Nonetheless the authorities were able to provide the limited information that they held.

Effectiveness and efficiency (R.13 & SR.IV)

700. By 18 March 2012 2 STRs had been filed under the AML/CFT regime by a financial institution. This appears to be low as the SAR regime had been in effect since 1 April 2011. Even if allowances are made for the small size of the financial sector in the HS/VCS and for the reporting entities needing some time to accustom themselves to the new regime and acquiring experience, effectiveness of the reporting system is questionable.

701. The SARs were founded on one of the indicators listed by the FIA in its Instruction n°4, which may be an indication of future reporting conduct. Both financial institutions which the evaluators met interpret the list as having a mandatory character that obliges them to report as soon as one of the indicators applies. This in itself is not a formal deficiency, but by doing so the institutions can, in effect, disregard their own responsibility to identify whether a transaction is suspicious. Furthermore, the mere fact of an indicator being met should not be a decisive element by itself, but should be underpinned by a subjective appreciation by the reporting entity of the suspicious character.

702. As stated, the obligation to report is "transaction" based and, as such, is narrower than the FATF essential criteria, which refers to the existence of funds with criminal origin. A restrictive interpretation would exclude, for instance, the situation where the suspicion is not raised by or at the occasion of a concrete transaction, but by outside information unrelated to any activity on an account. Such a minimalistic approach would of course negatively impact on the overall effectiveness. Furthermore, the lack of clarity about attempted transactions being included in the reporting duty in the new AML/CFT is to be deplored.

703. Bearing in mind that the ML offence in the HS/VCS is not an all crimes offence, this could be understood as requiring the reporting entities firstly to establish the predicate offence to determine if the suspicious fact should trigger a disclosure and to disclose only in cases where they can identify a relevant predicate offence. The FIA Regulations and Instructions do not touch upon this issue, which could have a serious restraining effect on the performance of the reporting regime if that interpretation would be upheld. As a general rule, the reporting entities should not be required to go further than a *prima facie* assessment of the elements being related to money laundering or terrorism financing activity, without going into a technical assessment of the offences.

704. Even if the effectiveness impact of the (primarily technical) deficiencies in relation to the reporting obligation in the terrorism context is considered low, since it may be expected that any suspected link to terrorism as such would trigger an STR, no doubt should be left on the scope of this key rule in the fight against terrorism.

3.7.2 Recommendations and comments

Recommendation 13

705. The reporting regime is basically sound. Reporting activity in this starting phase is low and it is hoped that the frequency will pick up in due time. In terms of effective asset recovery the rule of *a priori* reporting is a very positive feature of the system. There are still some refinements to be made in order to solidify the legal framework by doing away with the (potential) restrictions which could unduly narrow down the reporting obligation.

706. Therefore it is recommended to:

- Amend the law to broaden the reporting scope beyond the strict terrorism financing to bring it in line with the standards;
- Amend the reporting requirement to require that a report is submitted to the FIA when it is suspected or there are reasonable grounds to suspect that "funds" (rather than "transactions") are the proceeds of a criminal activity;
- formally broaden the reporting duty beyond suspect operations to include suspicions on funds generally;
- remove any doubt about the reporting obligation including attempted transactions;
- remove any uncertainty as to the extent of the reporting obligation of the financial institutions in respect of the identification of the predicate offence; and
- emphasise the priority rule of the subjective assessment of the suspicious nature of the funds, where the objective indicators should only be seen as a guidance and support.

Special Recommendation IV

707. The same comments apply as for R.13 above.

Recommendation 14

708. HS/VCS authorities should extend the tipping off prohibition to the fact that a STR has been identified and is in the process of being prepared/reported.

Recommendation 19

709. Particularly in the light of the large amounts of cash transactions and wire transfers carried out by the IOR, HS/VCS should consider the feasibility and utility of implementing a system where obliged subjects report all transactions in currency above a fixed threshold to a national central agency with a computerised data base.

Recommendation 25

710. Update all existing guidance in accordance with the new law as they currently all refer to the old law and to articles that no longer exist or have been changed considerably.

711. Provide an active explanation of the issued Regulations and Instructions to the financial sector and feedback on the internal procedures sent to the FIA by financial institutions.

3.7.3 Compliance with Recommendations 13, 14, 19, 25 and Special Recommendation SR.IV

	Rating	Summary of factors underlying rating
R.13	**PC**	• Attempted transactions not explicitly covered in the reporting obligation. • Reporting obligation is limited to "transactions" rather than "funds" • No reporting obligation covering funds suspected to be linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations. • Deficiencies in the terrorist financing offence formally limit the

		reporting obligation in respect of those who finance terrorism. • Effectiveness concerns.
R.14	**LC**	• There is no provision that restricts disclosure of the fact that a suspicious transaction has been identified and that an STR is in the process of being prepared/reported.
R.19	**NC**	• HS/VCS has not considered the feasibility and utility of implementing a system where obliged subjects report all transactions in currency above a fixed threshold to a national central agency with a computerised data base.
R.25	**PC**	• While the Regulations and Instructions all refer to and mention the old law as the basis for their existence, the question arises if those are still valid. • Effectiveness issues arise as the guidance is harder to understand in certain cases as several articles have been changed considerably. Overall the requirements have been introduced or clarified too recently to be considered fully effective. • Failure to provide further requested explanations on the issued guidelines or feedback on the internal procedures that were sent to the FIA.
SR.IV	**PC**	• Attempted transactions not explicitly covered in the reporting obligation. • No reporting obligation covering funds suspected to be linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations. • Deficiencies in the terrorist financing offence formally limit the reporting obligation in respect of those who finance terrorism. • Effectiveness concerns.

Internal controls and other measures

3.8 Internal Controls, Compliance, Audit and Foreign Branches (R.15 and 22)

3.8.1 Description and analysis

Recommendation 15

Generally

712. Art. 2 of the original AML/CFT Law provided, in line with criterion 1 of the essential criteria, that:

> Any subject, natural or legal person, body corporate or entity of any nature, including subsidiaries and branch offices of foreign subjects performing, on a professional basis, one of the activities indicated in Art. 2 §1 a, are obliged to observe the rules governing the

customer due diligence, registration of relationships and operations, keeping of the relevant information and reporting of suspect operations; to this end they have to provide for *adequate organisational arrangements and procedures*, as well as to assure an *adequate training* of the personnel.

713. The subjects referred to in the preceding paragraph shall adopt any provision necessary to assure the accurate and immediate fulfilment of the foreseen duties.

714. The new law stipulates in Art. 2 *ter* that:

1. The subjects referred to in paragraph 2, subparagraph 1, shall adopt adequate policies, organisation, measures and procedures to prevent and counter money laundering and the financing of terrorism, on the basis of the development of new technologies and of the phenomena of money laundering and the financing of terrorism.
2. The subjects referred to in article 2, paragraph 1, shall select those who exercise managerial functions, direction or control, among persons of suitable competence and professionalism.
3. The subjects referred to in article 2, paragraph 1, shall adopt policies, programs and measures to ensure that their employees, consultants, and collaborators on any grounds, possess an adequate professional level to permit the proper and effective observance of the requirements set forth in this law.

715. It further clarifies that these measures shall include training programs and continuous formation (training) on the prevention of money laundering and the financing of terrorism.

716. The original AML/CFT Law did not provide for an explicit requirement to develop appropriate compliance management arrangements or, at a minimum, the designation of an AML/CFT compliance officer at the management level. The new law does not change this.

717. Furthermore, the original AML/CFT Law did not provide for timely access by the AML/CFT compliance officer to customer identification data and other CDD information, transaction records, and other relevant information. The new law does not change this.

718. The original AML/CFT Law did not provide for a requirement to maintain an adequately resourced and independent audit function to test compliance with these procedures, policies and controls. The new law does not change this.

719. Art. 2 does provide for a requirement for adequate training. In addition Art. 33 §5 g) of the original AML/CFT Law established that the FIA prepares, after hearing the obliged subjects, programmes of training of the personnel to make them aware of the law in force and the activities that could be connected with money laundering or financing of terrorism. This is broadly replicated in the revised AML/CFT Law.

720. The only element which is missing in comparison with the essential criteria is the explicit requirement for an *ongoing* training of employees. The revised AML/CFT Law does not change this.

721. The AML/CFT Law does not provide a requirement for screening procedures to ensure high standards when hiring employees. The revised AML/CFT Law adds here in Art 2 *ter*, §2 that managers should be selected among persons of suitable competence and professionalism. In §3 it broadens this to their employees in general. In addition there are criteria in place in the HC/VCS for the recruitment of personnel as disclosed in the General Regulations of the Roman Curia, Title II, Art. 13 and 14, although it should be noted that there are no internal sanctions stipulated in the General Regulations.

722. Those by-laws stipulate that office managers and all the officers of level 10 are appointed by a bill of the Cardinal Secretary of State, upon proposal of the Head of Dicasteries. The other officers are hired by the Head of Dicastery within the limits of *organic table*, after hearing the opinions of the Secretary, Under-Secretary, Office manager or other officer acting in his place. Hiring requires the permission of the Secretariat of State after it has heard the advice of the

Administration of the Patrimony of the Apostolic See. In addition it stipulates that the qualification of candidates must be assessed on the grounds of appropriate titles of competence and possible tests and that officials are selected from among those distinguished for virtue, prudence, knowledge and due experience.

723. FIA Instruction No 1 in matters of organisation, procedures and internal controls preventing (see Annex XXII) came into force on 14 November 2011. The FIA has the power to issue guidelines on the basis of Art. 33, §5 a) of the original AML/CFT Law and Art. 2 *septies* §2 c) of the revised AML/CFT Law.

724. The instruction defines the necessity of the ongoing character of the training of employees. It also describes in depth the need for an audit function.

725. The instruction further states that the entities subject to this law shall be provided with a function specifically devoted to preventing and countering operations of money laundering and financing of terrorism, by appointing a person responsible for coordination and supervision, and possessing suitable requirements of independence, authoritativeness and professional skills. This seems to be very close to the requirement of the standard to designate an AML compliance officer at the management level. Yet, it is does not provide for an explicit requirement for a timely access.

726. The Instruction can be qualified as 'other enforceable means' as discussed earlier.

727. The conditions for 'other enforceable means' are broadly that the used language in the document should be of a mandatory nature, that the document is issued by a competent authority and that there are sanctions for non-compliance which should be effective, proportionate and dissuasive.

728. To assess this last condition consideration should be given to the range of sanctions available for legal and natural persons, the applicability in the case of breach of an AML/CFT requirement, availability of evidence that sanctions have been applied in practice and the possibility for an appeal if sanctions are applied.

729. In the context of the VCS it is mainly the sanctionability that is not fully satisfactory. Art. 42 of the AML/CFT Law (old and new) gives the FIU the power to apply sanctions for certain specified Articles.

730. Art. 33 of the original AML/CFT Law, the basis on which the FIA can issue guidelines like the instruction above, is not included in Art. 42 (old). This means that there is no legal ground for the FIA to apply the available administrative sanctions if there is no compliance with the Instruction.

731. In the new law the FIA has the obligation to issue guidelines and implementation norms in Art. 2 *septies*, letter 2c. This obligation to issue guidelines is further restricted to:

i. the requirement set forth by Art. 2 *ter* regarding the adoption of policies, organisational instruments, measures and procedures;

ii. the requirements set forth in Chapters V, VI and VII regarding the adequate verification, registration, preservation of records, and the reporting of suspicious transactions;

iii. the transfer of funds.

732. Letter i seems to restrict the right for issuing guidelines to Art. 2 ter, §1 only while it stipulates: 'regarding the adoption of policies, organisational instruments, measures and procedures'. As far as the guidance of the FIA of 14th November 2011 addresses those activities, the FIA has the right to apply the available pecuniary administrative sanctions for natural and legal persons on the basis of the new Art. 42.

733. This new Art. 42 (in combination with Art. 2 *septies*, §6) gives the FIU the right to impose pecuniary administrative sanctions in case of violation of certain specified articles and also for

'related duties established by the regulations and implementation norms adopted pursuant to this law'. This new Art. 42 does not refer to Art. 2 *septies but* it explicitly refers to Art. 2 *ter*.

734. As far as the FIA has the right to apply pecuniary administrative sanctions there are the concerns as mentioned under SR VII and R 17. Although the new law is a substantial improvement by adding sanctionability for legal persons, it still raises concerns regarding the effective, proportionate and dissuasive criminal, civil or administrative sanctions for the following reasons:

a) as APSA is regarded as a public authority the newly introduced administrative sanctions appear not to apply to APSA

b) the existence of additional disciplinary sanctions for natural and legal persons is not explicitly clear and not shown in practice;

c) explicit sanctions are not available for directors and senior management; and

d) no sanctions have been applied so far.

735. Although the condition of sufficient effective, proportionate and dissuasive criminal, civil or administrative sanctions are not fully met, the evaluators consider that there are sufficient grounds for considering the guidance as issued by the FIU as 'other enforceable means'. In practice the Regulations and Instructions are accepted by the relevant institutions as being binding and carrying sanctions that would be applied, particularly within the unique constitution and institutional framework of the HS/VCS. This means that the provisions in the guidance can be taken into account for rating purpose

IOR

736. Since June 2011 the IOR has had internal procedures in place that are in line with the requirements of the essential criteria. APSA has had procedures in place since 2 January 2012

737. The effective implementation and effectiveness of internal procedures of financial institutions is normally assessed by reviewing this against the legal obligations and supervisory guidance of the FIA, the scope and consistency of supervisory programme, discussions with financial institutions and the nature of enforcement actions. Unfortunately the FIA had no supervisory programme in place at the time of the MONEYVAL on-site visits and had not inspected IOR or APSA or imposed any sanctions. Discussions with the financial institutions nevertheless gave a positive impression.

Other financial institutions (*insurance, exchange bureaus and brokerage companies, credit unions, postal organisations,.*)

738. As previously stated, IOR and APSA are the only financial institutions operating in HS/VCS. These is a post office but its activities are limited to sale of stamps.

Additional elements

739. IOR explained to the evaluators that the AML/CFT compliance officers are able to act independently and to report to senior management above the compliance officers next reporting level, including to the board of directors

Recommendation 22

Application of AML/CFT Measures to Foreign Branches and Subsidiaries

740. HS/VCS stated that there are no foreign branches or subsidiaries. However, the establishment of branches or subsidiaries is not prohibited.

741. Prior to the amendments and additions to the original AML/CFT Law promulgated by Decree N. CLIX there were no requirements with respect to foreign branches and subsidiaries of obliged subjects at all.

742. In accordance with Art. 2 *bis* of the revised AML/CFT Law, the foreign branches and subsidiaries of the obliged subjects, as well as the institutions controlled exclusively or jointly, directly or indirectly, by them, are required to observe the requirements set out in the AML/CFT Law.

743. There is still no requirement to pay particular attention that this obligation is observed with respect to branches and subsidiaries in countries, which do not or insufficiently apply the FATF Recommendations.

744. When the requirements in force in the foreign State are not equivalent with those set out in the AML/CFT Law, the branches, subsidiaries or controlled institutions shall observe the requirements set out in the AML/CFT Law, to the extent that the laws of the foreign State permit so.

Requirement to Inform Home Country Supervisor if Foreign Branches and Subsidiaries are Unable to Implement AML/CFT Measures

745. When the requirements in force in the foreign State are not equivalent with those set out by this law; the branches, subsidiaries or controlled institutions shall inform the Financial Intelligence Authority.

746. This requirement is not fully in line with the essential criterion, which requires informing the home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures because this is prohibited by local (i.e. host country) laws, regulations or other measures.

747. However, the evaluators take the view that due to the above-mentioned reporting requirement contained in the AML/CFT Law obliged subjects would also have to report instances where the foreign branch or subsidiary is unable to observe appropriate AML/CFT measures because it is prohibited by the host country's laws, regulations or other measures (as required by essential criterion 22.2).

Additional elements

Additional Element—Consistency of CDD Measures at Group Level

748. There is no requirement for financial institutions subject to the Basel Core Principles for Banking Supervision (Core Principles) (the IOR and APSA qualify as such) to apply consistent CDD measures at the group level, taking into account the activity of the customer with the various branches and majority owned subsidiaries worldwide.

Effectiveness and efficiency

749. Neither the IOR nor the APSA has foreign branches or subsidiaries. The above-mentioned obligations are therefore not relevant in practice.

3.8.2 Recommendation and comments

Recommendation 15

750. Steps should be taken to ensure that all elements of guidance given by the FIU are sanctionable or ensure that relevant criteria are incorporated in the AML Law.

751. An explicit requirement for timely access to information for the compliance officer, either in law or guidance should be introduced.

Recommendation 22

752. HS/VCS authorities should introduce a requirement to pay particular attention that branches and subsidiaries in countries, which do not or insufficiently apply the FATF Recommendations,

observe AML/CFT measures consistent with the home country requirements and the FATF Recommendations.

753. HS/VCS authorities should consider introducing a requirement for financial institutions subject to the Core Principles (the IOR qualifies as such) to apply consistent CDD measures at the group level, taking into account the activity of the customer with the various branches and majority owned subsidiaries worldwide.

3.8.3 Compliance with Recommendations 15 and 22

	Rating	Summary of factors underlying rating
R.15	**PC**	• The right of the FIA to issue guidance is restricted. • Neither the law nor guidance provide for timely access by the AML/CFT compliance officer to customer identification data and other CDD information, transaction records, and other relevant information. • IOR has internal procedures but their effectiveness could only partly be assessed (Effectiveness issue). • Overall the requirements have been introduced or clarified too recently to be considered fully effective.
R.22	**LC**	• No requirement to pay particular attention concerning whether the AML/CFT measures are consistent with the home country requirements and the FATF Recommendations are observed with respect to branches and subsidiaries in countries, which do not or insufficiently apply the FATF Recommendations.

3.9 Shell Banks (R.18)

3.9.1 Description and analysis

Prohibition of Establishment of Shell Banks

754. Shell banks are defined in the revised AML/CFT Law as "a bank, or a credit institution that conducts similar activities, that has been incorporated in a State where it has no physical presence which enables it to be directed and managed effectively and which is not affiliated to regulated financial services group".

755. As set out in section 1.3 above, it must be noted that pursuant to Art. 7. of Act No. V on the Economic, Commercial and Professional Order of 1929, nobody is entitled to open shops, businesses or workshops, even for the exercise of simple trades, nor set up industrial or commercial enterprises of any kind, nor open offices, studios, agencies or fixed places of delivery for the exercise of any profession, without obtaining authorisation from the Governor. (See also section 5.1 of this report). Due to this public monopoly regime the establishment of shell banks would not be possible.

Prohibition of Correspondent Banking with Shell Banks

756. Pursuant to Art. 1 *bis* b) of the revised AML/CFT Law it is prohibited to open or hold correspondent current accounts in a shell bank, or to open or hold correspondent current accounts in a bank or in a financial or credit institution that is known to permit a shell bank to use its own accounts.

Requirement to Satisfy Respondent Financial Institutions Prohibition of Use of Accounts by Shell Banks

757. There is no express requirement for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

3.9.2 Recommendations and comments

758. The authorities should introduce an express requirement for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

3.9.3 Compliance with Recommendation 18

	Rating	Summary of factors underlying rating
R.18	**LC**	• There is no express requirement for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

Regulation, supervision, guidance, monitoring and sanctions

3.10 The Supervisory and Oversight System - Competent Authorities and SROs / Role, Functions, Duties and Powers (Including Sanctions) (R. 23, 29, 17 and 25)

3.10.1 Description and analysis

Authorities/SROs roles and duties & Structure and resources

Recommendation 23 (23.1, 23.2)

759. Art. 33 §1 of the original AML/CFT Law establishes that the FIA exerts its functions in full autonomy and independence. It is assigned sufficient financial means and resources to assure the effective pursuit of its institutional goals.

760. The provisions of Art. 33 §2 of the original AML/CFT Law state that the FIA has the power to perform inspections of the subjects referred to in Art. 2 and to impose administrative pecuniary sanctions on the responsible subjects, in the cases foreseen in this Act. The foregoing, therefore, automatically makes financial institutions subject to regulation and supervision.

761. Art. 2 *ter* of the revised AML/CFT Law sets out the powers and responsibilities of the FIA as supervisor and provides that:

1. The subjects referred to in §2.1 shall adopt adequate policies, organisation, measures and procedures to prevent and counter money laundering and the financing of terrorism, on the basis of the development of new technologies and of the phenomena of money laundering and the financing of terrorism.
2. The subjects referred to in Art. 2, §1, shall select those who exercise managerial functions, direction or control, among persons of suitable competence and professionalism.
3. The subjects referred to in Art. 2, §1, shall adopt policies, programs and measures to ensure that their employees, consultants, and collaborators on any grounds, possess an

adequate professional level to permit the proper and effective observance of the requirements set forth in this law.

762. These measures shall include training programs and continuous training on the prevention of money laundering and the financing of terrorism.

763. The indicated activities as mentioned above are described in Art. 2 §1 and consist of receiving deposits, insurance business, acquiring participations, collecting deposits, performing lending business and payment services, issuing means of payment or guarantees, renting safe deposit boxes, performing currency change operations, purchasing and selling land/property, managing monies and financial instruments, opening or managing bank accounts and deposits, establishing or managing trusts, performing investment services, performing the professions of auditor, external accountant or tax adviser, notary or lawyer, real estate agents, when they engage in a transaction for buying or selling real state and dealers in precious metals or stones, when they engage in a transaction equal to or above €15,000 or more.

764. Finally, as established by the letter c) of the *Apostolic Letter in form of a Motu Proprio on the prevention and countering of illegal activities in the financial sector* of December 30, 2010, the FIA exercises its duties with respect to the Dicasteries of the Roman Curia and of all the entities and institutions.

765. While countries should also ensure that financial institutions adequately comply with the requirements, Art. 33 of the original AML/CFT Law stipulates that the FIA supervises the observance of the duties established in matters of prevention and countering of money laundering and financing of terrorism and issues provisions for the implementation of the rules contained in this Act; furthermore, it has the power to issue guidelines and particular directives with reference to the subjects on which the duties foreseen in this Act are imposed.

766. Moreover, Art. 33, §5 h) of the original AML/CFT Law establishes that the FIA draws up statistics concerning the application and effectiveness of the administrative and organisational measures of prevention and repression of money laundering and financing of terrorism. Art 2 *septies* §4 of the revised AML/CFT Law instead states:

> The Financial Intelligence Authority, using, *inter alia,* the information gathered while fulfilling its tasks as set forth in paragraph 3, shall:
>
> a) prepare analysis and studies on particular sectors or instances of the economic and financial activity that are deemed to be under risk, and even on single anomalies that can be traced back to incidents of money laundering or financing of terrorism;
> b) release to the public periodic reports containing non-confidential statistics and information related to the exercise of its own activity.

767. So far the FIA has issued several examples of guidance, but has not drawn up statistics concerning the application and effectiveness of the measures taken.

768. The FIA is in the process of assessing which bodies in HS/VCS meet the requirements of Art. 2; both IOR and APSA fall under its remit. At the time of the MONEYVAL on-site visits, no inspections had been undertaken by the FIA.

769. The revised AML/CFT Law states, in Art. 2 *septies*, §2: "Regarding the supervision of the subjects listed in Art. 2, §1, the FIA shall:

a) Monitor their compliance of the requirements set forth in this law to prevent and counter money laundering and terrorist financing;

b) Verify, including through inspections, the suitability and effectiveness of the policies, organisational instruments, measures and procedures adopted by them pursuant to Art. 2 *ter*, to prevent and counter money laundering and terrorist financing;

The inspections shall be governed by a regulation issued by the Pontifical Commission of the Vatican City State."

770. This new article limits supervision to monitoring and verification of certain activities, such as those set out under Art. 2 *ter* of the revised AML/CFT Law which focus mainly on internal control measures and selection of employees. Verification is defined as including inspections and is therefore broader than the term inspection. It is not clear though if it includes on-site inspections.

771. Art. 33 of the original AML/CFT Law also directly mentioned the power to impose sanctions on the responsible subjects. This power has been removed in the revised AML/CFT Law. In this case we therefore have to fall back to the general provision in Art. 42 of the revised AML/CFT Law which covers administrative sanctions. Art. 42 does not refer to the violation of Art. 2 *septies*, but refers to the related duties established by the regulations and other enforceable measures adopted pursuant to the law.

772. In conclusion, the original definition appeared to be clearer and broader than the current one. Furthermore, the new article stipulates that inspections shall be governed by a regulation issued by the Pontifical Commission. It depends on the content of this Regulation to judge if the new situation in the end is better or worse. There was no Regulation available for the assessment team within the timeframes in which information has to be assessed.

773. The revisions of the law in this area could also raise an issue of independence. On this issue Art. 2 *septies* gives the FIA operational independence and autonomy. While no inspections have been executed it is still unclear what operational independence means in relation to the Regulation referred to. This is of particular importance as the original AML/CFT Law pointed to 'full independence'.

Recommendation 30 (Resources supervisors)

774. This part of Recommendation 30 assesses the structure, staff, resources and funding of supervisors. In the case of HS/VCS the FIA is the relevant supervisor for AML/CFT purposes. While the FIA also has a role as Financial Intelligence Unit for receiving, analysing and disseminating STRs, this part of the report does not focus on the resources for that task, focussing instead on the supervisory role.

775. The FIA has the power to conclude a Protocol of *Entente* with supervised subjects which also refers to the content of the activity of inspection. This power gives rise to a concern considering that supervisory activity has not yet been commenced. It will be necessary for the new Regulation to give effect to the Protocol of *Entente*.

776. Art. 33 §1 of the original AML/CFT Law provided that the FIA exerts its functions in full autonomy and independence. It is assigned sufficient financial means and resources to assure the effective pursuit of its institutional goals.

777. In the revised AML/CFT Law, Art. 2 *septies* stipulates, as previously described, that the FIA "shall perform its functions as set forth in this law with operational independence and autonomy and, in the application of those principles, it shall have adequate resources".

778. The structure of the FIA does not, however, reflect a division between the FIA as Supervisor or the FIA as FIU.

779. The Statute of the FIA (see Annex VI) governs its organisation and reflects the important articles of the old law including under Art. 2 that is has full independence. The organs of the FIA are the President and the Board of Directors. The President is appointed by the Supreme Pontiff for a period of 5 years and chairs the Board of Directors meeting. The other members of the Board of Directors are also appointed by the Supreme Pontiff. The Board is responsible for the organisation and functioning of the FIA, including its strategy.

780. The Director of the FIA is appointed by the President. The Director is responsible for the operational activity of the Authority and coordinates the activities of the personnel. The FIA forwards a report to the Secretary of State on its activities.

781. As described previously, the revised AML/CFT Law gives operational independence to the FIA instead of full independence and creates a different definition of supervision and inspection based on a Regulation that still has to come into effect. This raises concerns as to the power of the Board to define its strategy in supervisory issues and the status of the Statute of the FIA.

782. At the time of the MONEYVAL on-site visits, the FIA had a staff of 8 including the director and deputy director. There is no real division regarding FIA as supervisor or FIA as FIU; although, two of the 8 employees have backgrounds as supervisors.

783. The FIA has facilities and computers available. The budget was €600,000 for 2011 and has been raised to €900,000 for 2012.

784. Staff of the FIA should be required to maintain high professional standards, including standards concerning confidentiality, high integrity and should be appropriate skilled.

785. According to Art. 4 of the Statute of the FIA, the President of the FIA is appointed by the Supreme Pontiff. Art. 5 of the Statute requires that the Board of Directors is chaired by the President of the Authority and is made up of four more members, appointed by the Supreme Pontiff among persons of great reliability, competence and professional skills. Art. 6 of the Statute requires that the director of the FIA must be adequately qualified and haven proven competence and professional skills in the legal-financial and computer-science fields, acquired in the Authority's institutional matters and is appointed by the President with the permission of the Secretary of State. The personnel of the Authority are required by Art. 6.3 to have an adequate professional experience in the Authority's institutional matters and are hired by the President of the Authority with the permission of the Secretary of State.

786. Art. 7 obliges all relevant officials to keep the highest secrecy about anything concerning the FIA and its relationships with third parties.

787. In this regard, the provisions of Art. 13 §§1-2 (professional skills) and Art. 55 §2, p. 2 (provision of paid leave to take exams) of the *General Regulation of the Roman Curia* apply. As the latter governs the matter of permits for the attendance of the examinations for relevant jobs, a concession is imposed concerning staff training.

788. In accordance with the requirements of R.30.3, the staff of the FIA, as supervisor, should be provided with adequate and relevant training.

789. Employees have followed training in IT and different conferences and seminars. No specific training was provided for the supervisory side of the FIA.

