IS CAPITAL LAUNDERING POSSIBLE THROUGH FRAUDULENT USE OF FIDUCIARY AGREEMENT BY TRUST/FIDUCIARY COMPANIES?

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Abstract

Romanian jurists described the fiduciary agreement either by rendering texts of the Civil Code, or by taking over all or part of the definitions, opinions, interpretations and even some examples given by various authors, jurists, economists and financial experts in the bank field. However, after three years from its adoption, there is uncertainty about the legal regime applicable to the fiduciary agreement, created by the ambiguity and contradictions of the texts of the Civil Code. So, as a first step, the Civil Code defines fiduciary agreement as a transfer of/and over certain rights composing the fiduciary assets (art. 773) and over these rights the trustee undertakes the exercise of the full, holder specific powers (art. 784 para. 1), but subsequently it states that the fiduciary assets consists of goods (art. 786). Secondly, the Civil Code suggests that the fiduciary agreement is a contract establishing first degree movable securities (art. 781) or a contract of mandate (art. 783) and, regarding the trustee's remuneration, a contract of managing another person's properties (art. 784 par. 2), being uncertain whether the administration is simple (art. 795 - art. 799) or full (art. 800 to art. 801). Also, although the Civil Code limits the fiduciary capacity exclusively to lawyers, public notaries and credit institutions, investment companies and investment management firms, financial investment services companies, legally established insurance and reinsurance companies (art. 776 par. 2 and para. 3), it does not describe the rationality of this option. These reasons make necessary the analysis of the legal status and professional duties of the fiduciary trustees, to understand the relevance of their specialized activity, in order to answer the question whether together with the specific risks of the transactions imposed by the fiduciary contract there is also a possible the risk of capital laundering. The answer to this question requires a holistic approach based on risk and identifying mechanisms, situations, facts related to money laundering in order to obtain legal arguments to determine in the future the adoption of an effective national legislation, corresponding to the requirements of the European Union law and in particular to those set out in the (EU) Directive 2015/849[2] *and to those that ensure the international cooperation instruments in the protection of the capital market.*

Keywords*: Trust, trust company, trust agreement, securities market, capital laundering.*

JEL Classification: K21, K22

1. Short introductive considerations

The provisions of the Civil Code limits the jurist to a purely descriptive examination of the *fiduciary (trust),* insufficient to understand under what conditions the mechanisms and the techniques of putting into practice of this option become suspect and even related to serious money and capital laundering actions.

Neither the special law regarding the prevention and sanctioning of money laundering[3] offers more information about the illicit mechanisms, being limited to definitions, to the description of its incidence sphere among the natural and legal persons, to the establishment of their obligations to apply the procedure or standard measures of identifying the customers, the real beneficiary and of notifying the National Office of the Prevention and Control of Money Laundering, if the operation presents signs of anomaly for the activity of certain customers.

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[2] Directive (EU) 2015/849 of the European Parliament and of the Council of 2015, the 20th of May on the prevention of the use of the financial system for money laundering or terrorism financing, amending Regulation (EU) no. 648/2012 of the European Parliament and of the Council and of repealing Directive 2005/60 / EC of the European Parliament and of the Council and Directive 2006/70 / EC of the Commission. Note: Pursuant to Article 67 (1) "The Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 26 June 2017".

[3] Law nr. 656/12.12. 2002 *for the prevention and sanctioning money laundering, and for introduction of measures of prevention and combat of terrorism financing* published in the Official Gazette no. 904 of the 12th of December *2002,* with the subsequent amendments.

We must mention that, according to the Civil Code, the trust is a legal contract and the fiduciary, is part of this contract, together with the constituent and the beneficiary.

However, we include in the „schemes" of capital laundering the trust and the fiduciary activities and among the persons targeted by these schemes we find the fiduciary[4].

So being, the question relates to the situations and/or facts which can become legal operation, intended to generate new business opportunities by transforming capitals in a legal trust, associated with the risk of money and/or capital laundering.

