

**Mr. Fazio discusses the current situation as regards the prevention and repression of money laundering in the financial system in Italy** Statement by the Governor of the Bank of Italy, Dott. Antonio Fazio, before the Chambre of Commerce of the Senate of the Italian Republic in Rome on 25/2/97.

In my statement to this Committee in October 1994 I focused on the new legal framework for finance and credit, the role of the supervisory authorities and intermediaries in combatting illegal activities, and cooperation with the governmental authorities directly involved in the fight against organized crime.

In the last two years the broad context has changed and evolved. Progress has been made in developing the analysis of financial offences, instruments for preventing and repressing them.

The investment services Directive has been transposed; the law against usury has been approved. The cooperation between the Bank of Italy, intermediaries and law enforcement and judicial authorities has been further strengthened.

1. Adverse effects of criminal activity and money laundering on the economy and finance

My contribution today takes account of the experience of the Bank of Italy and that of the UIC; since 1991 the latter has been entrusted by law with special tasks in the anti-money-laundering field.

The repercussions of criminal activity on the economy and finance involve the supervisory function of the central bank and its responsibility for safeguarding monetary stability. Money is a typically and purely fiduciary value. It is indispensable that citizens should be aware that the State, through its institutions, guarantees the security and prompt execution of exchanges; financial enterprises must be able to operate in an efficient, correct and transparent manner.

In the first place it is necessary to prevent financial resources of **illicit origin from entering** the legitimate economy through the creation of **new intermediaries or the** acquisition of existing ones. Analogous, and **equally serious, problems, exist** in other sectors, notably the distributive trades. It is necessary to ensure that illicit resources cannot influence the ordinary course of financial intermediation.

The proper functioning of the market requires compliance with fundamental ethical rules. Correct behaviour is an economic value in itself; it enhances the strength and security of economic agents.

The existence of economic agents and structures in collusion with organized crime profoundly modifies the mechanisms of the market with respect to rules and objectives, distorts competition.

The gap between the level of economic development in the various regions of Italy is due to a considerable extent to inadequate economic and social infrastructure; shortcomings in the public administration and the slowness of the judicial system are other contributory factors.

Organized crime exploits the situation of underemployment in the depressed areas; to the socially weaker members of the community it appears as an economic force and even as a system of values, which undermines ethical principles and social solidarity.

It is possible to attack criminal organizations in the phase of infiltrating money into the legal financial circuits. This task is the responsibility of the law enforcement authorities and those entrusted with the control of the financial system; it requires full and convinced support on the part of agents and intermediaries.

The supervisory authorities of the leading industrial countries are aware of the threat to the integrity and stability of intermediaries posed by illicit capital. Increasing efforts are

being made to prepare weapons and defences with which to prevent contagion by criminal activities and the related instability of financial systems.

2. The international dimension of the money laundering problem

The removal of the restrictions and controls on capital movements and the emergence of a global market for credit, foreign exchange and securities have undoubtedly facilitated the international laundering of the proceeds of criminal activities.

The size of the phenomenon is difficult to gauge, but certainly considerable.

The authorities of the leading countries have defined a set of measures that should be embodied in all their legal systems in order to make prevention and repression more effective. The aim is to achieve uniform behaviour in the face of the phenomenon.

The recommendations of the international Financial Task Force set up within the Group of Seven and Community Directive 1991/308 contain clear guidelines and prescriptions, especially for EU countries.

International organizations are seeking to take more direct steps, in the first place with respect to countries that appear reluctant to introduce anti-money-laundering provisions into their legal systems.

The effectiveness of such provisions is reduced by the tolerant attitude towards money laundering in some countries, the so-called off shore centres, a classification that stretches to include independent territories and states in various continents.

The protection offered by banking secrecy that is impenetrable even for criminal investigators, shortcomings in legislation or the lack thereof, problems in cooperating with local judicial authorities and difficulty in supervising intermediaries make it particularly easy in some financial centres to launder money of illicit origin.