Authorities powers and sanctions

Recommendation 29

790. The Recommendation requires that supervisors should have adequate powers to monitor and ensure compliance by financial institutions. According to Art. 33 of the revised AML/CFT Law, paragraph. 5, letter a), the FIA supervises the observance of the duties established in matters of prevention and countering of money laundering and financing of terrorism and issues provisions for the implementation of the rules contained in this Act, except for the criminal rules as contained in Chapters II and III; furthermore, it has the power to issue guidelines and particular directives with reference to the subjects on which the duties foreseen in this Act are imposed.

791. Supervisors should have the authority to conduct inspections of financial institutions, including on-site inspections, to ensure compliance. Such inspections should include the review of policies, procedures, books and records, and should extend to sample testing.

792. According to Art. 33 §2 of the original AML/CFT Law, the FIA has the power to perform inspections at the subjects referred to in Art. 2 and to impose administrative pecuniary sanctions on the responsible subjects, in the cases foreseen in this Act.

793. As set out under the consideration of R.23.1 and 23.2 above, Art. 2 *septies*, §2 of the revised AML/CFT Law sets out the supervisory powers and responsibilities. As previous considered, this new article limits supervision to monitoring and verification of certain activities, such as those mentioned under Art. 2 *ter,* which focus mainly on internal control measures and selection of employees. Verification is defined as including inspections and is therefore broader than the term inspection. Nevertheless it is unclear whether it includes on-site inspections as required by the Recommendation. Inspections then are governed by an external Regulation.

794. Art. 33 of the original AML/CFT Law directly mentioned the power to impose sanctions on the responsible subjects. This power has been removed in the revised AML/CFT Law. In this case we therefore have to fall back to the general provision in Art. 42 of the revised AML/CFT Law, which covers administrative sanctions. Art. 42 does not refer to the violation of Art. 2 *septies*, but refers to the related duties established by the regulations and other enforceable measures adopted pursuant to the law.

795. In conclusion, the old definition seemed to be clearer and broader than the current one which seems restricted to certain activities. The new article stipulates that inspections shall be governed by a regulation issued by the Pontifical Commission. It depends on the content of this Regulation to judge if the new situation in the end is better or worse. There was no Regulation available for the assessment team within the timeframes in which information has to be assessed.

796. There is also the issue of independence. With regard to Art. 2 *septies*, this gives the FIA operational independence and autonomy. While no inspections have been executed it is still unclear what operational independence means in relation to the Regulation referred to. This is of particular importance given that the old law pointed to 'full independence'. The authorities explained that the new law is not intended to limit the supervisory powers or to limit the independence of the supervisor; this will be further clarified in the Regulations that are still in the process of being developed.

797. One of the members of the Cardinals Committee is also president of the FIA. This could raise concerns regarding a serious conflict of interest. It is therefore strongly recommended that the same person should not hold positions in the supervisory body and a supervised body.

798. Both under the original and revised AML/CFT Laws, it is unclear to what extent inspections include the review of policies, procedures, books and records, and should extend to sample testing. Under the new law this may be clarified in the Regulation to be issued by the Pontifical Commission, although this was not available to the evaluators at the time of the MONEYVAL on-site visits.

799. According to Art. 33, §2 of the original AML/CFT Law the FIA has access, also directly, to financial, administrative, investigative and judicial information, required to perform its tasks in countering money laundering and financing of terrorism. However, The revised AML/CFT Law does not give the FIA such clear powers. Again the new Regulation has to give more clarity here.

800. Both under the original AML/CFT Law as the revised AML/CFT Law, it was and is unclear if the legal empowerment of the supervisory authorities include the right of entry into the premises of the institution under supervision, the right to demand books of accounts and other information, the right to make and take copies of documents with a penalty on the institution if its officers fail to comply.

801. Under the original AML/CFT Law both the IOR and the Supreme Court held the legal opinion that (some of) those powers are not included. Under the revised AML/CFT Law the Regulation could create clarity.

802. In the HS/VCS legal system, the supervisor's power to compel production of or to obtain access for supervisory purposes is not predicated on the need to require a court order.

803. The Recommendation requires that the supervisor should have adequate powers of enforcement and sanction against financial institutions, and their directors or senior management

for failure to comply with or properly implement requirements. As mentioned above Art. 33, §2 under the old law gives the right to access information and to impose sanctions. Art. 42 under the new law gives the FIA the power to apply administrative pecuniary sanctions to natural and legal persons. Both in the old and new Law there is no explicit empowerment to sanction directors or senior management.

804. At the time of the MONEYVAL on-site visits, no sanctions had been applied against financial institutions, directors or senior management.

805. So far the assessment team received the following statistics regarding supervision and coordination:

supervision and coordination

Institution or obliged subject	Number of meetings June to December 2011
Secretary of State	4
Governorate	3
Prefecture for the Economic Affairs of the Holy See	2
Gendarmerie Corps	3
Administration of the Patrimony of the Apostolic See (APSA)	5
Institute for Works of Religion (IOR)	5
Judiciary offices	2
Propaganda Fide	2
Cor Unum	2
Other (Congregation for the Oriental Churches, Pontifical Commission for Sacred Archaeology and Equestrian Order of the Holy Sepulchre of Jerusalem)	3

806. With regard to the figures for the IOR, it is good to note that what is called 'supervision' was later explained to be supervision through correspondence between the FIA and IOR and consisted of the following actions:

- At the end of the 30 days period from the entering in force of the Act CXXVII, the FIA requested a formal communication, by 10 May 2011, regarding the issue of any provision for the implementation of AML requirements; the answer was received within the deadline established by the Law.
- On 12 May 2011, the FIA requested the agreements stipulated with foreign banks related to the implementation of AML measures, and all the documentation connected to pending inquiries before Italian (and other countries) Courts; a positive answer was given at the end of May.

- On 8 June 2011, the FIA, in order to have an explanation of the background to the letter that was sent to the customers of IOR on 23 May 2011, informed the IOR of the need for a meeting (scheduled on 14 June) for the discussion of the issue.
- Further communications between June and September were aimed at going in depth into details regarding the timing of applicability of the Law.
- Other requests were addressed to the IOR on the classification of customers, risk categories, CDD on the existing customers, the monitoring of persons delegated to operate on the funds[82].

Effectiveness and efficiency (R.23&29)

807. As stated above no inspections have been executed since the formation of the FIA at the beginning of 2011. All communication was done via correspondence. IOR states that it had sent its internal procedures to FIA for acceptance but never received a response.

808. Considering the issues at stake between IOR and foreign authorities and the small size of the financial sector in VCS, it is remarkable that FIA did not conduct an on-site inspection within IOR to investigate the issues in appropriate detail.

809. Since no on-site inspection has been executed, the effectiveness of the powers and authorities could not be established.

Recommendation 17

810. Recommendation 17 requires that countries should ensure that effective, proportionate and dissuasive criminal, civil or administrative sanctions are available to deal with natural or legal persons covered.

811. Art. 42 of the revised AML/CFT Law provides that:

(a) In case of violation of the obligations set forth in Arts. 1 *bis*; 2 *ter*, 25 paragraphs 1, 2, 4, and 5; 26; 27; 28; 28 *bis*; 28 *ter*; 29; 29 *bis*; 29 *ter*; 30; 31; 32; 33; 34; 35; 36; 37, §1; 37 *bis*; 38; and 39; or of the related duties established by the regulations and other enforceable measures adopted pursuant to this law, the Financial Intelligence Authority shall impose a pecuniary administrative sanction ranging from €10,000 to €250,000, for the natural persons, and from €10,000 to €1,000,000 for the legal persons.
(b) The sanctions shall be determined pursuant to the criteria set forth in Law n. CCXVII of 14 December 1994.
(c) The import of the sanction shall be acquired by the Holy See and it is destined to the charitable and religious works of the Roman Pontiff.
(d) The person sanctioned may object to the decision of the Financial Intelligence Authority resorting to a Single Judge. If it is a legal person, the entity sanctioned may take action against the natural person responsible for the violation.
(e) The preceding provisions shall be applied without prejudice to the disciplinary procedures related to an employment relationship.

812. The available administrative sanctions range from €10,000 up to €250,000 for natural persons.

813. Criminal sanctions for legal persons are dealt with under Recommendation 2 above. In HS/VCS there was no criminal liability for legal persons as, in the view of the authorities, this would be inconsistent with fundamental principles of domestic law. In addition it is not clear yet to what extent, if at all, criminal sanctions are possible in cases of infringement of the several articles of Act No. CXXVII relating to Chapters other than II (criminal provisions on money laundering) and III (other forms of criminal activity). Although criminal sanctions, are in cases of

[82] On 23 February 2012, a request was transmitted by the FIA regarding an updating on the acquisition of information on customers and persons delegated to operate on their behalf, the improvement of front office documentation and integration of electronic procedures for classification of customers in the risk categories, and on agreements of AML cooperation with foreign banks.

infringement of the several articles of the original and revised AML/CFT Laws relating to Chapters other than II and III for natural persons are not specifically provided for in the AML/CFT Law, Art. 9 of the Act on Sources of Law (see Annex XII) provides that "Should any penal provision be lacking, and an act has been committed that offends the principles of religion or morals, public order, personal security or safety of things, the judge may refer to the general principles of the legislation to inflict pecuniary penalties up to €3,000, or detention penalties up to six months, and apply, as the case may be, the alternative sanctions indicated in Law of 14 December 1994, No. CCXXVII". This is a unique solution which introduces the possibility of criminal sanctions in the most egregious cases.

814. R. 17.4 requires that the range of sanctions available should be broad and proportionate to the severity of a situation. They should include the power to impose disciplinary and financial sanctions and the power to withdraw, restrict or suspend the financial institution's licence, where applicable.

815. Article 42, §2 states that sanctions shall be determined pursuant to the criteria set out in Act No. CCXVII of December 14, 1994 on modifications to the penal system (see Annex XIV). This Act describes that the pecuniary administrative sanction should be proportionate to the severity of the situation (Art. 2). According to the authorities, this principle of proportionality also means that the FIA has the power to impose disciplinary sanctions. The authorities explained that, via Regulation No 3 Art. 12, the FIA issued guidance under the old law that was validated under Art. 2 of the new Decree where it was stated that all existing Regulations were adopted in so far as they were compatible with the new law.

816. Regulation No. 3 Concerning Administrative Sanctions included a provision to "maintain the rules concerning disciplinary measures in relation to work relationships with the Holy See or with Vatican City State". The authorities explained further that through Art. 12 of this Regulation, the disciplinary actions of the General Regulation of the Roman Curia could be applied as described in Art. 70 and further. Those articles describe the following disciplinary sanctions: written warnings; instructions; and dismissal of employees. Unfortunately those disciplinary sanctions are not explicitly given to the FIA. A change to this guidance on this particular issue seems not to be feasible while this power of the FIA to issue guidance is now more restricted. In addition, it is unclear to what extent those disciplinary actions can be practically applied to the IOR while, for example, directors are not hired under the conditions of the General Regulation of the Roman Curia. For those cases the Cardinals Commission might have the power to dismiss presidents and vice-presidents as described in Art. 8 of the Council of Superintendence. Regarding the Cardinals Commission, there remains the issue of its status as to whether it is an internal body of the IOR or in fact an independent 'supervisor'. The examiners were unclear on this.

817. In addition the term proportionality as described in Act CCXVII seems to refer, in particular, to the pecuniary administrative sanctions.

818. The range of sanctions does not include the power to withdraw, restrict or suspend a licence. IOR and APSA are formally not 'licensed'. As such these are "licensed" via the Chirograph and the Pastor Bonus respectively.

819. On the 14th of November 2011 the FIA issued Regulation No 3 concerning administrative sanctions in case of infringements of duties by Act No. CXXVII (see Annex XIX). This Regulation refers to the old Art. 42 and in addition describes procedures for challenges and notifications and provides rules for injunctions, the terms of deposits and enforcement.

820. Art. 42 *bis* of the new law stipulates:

1. In case of conviction for one of the crimes set forth in Arts. 412 *bis* and 138 *ter* of the Penal Code, the judicial authority shall impose an administrative economic sanction ranging from €20,000 to €2,000,000 to the legal person involved if:

a) the person convicted exercised its legal representation, management, direction, or a similar role;

b) the person convicted was under the direct responsibility, supervision or control or one of the persons referred to in paragraph a);

c) the crime was committed in favour of the legal person.

821. The same article further defines in paragraph 2 when legal persons are not deemed responsible. It also stipulates in paragraph 3 that in addition to the economic administrative sanctions, a temporary interdict on the exercise of its activities shall be imposed if certain conditions apply.

822. Under the standard, sanctions must be available in relation both to financial institutions and to their directors and senior management. The revised AML/CFT Law does not provide any specific sanctions for the directors and senior management of the legal person. However, the term "natural persons" would appear to be broad enough to cover directors and senior management.

823. In conclusion, there are pecuniary administrative sanctions for natural persons. There appears to be room for imposing some additional disciplinary sanctions, but it is not explicitly clear and not shown in practice.

824. For legal persons there is an appropriate range of pecuniary sanctions available in case of convictions for crimes. In addition a temporary interdict can be imposed. There seems to be room for imposing some additional disciplinary sanctions, but it is not explicitly clear and not shown in practice. Furthermore there is no ability to withdraw or suspend a licence. In addition there are no specific sanctions available for the directors and senior management of financial institutions although they would fall within the definition of "natural persons". Furthermore, as APSA is regarded as a public authority the newly introduced sanctions appear not to apply to APSA

825. Although the new law is a substantial improvement by adding sanctionability for legal persons, it still raises concerns regarding the effective, proportionate and dissuasive nature of criminal, civil or administrative sanctions for the following reasons:

a) as APSA is regarded as a public authority the newly introduced administrative sanctions appear not to apply to it;

b) the existence of additional disciplinary sanctions for natural and legal persons is not explicitly clear and not shown in practice;

c) explicit sanctions are not available for directors and senior management; and

d) no sanctions have been applied so far.

826. The condition of sufficient effective, proportionate and dissuasive criminal, civil or administrative sanctions are not fully met. The range is reasonably broad but could be improved with regard to disciplinary sanctions, and applied to APSA.

827. It is noted that Art. 42 and 42 *bis* of the revised AML/CFT Law provide that "The import of the sanction shall be acquired by the Holy See and it is destined to the charitable and religious works of the Roman Pontiff". Bearing in mind that financial sanctions in the context of HS/VCS inevitably would involve simply transferring money from one HS/VCS account to another it seems to the evaluators that, in the particular circumstances of the HS/VCS, the publication of any financial or other sanctions imposed would be of greater utility.

<u>*Market entry*</u>

Recommendation 23

(23.3, 23.5, 23.7) *licensing/registration elements only*

828. This Recommendation also requires that supervisors or other competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest, or holding a management function, including in the executive or supervisory boards, councils, etc. in a financial institution. In this context IOR and APSA are to be qualified as financial institutions according to the FATF methodology, taking into account the financial services they provide to their customers.

829. HS/VCS has taken no specific measures to involve the supervisor in the process of licensing and approving senior staffing financial institutions.

830. Directors and senior management of IOR and APSA are not specifically evaluated and 'licensed' on the basis of "fit and proper" criteria including those relating to expertise and integrity.

831. Nevertheless the heads and governing boards of the legal entities performing operations that could be relevant in the light of the FATF Recommendations in the HS/VCS are subject to the discipline of the *General Regulation of the Roman Curia* of 1999 (see Annex IX). This Regulation, regarding hiring and retention of staff, requires a high standard, both moral and professional. In particular, Art. 14 provides that executives shall be chosen 'among those distinguished for virtue, prudence, knowledge, due experience' (paragraph 1). Art. 13, paragraph. 4 establishes that 'the qualification of candidates shall be assessed on the grounds of appropriate titles of competence'. Art. 55, paragraph. 2, p. 2 provides for continuous vocational training.

832. In practice both the elements 'fit' and 'proper' appear to be met by the General Regulation.

833. In addition the new law requires in Art. 2 *ter* that "subjects shall select those who exercise managerial functions, direction or control, among persons of suitable competence and professionalism".

834. According to the HS/VCS authorities and upon request confirmed by IOR and APSA, there are no natural and legal persons providing money or value transfer services, or a money or currency changing service in HS/VCS. Criterion 23.5 is therefore not applicable.

835. Under criterion 23.7, financial institutions (other than those mentioned in Criterion 23.4) should be licensed or registered and appropriately regulated. While IOR and APSA are regulated as described above, they are not licensed. IOR and APSA are "licensed" as such via the Chirograph and the Pastor Bonus respectively.

On-going supervision and monitoring

Recommendation 23 & 32
(23.4, 23.6, 23.7) - supervision/oversight elements only) & 32.2d

836. Criterion 23.4 requires that, for financial institutions that are subject to the Core Principles[83], the regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, should apply in a similar manner for anti-money laundering and terrorist financing purposes, except where specific criteria address the same issue in this Methodology. The activities as mentioned in the footnote and which are subject to the Core Principles, are regulated under Art. 2 (old and new) of the AML/CFT Law and take place. They could therefore fall under the Core Principles but for this subscription is necessary by the IOR. So far the IOR has not subscribed to the Core Principles. Consequently, those entities do not fall under the Core Principles and indeed, in practice, are not supervised by a central bank, nor

[83] Broadly speaking this refers to: (1) banking and other deposit-taking business, (2) insurers and insurance intermediaries, and (3) collective investment schemes and market intermediaries.

assessed in the context of a regular IMF assessment of the Core Principles, therefore this particular criterion appears not to be applicable.

837. That said it is good to note that the IOR representatives stated that the global regulatory standard of the Basel Committee on Banking Supervision regarding banking adequacy and market liquidity risk are applied as 'best practice' with regard to CDD. It was stressed however by IOR that it is not legally required to do so. It should be noted that if IOR did legally fall under the Core Principles the relevance for the AML area would be that IOR would need to apply regulatory and supervisory measures which are relevant to AML, such as:

(i) licensing and structure;

(ii) risk management processes to identify, measure, monitor and control material risks;

(iii) ongoing supervision; and

(iv) global consolidated supervision when required by the Core Principles.

838. As previously stated, at the time of the MONEYVAL on-site visits, no inspections had been undertaken of the AML/CFT program of financial institutions. No standard manual was available and no cycle of visits had been determined or planned for. IOR stated that they had asked their supervisor, the FIA, several times for feedback on their internal procedures but never received a response and would have appreciated an inspection.

839. In view of the issues at stake between IOR and foreign authorities and the small size of the financial sector in VCS, it is remarkable that FIA did not undertake an on-site inspection within IOR to investigate the issues in appropriate detail.

840. According to the HS/VCS authorities and upon request confirmed by IOR and APSA, there are no natural and legal persons providing money or value transfer services, or a money or currency changing service in HS/VCS. This criterion is therefore not applicable.

841. Recommendation 32 requires *inter alia* that competent authorities should maintain comprehensive statistics on matters relevant to the effectiveness and efficiency of systems for combating money laundering and terrorist financing. This should include keeping annual statistics on on-site examinations conducted by supervisors relating to or including AML/CFT and any sanctions applied.

842. According to the Art. 33, §5 h) of the original AML/CFT Law, the FIA is required to draw up statistics concerning the application and effectiveness of the administrative and organisational measures of prevention and repression of money laundering and financing of terrorism. At the time of the MONEYVAL on-site visits those statistics had not been drawn up, although it is to be noted that the FIA only commenced operations on 1 April 2011. Furthermore, the FIA had not established a policy on the type and extent of statistics it will gather and the criteria for these statistics.

843. Art. 2 *septies* §4 of the revised AML/CFT Law states that the Financial Intelligence Authority, using, *inter alia,* the information gathered while fulfilling its tasks as set forth in paragraph 3, shall:

a) prepare analysis and studies on particular sectors or instances of the economic and financial activity that deemed to be under risk, and even on single anomalies that can be traced back to incidents of money laundering or financing of terrorism;
b) release to the public periodic reports containing non-confidential statistics and information related to the exercise of its own activity.

844. At the time of the MONEYVAL on-site visits no such statistics had been produced.

Effectiveness and efficiency

845. No sanctions have been applied since the commencement of FIA operations on 1 April 2011.

846. No entities have been licensed or licences withdrawn or suspended. Furthermore it appears that the FIA does not have the power to do so.

847. Directors and senior management are not specifically evaluated on the basis of 'fit and proper' but in practice both elements seem to be met by the General Regulation.

848. There is no ongoing supervision and monitoring effectively in place.

849. No comprehensive statistics have been maintained on matters relevant to the effectiveness and efficiency of systems for combating ML and FT, such as annual statistics on on-site examinations by supervisors or sanctions applied.

Recommendation 25 (Guidance for financial institutions other than on STRs)

850. Competent authorities should establish guidelines that will assist financial institutions and DNFBP to implement and comply with their respective AML/CFT requirements. At a minimum, the guidelines should give assistance on issues covered under the relevant FATF Recommendations, including a description of ML and TF techniques and methods and any additional measures that these institutions and DNFBP could take to ensure that their AML/CFT measures are effective.

851. Relevant parts of Art. 33 §5 of the original AML/CFT Law provides that the FIA:

a) supervises the observance of the duties established in matters of prevention and countering of money laundering and financing of terrorism and issues provisions for the implementation of the rules contained in this Act, except for those contained in Chapters II and III; furthermore, it has the power to issue guidelines and particular directives with reference to the subjects on which the duties foreseen in this Act are imposed;

b) issues and periodically updates indicators of anomalies in order to facilitate the identification of suspect operations;

c) receives the communications referring to suspect operations and provides for the performance of the required investigations in view of possibly reporting them to the Promoter of justice at the Tribunal;

f) proposes possible integrations and changes of the legislation in matters of prevention and countering of money laundering and financing of terrorism;

g) prepares, after hearing the obligated subjects, programmes of training of the personnel to let them be aware with the law into force and the activities that could be connected with money laundering or financing of terrorism;

h) draws up statistics concerning the application and effectiveness of the administrative and organisational measures of prevention and repression of money laundering and financing of terrorism;

i) carries out studies in matters of prevention and countering of money laundering and financing of terrorism and develop and disseminate models and format descriptive about unusual behaviours on the economic and financial level, referable to possible activities of money laundering or financing of terrorism.

852. In the revised AML/CFT Law Art. 2 *septies*, §2 c) gives the FIA the obligation to issue guidelines and implementation norms regarding:

i. the requirement set forth by Art. 2 *ter* regarding the adoption of policies, organisational instruments, measures and procedures;

ii. the requirements set forth in Chapters V, VI and VII regarding the adequate verification, registration, preservation of records, and the reporting of suspicious transactions;

iii. wire transfers.

853. Between 1 March 2011 and 14 November 2011, the FIA issued several Regulations and Instructions. Besides the ones regarding STRs as discussed earlier, the FIA has issued:

- Regulation No 1 concerning the carrying of cash on entering or leaving the VCS.
- Regulation No 2 concerning the transportation of cash and financial instruments entering or leaving the VCS.
- Regulation No 3 concerning administrative sanctions in case of infringements of duties established by the AML/CFT Law.
- Regulation No. 4 of the Financial Intelligence Authority regulating requirements vis-à-vis the transfer of funds according to Art. 38, §4 of act No. CXXVII of the 30th of December 2010.
- Regulation no. 5 of the authority of financial information governing the content, modes of identification, also through indicators of anomaly and forwarding of suspicious reports.
- Instruction No 1 in matters of organisation, procedures and internal controls.
- Instruction No 2 in matters of assessment of risk factors and CDD.
- Instruction No 3 regulating the identification of states considered as having an equivalent regime.
- Instruction No. 4 of Indicators of Anomalies for the reporting of suspicious transactions.

854. The FIA was also involved in the preparation of changes to the AML Law.

855. While the Regulations and Instructions all refer to and mention the old law as the basis for their existence, the question arises regarding the extent that they are still valid. The new law answers this question in that it states under article 2 that all existing Regulations were adopted in so far as they where compatible with the new law.

856. Furthermore, effectiveness issues arise as the guidance is harder to understand in certain cases as several articles in the law have been changed considerably and this has yet to be reflected in amendments to the guidance. However, the evaluators appreciated the speed with which amendments to the law were made and that it was not feasible to update the Regulations and Instructions at the same time. Nonetheless much of the content of the Regulations and Instructions issued on 1 January 2012 remain valid.

857. Discussions with IOR made clear that they are not satisfied with the guidance given by the FIA. At the time of the MONEYVAL on-site visits, the IOR had not received sufficient explanation from the FIA of the Regulations and Instructions issued. Furthermore they complained that they had not received any feedback on the internal procedures which they sent to the FIA.

3.10.2 Recommendations and comments

Recommendation 23

858. Under Recommendation 29, it is recommended that the definition of supervision and inspection is changed so that it is made clear what the powers, as given to the AML supervisor, encompass in practice and also to create clarity as to the exact meaning of "operational" as opposed to "full" independence. Uncertainty on those issues also leads to a lack of clarity on the role and authority of the FIA as supervisor, particularly in the absence of supervisory activities. It is therefore recommended to create this clarity both by changing the law and by providing a clear Regulation.

859. The HS/VCS has taken no specific measures to involve the supervisor in the process of licensing and approving senior staff in financial institutions.

860. Directors and senior management of IOR and APSA are not specifically evaluated and 'licensed' on the basis of "fit and proper" criteria including those relating to expertise and integrity. It is recommended to give the FIA the power to assess "fit and properness" on an ongoing basis.

861. It is recommended that the FIA (or another body) take up its supervisory role on AML issues directly, plan for (a schedule of) inspections, set up a standard manual and work procedure and provide for feedback proactively.

862. The evaluators appreciate that the FIA has been active since its creation in the preparation of Regulations and Instructions, and in assessing the range of institutions within the HS/VCS on which they should primarily focus. Nonetheless the evaluators were very surprised that, by the time of the MONEYVAL on-site visits, FIA had not conducted an on-site inspection within IOR to assess compliance in appropriate detail. It is therefore recommended that FIA start a supervisory inspection with IOR as soon as possible, given the issues at stake between IOR and foreign authorities and the small size of the financial sector in VCS.

863. As at the time of the MONEYVAL on-site visits, the FIA had issued several examples of guidance, but had not drawn up statistics concerning the application and effectiveness of the measures taken, such as annual statistics on on-site inspections by the supervisor or sanctions applied. It is recommended to do so. It is also recommended to reinstate that requirement in the law.

864. The Recommendation requires that, for financial institutions that are subject to the Core Principles[84], the regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, should apply in a similar manner for anti-money laundering and terrorist financing purposes, except where specific criteria address the same issue in this Methodology. The activities, as mentioned in the footnote and which are subject to the Core Principles, are regulated under Art. 2 (old and new) of the AML/CFT Law and take place. They could therefore fall under the Core Principles but for this subscription is necessary by the IOR. So far the IOR has not subscribed to the Core Principles. Consequently, those entities do not fall under the Core Principles and indeed in practice are not supervised by a central bank, nor assessed in the context of a regular IMF assessment of the Core Principles. Therefore this particular criterion does not appear to be applicable.

865. That said, it is good to note that the IOR representatives stated that the global regulatory standard of the Basel Committee on Banking Supervision regarding banking adequacy and market liquidity risk are applied as 'best practice'. It was stressed however by IOR that it is not legally required to do so. Although formally not subscribing to the Core Principles, in practice the IOR is involved in 'banking and deposit-taking business', for example when accepting cash deposits from a client to be placed on the IOR account through the services of a correspondent bank and administratively booked on the administrative account of the client. Subscription by IOR to the Core Principles is therefore recommended.

866. It is therefore strongly recommended that IOR is also supervised by a prudential supervisor in the near future. Even if this is not formally required, it poses large risks to the stability of the small financial sector of HS/VCS if IOR is not independently supervised. In addition it would require IOR to implement additional regulatory and supervisory measures which are relevant for AML. While the AML supervision regime cannot be regarded as being mature for the reasons described above, the conclusion is that, at the time of the MONEYVAL on-site visits, there was no adequate independent supervision of the IOR. In line with this, it is recommended to clearly separate the task of supervision from the FIA as FIU and combine this with adequate prudential supervision.

[84] Broadly speaking this refers to: (1) banking and other deposit-taking business, (2) insurers and insurance intermediaries, and (3) collective investment schemes and market intermediaries.

867. From an AML perspective prudential supervision on IOR would lead to regulatory and supervisory measures that are also relevant to money laundering such as:

(i) licensing and structure;

(ii) risk management processes to identify, measure, monitor and control material risks;

(iii) ongoing supervision; and

(iv) global consolidated supervision when required by the Core Principles.

Recommendation 17

868. It is recommended to stipulate explicitly in law or, if need be, in guidance what the full range of FIA's powers are in terms of disciplinary sanctions. Those sanctions should encompass written warnings, orders to comply with specific instructions accompanied with daily fines for non-compliance, ordering regular reports, fines for non compliance, barring individuals from employment in the sector, replacing or restricting the powers of managers, directors, imposing conservatorship, and at least the ability to withdraw or suspend a licence. All sanctions levied should be published.