Concretely, we ask the question whether capital laundering is possible by a fraudulent use of the fiduciary agreement and/or of other fiduciary activities by the fiduciary companies and if the answer is affirmative which would be these mechanisms and activities.

To answer this question one must start by explaining the capital laundering which is considered a delinquency consumed from the moment of owning and/or placing, changing, transferring, acquiring or using the goods originating from the committing of a crime, with the goal of hiding or dissimulating their illegal origin and of indicating the quality of active subject or legal person[5].

In the same time, it is necessary to evoke the definition from the Civil Code according to which the trust is an operation but also a contract[6].

2. Practical Application of the Fiduciary Mechanism by the Fiduciary Companies

The previously quoted definition points out two types of trusts that the legislator distinguishes, that is:

- *Warranty-trust*, by virtue of which the debtor transfers to his creditor the property of a good guaranteeing the execution of the obligation, and the creditor undertakes to give back the good to the debtor when he fully paid his debt. The warranty-trust is not the object of this analysis;
- *Administration-management-trust*, consists of the operation by which the constituent transfers the property of the goods to the fiduciary who undertakes to administrate and manage them, either in the interest of the constituent or in the interest of a third party-beneficiary.

Shortly, *administration-trust* means the preservation and management activity of the goods which are the object of the trust in the benefit of the constituent while the *transfer-trust* involves the management of the goods in favor of a third beneficiary, whom, at the end of the *operation*, the property will be transferred to.

We highlight the fact that the legislator uses the term "*operation*" to suggest a certain technical-economic mechanism which includes not only the "*legal act*" but any other actions or activities specific to the financial-banking sector, starting with the procurement, loaning, pledging, usufruct, transfer, registration or any other valuing activity and the storing, removal from storing, transferring, compensation, etc.

From another angle, the expression *„operation"* means *„financial operations*", that is activities related to the movement, mobilization of the capital.

We mention that, according to the Civil code (art. 776 paragraph 2), the legal persons who can be *trustees* are the credit institutions, investment companies and companies managing the investments, financial investment services companies, insurance and re-insurance companies.

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[4] We refer to art. 2 letter k point 4 of Law no 656/2012 which provides: „k) service providers for legal persons and other entities or legal arrangements means any natural or legal person which by way of business, provides any of the following services for third parties: 4. Acting as or arranging for another person to act as a *trustee* of an express *trust activity* or a similar legal operation".

[5] According to art.53[1] paragraph.3 letter (a-c) Criminal code, if the action, is committed using any of the described methods, by a legal person, besides the main penalty the court may decide, the case may be, *the dissolution, suspension of the activity of the legal person* for a 3 months – one year period, *suspension of one of the activities of the legal person by which the crime was committed* for a 3 months – 3 years period or the c*losing of a work point of the legal person* for a 3 months – 3 years period.

[6] Art.773 paragraph.1 Civil code : "*Fiducia is the legal operation whereby one or more grantors transfer[s] real property rights, rights of claim, guarantees or other patrimonial rights or a group of such rights, present or future (fiduciary property) to one or more trustees who exercise such rights with a given purpose, to the benefit of one or more beneficiaries*". Art.774 „*Fiducia is established expressly by the law or by a contract concluded in a authentic form".*

We will analyze the position of fiduciary (trustee) of a financial investment services company, because, having the activity object the taking over and placement of the money funds of individual investors (natural persons) and institutionalized investors (commercial companies, banks, investment companies, insurance companies, retirement funds or investment funds) they participate at the free circulation of the capitals, interceding the financial capitals related to the investment/disinvestment of the liquidities in securities ad in other long term credit titles (derived securities).

Under these conditions, the question is whether and to what extent these fiduciary companies can use fraudulently the trust contract with the goal of money and capital laundering.

It is generally known the fact that money and capital laundering is an operation originating from money funds or goods, such as securities deriving from illegal activities (corruption facts) by which the "legalization" of their origin is sought and their integrity in the financial circuit.

One of the methods used for illegal capital laundering is the international transfer of funds by and in legally functioning financial institutions.