In the case of branches and subsidiaries of international banks located in such centres, the controls of the parent bank and the supervisory authorities are sometimes made impossible or at any rate difficult. Since 1992 the Bank of Italy has adopted a restrictive stance to Italian banks setting up establishments in some off-shore centres; no new establishments have been authorized.

In this field the Italian regulatory framework reflects the progress made by the agreements among the Group of Ten countries.

The choice of such financial centres for the laundering of illicit proceeds is also due to factors that in any case attract financial resources and intermediaries, including particularly favourable tax regimes.

The use of electronic money in all its various forms has attracted the attention of supervisory authorities to the vulnerable points these new instruments introduce into the system of defence against money laundering. The nature, speed and volume of transactions tend to hinder the detection and reconstruction of anomalous financial operations. The greatest concern arises in connection with the issue of electronic money by financial businesses not subject to supervision.

Awareness of the seriousness of the problems has stimulated the renewed drive by the international community to react in several directions with measures aimed at fighting the circulation of funds deriving from criminal activities at the level of supervision and tax harmonization.

One route to limit the flows of dirty money towards lax financial centres is to require the financial institutions of countries where legislation is adequate to report transactions lacking an obvious licit economic motive in which the counterparty is located in a country with inadequate defences.

The top priority must be to improve the quality of supervision and the reliability of financial intermediaries. Steps are being taken in this direction by the Basle Banking

Supervision Committee, which is working to promote the adoption of minimum standards in the emerging countries.

The problem of tax harmonization in Europe and the OECD countries remains highly topical. It has been raised on several occasions in the Group of Seven and the European Union and there appears to be renewed recognition of its importance on the part of the leading countries. The OECD is carrying out analyses, but progress is slow and laborious.

The Republic of San Marino introduced a number of statutory provisions on money laundering in the spring of 1996. A bilateral committee is currently evaluating the degree of conformity with EU and Italian standards.

### 3. Illegal finance and usury

In Italy, despite the large increase in the number of bank branches, there continues to be a far from negligible area of unauthorized financial activity, in terms of both lending and fund-raising.

Usury feeds on this situation and is a cause for alarm. As I had occasion to point out in my concluding remarks to the Bank's general meeting on 31 May 1996, usury is a complex phenomenon and first and foremost a problem of public order.

Usury preys on households, as well as small commercial and artisan businesses, which more often than not are no longer considered creditworthy. It often provides the means for organized crime to infiltrate the legitimate productive economy. The present difficult phase that the economy is passing through increases the risk of the phenomenon spreading.

Banks, especially local and cooperative banks, have been spurred by the Bank of Italy to pay increased attention to the needs of smaller firms and guide them towards appropriate forms of financial planning.

Numerous initiatives are designed to simplify dealings with customers and speed up decisions on loan applications. In this respect the code of conduct prepared by the Italian Bankers' Association (ABI) and the protocols between intermediaries and local businessmen's associations are of particular importance. Funds have been earmarked by some large banks for the financing of persons in temporary difficulty and consequently exposed to the risk of usury. These funds supplement those of a public nature provided for in the new law for purposes of prevention and solidarity, which will be activated this year.

In the background there remains the need to educate households and firms to use money and financing responsibly. Prevention calls for full awareness of the dangers of borrowing from illegal sources of finance.

The new law on usury appears to be appropriately based on an overall view of the phenomenon. There nonetheless remain causes for concern, as has been frequently pointed out, concerning the possible adverse consequences of introducing "threshold rate" for regulated intermediaries. As I put it on another occasion, "The specification of a usurious rate of interest is intended to provide an objective yardstick for determining the existence of a crime. The limits established and their application to regulated intermediaries may push up interest rates for smaller loans, lead to the rationing of credit to marginal, weaker customers."

The Bank of Italy and the UIC are engaged in the complex task of gathering data on the interest rates charged by banks and other financial intermediaries for different size classes and types of loans. A start has been made on analysing the information collected with a view to the publication of the related ministerial decree. The Bank of Italy and the UIC are committed to providing the support needed to ensure a correct understanding and use of the data gathered.