869. It is recommended to make explicitly clear what the criminal sanctions are for natural persons in cases of infringement of the several articles of Act No. CXXVII relating to Chapters other than II and III.

870. It is recommended to make explicitly clear that sanctions can be applied to directors and senior management of financial institutions.

Recommendation 25

871. It is recommended that all regulations and instructions are amended to reflect the revised AML/CFT Law as they currently all refer to the original AML/CFT Law and to articles that no longer exist or have been changed considerably.

872. It is recommended to give proactive explanations of the issued Regulations and Instructions to the financial sector and provide feedback on procedures sent to the supervisor.

Recommendation 29

873. It is recommended that the definition of supervision and inspection in the law is amended to make it clear that it is not restricted to certain activities.

874. It is recommended that the Regulation of the Pontifical Committee is amended in order to clarify what is understood by monitoring, verification and inspection. It should also make clear that it includes –also via on-site inspections- the review of policies, procedures, books and records, and sample testing. Furthermore, the Regulation should make it explicitly clear what the impact is of the change from 'full independence' to 'operational independence' and to what extent this effects the role and tasks of the President and Board of Directors of the FIA as they currently have a role to set strategy according to the Statute of the FIA.

875. It is recommended to restore Art 33 §2 of the original AML/CFT LAW which gave the FIA direct access to the financial, administrative, investigative and judicial information, required to perform its tasks in countering money laundering and financing of terrorism, as the revised law does not give the FIA those explicit rights.

876. It is recommended that it is made explicitly clear in the Regulation that the legal empowerment of the supervisory authorities includes the right of entry into the premises of the institution under supervision, the right to demand books of accounts and other information and the right to make and take copies of documents.

877. It is recommended that the law is amended in such a way so that the supervisor has the right to impose sanctions against financial institutions, and their directors and senior management for failure to comply with the powers given to the supervisor.

878. As stated above, no inspections have been executed since the commencement of operations of the FIA in April 2011. All communication has been achieved via correspondence. IOR states that it has sent its internal procedures to FIA for acceptance but has never received a response. Taking into account the issues at stake between IOR and foreign authorities and the small size of the financial sector in VCS, it is remarkable that FIA did not commence an on-site inspection within IOR to investigate the issues in appropriate detail. It is therefore recommended that the FIA take up its supervisory role as soon as possible, including the provision of feedback.

879. One of the members of the Cardinals Committee is also President of the FIA. This could raise concerns regarding a serious conflict of interest. It is therefore strongly recommended that the same person should not hold positions in the supervisory body and a supervised body.

880. It is recommended that clarity is provided on the role of the Board of the FIA in terms of identifying the supervision and sanctioning strategy on the basis of the Statute given the change towards “operational independence” in the new law.

Recommendation 30

881. It is recommended that the structure and staffing of the FIA reflect its supervisory role.

882. It is recommended that staff receive appropriate training on the supervisory aspects of their function.

Recommendation 32

883. So far the FIA has issued several examples of guidance, but has not drawn up statistics concerning the application and effectiveness of the measures taken; for example, the annual statistics on on-site inspections by the supervisor or sanctions applied. It is recommended to do so.

3.10.3 Compliance with Recommendations 23, 29, 17 & 25

	Rating	Summary of factors underlying rating
R.17	**NC**	• The conditions of sufficient effective, proportionate and dissuasive criminal, civil or administrative sanctions are not fully met. In particular sanctions are not applicable for ASPA as it is regarded as a public authority. • No specific sanctions are available for directors and senior management. • No power to withdraw, restrict or suspend a financial institution's licence. • No inspections have been executed by the FIA and no disciplinary or administrative sanctions have been effectively applied. • Overall the requirements have been introduced or clarified too recently to be considered fully effective.
R.23	**NC**	• Lack of clarity on the role, responsibility, authority and independence of the FIA as supervisor. • Directors and senior management of IOR and APSA are not

		specifically evaluated on the basis of "fit and proper" criteria by the FIA. • IOR and APSA as such are "licensed" via the Chirograph and the Pastor Bonus respectively but are not by the FIA. • No inspections have been undertaken of the AML/CFT program of financial institutions; no standard manual is available; no cycle of visits has been determined or planned for; and no feedback provided to IOR.
R.25	**PC**	• Regulations and Instructions not yet updated to reflect amendments to the AML/CFT Law. • Effectiveness issues arise as the requirements have been introduced or clarified too recently to allow their application to be fully assessed. • Lack of further explanation on the issued guidelines or feedback on the internal procedures that were sent to the FIA.
R.29	**NC**	• Definition of inspection appears to be limited to certain activities. • Both under the old and the new law it is unclear to what extent inspections include the review of policies, procedures, books and records, and should extend to sample testing. • No specific power for the FIA to have direct access, to the financial, administrative, investigative and judicial information, required to perform its tasks in countering money laundering and financing of terrorism. • Unclear if the legal empowerment of the supervisory authorities includes the right of entry into the premises of institutions under supervision, the right to demand books of accounts and other information, the right to make and take copies of documents with a penalty on the institution if its officers fail to comply. • Power to impose sanctions is arranged for in general terms under Art. 42, without making the link explicit. No explicit empowerment to sanction directors or senior management. • Conflict of interest on supervisory issues due to one of the members of the Cardinals' Committee being President of the FIA. • No inspections have been undertaken by the FIA. • Overall the requirements have been introduced or clarified too recently to be considered fully effective. • Overall, as no inspections have been executed and the Regulation is not available it is still unclear what "operational independence" means and whether the powers of the FIA as supervisor are adequate (Effectiveness issue).

3.11 Money or value transfer services (SR.VI)

3.11.1 Description and analysis

884. There is no explicit prohibition of “money or value transfer service” within the HS/VCS legal system. However, according to the HS/VCS authorities, and upon request confirmed by IOR and APSA, there are no natural and legal persons providing money or value transfer services, or a money or currency changing service in HS/VCS. It is noted that pursuant to Art. 7 of Act No. V on the Economic, Commercial and Professional Order of 1929, no one is entitled to open shops, businesses or workshops, even for the exercise of simple trades, nor set up industrial or commercial enterprises of any kind, nor open offices, studios, agencies or fixed places of delivery for the exercise of any profession, without obtaining authorisation from the Governor (See also section 5.1 of this report). The article in practice leads to a prohibition of money or value transfer services. Thus the VCS has created what is virtually a public monopoly regime and, as such, there are no independent legal persons registered in the VCS. This Recommendation is therefore not applicable.

885. IOR and APSA offer to their clients a service of draft cheque issuing provided by correspondent banks. They do not issue draft cheques in their own name. These draft cheques must be paid on a bank account only.

Effectiveness and efficiency

3.11.2 Recommendations and comments

886. This Recommendation is not applicable to the HS/VCS.

3.11.3 Compliance with Special Recommendation VI

	Rating	Summary of factors underlying rating
SR.VI	**NA**	

4 PREVENTIVE MEASURES – DESIGNATED NON FINANCIAL BUSINESSES AND PROFESSIONS

4.1 Customer due diligence and record-keeping (R.12)

(Applying R.5 to R.10)

4.1.1 Description and analysis

887. As already set out in section 1.3 above (Overview of the Designated Non-Financial Businesses and Professions), it should be noted that pursuant to Art. 7. of Act No. V on the economic, commercial and professional order of 1929, no one is entitled to open shops, businesses or workshops, even for the exercise of simple trades, nor set up industrial or commercial enterprises of any kind, nor to open offices, studios, agencies or fixed places of delivery for the exercise of any profession, without obtaining authorisation from the Governor (See also sections 5.1 and 5.1 of this report). No such authorisation has ever been issued. Accordingly, only DNFBP services provided by HS/VCS entities as well as cross-border services provided by foreign domiciled persons are not subject to this authorisation requirement.

888. The revised AML/CFT Law covers all categories of DNFBP mentioned by the FATF standard except for casinos (including internet casinos) the establishment of which is expressly prohibited by the Law. Despite this broad scope of application HS/VCS authorities state that none of those DNFBP categories exist in the HS/VCS. DNFBP were in particular included into the AML/CFT Law against the backdrop that the legislator aimed at replicating the respective European and FATF standard. But it was also intended as a safeguard in order to cover any future activities, or activities of which the authorities are possibly not yet aware.

889. In line with the statement of the HS/VCS authorities, the evaluation team found, with one exception, no indications that relevant services are provided in practice.

890. No real estate transactions take place in the territory of the VCS and no real estate agents are licensed or registered within HS/VCS. As far as the HS is involved in real estate operations located on foreign territory and to the extent that real estate agents are involved in such transactions, foreign law would be applicable according to the territoriality principle.

891. Furthermore, there are neither dealers in precious metals and precious stones nor trust and company service providers.

892. There are a few foreign domiciled lawyers operating within the HS/VCS and also within its tribunals.

893. There is also a public notary. The functions of the Vatican City State Notary are set out in Art. 4 §l of the Law on the Sources of Law, 1 October, 2008, n. LXXI. The functions may be carried out only by a lawyer of the Holy See designated by the President of the Governorate of Vatican City State. Under the same provision, lawyers of the Roman Rota and civil lawyers who are employed or have a professional relationship or a contract with the Governorate of Vatican City State may also be designated. To date, no more than five notaries have been designated to practice. Their prevalent activity is drafting last wills and testaments, as well as delegations of authority. The HS/VCS representatives stress that the notarial activity is nevertheless minimal, considering that less than five hundred persons reside in the VCS.

894. There are also several foreign domiciled external auditors and accountants operating for different entities within the HS/VCS. While the HS/VCS authorities acknowledge that such professionals are active within the HS/VCS, they stress that they do not prepare or carry out transactions for their clients concerning the activities mentioned under criterion 12.1 (d):

- buying and selling of real estate;
- managing of client money, securities or other assets;
- management of bank, savings or securities accounts;
- organisation of contributions for the creation, operation or management of companies;
- creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

895. While this appears to be true for lawyers and the public notary, the evaluation team takes the view that there are accountants preparing and carrying out transactions for a client in relation to the managing of client moneys, securities or other assets, as well as in relation to the management of bank, savings or securities accounts. This refers in particular to the examination of the financial statements of the IOR. Therefore the evaluation team concludes that relevant services under R. 12.1 (d) are provided in practice.

896. Furthermore, the evaluation team takes the view that, regardless of the question of whether relevant services are being provided in practice, the obligations of all DNFBP categories mentioned in the AML/CFT Law have to be assessed in the context of this evaluation, simply due to the fact that a legal AML/CFT framework for those categories has been created and it cannot be ruled out, while unlikely, that relevant services may be carried out in the future.

897. For further details see section 1.3 Overview of the Financial Sector and Designated Non-Financial Businesses and Professions (DNFBP).

Casinos (including internet casinos)

898. According to Art. 1 *bis* §1 c) of the revised AML/CFT Law it is prohibited to open casinos. HS/VCS authorities stress that the term casino comprises land based and internet casinos. There are no indications that casinos or internet casinos are being operated within the HS/VCS.

899. Prior to the amendments and additions to the AML/CFT Law promulgated by Decree No. CLIX there was no such express prohibition.

900. The authority responsible for providing internet access is the Vatican Internet Service (*"Servizio Internet Vaticano"*). The provision of internet services in VCS is centralised; all servers belong and are under effective control of governmental authorities. Internet traffic is continuously monitored for content both to avoid access to material contrary to Christian moral principles, and to defend the Vatican servers from the frequent hacker attacks.

901. Based on this continuous monitoring mechanism internet casino operations could be identified immediately and the prohibition of such operations would be enforced.

Real estate agents

902. Real estate agents are bound to observe the measures regarding CDD, registration, and record-keeping, as well as the reporting of suspicious transactions when they engage in a transaction for buying or selling real state (Art. 2 §1 c) i. of the revised AML/CFT Law).

Dealers in precious metals and dealers in precious stones

903. Dealers in precious metals or stones are subject to the above-mentioned requirements of the AML/CFT Law, when they engage in a transaction equal or above €15,000 (Art. 2 §1 letter c) ii. of the revised AML/CFT Law).

Lawyers, notaries and other independent legal professionals and accountants

904. Lawyers, notaries, accountants, and external accounting or tax consultants are subject to the requirements of the AML/CFT Law:

- when they engage or participate in any financial or real estate transaction; or

- when they assist someone to plan or execute transactions relating to;
- buying or selling real estate or business entities;
- managing currency, financial instruments or other funds or other assets;
- opening or managing banking, savings or securities accounts; and
- organising the contributions necessary for the creation, operation or management of corporations or legal persons.

905. According to the essential criterion they should also be subject to AML/CFT requirements with respect to the creation, operation or management of legal persons or arrangements and buying and selling business entities. However, those activities are not covered by the AML/CFT Law (Art. 2 §1 b) i. of the revised AML/CFT Law).

Trust and company service providers

906. Trust and company service providers are, pursuant to Art. 2 §1 b) i. of the revised AML/CFT Law, subject to the requirements of the AML/CFT Law, when they:

- create a corporation or legal person;
- act as director, manager or partner in a partnership, or in a similar position in another kind of legal person; or
- arrange for other persons to occupy such a position;
- provide a registered office, a business, administrative or postal address and connected services to a corporation or legal person;
- act as a trustee in an express trust or in a similar entity, or arrange for other persons to act in such a role;
- act as a nominee shareholder on behalf of third persons or arrange that other persons do so, unless it is a corporation quoted in a regulated market and subject to a disclosure requirement.

Applying Recommendation 5

907. All obligations of the AML/CFT Law as described in this report under Recommendation 5 with respect to financial institutions are applicable to the above-mentioned DNFBP (except for casinos).

908. Real estate agents and dealers in precious metals or stones are required to fulfil CDD requirements in the same situations as described under essential criteria.5.2[85].

909. Art. 28 §2 of the revised AML/CFT Law requires notaries, lawyers, accountants and external accounting and tax consultants as well as trust and company service providers (hereinafter referred to as "professionals") to undertake CDD measures:

a) when the professional services have, as their object, means of payment, funds or other assets equal to or in excess of €15,000;
b) when they provide occasional professional services involving the transfer or movement of means of payment equal to or in excess of €15,000, regardless of whether it is conducted in a single transaction or in various transactions connected one to the other;
c) every time that the transaction is of an indeterminate or of an indeterminable value. For the purposes of customer due diligence requirements, the constitution, management or

[85] Only the term "transaction" is defined separately for real estate agents and dealers in precious metals or stones as a "determined or determinable activity with a financial or patrimonial scope, to be conducted through a professional service, that modifies the pre-existing legal situation" (Art. 1 No. 27 letter b) AML/CFT Law).

administration of a corporation or other legal persons shall always be deemed to involve a transaction of an indeterminate value;

d) when there exists a suspicion of money laundering or financing of terrorism, regardless of any derogations, exemptions, or applicable thresholds;

e) when there are doubts about the veracity or adequacy of the data previously obtained for identification of the counterpart;

910. The establishment of business relations appears not to be covered as a situation where CDD measures have to be performed and therefore the provision of the AML/CFT Law does not fully meet the essential criteria (essential criteria. 5.2.).

911. Professionals are required to undertake customer due diligence measures when conducting their activities individually, jointly, or in association with others (revised AML/CFT Law Art. 28 §2 last sentence). They are required to observe the customer due diligence requirements at the initial stage of their valuation of the counterparts' position (Art. 29 §2 of the revised AML/CFT Law).

Applying Recommendation 6, 8, 9, 10, 11

912. All obligations of the AML/CFT Law as described in this report under Recommendation 6, 8, 10 and 11 with respect to financial institutions are applicable to the above-mentioned DNFBP (except for casinos, whose establishment is expressly prohibited). The same deficiencies as identified for financial institutions apply also to them.

913. Recommendation 9 is not applicable given that the AML/CFT Law does not provide for reliance on intermediaries or other third parties to perform elements of the CDD process or to introduce business. The CDD requirements described under Recommendation 5 have to be performed by the DNFBP themselves.

Effectiveness and efficiency

914. As outlined above the only DNFBP which currently exist in HS/VCS appear to be foreign domiciled lawyers operating within the HS/VCS, and also within its tribunals, and one public notary. In addition, there are a few foreign domiciled external accountants operating for different entities within the HS/VCS.

915. External accountants appear to be the only DNFBP providing relevant services that fall under the scope of the AML/CFT Law. The evaluation team takes the view that they are obliged subjects under the AML/CFT Law to the extent that they assist someone (notably IOR and APSA) to plan or execute transactions relating to managing currency, financial instruments or other funds or other assets or alternatively relating to opening or managing banking, savings or securities accounts.

916. The auditors and accountants met did not take the view that their activities are subject to the AML/CFT Law. In their view, provided that they were to be considered subject to any AML/CFT requirements, they felt that they were subject to the respective laws in force in their country of origin.

917. At the time of the MONEYVAL on-site visits the accountants met had not implemented the requirements set out in the AML/CFT Law.

4.1.2 Recommendations and comments

918. The authorities should clarify in law or regulation that notaries, lawyers, accountants, external accounting and tax consultants, as well as trust and company service providers are also required to undertake CDD measures when establishing business relations.

919. The authorities should set out in law, regulation or "other enforceable means" that trust and company service providers are subject to CDD and record-keeping requirements with respect to

the creation, operation or management of legal persons or arrangements and buying and selling business entities.

920. The recommended actions in Section 3 above with respect to R 5, 6, 8, 10 and 11 should also be implemented for DNFBP.

921. The authorities should raise awareness amongst auditors and accountants with respect to their CDD and record-keeping obligations under the AML/CFT Law, provide training and put in place appropriate arrangements to monitor and ensure CDD and record-keeping compliance.

4.1.3 Compliance with Recommendation 12

	Rating	Summary of factors underlying rating
R.12	**PC**	• Requirement for notaries, lawyers, external accountants and tax advisers as well as trust and company service providers to undertake CDD measures when establishing business relations is not broad enough. • Trust and company service providers are not subject to CDD and record-keeping requirements with respect to the creation, operation or management of legal persons or arrangements and buying and selling business entities. • Shortcomings identified in the context of Recommendations 5, 6, 8, 10 et 11 are also applicable to DNFBP. Effectiveness • Lack of effective implementation of CDD and record-keeping requirements in respect of accountants providing services falling under the scope of the AML/CFT Law.

4.2 Suspicious transaction reporting (R. 16)

(Applying R.13 to 15 and 21)

4.2.1 Description and analysis

922. The reporting duty, as established under Art. 34.2 of the revised AML/CFT Law, also applies to all relevant categories of DNFBP. All comments made under section 3.7.1 equally apply to them.

923. Within the framework of the legal systems of the HS/VCS, there are no restrictions or exceptions to the CDD or the duty to report STR.

924. Several external auditors, lawyers and accountants operate for different entities within HS/VCS. Those also fall under Art. 2 (old and new) of the Act, and have an obligation to report to the FIA. This is also recognised by those professionals in their engagement letters, which include obligations to report to the FIA. So far DNFBP have not filed a report with the FIA.

925. The VCS authorities hold the opinion that there are no DNFBP operating within their jurisdiction that fall under the AML Law. There has been no outreach to externally based DNFBP providing services within the HS/VCS. Therefore reporting, is likely to be very low.

Internal control requirements for DNFBP

926. Art. 2.1 of the revised AML/CFT Law provides that named obligors are bound to observe the measures regarding customer due diligence, registration, and record-keeping, as well as the reporting of suspicious transactions.

927. Under Art. 2, §2 b and c the new law identifies the following professionals:

i. lawyers, notaries, accountants, and external accounting or tax consultants when they engage or participate in any financial or real estate transaction, or when they assist someone to plan or execute transactions relating to: buying or selling real estate or business entities; managing currency; financial instruments or other funds or financial assets; opening or managing banking, savings or securities accounts; and organising the contributions necessary for the creation, operation or management of corporations or legal persons.

ii. Trust and company service providers when delivering certain services.

iii. Real estate agents when they engage in a transaction for buying or selling real estate.

iv. Dealers in precious metals or stones, when they engage in a transaction equal or above €15,000.

928. The new law stipulates in Art. 2 *ter* that

a. The subjects referred to in para 2 shall adopt adequate policies, organisational instruments, measures and procedures to prevent and counter money laundering and the financing of terrorism, on the basis of the development of new technologies and of the phenomena of money laundering and terrorist financing.

b. It further states that the subjects shall select those who exercise managerial functions, direction or control, among persons of suitable competence and professionalism.

c. Those subjects shall adopt policies, programmes and measures to ensure that their employees, consultants and aides on any grounds, possess an adequate professional level to permit the proper and effective observance of the requirements set forth in this law.

929. It further clarifies that these measures shall include training programmes and continuous formation on the prevention of money laundering and the financing of terrorism.

930. With regard to safe harbour and tipping off provisions, the provisions of Art. 34 §4, as set out in section 3.7 above are also applied to DNFBP.

931. The weaknesses as described under Recommendation 15 regarding financial institutions also apply to DNFBP.

932. With regard to the requirements of Recommendation 21, there are no effective measures in place. For further details see section 3.6 above.

Additional elements

933. The reporting requirement was extended under the original AML/CFT Law to the rest of the professional activities of accountants, including auditing. The new law does not reflect this additional element anymore.

934. Under Art. 34 §1, DNFBP are required to report to the FIU when they suspect or have reasonable grounds to suspect that funds are the proceeds of all criminal acts that would constitute a predicate offence for money laundering domestically.

4.2.2 Recommendations and comments

935. It is recommended that the issues as mentioned under Recommendation R 13, R 14, R 15 and R 21 are also addressed regarding DNFBP.

4.2.3 Compliance with Recommendation 16

	Rating	Summary of factors underlying rating
R.16	**PC**	• Weaknesses regarding reporting as described under R 13 are also relevant for this Recommendation. • As the VCS authorities held the opinion that there are no DNFBP operating within their jurisdiction that fall under the AML Law, therefore there was no outreach to them and reporting is likely to be low. • The weaknesses as described under Recommendation 15 regarding financial institutions also apply for DNFBP. • The weaknesses as described under Recommendation 21, regarding giving special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF Recommendations, also apply for DNFBP.

4.3 Regulation, supervision and monitoring (R. 24-25)

4.3.1 Description and analysis

Recommendation 24

936. As described above, Art. 2 letters p and q of the original AML/CFT Law and Art. 2 of the revised AML/CFT Law place several DNFBP under the scope of the Act. The relevant FATF Recommendations are therefore applicable and need to be assessed.

937. In addition in HS/VCS several lawyers operate within its tribunals and HS/VCS has one public notary. Future activities of those DNFBP might fall under the scope of the FATF Recommendations unless those activities are clearly prohibited. The content of those activities have to be supervised.

938. As noted above, several external auditors, lawyers and accountants operate for different entities within HS/VCS. Those also fall under Art. 2 (old and new) of the Act, and have an obligation to report to the FIA and they should be supervised by the FIA. This is also recognised by those professionals in their engagement letters, including their obligation to report to the FIA.

939. There are no casinos operating within the jurisdiction of HS/VCS nor are they recognised. The essential criteria also requires taking measures against internet casinos. It requires that countries should establish rules to determine the basis or set of factors upon which it will decide whether there is a sufficient nexus or connection between the internet casino and the country. Examples of such factors include incorporation or organisation under the laws of the country, or place of effective management within the country.

940. In the new law Art. 1 *bis*, letter c, explicitly prohibits the opening of gambling houses. For internet casinos it is then important to have an (enforcement) strategy to prevent effective management of an internet casino within the country. Within the VCS there is an effective internet filtering system that prevents access to internet casinos from within the VCS. Likewise the same filtering system prevents servers located within the VCS from being utilised for the purposes of internet gambling.

941. As the activities carried out by DNFBP are subject to the same requirements as financial institutions, the same shortcomings as mentioned above are applicable to DNFBP.

942. The FIA is responsible for the supervision of financial institutions and DNFBP. So far the FIA has not commenced supervision of DNFBP.

943. The weaknesses regarding the power of the FIA to apply sanctions as described under R 17 also have an effect under this Recommendation.

944. The weaknesses as described regarding the powers of the FIA to perform inspections and what rights these entail, as described under R 29 and R 23, also have an effect under this Recommendation.

945. There are no specific resources allocated to the supervision of DNFBP. While there are not many auditors and lawyers delivering services to entities and financial services within the HS/VCS, supervision of them will not require much resource but it is important at least to make some supervisory staff responsible for DNFBP issues.

Recommendation 25 (Guidance for DNFBP other than guidance on STRs)

946. On the basis of both the old and the new AML Law the FIA has the power to issue guidelines. So far the FIA has issued several guidelines but did not issue specific guidelines for DNFBP.

947. As the instructions are "addressed to the subjects who are required to observe the duties concerning the prevention of money laundering and financing of terrorism pursuant to Art. 2 of the old and new AML Law" they can be regarded as covering the DNFBP. It nevertheless has to be noted that HS/VCS during the MONEYVAL on-site took the position that DNFBP are not operating in HS/VCS. As such the issued guidance had not the intention to cover them.

4.3.2 Recommendations and comments

948. As several external auditors and lawyers work for entities within HS/VCS it is recommended that the FIA issues a specific guideline for those DNFBP, in particular how they have to report to the FIA.

949. It is recommended that FIA commence supervising the activities of DNFBP.

4.3.3 Compliance with Recommendations 24 and 25 (criterion 25.1, DNFBP)

	Rating	Summary of factors underlying rating
R.24	**NC**	• The weaknesses regarding the power of the FIA to apply sanctions as described under R 17 also has its effect under this Recommendation. • The weaknesses as described regarding the powers of the FIA to perform inspections and what rights they exactly entail as described under R 29 and R 23 also have an effect under this Recommendation. • Supervision or monitoring of DNFBP has not taken place.
R.25	**PC**	• No specific guidance has been provided for DNFBP operating for entities within HS/VCS.

4.4 Other non-financial businesses and professions/ Modern secure transaction techniques (R.20)

4.4.1 Description and analysis

950. HS/VCS has considered applying Recommendations 5, 6, 8-11, 13-15, 17 and 21 to non-financial businesses and professions (other than DNFBP) that are at risk of being misused for money laundering or terrorist financing.

951. In particular, Recommendation 8 requires that countries should take measures to encourage the development and use of modern and secure techniques for conducting financial transactions that are less vulnerable to money laundering.

952. According to the Art. 2, paragraph. 1, of the revised AML/CFT Law, natural and legal persons obliged under the Act must respect the duties of CDD, recording of relationships and transactions, keeping of related information and reporting of suspicious transactions; to this end they have to provide for adequate organisational arrangements and procedures, as well as to assure an adequate training of the personnel. On this basis, it should also be noted that in view of "technological updating" the FIA has the power to adopt policies and other measures in accordance with Art. 33, §5, letters e), f) and g) of the original AML/CFT Law.

953. The new law stipulates in Art. 2 *ter* that:

- The subjects referred to in paragraph 2 shall adopt adequate policies, organisational instruments, measures and procedures to prevent and counter money laundering and the financing of terrorism, on the basis of the development of new technologies and of the phenomena of money laundering and terrorist financing.
- It further states that the subjects shall select those who exercise managerial functions, direction or control, among persons of suitable competence and professionalism.
- And that those subjects shall adopt policies, programs and measures to ensure that their employees, consultants and aides on any grounds, possess an adequate professional level to permit the proper and effective observance of the requirements set forth in this law.

954. It further clarifies that these measures shall include training programs and continuous formation on the prevention of money laundering and the financing of terrorism

955. This new article obliges subjects to adopt adequate policies on the basis of the development of new technologies and phenomena of money laundering.

4.4.2 Recommendations and comments

956. This Recommendation is fully met.

4.4.3 Compliance with Recommendation 20

	Rating	Summary of factors underlying rating
R.20	**C**	

5 LEGAL PERSONS AND ARRANGEMENTS AND NON-PROFIT ORGANISATIONS

5.1 Legal persons – Access to beneficial ownership and control information (R.33)

5.1.1 Description and analysis

957. The position within the VCS concerning matters relevant to FATF R.33 is best regarded as *sui generis*. This flows from the fact that Law No. V on the economic, commercial and professional order of 7 June 1929 (Annex XXX) created what is in effect a public monopoly regime within the territorial jurisdiction of the VCS. In their response to the MEQ (at p.134) the authorities emphasised that, as a consequence of the above-mentioned Act, "there are no legal persons exerting profit oriented activities (in particular, there are no companies that issue bearer shares)".

958. This unique feature was emphasised by the relevant authorities with some frequency in the course of the MONEYVAL on-site visits and in particular by representative of the Governorate. Indeed, the impressions formed by the evaluation team while in the VCS were entirely consistent with this characterisation of the situation.

959. In the view of the evaluators the structural, legal and institutional realities within the VCS at present renders, exceptionally, R.33 non applicable.

960. It must be acknowledged, however, that the current situation might evolve in the future. This point was accepted by the HS/VCS in responses to the MEQ (see, e.g., p.22 and p.134). Were this to happen within the present context reliance can be placed on the Italian Civil Code of 1942 "together with the acts that modified it" up to 1 January 2009. This incorporation flows from the operation of Art. 4 of Act No. LXXI on the sources of law of 1 October 2008 (see Annex XII). As can be seen from the analysis of R.33 contained in the 2006 FATF mutual evaluation of Italy (at pp.89-91) the system so provided is both detailed and broadly consistent with international standards and expectations. In the MER of Italy it is noted that the Italian Civil Code allows for bearer shares for joint stock companies as well as for limited partnership companies but the position has been largely reversed by subsequent Italian legislation. The authorities of the VCS have confirmed that these limiting measures have been received into the legal system of the VCS.

Additional elements

961. Exceptionally this Recommendation is not applicable to the VCS.

5.1.2 Recommendations and comments

962. In the event that the VCS decides to depart from the current public monopoly regime it would be necessary for detailed consideration to be given to the adequacy of the relevant provisions of the Italian Civil Code when viewed in the light of existing international standards and to supplement the same as required. Practical steps to facilitate the effective operation of the system should also be implemented at that time. In so doing the VCS can readily build upon the obligations concerning registration of legal persons, now reflected in the Art. 2 *quater* of the Law of January 2012. This is discussed in the context of R.34 below.

5.1.3 Compliance with Recommendation 33

	Rating	Summary of factors underlying rating
R.33	**N/A**	

5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34)

5.2.1 Description and analysis

963. Recommendation 34 requires countries to take measures to prevent the unlawful use of legal arrangements for the purposes of money laundering and terrorist financing particularly by ensuring that there is adequate, accurate and timely information on express trusts, including information on the settlor, trustee and beneficiaries that can be obtained or accessed in a timely fashion by competent authorities.

964. The law of the VCS does not provide for the creation of trusts. Furthermore, and in contrast to the position in Italy, the VCS is not a party to the Hague Convention of 1 July 1985 on the law applicable to trusts and their recognition. In the view of the evaluators these factors, in conjunction with the structural and institutional realities within the VCS at present, render, exceptionally, R.34 non applicable.

965. It must be acknowledged that the legal position in this sphere might evolve in the future. Were that to happen within this context the authorities of the VCS can readily build upon its existing system as it relates to legal persons. Of particular relevance is the obligation of registration of legal persons now provided for in Art. 2 *quarter* of the AML Law of January 2012. It reads in full as follows:

1. Legal persons having their registered office in the State, regardless of their nature and activity, shall register, pursuant to the domestic law in force, before the Governorate, where information regarding their nature, activities, organisation, organs of administration, direction and control, and its members, shall be kept and updated.

2. The registry referred to in paragraph 1 shall be accessible to the competent authorities for the prevention and countering of money laundering and financing of terrorism.

966. Following the visit paid by the evaluation team to the VCS in March 2012 the Governorate summarised the system of registration and its current requirements as follows:

> The Registers of Vatican Legal Persons are two: one civilian and one canonical, depending on its institutional or religious purpose (or mission).
> The Registers are composed of analytic entries that contain specific data on the legal persons and in particular:
>
> 1. name or denomination,
> 2. date of founding,
> 3. its purpose or mission,
> 4. its juridical nature or composition,
> 5. its address,
> 6. its legal representative,
> 7. description of its activities, and
> 8. the date of registration.
>
> These entries have a registration number that corresponds to a specific position in the Register and are signed by the Secretary General of the Governorate of Vatican City State. Any subsequent variation of the original data in the Register must be submitted on a new

entry by the Legal Person and once again approved with the signature of the Secretary General of the Governorate.

The registers of Vatican Legal Persons are public and may be consulted by anyone who has a valid interest through application to the competent authorities in the Governorate.

The documents required for registration are:

- The constitutional act of the Legal Person (notarial act or pontifical chirograph).
- Statutes and by laws containing:
  - b) the name,
  - c) purpose,
  - d) activity,
  - e) estate,
  - f) social organs,
  - g) name of legal representative at the moment of its founding,
  - h) disposition of its budgets/balance sheets,
  - i) the devolution of its estate if and when the Legal Person is cancelled.
- Documentation in relation to the authorisation granted for registration (letters of request from the individual and Vatican Secretariat of State).

967. It should be stressed that the obligations concerning registration would apply automatically should the legal system of the VCS ever be extended to the creation of trusts. This flows from the decision to specifically include reference to trusts, prophylactically, in the definition of "legal persons" contained in Art. 1(3) of the Law of January 2012. The same Act, and on the same basis, also lists "trust and company service providers" as obligated entities (Art. 2(b)(ii)). This explicitly extends to one who acts "as a trustee in an express trust or in a similar entity".

Additional elements

968. Exceptionally this Recommendation is not applicable to the VCS.

5.2.2 Recommendations and comments

969. Exceptionally this Recommendation is not applicable to the VCS.

5.2.3 Compliance with Recommendation 34

	Rating	Summary of factors underlying rating
R.34	**N/A**	

5.3 Non-profit organisations (SR.VIII)

5.3.1 Description and analysis

970. In HS/VCS the only normative act specifically concerned with the operation of non-profit organisations (NPOs) is Law No. CLXXXVII Concerning Volunteer Activities of 22 May 1992 (see Annex XXXI). This law provides detailed rules on the protection of the non-profit and

voluntary sector and the prevention and countering of the unlawful use of non-profit organisations and voluntary activities. Art. 1 of this law defines volunteer activities as activities that "consist of offering free and gratuitous services to the Apostolic See". Such activities should have the goal of:

a) co-operating in the evangelising mission of the Church;
b) contributing to the Christian animation of temporal realities;
c) supporting assistance activities promoted in favour of the poor, sick, immigrants, elderly and all those who are in need;
d) cooperating, in Christian spirit, in other undertakings of solidarity and human promotion.

971. Art. 4 2. of the Law Concerning Volunteer Activities requires that all such organisations must be registered in the Register of Voluntary Organisations which is maintained within the Governorate.

972. In the MEQ the authorities contend that there are only two active organisations which fall within this definition and which are registered in the Register of Voluntary Organisations,

a. Circolo di San Pietro; and
b. Associazione di San Pietro e Paolo.

973. Pontifical Council Cor Unum, which provides and oversees the provision of international humanitarian aid, is constituted under Arts. 145-148 of Pastor Bonus and, as such, forms part of the Roman Curia and is regarded as a dicastery of the Roman Curia. Cor Unum is accountable to the Prefecture for the Economic Affairs of the Holy See. As such Cor Unum would not be considered to fall within the FATF definition of an NPO.

974. Furthermore, activities relating to the operation and maintenance of the HS/VCS museum complex fall under the Department of Pontifical Monuments, Museums and Galleries which is, itself empowered through paragraph 15 of Act No. CCCLXXXIV on the Government of the Vatican City State (see Annex XI).

975. There are a number of other organisations that have been established under the laws of the VCS. These are registered with the Register of Voluntary Organisations. The Office of Public Registry, Records and Notary handles the official registration of Vatican Legal Persons (civilian and canonical) and the volunteer organisations; the procedure for registration varies depending whether the entities have juridical character or are volunteer organisations. Therefore, overall in the Governorate there exist three Registries:

- the first regards canonical legal persons;
- the second regards Vatican civil legal persons;
- the third regards volunteer organisations.

976. The first two Registries were established in 1993 by the then-President of the Governorate, after the enactment of the Law no. CCVI of June 28, 1993 (Law regarding Civil Legal Personalities). The number of entities listed in the Registries is 46, of which 15 have only canonical legal personality, 5 have only civil legal personality, and 26 have both canonical and civil legal personality. The third Registry was created by Law No. CLXXXVII concerning volunteer activities of May 1992, that regulates the activity of volunteer organisations and in it are listed 2 volunteer organisations as set out above. HS/VCS legal persons pursue a variety of activities linked to the overarching religious and charitable ends of the Apostolic See. Nine organisations promote educational activities; six provide humanitarian assistance; nine promote cultural or artistic activities; nine assist missionary work and the support of public worship; two promote peace; and fourteen organisations directly provide basic services (health, pensions, housing) to the HS/VCS staff. A full list of registered entities can be found in Annex XXXVI.

977. The definition of volunteer activities under the Law Concerning Volunteer Activities is extremely limited compared with the definition of non-profit organisation under the FATF

Methodology which states "The term non-profit organisation or NPO refers to a legal entity or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works". As such there are a significant number of NPOs that are formed and registered within the jurisdiction of HS/VCS that fall within the FATF definition of NPOs yet fall outside the scope of the Law Concerning Volunteer Activities (e.g. Caritas Internationalis, The Equestrian Order of the Holy Sepulchre of Jerusalem, etc.). All such organisations are accountable to the Supreme Pontiff but do not appear to be subject to any other form of supervision or regulation. At the time of the MONEYVAL on-site visits, the HS/VCS authorities were unable to provide the evaluators with a list or register of such organisations and it was therefore not possible to establish the scope or scale of their activities.

978. There is no legislation relating to countering the financing of terrorism which places any requirements on the NPO to institute CFT preventive measures or submit reports on suspicious transactions to the FIA. NPOs are not subject to the provisions of the AML/CFT Law, except in circumstances where they specifically perform those activities which are defined by Art. 2 of the revised AML/CFT Law.

979. Overall the NPO sector in the VCS controls significant flows of funds and many of the relevant organisations have international connections. As such, this sector requires a greater degree of oversight.

Reviews of the domestic non-profit sector

980. The HS/VCS authorities consider that, given that there are only two registered organisations, the regulation of the sector seems to be adequate and guarantees a high standard of protection against the unlawful use of the non-profit and voluntary sector, and in particular the pursuit of the goals of preventing and countering the infiltration of criminal or terrorist organisations, laundering of proceeds of criminal activities and financing of terrorism. This view is not, however, based on a empirical review of their activities to establish the vulnerability of activities to terrorist financing.

981. Furthermore, at the time of the MONEYVAL on-site visits, no formal review of the broader NPO sector had taken place to establish the adequacy of the legal and regulatory framework and the potential vulnerabilities to terrorist activities.

Protecting the NPO sector from terrorist financing through outreach and effective oversight

982. In the course of the first MONEYVAL on-site visit the evaluators met with representatives of two NPOs, Cor Unum and The Equestrian Order of the Holy Sepulchre of Jerusalem. The representatives of Cor Unum, which is a dicastery (Pastor Bonus Arts. 145-148) stated that they had met with the FIA and had received guidance and advice on how to apply the AML/CFT Law (although it does not apply to them) and considered that they were sufficiently aware of the risks of terrorist abuse. The representatives of The Equestrian Order of the Holy Sepulchre of Jerusalem had not, however, been the recipients of any outreach or other training concerning the risks of terrorist abuse.

983. The HS/VCS authorities consider that the provisions of the Law Concerning Volunteer Activities provide detailed rules on the protection of the non-profit and voluntary sector and the prevention and countering of the unlawful use of non-profit organisations and voluntary activities. As previously stated, this law is limited in scope and, in practice, only two organisations are subject to it. Furthermore, the law is limited to requiring registration and the filing of certain defined details (e.g. a list of volunteers and activities foreseen, balance sheets and evidence of financial resources). The law does not introduce any requirements regarding the prevention of the risk of the organisation being used for terrorist financing.

984. No written guidance for the NPO sector was provided to the evaluators at the time of the MONEYVAL on-site visits and details were not provided of any training or awareness raising initiatives undertaken for the sector as a whole.

985. Art. 4 3. of the Law Concerning Volunteer Activities requires organisations to file a copy of their statutes and any other appropriate documentation concerning their internal organisation, a list of volunteers and activities foreseen, balance sheets and evidence of financial resources at the time of application for admission to the register. Art. 4 5. requires them to update this information annually.

986. Although there is no overarching requirement to do so, the two NPOs which were met by the evaluators both produced an annual report which was audited and available to interested parties.

987. A number of the other NPOs which are based in HS/VCS do produce comprehensive annual reports which are audited and which provide details of the organisations' objectives, the identity of controllers including senior officers, board members and trustees as appropriate as well as accounting for funds received and dispersed. However, their disclosures are made in accordance with the requirements of the organisations statutes not as a consequence of any overarching requirement by HS/VHS.

988. There are no appropriate measures in place to sanction violations of oversight measures or rules by NPOs or persons acting on behalf of NPOs either in the Law Concerning Volunteer Activities or elsewhere.

989. Art. 4 5. of the Law Concerning Volunteer Activities requires that organisations subject to the law submit annual updates on the information filed at the Register. There is no specific requirement in the law to maintain books and records. Apart from the requirements of the Law Concerning Volunteer Activities, there are no other requirements in place for NPOs registered in HC/VCS regarding the maintenance and retention of books and records. As a consequence of this, there is no requirement for NPOs to maintain, for a period of at least five years, and make available to appropriate authorities, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organisation.

990. Overall the scope of outreach and oversight of the whole NPO sector appears to be limited to those organisations that fall directly under the responsibility of the Curia or the Governorate, with little or no outreach to other NPOs.

Targeting and attacking terrorist abuse of NPOs through effective information gathering, investigation

991. As set out above, there are three separate registers although, in aggregate, these cover all registered persons. In practice there are no independent profit making entities in the VCS (see section 5.1 above) therefore all entities entered on the registers could be regarded as non-profit organisations. It is noted, however, that only those organisations registered under the Law Concerning Volunteer Activities and Cor Unum are subject to any formal system of regulation. Furthermore, neither the Law Concerning Volunteer Activities nor Pastor Bonus contain any provisions concerning record keeping or access to books and records, etc.

992. The Law Concerning Volunteer Activities does require the filing and updating of certain information regarding volunteers, activities undertaken and financial data which would be available to investigating authorities.

993. The civil and canonical registers are composed of analytic entries that contain specific data on the legal persons and hold the same data as set out under section 5.2 above.

994. These entries have a registration number that corresponds to a specific position in the Register and are signed by the Secretary General of the Governorate of Vatican City State. Any subsequent variation of the original data in the Register must be submitted on a new entry by the Legal Person and once again approved with a signature of the Secretary General of the Governorate.

The Registers of Vatican Legal Persons are public and may be consulted by anyone who has a valid interest through application to the competent authorities in the Governorate. The documents required for registration are set out under section 5.2 above.

995. Although there is no specific register dedicated to NPOs based in HS/VCS, given the small number of entities involved (48) this does not constitute a major problem. However, there is no comprehensive system to ensure effective domestic co-operation, co-ordination and information sharing to the extent possible among all levels of appropriate authorities or organisations that hold relevant information on NPOs of potential terrorist financing concern.

996. However, there are no provisions which apply to the broader range of NPOs operating within HS/VCS. Therefore, it must be concluded that there are no wider provisions which grant investigating authorities full access to information on the administration and management of a particular NPO (including financial and programmatic information) which may be obtained during the course of an investigation.

Responding to international requests for information about an NPO of concern

997. As stated above, there is a lack of any form of centralised registration or supervision of NPOs as a whole and there do not appear to be any powers for investigating authorities to obtain information. Furthermore, there do not appear to be any appropriate points of contact or procedures to respond to international requests for information regarding particular NPOs that are suspected of terrorist financing or other forms of terrorist support.

5.3.2 Recommendations and comments

998. There are a number of organisations that are registered within the VCS that fall within the FATF definition of "non-profit organisations". Most of these organisations do not fall within the scope of the AML Law and do not appear to be subject to AML/CFT supervision or regulation. No formal review of the adequacy of domestic laws and regulations, as the international standard requires, has been undertaken. Although individual foundations may be subject to constitutions that require financial transparency there are no overarching provisions covering this high risk sector requiring this, nor are there any specific record keeping requirements.

999. The HS/VCS authorities should undertake a review the adequacy of domestic laws and regulations that relate to all NPOs located within VCS and conduct an assessment of the sector's potential vulnerabilities to terrorist activities.

1000. The FIA should have its responsibilities extended to risk-based monitoring of the NPO sector with necessary access to relevant books and financial records.

1001. The HS/VCS authorities should develop guidance on the risks of terrorist abuse and the available measures to protect against such abuse for all NPOs which are located within VCS and then undertake outreach to raise awareness within the sector.

1002. Legislation needs to be developed to:

a) Require NPOs to maintain and file records on the purpose and objectives of their stated activities and the identity of person(s) who own, control or direct their activities, including senior officers, board members and trustees;
b) Require NPOs to maintain, for a period of at least five years, and make available to appropriate authorities, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organisation; and
c) sanction violations of oversight measures or rules by NPOs or persons acting on behalf of NPOs.

1003. Legislation needs to be developed to provide the FIA and Gendarmerie with full access to information on the administration and management of a particular NPO (including financial and programmatic information) during the course of an investigation.

1004. Formal procedures for national co-operation and information exchange between the national agencies which investigate ML/FT cases should be developed.

1005. An appropriate point of contact should be identified to respond to international requests for information regarding particular NPOs that are suspected of terrorist financing or other forms of terrorist support. Procedures should be developed to process such requests.

5.3.3 Compliance with Special Recommendation VIII

	Rating	Summary of factors underlying rating
SR.VIII	**NC**	• No comprehensive review of the adequacy of the relevant laws in order to identify the risks and prevent the misuse of NPOs for terrorism financing purposes. • Lack of systematic outreach to the NPO sector. • No comprehensive monitoring activities and inspections for the whole NPO sector. • No explicit legal requirement for the NPOs to maintain business records for a period of at least five years. • No formal mechanism established for national co-operation and information exchange between the national agencies which investigate ML/FT cases relating to NPOs. • No formal mechanism established for responding to international requests regarding NPOs.

6 NATIONAL AND INTERNATIONAL CO-OPERATION

6.1 National co-operation and co-ordination (R. 31 & R.32)

6.1.1 Description and analysis

Recommendation 31

1006. The policy-making bodies of the HS/VCS operate in a coordinated way to enforce rules and measures generally and in the AML/CFT field in particular. As the *Fundamental Law of the Vatican City State* of 2000 states, "in matters of major importance it shall be proceeded *in agreement* with the Secretariat of State" (Art.6). Furthermore, the *Act on the Government of the Vatican City State* No. CCCLXXXIV of 2002 provides that the activity of the organs of the HS/VCS, in matters of common interest, shall be oriented towards the principles of functional integration and co-operation. The Act states "the Directorates shall operate in co-operation and concert, according to the principle of functional integration, in matters of common interest" (Art.29.4). The authorities mentioned the fact that the work on AML/CFT legislation was undertaken as a joint effort.

1007. The original AML/CFT Law stated that the FIA "supervises the observance of the duties established in matters of prevention and countering of money laundering and financing of terrorism and issues provisions for the implementation of the rules contained in this Act, except for those contained in Chapters II and III *(that is – criminal provisions of the Law)*; furthermore, it has the power to issue guidelines and particular directives with reference to the subjects on which the duties foreseen in this Act are imposed". However, it appears that the co-ordination of the activities of the Promoter of Justice, the FIA and the Gendarmerie Corps has so far been limited to the exchange of information. The MOU on the exchange of information regarding the co-operation between these bodies is still in draft form. The FIA is obliged to communicate to the Promoter of Justice of the HS/VCS the information that "on the basis of the known features, size, nature and circumstances whatsoever, integrate possible model cases of money laundering, self-laundering or financing of terrorism" (Art.33.3 amended law Art. 2 *septies*.2.3.c and Art. 36 *bis*.1.d with a slightly revised wording). The FIA, when it proceeds to the suspension of transactions suspected of money laundering or financing of terrorism, is obliged to "immediately report it to the Promoter of Justice" (Art.33.5 (k) the amended law in Art. 2 *septies*.3.h requires the FIA to report the suspensions to the Judicial Authorities). The Promoter of Justice of the HS/VCS, in his turn, in order to guarantee an adequate verification of the cases, is obliged to communicate to the FIA "the reports of suspicious transactions not subjected to further investigation" (Art.36, the amended law Art. 36 *bis*.2).

1008. According to the *Act on the Government of the Vatican City State*, (Art.13.3) "the Gendarmerie Corps operates *jointly* with the judicial organs and the competent authorities of the Holy See". So, in the AML/CFT field the Gendarmerie Corps operates in co-operation with the Promoter of Justice and the FIA.

1009. The revised AML/CFT Law introduced new Art. 2 *quinquies* that states that "the Secretariat of State is responsible for the definition of the policies for the prevention and countering of money laundering and the financing of terrorism. In those sectors, it promotes co-operation among the various authorities of the Holy See and the State competent on the prevention and countering of money laundering and the financing of terrorism". It therefore appears that the amended law has given the Secretariat of State the coordinating function. In addition to that a new "player" was introduced by Art. 2 *sexies* of the revised AML/CFT Law which makes the Pontifical Commission of the Vatican City State responsible for the adoption of general regulations for the implementation of the AML/CFT Law.

1010. To date, no formal mechanism has been established to enable competent authorities to cooperate and coordinate their actions in the AML/CFT sphere. Furthermore, there has been no collective review of the AML/CFT system and its performance which would have set the basis for future developments and implementation of policies and activities to combat money laundering and terrorist financing. The impact of the implementation of the new role of the Secretariat of State as a coordinating body remains to be seen, due to the novelty of the provision.

Additional Elements

1011. Art. 33.5(g) of the original AML/CFT Law stated that the FIA "prepares, after hearing the obliged subjects, programs of training of the personnel to let them be aware with the law into force and the activities that could be connected with money laundering or financing of terrorism". This is not a provision for co-operation *per se* but could mean that some form of consultation mechanism could be established on this basis to further focus on consulting obliged parties before the development of new measures. Unfortunately that provision disappeared in the revised AML/CFT Law and the FIA can now only follow the relevant policies and procedures adopted by the reporting entities themselves.

Effectiveness and efficiency

1012. The small size of HS/VCS and of the institutions involved, as well as the existing close relationship between the competent players involved in this process, needs to be taken into consideration when assessing domestic co-operation.

Recommendation 32

1013. The following chart sets out details of the information exchange between the FIA and the other bodies within the HS/VCS from 1 April 2011 (the date that the FIA became operational and 31 December 2011.

Exchange of information and meetings	
Exchange of information	2 between the FIA and the Gendarmerie 4 between the FIA and the Prefecture for Economic Affairs
Meetings	3 between the FIA and the Gendarmerie 2 between the FIA and the Prefecture for Economic Affairs

1014. The following chart sets out details of the information exchange between the Gendarmerie and the General Inspectorate of Public Security for the Vatican City.

Exchange of Information between the Gendarmerie and the General Inspectorate of Public Security for the Vatican City	
YEAR	**Number of Contacts**
2009	74
2010	73

2011	93

Recommendation 30 (Resources – Policy makers)

1015. The resources of the policy makers are adequate and enable them to fully perform their functions.

6.1.2 Recommendations and Comments

1016. The authorities should consider creating a formal mechanism for co-operation and co-ordination of their actions in the AML/CFT sphere. The MOU mechanism could be used for this purpose. In addition, there should be a collective review of the AML/CFT system and its performance which would have enable the authorities to set the basis for future developments and implementation of policies and activities to combat money laundering and terrorist financing.

6.1.3 Compliance with Recommendation 31

	Rating	Summary of factors underlying rating
R.31	**LC**	• No formal mechanisms for co-operation and co-ordination or MOUs have been established or signed. • The effectiveness of the new amendments in the law on coordinating mechanisms is yet to be seen.

6.2 The Conventions and United Nations Special Resolutions (R. 35 and SR.I)

6.2.1 Description and analysis

1017. Both the Holy See and the Vatican City State enjoy international legal personality. Under Art. 2 of the Lateran Treaty of 1929 "Italy recognises the sovereignty of the Holy See in the international realm as an attribute inherent in its nature in conformity with its tradition and with the requirements of its mission to the world".

1018. The HS maintains bilateral diplomatic relations with a substantial number of members of the international community. It is a member of certain international organisations and enjoys observer status in many others including the UN and the Council of Europe. It enjoys a treaty making capacity in international law and has become a party to a number of multilateral conventions including several negotiated under the auspices of the UN.

1019. In December 1988 the Holy See signed the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention) but had not, at the time of the on-site visit in November 2011, ratified this instrument. As of the date of that MONEYVAL on-site visit no steps had been taken towards becoming a party to the Palermo Convention or the 1999 UN International Convention for the Suppression of the Financing of Terrorism. The authorities confirmed that there was no technical impediment to such participation.

1020. In the course of the visit the evaluation team was briefed on the issues of principle and practicality which had minded the HS not to become formally bound by these significant international instruments. While the evaluators very much appreciated the explanations afforded for this policy stance they stressed that the relevant FATF standards (R.35 and SR.I) required formal participation in these treaty regimes.

1021. It is of importance to note, however, that the HS/VCS had not ignored the important underlying issues addressed by these treaties. Rather its focus, as noted in the earlier analysis of

R.1 and SR.II, had been to concentrate on criminalisation of the offences set out in them and to rely on the flexibility of domestic legal provisions to give effect to relevant international co-operation. It will be recalled in this context that Act No. CXXVII of 30 December 2010 contained several provisions inspired by the relevant UN Conventions including certain drugs, organised crime and terrorist offences and, indeed, that on money laundering. While this strategy had the effect of reducing the range of possible problems of a practical nature which would otherwise flow from non-participation it did not eliminate them especially in so far as legal obligations to provide various forms of co-operation was concerned. Nor did it address formal non-compliance with the FATF standards in question.

1022. In the period immediately following the conclusion of the first evaluation visit in November 2011 the authorities saw fit to reconsider their policy concerning the three UN Conventions in question. As a consequence of this review the necessary steps were taken in January 2012 (i.e. within two months from the end of the MONEYVAL on-site mission) to become parties to the Vienna, Palermo and Terrorist Financing Conventions of the UN and these are now in full force and effect. The evaluators warmly welcome this important development.

1023. It should be stressed that in the legal system of the VCS international treaty obligations are automatically incorporated. This flows from Art. 1(4) of the Act on the sources of law of 1 October 2008 (Annex XII) (see also, Canon 3). While implementing legislation is not formally required officials of the Secretariat of State informed the evaluators that a Committee had been formed to consider, *inter alia*, if there were specific areas in which legislation was nonetheless desirable from a policy or a practical perspective.

1024. SR.I also requires countries to fully implement UN Security Council Resolutions relating to the prevention and suppression of the financing of terrorism (although, as a non-member state of the UN, the HS/VCS does not regard itself as being legally bound by the same). As was noted in the analysis of SR.III above, Chapter IV of Act No. CXXVII of January 2012 is central to the approach (voluntarily) adopted and is broadly in line with international expectations. However, several practical steps, including the creation of a list of designated persons, were still required to make the system operational.

Additional elements

1025. The HS/VCS has not become a party to the 1990 Council of Europe Convention on laundering, search, seizure and confiscation of the proceeds from crime or its successor, the Warsaw Convention of 2005. However, Art. 8(1)(b) of the Monetary Agreement of 17 December 2009 between the EU and the HS/VCS (See Annex XXXII) is of relevance in this context. By virtue of that provision the HS/VCS undertakes to take all appropriate steps to adopt EU measures relating to, *inter alia*, money laundering as listed in the Annex to the Agreement. Among these is Council Framework Decision 2001/500/JHA of 26 June 2001 on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds of crime. It will be recalled that this Council Framework decision was based, in large measure, on the fact that all EU Member States had subscribed – through full formal participation – to the principles of the 1990 Convention. Similarly one of its primary purposes was to promote a high degree of harmonisation of approach to Member State implementation of certain of its key provisions. Compliance by the HS/VCS with the requirements of Art. 8(1)(b) was due to be achieved by 31 December 2010.

6.2.2 Recommendations and comments

1026. The HS/VCS should prioritise the effective implementation of Chapter IV of Act No. CXXVII of January 2012 through the completion of the listing process and other means, as necessary, to ensure full and effective implementation of UN Security Council Resolutions on the financing of terrorism.

1027. Legislative measures should be taken to address the current deficiencies in the criminalisation of terrorist financing as identified in the analysis of SR.II, and the system for implementing UNSCR 1267 and 1373 need to be made operational.

6.2.3 Compliance with Recommendation 35 and Special Recommendation I

	Rating	Summary of factors underlying rating
R.35	**C**	
SR.I	**PC**	• Failure to bring the new system concerning UN Security Council Resolutions into practical operation within the relevant period.