The law requires every form of financial intermediation to be inserted in a predetermined legal framework. The territorial control entrusted to governmental authorities, including the Bank of Italy for the matters assigned to it, is of fundamental importance.

Banks that learn of the existence of unauthorized organizations notify the Bank of Italy. In turn the Bank provides feedback for the purpose of prevention and informs the competent authorities.

More decisive steps have been taken to forestall and punish improper behaviour by employees of financial intermediaries. Safeguards have been introduced to protect against false representations to banks and breach of trust in the management of securities portfolios with the aim of contributing to the regularity and transparency of dealings between intermediaries and their customers.

#### 4. The activity of the Bank of Italy in preventing and repressing money laundering

Even unwitting involvement by an intermediary in circulating money of illicit provenance will undermine its sound and prudent management in the end.

A particularly delicate moment is the market-entry of new intermediaries, especially the opening of new banks.

The Bank of Italy's Supervision Department carries out controls on market entry; in particular, it examines ownership structure and organizational arrangements, and verifies compliance with the integrity and experience requirements for corporate officers.

In the three years 1994-96, 75 applications to open new banks were considered and 57 approved; of the 18 non-approvals, 16 concerned Southern Italy. Authorization was denied on account of the presence of corporate officers or owners who could not be trusted for the purposes of sound and prudent management and, in some instances, were suspected of collusion with organized crime. These decisions were upheld in administrative appeal proceedings.

Supervisory action is performed continuously through documentary control of the operational indicators and frequent meetings with banks' officers. On-site verifications are carried out regularly and systematically. These inspections supplement the documentary controls and are designed to assess banks' ability to engage in the collection and investment of savings in a correct manner, in accordance with criteria of sound and prudent management and all the legal requirements.

Inspections are not specifically designed to discover possible violations of criminal law. If a case of irregular conduct is found, its technical and legal aspects are carefully examined. Cases that may constitute crimes are resorted to the judicial authorities.

For its own aims of banking and financial supervision, the Bank of Italy has conducted 563 inspections in the last three years. Sixty per cent of Italy's banks were examined - 68 per cent of all those established in the South and 57 per cent of those in the Centre and North.

Following a number of these inspections the Bank of Italy submitted proposals to the Treasury Minister for the adoption of disciplinary measures for serious operational irregularities involving large capital losses. In particular, 25 banks were put into special administration, which entails the dissolution of their boards of directors and auditors. Fifteen banks were put into compulsory administrative liquidation.

The penal proceedings now under way will clarify whether there were instances of money laundering or collusion with criminal organizations.

The Bank submitted proposals to the Minister for pecuniary sanctions to be levied against 2,779 officers of more than 200 intermediaries.

The anti-laundering rules - Law 197/1997 - rely on the faithful collaboration of intermediaries. This takes the form of preparing a "trail" of the transactions they have effected, for use in possible investigations, and of reporting on any suspicions provoked by specific transactions on the technical and financial plane.

The rules:

- set limits to the use of cash,
- prohibit the making of payments by unauthorized intermediaries,
- require the identification of customers and the registration of significant transactions, and
- make it compulsory to report suspicious transactions.

The regular performance of credit and financial activity depends on intermediaries' having adequate information on every customer.

To assist in the identification of suspicious transactions, the Bank of Italy has published a "decalogue" systematically setting out examples of anomalies whose presence requires the various aspects of the transaction to be scrutinized and, possibly, a report to be filed.

Intermediaries are required to consider the objective features of a transaction and to compare them with the characteristics of the person making it in order to detect possible anomalies. Standardized schemas cannot take the place of careful transaction analysis and assessment by intermediaries' employees. The law calls for this kind of evaluation.

The difficulties initially encountered by the financial system are being overcome and the flow of reports has increased considerably. In 1996 the Finance Police received 3,075 reports, most of them from banks. There is growing understanding and support for the law's objectives among intermediaries and operators. It remains necessary to ensure the confidentiality of the procedure and, for reasons of personal safety, the anonymity of the persons making reports.