6.3 Mutual legal assistance (R. 36-38, SR.V)

6.3.1 Description and analysis

Recommendation 36

1028. In the HS/VCS issues of international legal co-operation are regulated by the relevant provisions of the Italian Code of Criminal Procedure of 1913 as it stood in 1929 (CCP). This flows, in turn, from Art. 8 of the Act No. LXX1on the Sources of Law of 1 October 2008 (see Annex XII). Art. 635 of the CCP stipulates, in relevant part, that international conventions and practices regarding letters rogatory and related matters are to be observed. However, at the time of the November 2011 MONEYVAL on-site visit no bilateral mutual legal assistance agreements had been concluded. Furthermore, the HS/VCS was not a participant in either the 1959 European Convention on Mutual Assistance in Criminal Matters or of the 1990 Strasbourg or 2005 Warsaw Conventions of the Council of Europe. However, following the change of policy described earlier, the HS/VCS is now a party to the Vienna, Palermo and Terrorist Financing Conventions of the UN. As such their extensive provisions relating to mutual legal assistance now apply as between the HS/VCS and all other state parties.

1029. In the absence of an applicable treaty nexus Arts. 636-639 of the CCP apply (see Annex XV). These set out, in relatively broad and flexible terms, a Letters Rogatory process. Such co-operation is, however, based on international comity or courtesy and does not flow from the discharge of an international legal obligation as such. Furthermore any countries which require a treaty base for international co-operation of the kinds contemplated in R.36 will not be able to avail themselves of this possibility save in respect of common participation in the three UN Conventions mentioned above.

1030. The Letters Rogatory process applies to the following: "the summoning and examination of witnesses or in general, for acts regarding the preliminary judicial investigation or for execution of provisions in the acts concerning this preliminary investigation …." (See Arts. 636 and 637 of the CCP). Requests are made to the Secretary of State through the diplomatic channel. Accepted requests are then forwarded by the Secretariat of State to the competent authorities for a determination concerning enforceability.

1031. A striking feature of the relevant provisions of the CCP is that they do not articulate specific grounds for refusal. Thus, unlike the position concerning extradition (see below), there is no dual criminality requirement – a conclusion confirmed on-site in discussions with the Promoter of Justice and a representative of the judiciary. Similarly, bank secrecy, fiscal, and political offence

considerations are notably absent as specified grounds for refusal. It would thus appear that the HS/VCS legal system is consistent with the expectations of criteria 36.2, 36.3 and 36.4 of the FATF methodology.

1032. Given the wording of the relevant CCP Arts. outlined above and the nature of the preliminary investigation phase to which they are tied, it would appear that the HS/VCS can assist in (a) the production, search and seizure of information, documents, or evidence; (b) the taking of evidence or statements; and (c) providing originals or copies of relevant documents and records as well as other information and evidentiary items. It did not appear to the evaluation team that the legislative scheme in question could apply, as such, to effecting service of judicial documents or facilitating the voluntary appearance of persons in the requesting State. That said the team is not aware of any legal provisions inhibiting such actions; a view subsequently confirmed by the President of the Tribunal.

1033. Given the relative antiquity of the provisions of the CCP it is not surprising that there is no focused coverage of co-operation in the identification, freezing, seizure or confiscation of assets laundered or intended to be laundered, the proceeds of money laundering and assets used for or intended to be used for terrorist financing, as well as instrumentalities of such offences, and assets of corresponding value. In such circumstances the general articles on Letters of Rogatory are reliant on the adequacy of other provisions of the CCP and HS/VCS legislation in these areas. These matters are explored further below in the context of R.38.

1034. The evaluators were satisfied that the powers of the competent authorities required under Recommendation 28 are also available for use in response to requests for mutual legal assistance.

1035. In the context of the enhanced criminal co-operation with Italy established by the Lateran Treaty of 1929, and especially by virtue of Art. 22 thereof, a mechanism exists for determining on an ad hoc basis the most appropriate venue for the prosecution of defendants. Given the geographic and practical importance of that relationship a significant proportion of criminal cases are, in effect, subject to possible consideration in this context. However, no formal consideration appears to have been given to addressing this matter in the context of cases involving other members of the international community. This would, it is understood, be addressed on an ad hoc basis by the appropriate authorities of the HS/VCS.

Additional Elements

1036. In the law of the VCS direct requests from foreign judicial or law enforcement authorities for the use of powers required under R.28 cannot be complied with by domestic VCS counterparts. The Letters Rogatory process must be utilised.

Recommendation 37 (dual criminality relating to mutual legal assistance)

1037. As was noted above, the relevant provisions of the CCP do not subject the Letters Rogatory process to a requirement of dual criminality. Criteria 37.1 and 37.2 are thus fully satisfied in the context of mutual assistance.

Recommendation 38

1038. As noted previously, the HS/VCS has recently become a party to the Vienna and Palermo Conventions. It is not a party to any other international agreements, bilateral or multilateral, providing for assistance in the area of confiscation. In the latter context it is obliged to rely on the Letters Rogatory provisions in the CCP. These were examined in the context of R.36 above and are explicitly tied to the preliminary investigation phase. There are no specific provisions which govern the freezing, seizure and confiscation of criminal proceedings at the request of a foreign state.

1039. In the course of the analysis of R.3 it was seen that the CCP contains a range of provisions which facilitate the taking of provisional measures in domestic cases. Such provisions are, by virtue of Arts. 636-639, available for use in response to a Letters Rogatory request.

1040. Article 635 of the CCP, discussed above, also stipulates that international conventions and practices regarding 'the legal effect of foreign convictions and other relations with foreign authorities concerning the administration of criminal justice are to be observed'. Consequently confiscation assistance can be provided on this basis where the request is made pursuant to the provisions of any of the three recently ratified UN Conventions. At the time of the MONEYVAL on-site visits the evaluators were informed that in the absence of such a treaty nexus the HS/VCS authorities would not be in a position to submit to their courts, with a view to giving effect to it, an order of confiscation issued by a requesting state in relation to proceeds, property or instrumentalities. However, at the May 2012 pre-meeting the attention of the evaluators was drawn to the facilitating provisions contained in Arts. 651 to 653 of the CCP. These specifically address the effects of foreign guilty sentences. It is noted, in particular, that Art. 653 treats the recognition of the civil effects of foreign penal convictions. Although these provisions are of some antiquity and were drafted in an era prior to the emergence of modern confiscation assistance they appear to form a basis on which cooperation could be afforded in a range of relevant circumstances. These provisions are reproduced in Annex XV. The evaluators are not, however, aware of any use of these provisions in practice.

1041. As was noted in relation to R.3, paragraph 6 of Art. 421 *bis* on money laundering recognises the concept of property of corresponding value. The HS/VCS authorities confirmed that co-operation on this basis could thus be provided to foreign countries.

1042. In the HS/VCS there are not presently in effect any arrangements for coordinating seizure or confiscation actions with foreign countries. This would be done on an ad hoc basis as and when necessary.

1043. Paragraph 7 of Art. 421 *bis* of the Criminal Code, inserted by Art. 3 of the January 2012 Law, specifically contemplates the possibility of entering into international asset sharing agreements though none have been concluded to date. In the absence of the same, confiscated criminal proceeds are to be used for the charitable and religious works of the Roman Pontiff. A very similar approach is adopted in relation to confiscation under Art. 138 *bis* (associations for terrorist purposes or subversion) and Art. 138 *ter* (financing of terrorism) save that both anticipate that some at least of the funds and other assets in question will be devoted to providing assistance to the victims of terrorism and their families.

Additional Elements

1044. At present non criminal confiscation orders cannot be recognised or enforced by the HS/VCS.

Special Recommendation V

1045. Outside of the context of SR.III there are no specific provisions in the legal system of the HS/VCS designed to facilitate international co-operation in the terrorist financing sphere. The general system as described above in relation to R.36-38 thus applies equally to the situations addressed by SR.V. The provisions of the Terrorist Financing Convention will however, apply to requests made by states which are parties to it.

Effectiveness and efficiency

1046. In the course of its dialogue with the HS/VC,S the evaluation team was informed that, in the period 2001-2010, the Secretariat of State had received approximately 20 Letters Rogatory requests from a range of states, primarily in Europe and the Americas. It was also informed that only one request was not executed. This flowed from the fact that the VCS Tribunal was exercising jurisdiction over this case resulting from a death in VCS territory. On average the authorities of the HS/VCS estimate that requests are answered within three months from the date of receipt. Of the requests in question the evaluators were informed that one, in 2003, involved a

criminal case involving allegations of money laundering. In that instance the VCS Tribunal took the testimony of numerous witnesses and collected relevant documents. The materials were then transmitted to the USA and thereafter to the relevant Federal Court. The authorities of the HS/VCS confirmed that none of the requests involved the provision of confiscation assistance. The evaluators were further informed that at the end of the period relevant to this evaluation (25 January 2012) there were no pending requests awaiting execution. Finally the HS informed the evaluators that it has also provided substantial diplomatic cooperation and information with respect to criminal matters through its apostolic nuncios who enjoy the status of ambassadors under the terms of the Vienna Convention on Diplomatic Relations. However, no specific materials were provided to the team in this regard. While the above information reveals a broadly satisfactory track record of cooperation one country indicated, in the course of the normal consultation with MONEYVAL and FATF members, that it had encountered some difficulties in the context of its mutual legal assistance relationship with the HS/VCS.

6.3.2 Recommendations and comments

1047. At present the HS/VCS must rely on the Letters Rogatory process provided for in Arts. 636-639 of the Code of Criminal Procedure. This is drafted in relatively broad and flexible terms and double criminality is not required. As noted above, this scheme of co-operation is generally adequate in relation to the provision of assistance for money laundering, terrorist financing and predicate offence investigations and prosecutions. As seen, Arts.651-653 facilitate giving effect to foreign convictions including the civil effects thereof. These will be of value in a range of possible circumstances relating to confiscation.

1048. However, and unsurprisingly given their relative antiquity, these provisions do not directly address the complexities associated with the tracing, freezing and seizure and confiscation of the proceeds of money laundering, predicate offences, and terrorist finances or related instrumentalities. Consideration should be given to enacting modern and detailed legislative provisions in this sphere.

1049. Art. 635 of the CCP however stipulates that international conventions regarding *inter alia*, both letters rogatory and the legal effect of foreign convictions and other relations with third states in the criminal justice sphere are to be observed. As the mutual legal assistance and confiscation co-operation provisions of both the Vienna and Palermo Conventions are highly detailed the fact that the HS/VCS is now a party to these instruments goes some way towards securing the availability of modern practice in these areas of concern.

1050. Currently, there are no mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country and the HS/VCS authorities are encouraged to develop a procedure to cover this deficiency.

6.3.3 Compliance with Recommendations 36 to 38 and Special Recommendation V

	Rating	Summary of factors underlying rating
R.36	**LC**	• No mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country other than Italy.
R.37	**C**	
R.38	**LC**	• No action to implement criteria 38.3. • Effectiveness concerns.
SR.V	**LC**	• No action to implement criteria 38.3 • Effectiveness concerns.

6.4 Extradition (R. 37, 39, SR.V)

6.4.1 Description and analysis

Recommendation 39

1051. In so far as extradition is concerned it is necessary to distinguish between two situations: a) relations with Italy; and b) relations with other countries and territories.

1052. Under Art. 22 of the Lateran Treaty of 1929 the HS/VCS enjoys "an enhanced co-operation" with Italy. The text is worded thus:

> At the request of the Holy See, or by its delegation which may be given in individual cases or permanently, Italy will provide within its territory for the punishment of crimes committed within Vatican City, except when the author of the crime will have taken refuge in Italian territory, in which event he will be certainly prosecuted according to the provision of Italian laws.
>
> The Holy See will hand over to the Italian State persons who may have taken refuge within Vatican City and who have been accused of acts, committed within Italian territory, which are considered to be criminal by the laws of both States.
>
> The same provisions will apply in regard to persons accused of crimes who may have taken refuge within the buildings declared to be immune in Art. 15 hereof, unless the persons in charge of such buildings prefer to invite the Italian police agents to enter them in order to arrest such persons.

1053. In the course of the MONEYVAL on-site visits the authorities confirmed that the operation of this enhanced system was not automatic. For instance in the situation envisaged in paragraph 2 of Art. 22 Italy would have to file a formal request for surrender with the Secretary of State through the diplomatic channel. A judicial determination would follow before surrender could take place. This would address, *inter alia*, the satisfaction of the requirement of double criminality.

1054. In the HS/VCS the issue of extradition is regulated primarily by the provisions of the Code of Criminal Procedure. As noted earlier in this report, in the absence of a relevant subsequent legislative enactment Art. 8 of the Act No. LXXI on the sources of law of 1 October 2008 (see Annex XII) stipulates that it is the Italian Code of Criminal Procedure of 1913 as it existed in 1929, which governs. This is the case in regard to extradition.

1055. Under Art. 635 of the CCP the terms of relevant extradition treaties are to be observed. In the absence of the same CCP provisions are to be applied. At the time of the visits made by the evaluation team to the HS/VCS no bilateral extradition treaties were in operation. Similarly the HS/VCS is not a party to the European Convention on Extradition of 1957 or of any other multilateral extradition arrangements. However, as a party to the Vienna, Palermo and Terrorist Financing Conventions their provisions on extradition (Arts. 6, 16 and 11 respectively) would apply in relevant cases. Otherwise it is the CCP (and in particular Arts. 640-650 thereof) which applies.

1056. Notwithstanding its relative antiquity the extradition scheme provided for in the CCP it appears to be broadly adequate for present purposes. It is triggered by a request made through the diplomatic channel and the courts play a decisive role in determining whether the relevant requirements have been satisfied. The final determination is made by the executive branch of government (Art. 648).

1057. While extradition is subject to the requirement of double criminality (Art. 641(2)) the CCP does not establish either a list of extraditable offences or a set minimum threshold of punishment. Money laundering is an extraditable offence by virtue of its criminalisation within the HS/VCS.

1058. By virtue of Art. 9 of the Italian Criminal Code of 1888 which applies within the HS/VCS by virtue of Art. 7 of the Act on the sources of law of 1 October 2008 (No. LXXI) extradition "is not permitted for political crimes, nor any related offences". Art. 641(3) of the CCP is to a similar effect. It will be recalled that Art. 3(10) of the 1988 Vienna Convention was designed, *inter alia*, to limit the possibility that the political offence exception could be raised as a bar to extradition in drug money laundering cases. This now applies to the HS/VCS.

1059. Art. 9 of the CC also stipulates that "[t]he extradition of a citizen is not permitted". Art. 641(1) of the CCP is to the same effect. In such cases reliance must be placed on Art. 5 of the CC which embraces the nationality principle of criminal jurisdiction as envisaged by criterion 39.2(b). However, in cases where the Vienna and Palermo Conventions are relevant the extradite or prosecute provisions of these instruments also apply (see Arts. 6(9) and 16(10) respectively.

1060. In the HS/VCS the ability to cooperate on procedural and evidentiary aspects of prosecutions of HS/VCS citizens accused of extraterritorial offences for which extradition is not permissible are regulated by the provisions of the CCP dealing with letters rogatory (Arts. 636-639). These were discussed above.

1061. The extremely small size of the HS/VCS and the nature of its judicial system both lend themselves, at least in the abstract, to allowing extradition requests and proceedings relating to money laundering to be handled without undue delay. Certain provisions of the CCP also encourage timely and effective decision making in this context. In particular, under Art. 647 appeals must be filed within one day of the decision and the matter must be determined by the relevant judicial body within 10 days from receiving the appeal.

Recommendation 37 (dual criminality relating to extradition)

1062. As noted above, Art. 641(2) of the CCP subjects extradition to the satisfaction of the requirement of double criminality. The wording used embraces this concept *in abstracto* Consequently the requirement will be satisfied regardless of whether the HS/VCS and the country concerned place the offence within the same category of offence or denominate it by the same terminology, so long as the underlying conduct is criminalised in both jurisdictions.

Special Recommendation V

1063. As was seen in the analysis of SR.II, action has been taken to criminalise the core aspects of the financing of terrorism as well as certain other terrorist acts. All such offences are extraditable under the law of the HS/VCS. However, it was also noted that there remain certain deficiencies in the approach of the existing legislation with respect to the complete satisfaction of existing international standards. These deficiencies could have an adverse impact on the application of the dual criminality requirement for extradition in relevant cases. It is also of relevance to note that Art. 10 of the Terrorist Financing Convention includes a broad "extradite or prosecute" obligation, which now applies to the VCS.

Recommendation 32

1064. Concerning extradition, it has been confirmed by the HS/VCS authorities that, in the course of the last decade, the VCS has received no requests for extradition from third countries nor has it submitted requests to third countries. By way of contrast, as is noted under section 1.5 b. above, there is a continuing and not infrequent practice of surrender of violators from the VCS to Italy in accordance with Art. 22 of the Lateran Treaty (see above).

Additional elements

1065. As was seen in the context of R.39 above, the HS/VCS shares an enhanced cooperative arrangement with Italy in this sphere by virtue of the operation of Art. 22 of the Lateran Treaty of 1929. However, even here a formal request by Italy must be submitted through the diplomatic channel**.**

1066. By virtue of Art. 644 of the CCP a simplified procedure exists for persons consenting to extradition. It is crafted, in relevant part, thus:

> If the request for extradition comes from the State of nationality of the arrested person, and there is no other request for extradition by other States, the person under arrest assisted by his defence lawyer, may request to be surrendered to the requesting government; in such case, there is no judgement by the pre-trial chamber.

Effectiveness and efficiency

1067. The evaluators have noted the ongoing practice of surrender between the VCS and Italy pursuant to the Lateran Treaty and are unaware of any significant issues in this context. Notwithstanding the availability of extradition no requests were received in the course of the last decade have emerged and they draw no negative inferences from this.

6.4.2 Recommendations and comments

1068. Extradition from the HS/VCS is subject to the satisfaction of the requirement of double criminality. Deficiencies in the criminalisation of terrorist financing and other conduct, as required by SR.II, and possibly in respect of some predicate offences, have the potential to have an adverse impact on extradition in relevant cases. Such deficiencies should be addressed as a matter of priority.

6.4.3 Compliance with Recommendation 37 & 39 and Special Recommendation V

	Rating	**Summary of factors underlying rating**
R.37	**LC**	• Financing of terrorism insufficiently provided for so limiting the possibilities for extradition (dual criminality).
R.39	**LC**	• Deficiencies in the criminalisation of financing of terrorism and some predicate offences may limit the possibilities for extradition (dual criminality).
SR.V	**LC**	• Deficiencies in the criminalisation of terrorist financing. • Effectiveness concerns.

6.5 Other Forms of International Co-operation (R. 40 and SR.V)

6.5.1 Description and analysis

Recommendation 40

1069. The legal systems of the HS/VCS do not contain any undue restrictions to law enforcement co-operation in fiscal issues or matters. Moreover, the legal system of the HS/VCS does not contain any particular restrictions or conditions on international co-operation on the basis of the protection of the financial secrecy and professional privilege of possible designated non-financial subjects. Competent authorities are endowed with powers to carry out inquiries on both the internal and international levels. In particular, the Gendarmerie Corps, in close co-operation with the Judicial Authority, carries out inquiries and investigations and cooperates with authorities of other states within the framework of INTERPOL. Furthermore, taking into account the Lateran Treaty, it can request, through the competent channels, the co-operation of the equivalent Italian agencies. As far as the latter aspect is concerned, the relations between the Gendarmerie and the Italian Police take place through the *General Inspectorate of Public Security for the Vatican City* (an Italian state institution which acts as a liaison body) representing the liaison body between the two bodies of the two countries.

1070. The following table provides details of co-operation between the HS/VCS and Italian authorities from 1 April 2011 to 31 December 2011.

Cooperation with Italian authorities	
Exchange of information	7 requests by the Italian FIU 7 answers by the FIA
Meetings	2 meetings between the FIA and Bank of Italy (including both the supervisory body and the FIU) 1 Meeting between the FIA and the Italian Customs authorities 2 meetings between the FIA and the Italian Ministry of Economy and Finance

1071. The original AML/CFT Law mandated the FIA to maintain relationships with international organisations entitled to define policies and standards in matters of prevention and countering ML and FT (Art.33.5 (l)). The revised AML/CFT Law does not exclude this provision although it vested the Secretariat of State with the authority for "relation with, and participation in, the various international institutions and organisations competent for the definition of norms and best practices regarding the prevention and countering of money laundering and the financing of terrorism" (Art. 2 *quinquies*.2).

1072. The original AML/CFT Law contained a provision that the FIA "shall exchange information under reciprocity agreements and, normally, on the basis of memoranda of understanding, in matters of suspicious operations and cooperate with the Authorities of foreign States pursuing the same goals of prevention and countering of money laundering and financing of terrorism" (Art. 41.1). Now, according to Art. 41.1, "the Financial Intelligence Authority exchanges information regarding suspicious transactions in matters of money laundering and the financing of terrorism with analogous Authorities in other States, on the condition of reciprocity and on the basis of Memoranda of Understanding". The new wording made mandatory the existence of an MOU before any exchange of information can be effected. However, at present, no MOUs have been concluded.

1073. Art. 41.2 of the revised AML/CFT Law states "Secrecy and restrictions to the report of classified information stemming from contract obligations or legislative, regulatory or administrative provisions, shall not hinder the performance of the duties of international exchange of information". The amended law confirmed this in a slightly different wording without changing the substance.

1074. The evaluators were provided with conflicting opinions regarding the ability of the FIA to share information concerning events prior to the date of entry of the AML/CFT Law which came into force on 1 April 2011. On one view, the evaluators were advised that the law has no retroactive effect; and on another view, the 1 April 2011 does not mark a date of limitation prior to which financial information may not be accessed for the purposes of engaging in cooperation with counterpart FIUs. It was subsequently clearly demonstrated to the evaluators that the FIA had on a number of occasions received details of transactions and other information relating to the period prior to 1 April 2011. Furthermore, it was demonstrated to the evaluators that this information had been disseminated to the FIA's foreign counterparts. The evaluators have, therefore come to the conclusion that there is no restriction on the ability of the FIA to receive or disseminate information relating to transactions prior to 1 April 2011.

1075. The gateways to facilitate and allow prompt and constructive exchanges of information directly between counterparts for police co-operation are the INTERPOL channels. Vatican City State joined the International Criminal Police Organisation (INTERPOL) in October 2008. There is an officer responsible for relations with INTERPOL. The Gendarmerie can conduct inquiries on behalf of foreign counterparts only upon an order of the judicial authority.

1076. Art. 2 *octies* §3 of the revised AML/CFT Law says that "with the *nulla osta* of the Secretariat of State, the Gendarmerie may conclude Memoranda of Understanding with similar authorities from other States to prevent and counter criminal activities, money laundering, and the financing of terrorism". The AML/CFT Law does not seem to make the existence of an MOU mandatory in the case of the Gendarmerie. Furthermore, as far as inquiries are concerned, it is noted that the activity of the Gendarmerie Corp within the framework of INTERPOL facilitates contacts with the authorities of states and the exchange of information. It thus appears that there is an inconsistency in that the Gendarmerie can co-operate without the necessity of an MoU whereas this is mandatory for the FIA.

1077. The HS/VCS authorities consider that information, which is consistent with the fundamental principles and rules of the internal legal system, may be exchanged both spontaneously and upon justified requests, and which should be adequately examined and on a timely basis.

1078. There are no formal or express provisions authorising the FIA to make inquiries on behalf of foreign counterparts which may include searching its own databases (including with respect to information related to suspicious transaction reports), searching other databases to which it may have direct or indirect access, including law enforcement databases, public databases, administrative databases and commercially available databases. This issue might be resolved if the text of future MOUs contain the relevant provisions.

1079. The Gendarmerie is the only body formally entitled to carry out enquiries on behalf of foreign counterparts. There are no other provisions in the law of HS/VCS for other authorities to carry out enquiries on behalf of foreign counterparts.

1080. Co-operation and information exchange is not subject to restrictions or conditions apart from such limitations as are determined by law solely for the purpose of securing due recognition and respect for morality, public order and the general welfare as well fundamental human rights.

1081. The legal system of the HS/VCS does not set out any restrictions on law enforcement co-operation in fiscal matters.

1082. There are no constraints, restrictions or conditions on international co-operation on the basis of the protection of bank (or financial) secrecy or professional privilege of possible designated

non-financial subjects. Art. 41 §2 of the revised AML/CFT Law states "Financial secrecy and any eventual restrictions on the communications shall not inhibit the international exchange of intelligence".

1083. The officers of the competent authorities are subjected to the discipline of the General Regulation of the Roman Curia of 1999. According to Art. 36, "all are obliged to rigorously observe the rule of classified information. As a consequence, they cannot give, to those who are not entitled to this, information relevant to deeds or news they learned because of their work".

1084. Furthermore, as regards the prevention and countering of the laundering of proceeds from criminal activities and financing of terrorism, the revised AML/CFT Law provides for rules aimed to guarantee the correct use of information and the protection of the right to privacy of the natural and legal persons concerned. Art. 40 provides that: "all information held by the competent authorities shall be subject to official secrecy, without prejudice to the activities of the Judicial Authorities in case of criminal proceedings… all data, information and documents held by the competent authorities shall be preserved using systems that ensure their security and integrity".

1085. Furthermore Art. 37 §3 of the revised AML/CFT Law states "The Promoter of Justice, the Financial Intelligence Authority, and the Gendarmerie shall conclude Memoranda of Understanding to ensure that their exchanges of information are secure and the utmost confidentiality is given to identity of the persons who make the reports".

Supervisory Co-operation

1086. There are no provisions that allow for the passing or exchange of information to overseas supervisors. However, the impact of this deficiency is limited by the fact that neither of the two financial institutions, IOR and APSA, possess any overseas branches. Moreover, due to the existence of the public monopoly regime, as described under section 5.1 above, no independent financial institutions are established within the HS/VCS.

Additional elements

1087. So far as exchange of information with non-counterparts is concerned, the FIA cannot cooperate in such manner as the law directly provides for the exchange of information with agencies with the same functions.

Special Recommendation V

1088. The same problems identified above in relation to exchange of information apply to financing of terrorism.

Additional elements

1089. The same approach has been adopted regarding the exchange of information on the financing of terrorism as on money laundering (see above).

Recommendation 32 (Statistics – other requests made or received by the FIU, spontaneous referrals, requests made or received by supervisors)

1090. No statistics on relevant international co-operation under Recommendation 40 were provided to the evaluation team. The law enforcement agencies do not maintain special statistics on this subject.

Additional elements

1091. The statistics provided by the Gendarmerie on international cooperation were not related to money laundering or terrorism financing but were of a general character.

Effectiveness and efficiency

1092. The FIA is limited in its ability to exchange information by existence of an MOU and no MOUs have been signed[86].

6.5.2 Recommendation and comments

1093. There is no information as to how quickly the FIU would be able to respond to requests. The FIA should quickly conclude MOUs with at least FIUs from those countries with which it will most likely need to exchange information. The FIA and the Gendarmerie should keep detailed statistical data showing in particular their response times and whether the requests were fulfilled in whole or in part or were incapable of being fulfilled. It is also advised that statistical information is kept in relation to the numbers and types of spontaneous disclosures made by the FIA.

1094. The law should be amended to specifically allow for the exchange of supervisory information.

6.5.3 Compliance with Recommendation 40 and SR.V

	Rating	Summary of factors underlying rating
R.40	**PC**	• The FIA does not have the explicit authority to share supervisory information. • The FIA is limited in its ability to exchange information by existence of an MOU and no MOUs have been signed (effectiveness issue).
SR.V	**PC**	• The same problems identified in R.40 in relation to exchange of information apply to financing of terrorism.

[86] The authorities have subsequently reported that they have entered into one MoU with an FIU. In addition they have approached 11 other FIUs receiving formal assent from two.

7 OTHER ISSUES

7.1 Resources and Statistics

Recommendations 30 and 32

1095. The text of the description, analysis and Recommendations for improvement that relate to Recommendations 30 and 32 is contained in all the relevant Sections of the report i.e. all of Section 2, parts of Sections 3 and 4, and in Section 6. There is a single rating for each of these Recommendations, even though the Recommendations are addressed in several Sections. Section 7.1 of the report contains only the box showing the ratings and the factors underlying the rating.

	Rating	Summary of factors underlying rating
R.30	**PC**	• Lack of training and experience in financial investigation for the Gendarmerie. • The structure of the FIA does not reflect division between the FIA as Supervisor or the FIA as FIU. There is also no real division in staff for the two different tasks. • No specific training was provided for the supervisory tasks. • Status of the Statue of the FIA is unclear while it refers to the old law. Although it gives the Board the task to define the strategy it has according to the new law only operational independence.
R.32	**LC**	• No statistics concerning the application and effectiveness of the supervisory measures taken.

7.2 Other Relevant AML/CFT Measures or Issues

IV. TABLES

Table 1: Ratings of Compliance with FATF Recommendations
Table 2: Recommended Action Plan to improve the AML/CFT system

8 TABLE 1. RATINGS OF COMPLIANCE WITH FATF RECOMMENDATIONS

Forty Recommendations	Rating	Summary of factors underlying rating[87]
Legal systems		
1. Money laundering offence	**LC**	• Effectiveness concerns.
2. Money laundering offence Mental element and corporate liability	**LC**	• The evaluators have concerns regarding the effectiveness of the corporate liability provisions.
3. Confiscation and provisional measures	**LC**	• Lack of comprehensive authority to prevent or void actions (c.3.6). • Effectiveness concerns.
Preventive measures		
4. Secrecy laws consistent with the Recommendations	**LC**	• While in practice information covered by financial secrecy appears to be exchanged with foreign financial institutions where this is required to implement FATF Recommendations, there is no express exemption from the obligation to observe financial secrecy with respect to such information exchange and could therefore be challenged before the court. • Given that there is no clear empowerment for FIA to exchange information with foreign supervisory authorities, it remains unclear whether official secrecy could inhibit the information exchange with other foreign supervisors.
5. Customer due diligence	**PC**	• No requirement to verify that the transactions are consistent with the institution's knowledge of the source of funds, if necessary. • Failure to have undertaken any formal risk assessment implies that there is no basis for determining whether potential risks are addressed

[87] These factors are only required to be set out when the rating is less than Compliant.

		appropriately by the current risk based approach in place.
		• Rather than providing for simplified due diligence measures, the AML/CFT Law creates blanket exemptions from the CDD requirements.
		• The AML/CFT Law allows for simplified CDD measures even where higher risk scenarios apply.
		• Where obliged subjects are permitted to apply simplified or reduced CDD measures to customers resident in another country, this is not always limited to countries that the HS/VCS is satisfied are in compliance with and have effectively implemented the FATF Recommendations.
		• The FIA Instruction allows for the verification of the identity of the customer and beneficial owner following the establishment of the business relationship without all conditions mentioned under criterion 5.14 being met cumulatively.
		• The definition of "linked transactions" is not in line with the Standard, which does not provide for a limitation in respect of the time elapsing between transactions.
		
		<u>Effectiveness</u>
		
		• The following requirements have been introduced or clarified too recently to be considered fully effective[88]:
		  ◦ The requirement to undertake CDD measures when carrying out occasional transactions that are wire transfers in the circumstances covered by the Interpretative Note to SR VII.
		  ◦ The requirement to verify that any person purporting to act on behalf of the customer is so authorised, and to identify and verify the identity of that person.
		  ◦ The requirement to verify the legal status of the legal person or legal arrangement as required by the Standard.
		  ◦ The clarification of the requirement to verify the identity of the beneficial owner as required by the Standard.
		  ◦ The requirement to understand the ownership and control structure of the customer.
		  ◦ The requirement to perform scrutiny of

[88] However, it has to be taken into account, that some of those requirements had been incorporated earlier in the IOR internal procedures.

		transactions undertaken. • The requirement to apply CDD requirements to existing customers on the basis of materiality and risk and to CDD on such existing relationships at appropriate times. • The requirement to examine the need to report an STR in situations where no relationship was established following failure to satisfactorily complete CDD. • Further effectiveness concerns with respect to some criteria (see shortcomings identified under "Effectiveness and efficiency").
6. Politically exposed persons	**PC**	• The requirement to put in place appropriate risk management systems to determine whether the counterpart is a politically exposed person does not extend to the case of the beneficial owner. • Beyond the requirement to establish the source of funds of customers and beneficial owners identified as PEPs there is no express requirement to establish the source of their wealth. Effectiveness • The following requirements have been introduced or clarified too recently to be considered fully effective: • the requirement to apply PEP requirements irrespective of the residence. • the requirement to obtain senior management approval, where a customer has been accepted and the customer or beneficial owner is subsequently found to be, or subsequently becomes a PEP. • the requirement to determine a PEP in all instances, irrespective of "risky situations".
7. Correspondent banking	**LC**	• No express requirement to assess whether a correspondent body has been subject to a ML/TF investigation or regulatory action nor to assess the respondent institution's AML/CFT controls, and to ascertain that they are adequate and effective.
8. New technologies and non face-to-face business	**PC**	• Undue exemptions from the CDD requirements, in particular with respect to ongoing monitoring (due to Art. 31 §3 of the revised AML/CFT Law). Effectiveness • The following requirements have been introduced

		or clarified too recently to be considered fully effective: • The requirement to have policies in place or take such measures as may be needed to prevent the misuse of technological developments in ML or TF schemes. • The measures to be applied to manage risks related to non-face to face relationships were not fully appropriate to do so.
9. Third parties and introducers	**N/A**	
10. Record keeping	**LC**	Effectiveness • The requirement to maintain records of the business correspondence has been introduced too recently to be considered fully effective. • The lack of on-site inspections (including sample testing) with respect to the implementation of record keeping duties raises concerns. Furthermore, APSA has no internal procedures in place with regard to record-keeping obligations.
11. Unusual transactions	**PC**	• No requirement to examine as far as possible the background and purpose of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose and to set forth their findings in writing. • No express requirement to keep such findings available for competent authorities and auditors for at least five years. Effectiveness • The requirement to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose had not been fully implemented at the time of the MONEYVAL on-site visits.
12. DNFBP – R.5, 6, 8-11	**PC**	• Requirement for notaries, lawyers, external accountants and tax advisers as well as trust and company service providers to undertake CDD measures when establishing business relations is not broad enough. • Trust and company service providers are not subject to CDD and record-keeping requirements with respect to the creation, operation or management of legal persons or arrangements and buying and

		selling business entities. • Shortcomings identified in the context of Recommendations 5, 6, 8, 10 et 11 are also applicable to DNFBP. Effectiveness • Lack of effective implementation of CDD and record-keeping requirements in respect of accountants providing services falling under the scope of the AML/CFT Law.
13. Suspicious transaction reporting	**PC**	• Attempted transactions not explicitly covered in the reporting obligation. • Reporting obligation is limited to "transactions" rather than "funds". • No reporting obligation covering funds suspected to be linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations. • Deficiencies in the terrorist financing offence formally limit the reporting obligation in respect of those who finance terrorism. • Effectiveness concerns.
14. Protection and no tipping-off	**LC**	• There is no provision that restricts disclosure of the fact that a suspicious transaction has been identified and that an STR is in the process of being prepared/reported.
15. Internal controls, compliance and audit	**PC**	• The right of the FIA to issue guidance is restricted. • Neither the law nor guidance provide for timely access by the AML/CFT compliance officer to customer identification data and other CDD information, transaction records, and other relevant information. • IOR has internal procedures but their effectiveness could only partly be assessed (Effectiveness issue). • Overall the requirements have been introduced or clarified too recently to be considered fully effective.
16. DNFBP – R.13-15 & 21	**PC**	• Weaknesses regarding reporting as described under R 13 are also relevant for this Recommendation. • While at the moment the VCS authorities held the opinion that effectively there are no DNFBP operating within their jurisdiction that fall under the AML Law, the effectiveness of reporting to the FIA

		in practice might be very low. • The weaknesses as described under Recommendation 15 regarding financial institutions also apply for DNFBP. • The weaknesses as described under Recommendation 21, regarding giving special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF Recommendations, also apply for DNFBP.
17. Sanctions	**NC**	• The conditions of sufficient effective, proportionate and dissuasive criminal, civil or administrative sanctions are not fully met. In particular sanctions are not applicable for ASPA as it is regarded as a public authority. • No specific sanctions are available for directors and senior management. • No power to withdraw, restrict or suspend a financial institution's licence. • No inspections have been executed by the FIA and no disciplinary or administrative sanctions have been effectively applied. • No particular sanctions have been applied to DNFBP. • Overall the requirements have been introduced or clarified too recently to be considered fully effective.
18. Shell banks	**LC**	• There is no express requirement for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.
19. Other forms of reporting	**NC**	• HS/VCS has not considered the feasibility and utility of implementing a system where obliged subjects report all transactions in currency above a fixed threshold to a national central agency with a computerised data base.
20. Other DNFBP and secure transaction techniques	**C**	
21. Special attention for higher risk countries	**NC**	• No requirement to give special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF Recommendations.

		• No requirement to examine transactions, the background and purpose of such transactions, as far as possible, and to keep written findings available, if they have no apparent economic or visible lawful purpose. • No effective measures in place to ensure that obliged subjects are advised of concerns about weaknesses in the AML/CFT systems of other countries. • There is no empowerment to apply appropriate counter-measures where countries continue not to apply or insufficiently apply the FATF Recommendations.
22. Foreign branches and subsidiaries	**LC**	• No requirement to pay particular attention concerning whether the AML/CFT measures are consistent with the home country requirements and the FATF Recommendations are observed with respect to branches and subsidiaries in countries, which do not or insufficiently apply the FATF Recommendations.
23. Regulation, supervision and monitoring	**NC**	• Lack of clarity on the role, responsibility, authority and independence of the FIA as supervisor. • Directors and senior management of IOR and APSA are not specifically evaluated on the basis of "fit and proper" criteria by the FIA. • IOR and APSA as such are "licensed" via the Chirograph and the Pastor Bonus respectively but are not by the FIA. • No inspections have been undertaken of the AML/CFT program of financial institutions; no standard manual is available; no cycle of visits has been determined or planned for; and no feedback provided to IOR.
24. DNFBP - Regulation, supervision and monitoring	**NC**	• The weaknesses regarding the power of the FIA to apply sanctions as described under R 17 also has its effect under this Recommendation. • The weaknesses as described regarding the powers of the FIA to perform inspections and what rights they exactly entail as described under R 29 and R 23 also have an effect under this Recommendation. • Supervision or monitoring of DNFBP has not taken place.
25. Guidelines and Feedback	**PC**	• Regulations and Instructions not yet updated to reflect amendments to the AML/CFT Law.

		• Failure to provide further requested explanations on the issued guidelines or feedback on the internal procedures that were sent to the FIA. • No specific guidance has been provided for DNFBP operating for entities within HS/VCS. • Effectiveness issues arise as the guidance is harder to understand in certain cases as several articles have been changed considerably. • Effectiveness issues arise as the requirements have been introduced or clarified too recently to allow their application to be fully assessed.
Institutional and other measures		

26. The FIU	**LC**	• Power to query additional information does not appear to extend to all entities subject to the reporting obligation.
		• Effectiveness considerations:
		  • No access to information held by HS foundations.
		  • Recent adoption of AML/CFT Law meant that it was not possible to assess effectiveness of implementation.

27. Law enforcement authorities	**LC**	• Effectiveness not demonstrated. • Lack of experience and training in financial investigations (effectiveness issue).
28. Powers of competent authorities	**C**	
29. Supervisors	**NC**	• Definition of inspection appears to be limited to certain activities. • Both under the old and the new law it is unclear to what extent inspections include the review of policies, procedures, books and records, and should extend to sample testing. • No specific power for the FIA to have direct access, to the financial, administrative, investigative and judicial information, required to perform its tasks in countering money laundering and financing of terrorism. • Unclear if the legal empowerment of the supervisory authorities includes the right of entry into the premises of institutions under supervision,

		the right to demand books of accounts and other information, the right to make and take copies of documents with a penalty on the institution if its officers fail to comply. • Power to impose sanctions is arranged for in general terms under Art. 42, without making the link explicit. No explicit empowerment to sanction directors or senior management. • Conflict of interest on supervisory issues due to one of the members of the Cardinals' Committee being President of the FIA. • No inspections have been undertaken by the FIA. • Overall the requirements have been introduced or clarified too recently to be considered fully effective. • Overall, as no inspections have been executed and the Regulation is not available it is still unclear what "operational independence" means and whether the powers of the FIA as supervisor are adequate (Effectiveness issue).
30. Resources, integrity and training	**PC**	• Lack of training and experience in financial investigation for the Gendarmerie. • The structure of the FIA does not reflect division between the FIA as Supervisor or the FIA as FIU. There is also no real division in staff for the two different tasks. • No specific training was provided for the supervisory tasks. • Status of the Statue of the FIA is unclear while it refers to the old law. Although it gives the Board the task to define the strategy it has according to the new law only operational independence.
31. National co-operation	**LC**	• No formal mechanisms for co-operation and co-ordination or MOUs have been established or signed. • The effectiveness of the new amendments in the law on coordinating mechanisms is yet to be seen.
32. Statistics	**LC**	• No statistics concerning the application and effectiveness of the supervisory measures taken.
33. Legal persons – beneficial owners	**N/A**	

34. Legal arrangements – beneficial owners	**N/A**	
International Co-operation		
35. Conventions	**C**	
36. Mutual legal assistance (MLA)	**LC**	• No mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country other than Italy.
37. Dual criminality	**LC**	• Financing of terrorism insufficiently provided for so limiting the possibilities for extradition (dual criminality).
38. MLA on confiscation and freezing	**LC**	• No action to implement criteria 38.3. • Effectiveness concerns.
39. Extradition	**LC**	• Deficiencies in the criminalisation of financing of terrorism and some predicate offences may limit the possibilities for extradition (dual criminality).
40. Other forms of co-operation	**PC**	• The FIA does not have the explicit authority to share supervisory information. • The FIA is limited in its ability to exchange information by existence of an MOU and no MOUs have been signed (effectiveness issue).
Nine Special Recommendations		
SR.I Implement UN instruments	**PC**	• Failure to bring the new system concerning UN Security Council Resolutions into practical operation within the relevant period.
SR.II Criminalise terrorist financing	**LC**	• Absence of specific criminalisation of financing in respect of certain terrorist acts in the relevant UN counter-terrorism conventions annexed to the Terrorist Financing Convention. • Financing of individual terrorists or terrorist organisations for legitimate purposes not covered.
SR.III Freeze and confiscate terrorist assets	**NC**	• No designations under UNSCR 1267 or 1373 within the evaluation period. • Communication systems for designation were not tested within the evaluation period. • Lack of guidance for obligated entities.

		• Lack of comprehensive coverage of delisting procedures and exemption procedures. • Lack of publicly known procedures for unfreezing in a timely manner of the funds or other assets of persons inadvertently affected by a freezing order. • No procedures for authorising access to funds frozen pursuant to UNSCR 1267 that have been determined to be necessary for basic expenses. • Recent adoption of AML/CFT Law meant that it was not possible to assess effectiveness of implementation.
SR.IV Suspicious transaction reporting	**PC**	• Attempted transactions not explicitly covered in the reporting obligation. • No reporting obligation covering funds suspected to be linked or related to, or to be used for terrorism, terrorist acts or by terrorist organisations. • Deficiencies in the terrorist financing offence formally limit the reporting obligation in respect of those who finance terrorism. • Effectiveness concerns.
SR.V International co-operation	**LC**	• No action to implement criteria 38.3. • Deficiencies in the criminalisation of terrorist financing. • The same problems identified in R.40 in relation to exchange of information apply to financing of terrorism. • Effectiveness concerns.
SR.VI AML requirements for money/value transfer services	**N/A**	
SR.VII Wire transfer rules	**NC**	• No explicit requirement in the Regulation that ensures that non-routine transactions are not batched where this would increase the risk of money laundering. • No effective risk-based procedures have been required from beneficiary financial institutions for identifying and handling wire transfers that are not accompanied by complete originator information. • The Regulation itself contains weaknesses regarding the verification of identity and too broad an interpretation of the concept of 'domestic

		transfers'. • APSA had no written internal procedures in place at the time of the MONEYVAL on-site visits. • The FIA has not inspected IOR and APSA yet in its supervisory role. This does not give the impression that there are measures in place to effectively monitor the compliance. • Overall the requirements have been introduced too recently to be considered fully effective and the evaluators were unable to assess the effectiveness of implementation.
SR.VIII Non-profit organisations	**NC**	• No comprehensive review of the adequacy of the relevant laws in order to identify the risks and prevent the misuse of NPOs for terrorism financing purposes. • Lack of systematic outreach to the NPO sector. • No comprehensive monitoring activities and inspections for the whole NPO sector. • No explicit legal requirement for the NPOs to maintain business records for a period of at least five years. • No formal mechanism established for national co-operation and information exchange between the national agencies which investigate ML/FT cases relating to NPOs. • No formal mechanism established for responding to international requests regarding NPOs.
SR.IX Cross Border declaration and disclosure	**PC**	• The declaration requirement does not cover shipment of currency through containerised cargo. • Doubts on the ability of the Gendarmerie to restrain currency where there is a suspicion of ML/FT as all declarations have been made at financial institutions. • Restrictions on the ability of the FIA to exchange information with counterparts on cross-border transportation. • The voluntary payment rule substantially reduces the level of sanctions and may undermine the deterrent scope of the sanction. • It was not demonstrated that the relevant authorities were provided with sufficient training to effectively perform their functions (Effectiveness issue).

9 TABLE 2: RECOMMENDED ACTION PLAN TO IMPROVE THE AML/CFT SYSTEM

AML/CFT System	Recommended Action (listed in order of priority)
1. General	**No text required**
2. Legal System and Related Institutional Measures	
2.1 Criminalisation of Money Laundering (R.1 & 2)	**R.1** • Further consideration should be given to clarifying the relationship between the money laundering offence (Arts. 1 (4) & (5) of the revised AML/CFT Law) and the traditional receiving offence (Art. 421 of the Criminal Code). **R.2** • Art. 42 *bis* of the revised AML/CFT Law on administrative responsibility of legal persons being contingent on the securing of a prior conviction of a natural person should be reconsidered in the light of the examiners' concerns and practical experience of its functioning.
2.2 Criminalisation of Terrorist Financing (SR.II)	• The terrorist acts set out in the Annex to the UN Terrorist Financing Convention should be brought into the Criminal Code. • The Criminal Code should be amended to criminalise the financing of terrorist organisations and individual terrorists for legitimate purposes. • Art. 42 *bis* of the revised AML/CFT Law on administrative responsibility of legal persons being contingent on the securing of a prior conviction of a natural person should be reconsidered in the light of the examiners' concerns and practical experience of its functioning.
2.3 Confiscation, freezing and seizing of proceeds of crime (R.3)	• A detailed, comprehensive and modern scheme to address the range of issues described in the report should be introduced. • The Criminal Procedure Code should be amended quickly to clarify the authority to take steps to prevent or void actions, whether contractual or otherwise, where the persons involved knew or should have known that as a result of those actions the authorities would be prejudiced in their ability to recover property subject to confiscation.
2.4 Freezing of funds used for	• The legislative framework should be brought into full

terrorist financing (SR.III)	force and effect as a matter of urgency. • Art. 24 of the revised AML/CFT Law should be clarified to place beyond doubt that it is intended to give effect to "designations" made by the EU and other "international" bodies and by third states. • On the basis that Art. 24 is so intended, separate procedures should be put in place to cover the so called "EU internals" (which are not subject to designation as such by the European Union). • Guidance to obligated entities on the freezing of funds for terrorist purposes should be finalised and circulated. • Steps need to be taken to create a comprehensive and effective system for delisting, exemptions and like matters. This is particularly the case in respect to the authorisation of access to funds needed for basic expenses or for extraordinary expenses in accordance with Security Council Resolutions 1452 (2002).
2.5 The Financial Intelligence Unit and its functions (R.26)	• Expressly extend the power of enquiry of the FIA to the information held by all entities subjected to the reporting duty. • Clarify to what additional sources the FIA has access and to include explicitly the foundations located in and/or dependent from the HS. • Specify the instances triggering the authority and intervention of the FIA, beside the receipt of SARs. • reinforce the autonomy of the FIA by restoring its decision power to conclude mutual co-operation agreements with its counterparts. • As an effectiveness consideration, strengthen the freezing capacity of the FIA to include accounts and revisit the obligation of immediate handover to the Promoter of Justice.
2.6 Law enforcement, prosecution and other competent authorities (R.27 & 28)	• Intensify the training of the law enforcement authorities in AML/CFT investigative tools, computer techniques and financial investigation. • Include the judiciary in such training to develop its own expertise to deal with the legal challenges inherent in the prosecution of ML/FT. • Law enforcement should further interact and coordinate with the FIA to develop the necessary investigative skills. • Develop HS/VCS' own experience and jurisprudence in stand-alone money laundering prosecutions, rather than transferring cases to the Italian investigative authorities. • Consider developing a joint committee to review and

	evaluate the effectiveness of the AML/CFT system.
2.7 Cross Border Declaration & Disclosure (SR.IX)	• Take stock of the sanctions applied and analyse whether the voluntary settlement provisions undermine the effectiveness of the sanctions. • As necessary reconsider the statutory sanctions to ensure that these are proportionate. • Consider introduction of clearer law enforcement powers to act on suspicion of money laundering or financing of terrorism in Art. 39 of the revised AML/CFT Law. • Review the existing legal provisions to facilitate more effective Gendarmerie action in the restraint of suspect currency.
3. Preventive Measures – Financial Institutions	
3.1 Risk of money laundering or terrorist financing	• HS/VCS authorities should undertake a formal and comprehensive risk assessment and should in particular review if the circumstances for simplified and enhanced due diligence are appropriate for the local environment/peculiarities.
3.2 Customer due diligence, including enhanced or reduced measures (R.5 to 8)	**R.5** • The AML/CFT Law needs to be amended to specifically require that financial institutions should verify that the transactions are consistent with the institution's knowledge of the source of funds, if necessary. • Serious consideration should be given to a statutory provision describing the types of legal and natural persons eligible to maintain accounts in the IOR and APSA. • Amend the exemptions for low-risk customers, products and transactions as adopted from the Third EU AML Directive by clarifying that minimum CDD (i.e. less detailed CDD) should nevertheless be accomplished. • Provide in the Law that simplified CDD measures are not permissible where higher risk scenarios apply. • Stipulate in the AML/CFT Law that simplified CDD measures, with respect to credit or financial institutions located in a State that observes equivalent AML/CFT requirements, shall only be permissible where those institutions are supervised for compliance with those requirements. • Simplified CDD measures should only be permissible if listed companies are subject to regulatory disclosure requirements. • Amend FIA Instruction No. 2 to clarify that the verification of the identity of the customer and beneficial

	owner, following the establishment of the business relationship, should only be permissible where all conditions mentioned under criterion 5.14 are met cumulatively. • Abolish the exemptions to CDD provided under Art. 31 §3 of the revised AML/CFT Law. • Where the Law allows for simplified or reduced CDD measures to customers resident in another country, HS/VCS authorities should limit this in all cases to countries that the HS/VCS is satisfied are in compliance with and have effectively implemented the FATF Recommendations. • The FIA Instructions should be amended to require that verification should occur as soon as possible in situations where verification occurs after establishment of a business relationship. • The provision that only transactions executed within a period of seven days have to be considered as "linked transactions" should be abolished. • Introduce an express requirement to verify that the transactions are consistent with the institution's knowledge of the source of funds where necessary. **R.6** • Extend the requirement to put in place appropriate risk management systems to determine whether the counterpart is a politically exposed person to the case of the beneficial owner. • Extend the requirement to establish the source of funds of customers and beneficial owners identified as PEPS to expressly include the establishment of their wealth. **R.7** • The AML/CFT Law should be amended to introduce an express requirement to assess whether a correspondent body has been subject to a ML/TF investigation or regulatory action nor to assess the respondent institution's AML/CFT controls, and to ascertain that they are adequate and effective. • Abolish the possibility to delegate the senior management approval for establishing new business relationships with a correspondent relationship. **R.8** • Eliminate the exemptions from CDD provided by Art. 31 §3 of the revised AML/CFT Law (in particular with respect to ongoing monitoring). **R.5 to R.8 generally**

	• FIA should raise awareness with respect to the obligations that have been introduced or clarified in the AML/CFT Law after the MONEYVAL on-site visits to ensure effective implementation. • FIA should put in place appropriate arrangements to monitor and ensure compliance with the requirements under R. 5 to 8 (including adequate sample testing).
3.3 Third parties and introduced business (R.9)	
3.4 Financial institution secrecy or confidentiality (R.4)	• Introduce an express exemption from the obligation to observe financial secrecy with respect to the exchange of information with foreign financial institutions where this is required to implement FATF Recommendations. • Clarify FIA's powers to request information as recommended under R. 26 and R. 29 to ensure that obliged subjects cannot refuse to comply with a request for information based on the financial secrecy obligation. • Clarify FIA´s power to exchange information with foreign supervisory authorities to make sure that official secrecy cannot inhibit such information exchange. • Consider adding the Judicial Authority to the list of all competent authorities in Chapter I *bis* of the revised AML/CFT Law in order to eradicate any potential doubts.
3.5 Record keeping and wire transfer rules (R.10 & SR.VII)	**R.10** • FIA should put in place appropriate arrangements to monitor and ensure effective implementation of the record-keeping requirements (including adequate sample testing). • Adopt internal procedures clearly specifying the record keeping duties and responsibilities of APSA staff. **SR.VII** • A clearer basis for requirements regarding the obligations of payment service providers in the law (instead of in guidance) should be established. • An explicit requirement that ensures that non-routine transactions are not batched where this would increase the risk of money laundering should be established. • Effective risk-based procedures for identifying and handling wire transfers from beneficiary financial institutions which are not accompanied by complete originator information should be established for beneficiary financial institutions. • The FIA should apply its sanctioning powers where breaches of regulations are uncovered.