##### 5. The activity of the UIC

The UIC's essential, traditional tasks are the management of the foreign reserves and the collection and processing of the statistics needed to compile Italy's balance of payments and the related publications.

In 1991 Law 197 assigned the UIC a central role in administrative action to combat money laundering. The UIC, in agreement with the competent supervisory authorities, verifies intermediaries' compliance with the anti-laundering rules, keeps the register of companies in the financial sector, and does statistical studies using the aggregated data drawn from the databases of authorized intermediaries.

There were 21,318 financial companies in the register at the end of last year. Only 1,604 of them did business with the public; the rest were groups' dedicated financial companies (the great majority) or loan underwriting consortia.

In 1996 the UIC issued some 500 notices to companies regarding initial or subsequent failure to satisfy the requirements for entry in the register or findings of serious violations of law. Among companies that do business with the public, which are potentially more exposed to the risk of being used for illicit purposes, there were 120 deletions from the register and 72 new listings. For the financial sector as a whole, in the three years from 1994 to 1996 there were 3,803 de-listings and 1,571 new listings.

In 1995 a survey was made of all the banks' computerized data collection and database management procedures.

By the end of 1996 72 inspections aimed at verifying compliance with the anti-laundering rules had been completed: these led to 40 reports being sent to the judicial authorities and 36 to the Treasury Minister for administrative infractions.

The main deficiencies found during the inspections were attributable primarily to organizational problems involving computerized procedures and inadequate internal controls.

The UIC is charged with monitoring the aggregated data originating from the company's single databases, with a view to bringing out anomalies that may signal money laundering. The anomalies are detected from among the mass of available data on the basis of a grid of essentially statistical criteria.

Data are collected **from** 2,000 authorized intermediaries. The number of operations subject to aggregation is more than 30 million a month, including some 10 million cash transactions.

This is a completely new field, and not just in Italy, and the UIC, in contact with leading research centres, has begun to experiment in depth with new methodologies designed to detect anomalous financial flows. Once the initial results are available the UIC will provide the competent bodies with indications that can be used in investigative activity.

Careful methodological consideration has brought out the need for a deeper scientific analysis of the nature and manner of the links between the economy and organized crime.

Representatives of the police forces and the judiciary, together with academic specialists, are collaborating with the newly formed "Anti-Money-Laundering Observatory". For now this body is strictly informal. It is a research facility established to investigate key aspects of the economy, organized crime and money laundering in particular, with a view to keeping preventive strategies abreast of the evolution of criminal techniques and the spread of the phenomenon to new sectors.

#### 6. Collaboration with the judicial authorities

In the last three years the Supervision Department has sent reports on 92 intermediaries to the criminal justice authorities. A steadily growing number of requests for data and technical information are being addressed to the Bank of Italy. Around 1,000 requests for information and documentation have been handled, and officers of the Bank have testified in 185 cases.

Experts of the Bank of Italy and the UIC are increasingly engaged in technical advisory tasks: one fifth of the staff of the Central Supervision Inspectorate, that is to say some 30 officers, are assigned to such duties full-time. Major assistance is provided to the judicial and investigating authorities in examining aspects of the various types of money laundering **and for refresher** courses on technical points of the phenomena that may **come under** investigation.

There is intense collaboration with the law-enforcement agencies, especially the Finance Police, and with the Racket and Usury Bureau.

The Bureau of Antimafia Investigation is kept up to date on serious management irregularities found at intermediaries operating in the regions most affected by organized crime. Contacts are under way to develop collaboration with the National Antimafia Bureau, for a better knowledge of money laundering techniques and for the exchange of information.

Under the legislation in force, the judicial authorities inform the Governor of the Bank of Italy, for the initiatives within his sphere of **competence, when** there is good reason to think that banks are involved in money laundering

Cases of possible fraud or money laundering connected with foreign undertakings established in countries which lack reliable controls are more and more frequently **coming to the central** bank's attention. These are the subject of exchanges of information with domestic and foreign authorities.