	• Art. 5 of Regulation 4 which obliges the payment service provider of the payer to 'verify the completeness' of the informative data before transferring the funds should be extended to require that financial institutions should verify the 'identity' of the originator as well. • Art. 6 of Regulation 4 should be amended to limit the exemption that domestic transfers include only the originator's account number or a unique identifier to domestic transactions within the HS/VCS. • Full originator information in the message or payment form accompanying the wire transfer should be required for all other transactions. • Art. 1 should be deleted and the Art. should apply only to transactions where technical limitations prevent the full originator information accompanying a cross-border wire transfer from being transmitted with a related domestic wire transfer.
3.6 Monitoring of transactions and relationships (R.11 & 21)	**R.11** • Introduce a requirement in Law, regulation or "other enforceable means" to examine as far as possible the background and purpose of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose and to set forth their findings in writing. • Introduce a requirement in Law, regulation or "other enforceable means" to keep such findings available for competent authorities and auditors for at least five years. **R.21** • Introduce a requirement to give special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF Recommendations. • Introduce a requirement to examine transactions the background and purpose of such transactions, as far as possible, and to keep written findings available, if they have no apparent economic or visible lawful purpose. • Put in place effective measures to ensure that obliged subjects are advised of concerns about weaknesses in the AML/CFT systems of other countries. • Introduce a clear empowerment to apply appropriate counter-measures where countries continue not to apply or insufficiently apply the FATF Recommendations.
3.7 Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	**R.13 & SR.IV** • Amend the AML/CFT Law to broaden the reporting scope beyond the strict terrorism financing to bring it in

	line with the standards. • Amend the reporting requirement to require that a report is submitted to the FIA when it is suspected or there are reasonable grounds to suspect that "funds" (rather than "transactions") are the proceeds of a criminal activity. • Formally broaden the reporting duty beyond suspect operations to include suspicions on funds generally. • Remove any doubt about the reporting obligation including attempted transactions. • Remove any uncertainty as to the extent of the reporting obligation of the financial institutions in respect of the identification of the predicate offence. • Emphasise the priority rule of the subjective assessment of the suspicious nature of the funds, where the objective indicators should only be seen as a guidance and support. **R.14** • Extend the tipping off prohibition to the fact that a STR has been identified and is in the process of being prepared/reported. **R.19** • Consider the feasibility and utility of implementing a system where obliged subjects report all transactions in currency above a fixed threshold to either the FIA or the Gendarmerie. **R.25** • All existing guidance should be updated in accordance with the revised AML/CFT Law. • The FIA should provide active explanations of the issued Regulations and Instructions to the financial sector. • The FIA should provide appropriate feedback on the internal procedures sent to the FIA by financial institutions.
3.8 Internal controls, compliance, audit and foreign branches (R.15 & 22)	**R.15** • Steps should be taken to ensure that all elements of guidance given by the FIU are sanctionable or make sure that relevant criteria are incorporated in the AML Law. • An explicit requirement for timely access to information for the compliance officer, either in law or guidance should be introduced. **R.22** • Introduce a requirement to pay particular attention that branches and subsidiaries in countries, which do not or

	insufficiently apply the FATF Recommendations, observe AML/CFT measures consistent with the home country requirements and the FATF Recommendations. • Consider introducing a requirement for financial institutions subject to the Basel Core Principles for Banking Supervision (the IOR qualifies as such) to apply consistent CDD measures at the group level, taking into account the activity of the customer with the various branches and majority owned subsidiaries worldwide.
3.9 Shell banks (R.18)	• Introduce an express requirement for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.
3.10 The supervisory and oversight system - competent authorities and SROs. Role, functions, duties and powers (including sanctions) (R.23, 29, 17 & 25)	**R.23** • The definition of supervision and inspection should be changed so that it is made clear what the powers, given to the AML supervisor, encompass in practice. • Clarify in law or regulation the exact meaning of "operational" as opposed to "full" independence of the FIA as supervisor. • Introduce specific measures to involve the supervisor in the process of licensing and approving of senior staff at financial institutions. • Directors and senior management of IOR and APSA should be specifically evaluated and 'licensed' on the basis of "fit and proper" criteria including those relating to expertise and integrity. • Give the FIA the power to assess 'fit and properness' on an ongoing basis. • The FIA (or another body) should take up its supervisory role on AML issues immediately, plan for (a schedule of) inspections, set up a standard manual and work procedure and provide for feedback proactively. • The FIA should start a supervisory inspection with IOR as soon as possible. • Annual statistics on on-site inspections by the supervisor or sanctions applied should be published. Reinstate the requirement to draw up such statistics in the law. • IOR should subscribe to the Basel Core Principles for Banking Supervision. • IOR should be supervised by a prudential supervisor in the near future. • Clearly separate the task of supervision from the FIA as FIU and combine this with adequate prudential

	supervision, including: (i) licensing and structure; (ii) risk management processes to identify, measure, monitor and control material risks; (iii) ongoing supervision and (iv) global consolidated supervision when required by the Core Principles. **R.17** • Stipulate explicitly in law or guidance the full range of FIA's powers of disciplinary sanction. • Sanctions should encompass written warnings, orders to comply with specific instructions accompanied with daily fines for non-compliance, ordering regular reports, fines for non compliance, barring individuals from employment in the sector, replacing or restricting the powers of managers, directors, imposing conservatorship, and at least the ability to withdraw or suspend a licence. • All sanctions levied should be published. • Make explicit what the criminal sanctions are for natural persons in cases of infringement of the several articles of Act No. CXXVII relating to Chapters other than II and III. • Make explicit that sanctions can be applied to directors and senior management of financial institutions. **R.25** • All regulations and instructions should be amended to reflect the revised AML/CFT Law (as they currently all refer to the original AML/CFT Law and to articles that no longer exist or have been changed considerably). • Give proactive explanations of the issued Regulations and Instructions to the financial sector and provide feedback on procedures sent to the supervisor by financial institutions. **R.29** • It is recommended that the definition of supervision and inspection in the law is amended to make it clear that it is not restricted to certain activities. • The Regulation of the Pontifical Committee should be amended to clarify what is understood by monitoring, verification and inspection. Ensure that it includes (also via on-site inspections) the review of policies, procedures, books and records, and sample testing. • The Regulation should make it clear how the change from

	'full independence' to 'operational independence' in the law applies and to what extent this effects the role and tasks of the President and Board of Directors of the FIA. • Reinstate Art 33, §2 of the original AML/CFT Law (which gave the FIA direct access to the financial, administrative, investigative and judicial information, required to perform its tasks in countering money laundering and financing of terrorism). • Ensure supervisory authorities have the legal right of entry into the premises of the institution under supervision, the right to demand books of accounts and other information and the right to make and take copies of documents. • Ensure sanctions can be imposed against financial institutions, and their directors and senior management for failure to comply with the powers given to the supervisor. • The FIA should take up its supervisory role as soon as possible. • The President of the FIU should not be a member of the Cardinal's Committee. • clarity should be provided on the role of the Board of the FIA in terms of identifying the supervision and sanctioning strategy on the basis of the Statute given the change towards "operational independence" in the new law.
3.11 Money value transfer services (SR.VI)	
4. Preventive Measures – Non-Financial Businesses and Professions	
4.1 Customer due diligence and record-keeping (R.12)	• Clarify in law or regulation that notaries, lawyers, accountants, external accounting and tax consultants as well as trust and company service providers are also required to undertake CDD measures when establishing business relations. • Set out in law, regulation or "other enforceable means" that trust and company service providers are subject to CDD and record-keeping requirements with respect to the creation, operation or management of legal persons or arrangements and buying and selling business entities. • The recommended actions in Section 3 above with respect to R 5, 6, 8, 10 and 11 should also be implemented for DNFBP. • Raise awareness amongst auditors and accounts with respect to their CDD and record-keeping obligations

	under the AML/CFT Law, provide training and put in place appropriate arrangements to monitor and ensure CDD and record-keeping compliance.
4.2 Suspicious transaction reporting (R.16)	• The issues under Recommendations 13, 14, 15 and 21 should also be addressed for DNFBP.
4.3 Regulation, supervision and monitoring (R.24-25)	• The FIA should issue a specific guideline for those DNFBP that operate in the HS/VCS, in particular on how they are to report to the FIA. • The FIA should commence supervising the activities of DNFBP.
4.4 Other non-financial businesses and professions (R.20)	
5. Legal Persons and Arrangements & Non-Profit Organisations	
5.1 Legal Persons – Access to beneficial ownership and control information (R.33)	
5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34)	
5.3 Non-profit organisations (SR.VIII)	• Undertake a review the adequacy of domestic laws and regulations that relate to all NPOs located within VCS and conduct an assessment on the sector's potential vulnerabilities to terrorist activities. • The FIA should have its responsibilities extended to risk-based monitoring of the NPO sector with necessary access to relevant books and financial records. • Develop guidance on the risks of terrorist abuse and the available measures to protect against such abuse for all NPOs which are located within VCS and then undertake outreach to raise awareness within the sector. • Legislation should: a) Require NPOs to maintain and file records on the purpose and objectives of their stated activities and the identity of person(s) who own, control or direct their activities, including senior officers, board members and trustees; b) Require NPOs to maintain, for a period of at least five years, and make available to appropriate authorities, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and

	objectives of the organisation; and c) Sanction violations of oversight measures or rules by NPOs or persons acting on behalf of NPOs. • Legislation should develop provisions for the FIA and Gendarmerie to have full access to information on the administration and management of a particular NPO (including financial and programmatic information) during the course of an investigation. • Formal procedures for national co-operation and information exchange between the national agencies which investigate ML/FT cases should be developed. • An appropriate point of contact should be identified to respond to international requests for information regarding particular NPOs that are suspected of terrorist financing or other forms of terrorist support. Procedures should also be developed to process such requests.
6. National and International Co-operation	
6.1 National co-operation and co-ordination (R.31)	• Consider creating a formal mechanism for co-operation and co-ordination of their actions in the AML/CFT sphere. • There should be a collective review of the AML/CFT system and its performance which would enable setting the basis for future developments and implementation of policies and activities to combat money laundering and terrorist financing.
6.2 The Conventions and UN Special Resolutions (R.35 & SR.I)	• Prioritise the effective implementation of Chapter IV of Act No. CXXVII of January 2012 through the completion of the listing process and other means, as necessary, to ensure full and effective implementation of UN Security Council Resolutions on the financing of terrorism. • Legislative measures should be taken to address the current deficiencies in the criminalisation of terrorist financing as identified in the analysis of SR.II. • The system for implementing UNSCR 1267 and 1373 needs to be made operational.
6.3 Mutual Legal Assistance (R.36-38 & SR.V)	• Consideration should be given to enacting modern and detailed legislative provisions covering tracing, freezing and seizure and confiscation of the proceeds of money laundering, predicate offences, and terrorist finances or related instrumentalities. • Develop a procedure to cover mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country.

6.4 Extradition (R.39, 37 & SR.V)	• Address the identified deficiencies in the criminalisation of terrorist financing and other conduct, as required by SR.II, to ensure that extradition is not inhibited.
6.5 Other Forms of Co-operation (R.40 & SR.V)	• The FIA should quickly conclude MOUs with at least FIUs from those countries with which it will most likely need to exchange information. • The law should be amended to specifically allow for the exchange of supervisory information.
7. Other Issues	
7.1 Resources and statistics (R. 30 & 32)	**R.30** • Ensure an adequate structure and staffing of the FIA to reflect its supervisory role. • Ensure that FIA staff receive appropriate training on the supervisory aspect of their function. **R.32** • The FIA should draw up statistics concerning the application and effectiveness of the measures taken; for example, the annual statistics on on-site inspections by the supervisor or sanctions applied. • The FIA and the Gendarmerie should keep detailed statistics showing in particular their response times and whether the requests were fulfilled in whole or in part or were incapable of being fulfilled. • Statistics should also be kept in relation to the numbers and types of spontaneous disclosures made by the FIA.

10 TABLE 3: AUTHORITIES' RESPONSE TO THE EVALUATION

The Holy See, acting also on behalf of Vatican City State, and coherently with its nature and international personality, as well as its religious and moral mission, entered the mutual evaluation procedures of the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL).

Under the guidance of the moral authority of His Holiness Pope Benedict XVI, particularly as expressed in the *Motu Proprio* of 30 December, 2010, the Holy See shares the commitment undertaken by the international community to develop and implement global standards for the prevention and countering of money laundering and financing of terrorism.

Reaffirming the principles of mutual respect and reciprocity, the Holy See also expresses its appreciation for the objectivity of the mutual evaluation procedures, the evaluators' acumen, and the active participation of the Members of the MONEYVAL Plenary who, by consensus, adopted the Mutual Evaluation Report.

Finally, the Holy See extends its assurance that the observations contained in the Report will be given due and appropriate consideration in the efforts to prevent and counter money laundering and the financing of terrorism, and that it will continue to lend its voice to the eradication of these phenomena.

V. COMPLIANCE WITH THE 3RD EU AML/CFT DIRECTIVE

The Holy See (including Vatican City State) is not a member country of the European Union. It is not directly obliged to implement **Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing** (hereinafter: "the Directive") and the **Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of 'politically exposed person' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis**.

The following sections describe the major differences between the Directive and the relevant FATF 40 Recommendations plus 9 Special Recommendations.

1.	**Corporate Liability**
Art. 39 of the Directive	Member States shall ensure that natural and legal persons covered by the Directive can be held liable for infringements of the national provisions adopted pursuant to this Directive.
FATF R. 2 and 17	Criminal liability for money laundering should extend to legal persons. Where that is not possible (i.e. due to fundamental principles of domestic law), civil or administrative liability should apply.
Key elements	The Directive provides no exception for corporate liability and extends it beyond the ML offence even to infringements which are based on national provisions adopted pursuant to the Directive. What is the position in your jurisdiction?
Description and Analysis	Art.42 of the revised AML/CFT Law of January 2012 creates a scheme of administrative sanctions for violations, by natural and legal persons, of a fairly comprehensive range of obligations imposed on obligated entities under the Act. This extends to breaches of "related duties established by the regulations and other enforceable measures adopted pursuant to this law…"(§.1). The range of penalties, which differ for natural and legal persons, appear to be potentially effective, proportionate and dissuasive. As noted in the analysis of FATF Recommendation 2, this scheme of administrative liability does not extend to money laundering and the financing of terrorism as such. This dimension is addressed in Art.42 *bis* entitled "administrative liability for legal persons" and has been influenced in its drafting by Art.39 of the Directive. It is tightly drawn in that it requires the prior conviction of a natural person before it can be applied. This is not, however, inconsistent with the terms of the Directive. Penalties to be applied are specified (§.1) as ranging from €20,000 to €2,000,000.
Conclusion	The approach adopted to corporate liability is broadly consistent with the requirements of the Directive.
Recommendations and Comments	The evaluators have concerns as to the manner in which Art.42 *bis* has been made contingent on securing a prior conviction of a natural person for money laundering or terrorist financing. They urge the appropriate authorities to revisit this issue in due course.

2.	**Anonymous accounts**
Art. 6 of the Directive	Member States shall prohibit their credit and financial institutions

	from keeping anonymous accounts or anonymous passbooks.
FATF R. 5	Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names.
Key elements	Both prohibit anonymous accounts but allow numbered accounts. The Directive allows accounts or passbooks on fictitious names but always subject to full CDD measures. What is the position in your jurisdiction regarding passbooks or accounts on fictitious names?
Description and Analysis	Art. 1 *bis* letter a) of the revised AML/CFT Law prohibits to open or hold anonymous or ciphered accounts, deposit, savings accounts or similar relationships, or accounts under fantasy or fictitious names.
Conclusion	By also prohibiting passbooks and accounts on fictitious names the AML/CFT Law is more stringent than the Directive and in line with FATF R.5.
Recommendations and Comments	None.

3.	**Threshold (CDD)**
Art. 7 b) of the Directive	The institutions and persons covered by the Directive shall apply CDD measures when carrying out occasional transactions amounting to EUR 15,000 or more.
FATF R. 5	Financial institutions should undertake CDD measures when carrying out occasional transactions above the applicable designated threshold.
Key elements	Are transactions and linked transactions of EUR 15,000 covered?
Description and Analysis	Pursuant to Article 28 (b) of the revised AML/CFT Law the obliged subjects shall fulfil CDD requirements when they carry out occasional transactions equal to or in excess of €15,000, regardless of whether it is conducted in a single transaction or in various transactions connected one to the other. However, pursuant to the definition provided in Art. 1 §28 of the revised AML/CFT Law, only transactions conducted within a period of seven days have to be considered as "linked transactions". This is not in line with the Directive, which does not provide for such a limitation of the time elapsed between transactions.
Conclusion	In line with the Directive, CDD measures have also to be applied for transactions and linked transactions amounting to €15,000.
Recommendations and Comments	Abolish the time limit of seven days for linked transactions provided in Art. 1 §28 revised AML/CFT Law.

4.	**Beneficial Owner**
Art. 3(6) of the Directive (see Annex)	The definition of 'Beneficial Owner' establishes minimum criteria (percentage shareholding) where a natural person is to be considered as beneficial owner both in the case of legal persons and in the case of legal arrangements
FATF R. 5 (Glossary)	'Beneficial Owner' refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or legal arrangement.
Key elements	Which approach does your country follow in its definition of "beneficial owner"? Please specify whether the criteria in the EU definition of "beneficial owner" are covered in your legislation.

Description and Analysis	The definition of "Beneficial Owner" contained in Art. 1 para 2 and 3 of the Annex to the revised AML/CFT Law is almost a verbatim implementation of the respective definition provided by Art 3 (6) of the Directive
Conclusion	The criteria in the EU definition of "beneficial owner" are covered by the AML/CFT Law.
Recommendations and Comments	None.

5.	**Financial activity on occasional or very limited basis**
Art. 2 (2) of the Directive	Member States may decide that legal and natural persons who engage in a financial activity on an occasional or very limited basis and where there is little risk of money laundering or financing of terrorism occurring do not fall within the scope of Art. 3(1) or (2) of the Directive. Art. 4 of Commission Directive 2006/70/EC further defines this provision.
FATF R. concerning financial institutions	When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering activity occurring, a country may decide that the application of anti-money laundering measures is not necessary, either fully or partially (2004 AML/CFT Methodology para 23; Glossary to the FATF 40 plus 9 Special Recs.).
Key elements	Does your country implement Art. 4 of Commission Directive 2006/70/EC?
Description and Analysis	The option provided by Art. 2 (2) of the Directive not to apply this Directive to certain legal or natural persons carrying out a financial activity on an occasional or very limited basis has not been used in the AML/CFT Law. The AML/CFT Law does not provide for such an exemption.
Conclusion	The option provided under Art. 2 (2) of the Directive has not been used. As a consequence there was no need to implement Art. 4 of Commission Directive 2006/70/EC.
Recommendations and Comments	None.

6.	**Simplified Customer Due Diligence (CDD)**
Art. 11 of the Directive	By way of derogation from the relevant Article the Directive establishes instances where institutions and persons may not apply CDD measures. However the obligation to gather sufficient CDD information remains.
FATF R. 5	Although the general rule is that customers should be subject to the full range of CDD measures, there are instances where reduced or simplified measures can be applied.
Key elements	Is there any implementation and application of Art. 3 of Commission Directive 2006/70/EC which goes beyond the AML/CFT Methodology 2004 criterion 5.9?
Description and Analysis	According to Art 30 §§1, 3 and 6 the obliged subjects are exempted from observing the CDD requirements if the customer is a: • credit or financial institution located in a State that observes equivalent AML/CFT requirements (no requirement that they are

	supervised for compliance with those requirements). • (domestic) public authority; and in relation to: • life insurance policies where the annual premium is not in excess of €1,000 or a single premium of no more than €2,500; • complementary pension schemes, provided that there is no surrender clause and that they cannot be used as collateral for a loan; • obligatory and complementary pensions and similar schemes that provide retirement benefits, when the contributions are made through deductions from the wages and whose rules do not permit the beneficiaries to transfer their own rights until after the death of the title holder; • beneficial owners of pooled accounts managed by foreign notaries or professionals that conduct similar activities in another State, provided that they are subject to requirements regarding the prevention and countering of ML and FT equivalent to those set forth in the AML/CFT Law; • electronic money, if no more than €150 can be memorised in the device, if it is not rechargeable; or, if it is rechargeable, if no more than €2,500 can be deducted in a legal year, unless €1,000 or more is reimbursed to the titular account holder in the same legal year. Those instances are taken from Art. 11 of the Directive. Art. 3 of Commission Directive 2006/70/EC provides criteria which the above-mentioned customers and products must meet so that they can be considered as customers or products representing a low risk of money laundering or terrorist financing. The criteria of Art. 3 of the Commission Directive 2006/70/EC are not implemented in the AML/CFT Law. The AML/CFT Law allows in these instances for simplified due diligence irrespective of whether those criteria are met or not. Differing from the concept of the Directive, the AML/CFT Law implemented Art. 3 of the Commission Directive in order to provide for additional instances of simplified due diligence to those mentioned in Art. 11 of the Directive. Pursuant to Art. 30 §7 of the revised AML/CFT Law the FIA may authorise the obliged subjects not to apply CDD requirements regarding particular categories of counterparts and typologies of relationships, services and transactions of low risk of money laundering or financing of terrorism. Such authorisation has to be granted pursuant to criteria set out to in the Annex to the revised AML/CFT Law, which are modelled on Art. 3 of the European Commission Directive 2006/70/EC. Based on Art. 3 §1 of the Annex to the revised AML/CFT Law, FIA may authorise obliged subjects not to apply CDD requirements with respect to a) public institutions and corporations as well as concessionaries of public activities that fulfil specific requirements (in particular: identity is publicly verifiable and certain; activity and accounting procedures are transparent; subject to the monitoring and control of a Public Authority established by the domestic law). Difference

	between public institution/ corporation and public authority according to Art. 30 §3 of the revised AML/CFT Law remains unclear. b) <u>corporations or legal persons</u> that conduct financial activities outside the scope of Art. 2 §1 revised AML/CFT Law but which have been subjected to this law and which fulfil the abovementioned criteria required for public institutions. (this provision appears not to make much sense, given that there are no subjects that are not covered by Art. 2 §1 of the revised AML/CFT Law) c) <u>companies listed on a regulated stock exchange</u> (there is no express requirement that the listed company has to be subject to regulatory disclosure requirements) d) <u>transactions and related products</u> that fulfil specific requirements (in particular: transaction or product has a written contractual basis; the transaction is conducted through an account of the counterpart at a credit or financial institutions based in a State that imposes equivalent CDD requirements; the transaction or product are not anonymous and their nature permits fulfilling the CDD requirements; the product has a pre-set maximum value (maximum value should be specified by State/Authority); etc.) While assessing whether the above-mentioned instances present a low risk of ML or FT, the FIA is required to consider carefully whether the counterpart, transaction or product is particularly susceptible, due to its nature, to be used for ML or FT. They shall not be presumed to present a low risk of money laundering or of financing of terrorism if there are no data or information that furnish sufficient certainty of the low risk. Rather than providing for simplified due diligence measures, Art. 30 of Act. CXXVII creates blanket exemptions from the CDD requirements. These customers and products are exempt from the CDD provisions that address the key CDD components of identifying and verifying the customer's identity, identifying the beneficial owner and verifying its identity, determining the purpose and intended nature of the business relationship, and conducting ongoing monitoring of the relationship. Therefore, these are not reduced or simplified CDD measures as suggested by the essential criteria, but an exemption from any CDD except in those situations when ML or FT are suspected, or when there are reasons to believe that the previous verification is unreliable or insufficient to provide the necessary information. (Art. 30 §5 of the revised AML/CFT Law). For both, credit/financial institutions and public authorities the obliged subjects are required to gather enough information to determine that the counterpart falls within one of these categories (Art. 30 §4 of the revised AML/CFT Law). However, there is no further clarification on what "enough data" means and the provision's scope seems limited to the process of determining whether the customers qualifies for the exemption. Furthermore, there is no requirement to gather sufficient information for the exemptions according to Art. 30 §6 and 7 of the revised AML/CFT Law.
Conclusion	The implementation and application of Art. 3 of Commission Directive 2006/70/EC goes beyond the AML/CFT Methodology 2004 criterion 5.9

	in so far as Art. 30 of the revised AML/CFT Law creates blanket exemptions from the CDD requirements rather than providing for simplified due diligence measures.
Recommendations and Comments	Address the exemptions for low-risk customers and products as adopted from the Directive by clarifying that minimum CDD (i.e. less detailed CDD) should nevertheless be accomplished.

7.	**Politically Exposed Persons (PEPs)**
Art. 3 (8), 13 (4) of the Directive (see Annex)	The Directive defines PEPs broadly in line with FATF 40 (Art. 3(8)). It applies enhanced CDD to PEPs residing in another Member State or third country (Art. 13(4)). Directive 2006/70/EC provides a wider definition of PEPs (Art. 2) and removal of PEPs after one year of the PEP ceasing to be entrusted with prominent public functions (Art. 2(4)).
FATF R. 6 and Glossary	Definition similar to Directive but applies to individuals entrusted with prominent public functions in a foreign country.
Key elements	Does your country implement Art. 2 of Commission Directive 2006/70/EC, in particular Art. 2(4), and does it apply Art. 13(4) of the Directive?
Description and Analysis	Politically exposed persons are defined in Art. 1 §18 of the revised AML/CFT Law as persons who are or who have been entrusted with prominent public functions, as well as their immediate family members and those with whom they publicly maintain a close association. The revised AML/CFT Law does not distinguish between persons who hold prominent functions domestically and those holding prominent functions in another country. The persons who are or have been entrusted with prominent public functions are defined in the Annex to the revised AML/CFT Law in line with Art. 2 (1) of the Commission Directive. Immediate family members and those with whom they publicly maintain a close association are defined in line with Art. 2 (2) and (3) of the Commission Directive. In line with Art. 2 (4) of the Commission Directive, a person no longer holding prominent public offices for a period of at least one year is not to be considered as a PEP. However, it is clearly stated in the same provision that this is without prejudice to the general obligation to apply enhanced due diligence on the basis of the assessment of the existing risk (Art. 2 §4 of the Annex to revised AML/CFT Law). The FATF plenary has considered the one-year limit in the context of an EU member state's mutual evaluation report, and has concluded that such a threshold is not a material deficiency when there is a general obligation to apply enhanced due diligence to customers (including PEPs) who still present a higher risk of ML or TF regardless of any timeframe. Such an obligation is provided in Art. 31 (1) of the revised AML/CFT Law. Art. 31 (5) of the revised AML/CFT Law transposes Art. 13 (4) of the Directive but does not limit the PEP requirements to persons residing in a Member state or a third country. The requirements apply irrespective of the residence of the PEP. It is a concern that pursuant to Art. 31 §5 of the of the revised AML/CFT Law (and in line with Art. 13 (4) (a) of the Directive) the procedure to determine politically exposed persons has to be applied only to the customer and not to the beneficial owner or to the

	potential customer.
Conclusion	Art. 2 of Commission Directive 2006/70/EC and in particular Art. 2(4) Commission Directive have been implemented into the AML/CFT Law. The PEP requirements are implemented in line with Art. 13(4) of the Directive but have to be applied irrespective of the residence of the PEP.
Recommendations and Comments	The requirement to determine politically exposed persons should be extended to the beneficial owner and the potential customer.

8.	**Correspondent banking**
Art. 13 (3) of the Directive	For correspondent banking, Art. 13(3) limits the application of Enhanced Customer Due Diligence (ECDD) to correspondent banking relationships with institutions from non-EU member countries.
FATF R. 7	Recommendation 7 includes all jurisdictions.
Key elements	Does your country apply Art. 13(3) of the Directive?
Description and Analysis	The provisions relating to enhanced CDD for correspondent banking relationships contained in Art. 31 §4 have to be applied to correspondent bodies of all foreign states.
Conclusion	Art. 13 (3) of the Directive has not been applied.
Recommendations and Comments	None.

9.	**Enhanced Customer Due Diligence (ECDD) and anonymity**
Art. 13 (6) of the Directive	The Directive requires ECDD in case of ML or TF threats that may arise from products or transactions that might favour anonymity.
FATF R. 8	Financial institutions should pay special attention to any money laundering threats that may arise from new or developing technologies that might favour anonymity [.].
Key elements	The scope of Art. 13(6) of the Directive is broader than that of FATF R. 8, because the Directive focuses on products or transactions regardless of the use of technology. How are these issues covered in your legislation?
Description and Analysis	Pursuant to Art. 2 *ter* §1 of the revised AML/CFT Law, the obliged subjects are required to adopt adequate policies, organisation, measures and procedures to prevent and counter ML and FT, on the basis of the development of new technologies and of the phenomena of money laundering and the financing of terrorism. Furthermore, the obliged parties are required, pursuant to FIA Instruction No. 1, to take into account technological progress and financial innovation when preparing effective organisational and computerised tools in order to guarantee an adequate protective scheme against ML and FT risks. Furthermore, FIA Instruction No. 1 requires that the staff training is reviewed regularly and should take into account progresses made in the fields of technology and financial innovation.
Conclusion	There is no provision requiring ECDD in case of ML or TF threats that may arise from products or transactions that might favour anonymity as foreseen under Art. 13 (6) of the Directive.
Recommendations and Comments	Consider implementing Art. 13 (6) of the Directive.

10.	Third Party Reliance
Art. 15 of the Directive	The Directive permits reliance on professional, qualified third parties from EU Member States or third countries for the performance of CDD, under certain conditions.
FATF R. 9	Allows reliance for CDD performance by third parties but does not specify particular obliged entities and professions which can qualify as third parties.
Key elements	What are the rules and procedures for reliance on third parties? Are there special conditions or categories of persons who can qualify as third parties?
Description and Analysis	The AML/CFT Law does not provide for reliance on intermediaries or other third parties to perform elements of the CDD process or to introduce business. The CDD requirements described under Recommendation 5 have to be performed by the obliged subjects themselves.
Conclusion	Act no. CXXVII/2010 is more stringent than the Directive, given that the reliance on intermediaries or other third parties to perform elements of the CDD process is not allowed.
Recommendations and Comments	None.

11.	Auditors, accountants and tax advisors
Art. 2 (1)(3)(a) of the Directive	CDD and record keeping obligations are applicable to auditors, external accountants and tax advisors acting in the exercise of their professional activities.
FATF R. 12	CDD and record keeping obligations 1. do not apply to auditors and tax advisors; 2. apply to accountants when they prepare for or carry out transactions for their client concerning the following activities: • buying and selling of real estate; • managing of client money, securities or other assets; • management of bank, savings or securities accounts; • organisation of contributions for the creation, operation or management of companies; • creation, operation or management of legal persons or arrangements, and buying and selling of business entities (2004 AML/CFT Methodology criterion 12.1(d)).
Key elements	The scope of the Directive is wider than that of the FATF standards but does not necessarily cover all the activities of accountants as described by criterion 12.1(d). Please explain the extent of the scope of CDD and reporting obligations for auditors, external accountants and tax advisors.
Description and Analysis	The AML/CFT Law covers accountants and external accounting and tax consultants. In contrast to the requirements of the Directive, auditors do not fall under the scope of the AML/CFT Law. With respect to the activities that are subject to CDD and record keeping requirements, the AML/CFT Law is linked to the FATF standard rather than the Directive. According to Art. 2 §1 (b) of the revised AML/CFT Law accountants, and external accounting or tax

	consultants are subject to the requirements of the AML/CFT Law,
	• when they engage or participate in any financial or real estate transaction, or
	• when they assist someone to plan or execute transactions relating to:
	  • buying or selling real estate or business entities;
	  • managing currency, financial instruments or other funds or other assets;
	  • opening or managing banking, savings or securities accounts; and
	  • organising the contributions necessary for the creation, operation or management of corporations or legal persons;
	According to the essential criterion they should also be subject to AML/CFT requirements with respect to the creation, operation or management of legal persons or arrangements and buying and selling business entities. However, those activities are not covered by the revised AML/CFT Law (Art. 2 §1 b) i. of the revised AML/CFT Law).

Conclusion	CDD and record keeping requirements do not cover all relevant activities of accountants as described by criterion 12.1(d).
Recommendations and Comments	The scope of the AML/CFT Law should be extended. Accountants should also be subject to CDD and record keeping requirements when they prepare for or carry out transactions for their client related to the creation, operation or management of legal persons or arrangements and buying and selling business entities.

12.	**High Value Dealers**
Art. 2(1)(3)e) of the Directive	The Directive applies to natural and legal persons trading in goods where payments are made in cash in an amount of EUR 15,000 or more.
FATF R. 12	The application is limited to those dealing in precious metals and precious stones.
Key elements	The scope of the Directive is broader. Is the broader approach adopted in your jurisdiction?
Description and Analysis	The AML/CFT Law applies to dealers in precious metals or stones, when they engage in a transaction equal or above €15,000 (Art. 2 §1 letter c) ii. of the revised AML/CFT Law).
Conclusion	The AML/CFT Law has not adopted the approach of the Directive.
Recommendations and Comments	None.

13.	**Casinos**
Art. 10 of the Directive	Member States shall require that all casino customers be identified and their identity verified if they purchase or exchange gambling

	chips with a value of EUR 2,000 or more. This is not required if they are identified at entry.
FATF R. 16	The identity of a customer has to be established and verified when he or she engages in financial transactions equal to or above EUR 3,000.
Key elements	In what situations do customers of casinos have to be identified? What is the applicable transaction threshold in your jurisdiction for identification of financial transactions by casino customers?
Description and Analysis	According to Art. 1 *ter* §1 c) of the revised AML/CFT Law it is prohibited to open casinos.
Conclusion	Given that the operation of casinos is not allowed in the HS/VCS there are no respective rules contained in the AML/CFT Law.
Recommendations and Comments	None.

14.	**Reporting by accountants, auditors, tax advisors, notaries and other independent legal professionals via a self-regulatory body to the FIU**
Art. 23 (1) of the Directive	This article provides an option for accountants, auditors and tax advisors, and for notaries and other independent legal professionals to report through a self-regulatory body, which shall forward STRs to the FIU promptly and unfiltered.
FATF Recommendations	The FATF Recommendations do not provide for such an option.
Key elements	Does the country make use of the option as provided for by Art. 23 (1) of the Directive?
Description and Analysis	Pursuant to Art. 34 §1 of the revised AML/CFT Law all obliged subjects (including the above-mentioned DNFBP) are required to report to the Financial Intelligence Authority.
Conclusion	No use was made of the option provided by Art. 23 §1 of the Directive.
Recommendations and Comments	None.

15.	**Reporting obligations**
Arts. 22 and 24 of the Directive	The Directive requires reporting where an institution knows, suspects, or has reasonable grounds to suspect money laundering or terrorist financing (Art. 22). Obliged persons should refrain from carrying out a transaction knowing or suspecting it to be related to money laundering or terrorist financing and to report it to the FIU, which can stop the transaction. If to refrain is impossible or could frustrate an investigation, obliged persons are required to report to the FIU immediately afterwards (Art. 24).
FATF R. 13	Imposes a reporting obligation where there is suspicion that funds are the proceeds of a criminal activity or related to terrorist financing.
Key elements	What triggers a reporting obligation? Does the legal framework address *ex ante* reporting (Art. 24 of the Directive)?
Description and Analysis	Pursuant to Art. 34.1 of the revised AML/CFT Law, the relevant entities are obliged to inform the FIA, on their own initiative, of any suspicious transaction, when they know, suspect or have reasons to suspect that the relevant funds are the proceeds of criminal activities or when ML or FT

	has been or is being committed or has been attempted. Art. 35.1 of the revised AML/CFT Law sets the rule of *a priori* reporting, prohibiting the reporting entities to carry out operations they consider suspect, unless they have filed a SAR. Deviating from this rule is only allowed if it is impossible to abstain from executing the transaction or if by doing so it would jeopardise an investigation. In those cases the report must be filed immediately after execution (Art.35.2 of the revised AML/CFT Law). As the reporting rule refers to the offence of financing of terrorism, the concerns raised about the scope of the offence are also relevant in this context.
Conclusion	Except for the cascading effect of the TF offence deficiencies, the reporting obligation complies with the EU rules.
Recommendations and Comments	Full compliance will be achieved once the TF offence has been properly addressed.

16.	**Tipping off (1)**	
Art. 27 of the Directive	Art. 27 provides for an obligation for Member States to protect employees of reporting institutions from being exposed to threats or hostile actions.	
FATF R. 14	No corresponding requirement (directors, officers and employees shall be protected by legal provisions from criminal and civil liability for "tipping off", which is reflected in Art. 26 of the Directive)	
Key elements	Is Art. 27 of the Directive implemented in your jurisdiction?	
Description and Analysis	The AML/CFT Law does not provide for protection of employees of reporting institutions from being exposed to threats or hostile actions.	
Conclusion	Art. 27 of the Directive is not implemented in the AML/CFT Law.	
Recommendations and Comments	Consider implementing Art. 27 of the Directive.	

17.	**Tipping off (2)**	
Art. 28 of the Directive	The prohibition on tipping off is extended to where a money laundering or terrorist financing investigation is being or may be carried out. The Directive lays down instances where the prohibition is lifted.	
FATF R. 14	The obligation under R. 14 covers the fact that an STR or related information is reported or provided to the FIU.	
Key elements	Under what circumstances are the tipping off obligations applied? Are there exceptions?	
Description and Analysis	Art. 36 of the revised AML/CFT Law establishes a prohibition for the reporting parties, their legal representatives, administrators, directors, employees, consultants, and collaborators of whatever nature, as well as anyone else who is aware of it, to disclose to the entitled person or to third parties the report of suspicious transactions, including correlative information.	

	In line with Art. 28 of the Directive the prohibition is extended to where a ML or TF investigation is being or may be carried out. The AML/CFT Law does not provide for exceptions to the tipping off obligations.
Conclusion	The tipping-off obligations of the AML/CFT Law cover both, the instances provided by the FATF Standard and those foreseen by the Directive. There are no exceptions to the tipping-off obligations.
Recommendations and Comments	None.

18.	**Branches and subsidiaries (1)**
Art. 34 (2) of the Directive	The Directive requires credit and financial institutions to communicate the relevant internal policies and procedures where applicable on CDD, reporting, record keeping, internal control, risk assessment, risk management, compliance management and communication to branches and majority owned subsidiaries in third (non EU) countries.
FATF R. 15 and 22	The obligations under the FATF 40 require a broader and higher standard but do not provide for the obligations contemplated by Art. 34 (2) of the EU Directive.
Key elements	Is there an obligation as provided for by Art. 34 (2) of the Directive?
Description and Analysis	Pursuant to Art. 2 *bis* of the revised AML/CFT Law the foreign branches and subsidiaries of the obliged subjects, as well as the institutions controlled exclusively or jointly, directly or indirectly, by them, are required to observe the requirements set out in the AML/CFT Law. When the requirements in force in the foreign State are not equivalent with those set out by this law, the branches, subsidiaries or controlled institutions they are required to observe the requirements set out in this law, to the extent that the laws of the foreign State permit so.
Conclusion	There is no obligation as provided for by Art. 34 (2) of the Directive.
Recommendations and Comments	Consider implementing Art. 34 (2) of the Directive.

19.	**Branches and subsidiaries (2)**
Art. 31(3) of the Directive	The Directive requires that where legislation of a third country does not permit the application of equivalent AML/CFT measures, credit and financial institutions should take additional measures to effectively handle the risk of money laundering and terrorist financing.
FATF R. 22 and 21	Requires financial institutions to inform their competent authorities in such circumstances.
Key elements	What, if any, additional measures are your financial institutions obliged to take in circumstances where the legislation of a third country does not permit the application of equivalent AML/CFT measures by foreign branches of your financial institutions?
Description and Analysis	When the requirements in force in the foreign State are not equivalent with those set out by the AML/CFT Law, Art. *bis* §3 of the revised

	AML/CFT Law requires branches, subsidiaries or controlled institutions to inform the Financial Intelligence Authority.
Conclusion	There is no obligation as provided for by Art. 31 (3) of the Directive.
Recommendations and Comments	Consider implementing Art. 31 (3) of the Directive.

20.	**Supervisory Bodies**
Art. 25 (1) of the Directive	The Directive imposes an obligation on supervisory bodies to inform the FIU where, in the course of their work, they encounter facts that could contribute evidence of money laundering or terrorist financing.
FATF R.	No corresponding obligation.
Key elements	Is Art. 25(1) of the Directive implemented in your jurisdiction?
Description and Analysis	In the HS/VCS the supervisory functions are assigned to the FIA. Accordingly, there is no need to impose an obligation to inform the FIU, where, in the course of their work, they encounter facts that could contribute evidence of money laundering or terrorist financing.
Conclusion	Given that supervisory functions are assigned to FIA there is no need to implement Art. 25 (1) of the Directive.
Recommendations and Comments	

21.	**Systems to respond to competent authorities**
Art. 32 of the Directive	The Directive requires credit and financial institutions to have systems in place that enable them to respond fully and promptly to enquires from the FIU or other authorities as to whether they maintain, or whether during the previous five years they have maintained, a business relationship with a specified natural or legal person.
FATF R.	There is no explicit corresponding requirement but such a requirement can be broadly inferred from Recommendations 23 and 26 to 32.
Key elements	Are credit and financial institutions required to have such systems in place and effectively applied?
Description and Analysis	Pursuant to Art. 33 §5 the obliged subjects are required to adopt record-keeping mechanisms that make it possible to respond promptly and effectively to the inquiries of the competent authorities. However, there is no explicit requirement to have systems in place that enable financial institutions to respond fully and promptly to enquires from the FIU or other authorities as to whether they maintain, or whether during the previous five years they have maintained, a business relationship with a specified natural or legal person.
Conclusion	Art. 32 of the Directive was not implemented.
Recommendations and Comments	Consider implementing Art. 32 of the Directive.

22.	**Extension to other professions and undertakings**

Art. 4 of the Directive	The Directive imposes a *mandatory* obligation on Member States to extend its provisions to other professionals and categories of undertakings other than those referred to in Art.2(1) of the Directive, which engage in activities which are particularly likely to be used for money laundering or terrorist financing purposes.
FATF R. 20	Requires countries only to consider such extensions.
Key elements	Has your country implemented the mandatory requirement in Art. 4 of the Directive to extend AML/CFT obligations to other professionals and categories of undertaking which are likely to be used for money laundering or terrorist financing purposes? Has a risk assessment been undertaken in this regard?
Description and Analysis	The AML/CFT obligations have not been extended to other professionals and categories of undertaking than those referred to by the FATF standard respectively by Art. 2(1) of the Directive (with the exception of casinos). It remains unclear whether there are other professionals and categories of undertakings which are likely to be used for ML or TF purposes given that a risk assessment has not been undertaken in this regard.
Conclusion	The mandatory requirement in Art. 4 of the Directive has not been implemented.
Recommendations and Comments	HS/VCS authorities should undertake a risk assessment in order to find out if there are other professionals and categories of undertakings which are likely to be used for ML and TF purposes. As the case may be, they should consider implementing Art. 4 of the Directive.

23.	**Specific provisions concerning equivalent third countries**
Art. 11, 16(1)(b), 28(4),(5) of the Directive	The Directive provides specific provisions concerning countries which impose requirements equivalent to those laid down in the Directive (e.g. simplified CDD).
FATF R.	There is no explicit corresponding provision in the FATF 40 plus 9 Recommendations.
Key elements	How, if at all, does your country address the issue of equivalent third countries?
Description and Analysis	While the Directive refers to requirements equivalent to those laid down in the Directive the AML/CFT Law refers to "equivalent requirements to those set out in the AML/CFT Law". Such references are contained in various provisions: • Art. 30 §1 of the revised AML/CFT Law (SDD for financial institutions); • Art. 3 para 1 (d) Annex to the revised AML/CFT Law (SDD for beneficial owner of pooled accounts managed by notaries public or other legal professionals); • Art. 31 §2 (b) of the revised AML/CFT Law (confirmatory certification by a financial institution for non-face-to face customers); • Art. 6 FIA Regulation (transfers of funds involving States having equivalent legislative schemes);

	• Part 2 Section IV FIA Instruction No. 2 (verifications documents; websites of public organisations and authorities); • Part 5 Instruction No. 2 (rules of ECDD towards financial institutions located in States that do not have equivalent regulations). The States whose regimes are deemed to be equivalent are identified by the Secretariat of State based on Art. 30 §2 AML/CFT. The list of equivalent countries, which was drawn up by FIA before the AML/CFT Law has been revised, is contained in FIA Instruction No. 3[89]. According to the Instruction the list was drawn up on the basis of the information available at the international level, and of information taken from assessment reports of national systems for preventing and countering money laundering and financing of terrorism, adopted by the GAFI/FATF, any FSRB, the IMF or the World Bank, as well as other updated information provided by the States concerned.
Conclusion	HS/VCS has adopted specific provisions concerning countries which impose requirements equivalent to those of the State.
Recommendations and Comments	None.

Annex to Compliance with 3rd EU AML/CFT Directive Questionnaire

Article 3 (6) of EU AML/CFT Directive 2005/60/EC (3rd Directive):

(6) "beneficial owner" means the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:

(i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25 % plus one share shall be deemed sufficient to meet this criterion;
(ii) the natural person(s) who otherwise exercises control over the management of a legal entity:

(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:

(i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25 % or more of the property of a legal arrangement or entity;
(ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;

[89] At the time of the MONEYVAL on-site visit the list included the following states and territories: Member states of the European Community and the European economic area (Iceland, Liechtenstein and Norway), Australia, Brazil, Canada, Japan, Hong Kong, India, Republic of Korea, Mexico, Russian Federation, Singapore, United States of America, Republic of South Africa, Switzerland, Mayotte, New Caledonia, French Polynesia, Saint-Pierre and Miquelon, Wallis and Futuna, Aruba, Curaçao, Sint Maarten, Bonaire, Sint Eustatius, Saba.

(iii) the natural person(s) who exercises control over 25 % or more of the property of a legal arrangement or entity;

Article 3 (8) of the EU AML/CFT Directive 2005/60EC (3rd Directive):

(8) "politically exposed persons" means natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons;

Article 2 of Commission Directive 2006/70/EC (Implementation Directive):

Article 2
Politically exposed persons

1. For the purposes of Article 3(8) of Directive 2005/60/EC, "natural persons who are or have been entrusted with prominent public functions" shall include the following:
(a) heads of State, heads of government, ministers and deputy or assistant ministers;
(b) members of parliaments;
(c) members of supreme courts, of constitutional courts or of other high-level judicial bodies whose decisions are not subject to further appeal, except in exceptional circumstances;
(d) members of courts of auditors or of the boards of central banks;
(e) ambassadors, chargés d'affaires and high-ranking officers in the armed forces;
(f) members of the administrative, management or supervisory bodies of State-owned enterprises.
None of the categories set out in points (a) to (f) of the first subparagraph shall be understood as covering middle ranking or more junior officials.
The categories set out in points (a) to (e) of the first subparagraph shall, where applicable, include positions at Community and international level.

2. For the purposes of Article 3(8) of Directive 2005/60/EC, "immediate family members" shall include the following:
(a) the spouse;
(b) any partner considered by national law as equivalent to the spouse;
(c) the children and their spouses or partners;
(d) the parents.

3. For the purposes of Article 3(8) of Directive 2005/60/EC, "persons known to be close associates" shall include the following:
(a) any natural person who is known to have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a person referred to in paragraph 1;
(b) any natural person who has sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the benefit *de facto* of the person referred to in paragraph 1.

4. Without prejudice to the application, on a risk-sensitive basis, of enhanced customer due diligence measures, where a person has ceased to be entrusted with a prominent public function within the meaning of paragraph 1 of this Article for a period of at least one year, institutions and persons referred to in Article 2(1) of Directive 2005/60/EC shall not be obliged to consider such a person as politically exposed.

VI. LIST OF ACRONYMS AND GLOSSARY OF TERMS USED

Term	Definition
Acta Apostolicae Sedis (Acts of the Apostolic See)	The official gazette of the Holy See which, since 1909, appears approximately 12 times a year. It contains all the principal Papal documents and the documents issued by the Roman congregations, and notices of ecclesiastical appointments.
Acta Sanctae Sedis	A monthly publication founded in 1865. Between 1904 and 1909, when the Acta Apostilicae Sedis was founded, it had an official character. It contains the principal documents issued by the Pope, directly or through the Roman Congregations.
Additional elements	The additional elements are options that can further strengthen the AML/CFT system and may be desirable. They are derived from non-mandatory elements in the FATF Recommendations or from Best Practice and other guidance issued by the FATF, or by international standard-setters such as the Basel Committee on Banking Supervision. Although they form part of the overall assessment, they are not mandatory, and are not assessed for compliance purposes.
Ad limina visit	The obligation of residential diocesan bishops and certain prelates with jurisdiction (such as territorial abbots), of visiting every five years the thresholds of the [tombs of the] Apostles, Saints Peter and Paul, and of meeting the Pope and the dicasteries of the Roman Curia to report on the state of their dioceses or prelatures.
AIF	Autorità di Informazione Finanzaria - Financial Intelligence Authority.
AML/CFT Law	Refers both to Act of the Vatican City State No. CXXVII, concerning the prevention and countering of the laundering of proceeds resulting from criminal activities and financing of terrorism, 30th December 2010 revised and Decree No. CLIX promulgating amendments and additions to Law n. CXXVII, On the Prevention and countering of the laundering of the proceeds of criminal activities and the financing of terrorism, of 30 December 2010 of 25 January 2012.
Amministrazione del Patrimonio della Sede Apostolica	Administration of the Patrimony of the Apostolic See (APSA).
Annuario Pontifico	Pontifical Yearbook.
Apostolic Letter	In this context, 'Apostolic Letters' means documents issued by the Pope, e.g. bulls and briefs.
Apostolic Nuncio	A permanent diplomatic representative (head of diplomatic mission) of the Holy See to a state or international organisation (e.g., the United Nations), having the rank of an ambassador extraordinary and plenipotentiary, usually with the ecclesiastical rank of titular archbishop. The Nuncio represents in a stable manner the person of the Roman Pontiff before the Roman Catholic diocesan episcopate in the nation or region to which he is assigned (can. 363). His principal task is to make more firm and effective the bonds of unity which exist between the Holy See and the particular Churches (can. 364). In those States that maintain diplomatic relations with the Holy See, he

	is tasked with promoting and fostering relationships between the Apostolic See and the Authorities of the State (can. 365). Under the 1961 Vienna Convention on Diplomatic Relations, a Papal Nuncio is an ambassador like those from any other country. However, the Vienna Convention allows the receiving state to grant seniority of precedence to the Papal Nuncio over others of ambassadorial rank accredited to the same country, and may grant the deanship of that country's diplomatic corps to the Nuncio regardless of seniority.
Apostolic Palace	The official residence of the Pope, which is located in Vatican City. the Apostolic Palace houses both residential apartments and support offices of various functions as well as administrative offices not focused on the life and functions of the Pope himself.
APSA	Administration of the Patrimony of the Apostolic See.
Autorità di Informazione Finanzaria	Financial Intelligence Authority.
Can.	Code of Canon Law clause.
Canonical legal system	The written policies, issued by the legitimate authority, that guide the inter-subjective relations in the Church's community.
Carabinieri	One of the four branches of the Italian armed forces It is a military police force entrusted with public security.
Caritas in Veritate	Latin for 'Charity in Truth'. It is the third encyclical of Pope Benedict XVI and his first social encyclical. It was signed on June 29, 2009, and was published on July 7, 2009. The encyclical is concerned with the problems of global development and progress towards the common good. The work is addressed to all strata of global society, with specific points aimed at political leaders, business leaders, religious leaders, financiers and aid agencies but the work as a whole is also addressed to all people of good will. The encyclical contains detailed reflection on economic and social issues and problems.
CCL	Code of Canon Law.
CDD	Customer Due Diligence.
CETS	Council of Europe Treaty Series.
CFT	Combating the financing of terrorism.
Chirograph	A papal document of medieval origin, which has been written in duplicate, triplicate or very occasionally quadruplicate on a single piece of parchment, where the Latin word "chirographum" (or equivalent) has been written across the middle, and then cut through so that both parties to an agreement could verify the authenticity of their respective copies by comparing one to the other. The cut itself would often be made to produce a wavy or serrated edge, in order to further reduce the scope for forgery, and this practice gave rise to the document description "indenture", since these edges would be said to be "indented".
Code of Canon Law	The Code of Canon Law represents the principal body of laws and regulations made by or adopted by ecclesiastical authority, for the government of the Christian organisation and its members. The current Code was promulgated on the 25th day of January 1983.
Codex Iuris Canonici	Code of Canon Law.

Concordats	An agreement between the Holy See and a sovereign state on diplomatic and religious matters. Legally, a concordat is an international treaty, that regulates the external activities and the social role of the Church within a particular State as well as State-Church relations.
Corpus delicti	Under common law, this refers to the principle that a crime must have been proven to have occurred before a person can be convicted of committing that crime. Under civil law it also means the body of the offence, i.e. the object on which the offence is committed.
CTR	Cash Transaction Reports.
Curia Romana	Roman Curia.
Delicts	Offences.
Dicasteries	An Italicism sometimes used in English to refer to the Departments of the Roman Curia.
DNFBP	Designated Non-Financial Businesses and Professions.
ECB	European Central Bank.
Egmont Group	Forum for FIUs around the world to improve co-operation in the fight against money laundering and financing of terrorism and to foster the implementation of domestic programs in this field.
Encharged persons	persons entitled to execute a single ad hoc transaction, without a general proxy.
Encyclical Letter	According to its etymology, an encyclical (from the Greek *egkyklios, kyklos* meaning a circle) is nothing more than a circular letter. In modern times, usage has confined the term almost exclusively to certain papal documents explicitly addressed to the patriarchs, primates, archbishops, and bishops of the Universal Church in communion with the Apostolic See and even to all men of good will. Encyclicals indicate high Papal priority for an issue at a given time.
Episcopal see	The official seat of a bishop. This seat, which is also referred to as the bishop's cathedra, is placed in the principal church of the bishop’s jurisdiction, which is therefore called the bishop's cathedral. Frequently, this term is used as a synonym for “dioceses”.
Episcopalis sedes	Episcopal see; the official seat of a bishop.
Essential criteria	Those elements that should be present in order to demonstrate full compliance with the mandatory elements of each of the FATF Recommendations
ETS	European Treaty Series [since 1.1.2004: CETS = Council of Europe Treaty Series]
FATF	Financial Action Task Force.
FIA	Financial Intelligence Authority, the FIU of the Holy See (including the Vatican City State).
FIU	Financial Intelligence Unit.
Flagrante delicto	*In flagrante delicto* is a legal term used to indicate that a criminal has been caught in the act of committing an offence. The colloquial "caught in the act", "caught red-handed", or "caught rapid" are English equivalents.

Guardia di Finanza	An Italian law enforcement agency under the authority of the Minister of Economy and Finance responsible for dealing with financial crime and smuggling.
Holy See/Apostolic See	These terms refer both to the Pope and, unless the contrary is clear from the nature of things or from the context, to the Secretariat of State, the Council for the public affairs of the Church, the Congregations, the Tribunals and the other Institutes of the Roman Curia, which acts in his name and with his authority, and through which the Pontiff usually conducts the business of the universal Church (Code of Canon Law clauses 360-361).
HS	Holy See.
IN	Interpretative Note.
In abstracto	In the abstract.
In rem	Latin for "against a thing."http://en.wikipedia.org/wiki/In_rem - cite_note-0#cite_note-0
Inter vivos	A legal term referring to a transfer or gift made during one's lifetime, as opposed to a testamentary transfer (a gift that takes effect on death).
IOR	Institute for the Works of Religion (Istituto per le Opere di Religione)
Istituto per le Opere di Religione	Institute for Works of Religion (IOR).
IT	Information Technology.
Iure gestionis	Commercial or private acts.
Iure imperii	By virtue of its sovereignty.
Ius legationis	A Latin legal term meaning the capacity to send and receive consuls and diplomats.
Ius officii	A Latin legal term meaning the right or power of an office. It is invested to those who have been appointed to fulfil a role, exercise an office or perform a task for the Holy See or in the Vatican City State to work at the Vatican, and it is usually revoked upon the termination of their employment.
Ius sanguinis	Latin for ‘right of blood’. It is a social policy by which citizenship is determined by parentage (not place of birth).
Ius soli	Latin for ‘right of soil’. It is a social policy by which citizenship is determined by place of birth (not parentage).
Ius tractandi	The capacity of a state to conclude treaties and conduct its own policy abroad.
Lateran Treaty	The Lateran Treaty is one of the Lateran Pacts of 1929 or Lateran Accords, three agreements made in 1929 between the Kingdom of Italy and the Holy See, ratified June 7, 1929, ending the ‘Roman Question’. The Treaty establishes and recognises the full sovereignty of the Holy See in the Vatican City State.
LEA	Law Enforcement Agency.
Legal persons without canonical recognition	Legal persons recognised under civil law but without canonical recognition. (Sometimes referred to as “improper foundations”).
MEQ	Mutual Evaluation Questionnaire.

MLA	Mutual Legal Assistance.
Motu Proprio	A document issued by the Pope on his own initiative directed to the Roman Catholic Church.
MOU	Memorandum of Understanding.
NCCT	Non-cooperative countries and territories.
Nunciature	A top-level diplomatic mission of the Holy See, equivalent to an embassy.
Nuncio	See “Apostolic nuncio” above.
Original AML/CFT Law	Law n. CXXVII, On the Prevention and countering of the laundering of the proceeds of criminal activities and the financing of terrorism, of 30 December 2010 (replaced by Decree No. CLIX).
Pastor Bonus	An Apostolic Constitution promulgated by Pope John Paul II on 28 June 1988. It instituted a number of reforms in the process of running the central government of the Roman Catholic Church and sets out the roles of the Secretariat of State, Congregations, Tribunals, Pontifical Councils, Administrative Services and Pontifical Commissions of the Roman Curia. It also establishes the norms for the *Ad limina* visits of bishops to Rome.
PEP	Politically Exposed Persons.
Peregrinatio ad Petri Sedem	A canonical body of the Holy See, constituted in 1933 for the co-ordination and assistance of the pilgrims who come to Rome, "*ad Petri sedem*" in particular during the jubilee years.
Peter´s Pence	A voluntary payment made to the Roman Catholic Church which began under the Saxons in England.
Pontifical State	The Papal States before 1870.
Pontifical Yearbook	The annual directory of the Holy See. It lists all the Popes to date and all officials of the Holy See's departments. It also gives complete lists, with contact information, of the Cardinals and Catholic bishops throughout the world, the dioceses (with statistics about each), the departments of the Roman Curia, the Holy See's diplomatic missions abroad, the embassies accredited to the Holy See, the headquarters of religious institutes (again with statistics on each), certain academic institutions, and other similar information.
Pontificial Commission for Vatican City State	The legislative body of the Vatican City State.
Prefecture for the Economic Affairs of the Holy See	An office of the Roman Curia, entrusted with overseeing all the offices of the Holy See that manage finances.
Prudential supervision	The supervision and regulation of financial institutions where the supervising authority seeks to ensure that the customers are protected by the institution in question being financially sound.
Questione Romana	The Roman Question.
Rescript	A rescript is an administrative act issued in writing by a competent authority, by which of its very nature a privilege, dispensation or other favour is granted at someone’s request (can. 59§1).

Revised AML/CFT Law	Decree No. CLIX promulgating amendments and additions to Law n. CXXVII, On the Prevention and countering of the laundering of the proceeds of criminal activities and the financing of terrorism, of 30 December 2010.
Roman Curia	The complex of Dicasteries and institutes through which the Roman Pontiff usually conducts the business of the universal Church in the exercise of his supreme pastoral office for the good and service of the whole Church and of the particular Churches. (can 360-361). The Curia, together with the Pope, represents the administrative apparatus of the Holy See and central governing body of the Catholic Church.
Roman Pontiff; Supreme Pontiff	The Bishop of Rome, i.e. the Pope.
Roman Question	A political dispute between the Italian Government and the Papacy from 1870 to 1929.
Sancta Sedes	Holy See/Apostolic See.
SAR	Suspicious activity report.
Secretariat of State	A dicastery of the Roman Curia. It is headed by the Cardinal Secretary of State and performs the main political and diplomatic functions of the Holy See.
Segnalazioni	Reported cases.
Sezione Ordinaria	Ordinary Section of APSA.
Sezione Straordinaria	Extraordinary Section of APSA.
Specola Vaticana	The Vatican Observatory. An astronomical research and educational institution supported by the Holy See.
SRO	Self-Regulatory Organisation.
stricto sensu	In the narrow sense.
STRs	Suspicious transaction reports.
Sub judice	Under judgement.
sui generis	Unique, only one of a kind.
SWIFT	Society for Worldwide Interbank Financial Telecommunication.
Una gestione reale	Effective control and management.
VCS	Vatican City State.