#### 7. The new shape of anti-money-laundering legislation

The current provisions against money laundering are not yet the outcome of systematic legislative intervention corresponding to a single logic. They are the result of accretion over time, as was underscored in the chapter of the Bank's 1995 Annual Report on supervisory activity.

According to the Financial Action Task Force, the only deficiencies in the rules adopted in Italy are lack of full confidentiality of reports and failure to provide for a body that centralizes reports. The active collaboration requested of intermediaries is not protected by

adequate safeguards for secrecy in reporting suspicious transactions. This entails obvious dangers for the safety of operators and creates obstacles to unreserved collaboration.

The occasion for rectifying these deficiencies is the delegation of legislative power under Article 15 of Law 52 of 6 February 1996, which establishes the criteria for completing the transposition into Italian law of Community Directive 308/1991 concerning measures to combat money laundering. Although the Directive takes the approach that laundering must be fought primarily with penal instruments, it underscores the fundamental role of collaboration by the financial system and the supervisory authorities.

Policymaking in the fight against money laundering is a prerogative of the Government. From a strategic point of view, the matter is essentially financial, and so it is natural for the central role to be entrusted to the Treasury Minister.

According to the orientations that are emerging, the basic approach is, correctly, to keep the realm of financial controls distinct from that of investigative activity while ensuring the necessary coordination. The UIC would be made responsible for financial analysis and administrative control for the prevention of money laundering, to capitalize on the financial system's expertise in the fight against laundering.

The solution respects the distinction between administrative and investigative activity. There must be no mingling of these roles.

Reports of suspicious transactions would be routed through the UIC, which would subject them to technical examination and supplement the information with the aid of the sectoral supervisory authorities, for the purpose of immediate transmission to the law-enforcement authorities. The confidentiality of sources would be safeguarded even during an ensuing criminal investigation.

The same logic of coordination between different functions would be affirmed with regard to the significant findings of the statistical studies performed by the UIC.

The drafting of the codified law provided for by Law 52/1996 will make it possible to put prevention before repression and to restrict penal sanctions to conduct that is actually deviant with respect to standard operating practice. It is also necessary to specify other activities to which the anti-laundering requirements should be extended. These include security courier services, debt collection services and even some professional activities that are involved in various types of circulation of wealth in the form of securities and real estate.

Honourable Members of Parliament,

The acquisition by organized crime of instruments serving to control finance is an especially serious matter in that it can become a sort of multiplier of the criminals' strength and of the resulting contamination of the economy.

As far as the creation of new banks or the acquisition of existing ones is concerned, we are fully confident in the efficacy of prevention.

Intercepting illicit capital during ordinary operations appears more problematic. As a rule, criminals cannot avoid using the normal financial channels, and the payment and funds transfer system operated by the banks is a natural conduit for funds of illegal provenance. These are a very small share of the total funds handled by the banks, so that identifying them is difficult in several respects.

The collaboration of intermediaries and of their operating staff is all-important. Reports of suspicious cases are on the rise. Those who file reports have to have greater assurances as to their safety and protection.

Transfers of funds linked to illegal activities are becoming substantial in terms of absolute value and are tending to concentrate in particular regions, areas and intermediaries. Statistically-based studies are being conducted at the UIC, with promising results, to identify "clusters" of illicit capital that tend to move systematically from particular areas to others.

The Italian banking system is fully aware of the need for an unflagging effort to detect and eliminate these pathological phenomena and to accept the costs involved.

The Financial Action Task Force (FATF) has recognized the adequacy of Italy's legislation. It is necessary for the international community to avoid any tolerance, even tacit, for those financial centres and international banks that for profit-seeking motives operate in conditions of less-than-perfect transparency. Such attitudes subvert the rules of correct competition and, through the circulation of money of illegal provenance, the international economic order itself.

There must be growing awareness, extending beyond the circle of advanced countries, of the grave threat that the spread of criminal economic activity poses to the benefits of trade and financial liberalization.

The Bank of Italy and the UIC remain actively committed at the side of the governmental authorities in providing the necessary collaboration to prevent and combat financial crime, for the good of our nation and of the international community.