To begin with we have to mention that the freedom to conclude cross-border operations is a principle mentioned by Article *63* of the European Union's Functioning Treaty (ex-article 56 TCE) which, expressly, *forbids* „*any restrictions regarding the circulation of capitals between the member states and between the member states and third countries*" (paragraph 1) and also „*any restrictions regarding payments between member states and member states and third countries*".

We add that the circulation of the capitals supposes the conclusion of certain financial operations which reflect firstly the admission of securities at the official quota of a member or third state and secondly the direct investment or placement in securities of residents of member or third states.

According to the law, the securities are part of the credit title categories and the actions and bonds issued by capital companies, named by the Romanian law *equity securities*[7], represent the legal species of these values.

More exactly, from a legal point of view, the securities are rights of claim, that is intangible securities, which, with the goal of being put in circulation are incorporate in support-material or magnetic instruments so they are called bond or action *titles*. So, the Romanian legislator defines the actions and bonds (generically) capital titles (with the mention that in the case of actions the correct name would be *own capital title,* and in the case of bonds *loan capital titles*).

On the other hand, the law includes *in the broker category* the financial investment services companies and the investment management companies (collective placement institutions), whose foundation, functioning and cessation is authorized and supervised by the Financial Supervising Authority[8], and by other authorized entities of the member states or third states to provide financial investment services.

The legal form of the financial investment services company and of the investment management company is *joint-stock company* and their object of activity is exclusively the

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[7] Art. 2 point 34 of Law no. 297/2004 *regarding the capital market* published in the Official Gazette no. 571 of June the 29th, 2004, in an updated form.

[8] By Law no **113/***2013 for the approval of the Government's Emergency Ordinance no. 93/2012 regarding the foundation, organization and functioning of the Financial Surveillance Authority* published in the Official Gazette no. 234 from 2013 the 23rd of April, the surveillance of the capital market was taken over by the Financial Surveillance Authority, legal person having the competences of the former National Commission of Securities and of other surveillance authorities of the markets on which financial instruments are traded. The national regulation of the securities' market reflects the transposal of the Union's right regarding the collective placement in securities, which is not applied to the alternative investments regulated by Law no. 74 from 2015, the 14th of April *regarding the alternative investments funds managers*, published in the Official Gazette no. 274 from 2015 the 23rd of April. So, they are not the object of this theme even though they can be trustees, the other "intermediates" – credit institutions whose founding, functioning and ceasing is authorized and controlled by the National Bank of Romania, that is banking commercial companies and currency exchange companies ; companies administrating and/or distributing in Romania participation titles of other alternative investment funds, that is hedge funds and real estate funds which can have alternative funds management activities on the market of the member states only by receiving "*European passport*" meaning that they fulfill the conditions established by Directive 2011/61/UE of the European Parliament and Council from 2011 the 8th of June regarding the administration of alternative investment funds and of modification of the Directive 2003/41/EC and 2009/65/EC and of the Regulations (EC) no. 1.060/2009 and (EU) no. 1.095/2010, transferred in our legislation in Law no.74/2015.

administration, subscription and placement on a regulated market of the securities which they were entrusted with by natural or legal persons called *investors* (customers).

The warranty of the investments is materialized by forcing these intermediates to be members of a joint-stock company called „Fond", whose goal is to compensate the investors in case the intermediates become incapable of refunding the money and/or securities belonging to them or which were "submitted" and owned on their behalf for the providing of financial investment services or for the administration of their individual investment portfolio.

On the other hand, considering the inherent risks of the speculations on the stock market, the law obliges the intermediate companies to organize financial-accounting evidence on the principle of dividing the patrimonies and comply with the obligation of operation transparence, of the prudence and conduit rules. The principle of assets division is applicable if against the intermediate companies an insolvency procedure is initiated having *ex nunc* effect, not being applicable regarding the rights and obligations born after the settlements and/or compensations resulted from the operations with securities.

Therefore, we must retain the fact that, regarding the "trust" of securities, the fiduciaries are intermediates on the regulated capital market, they are fiduciary companies and the constituents are the owners of the securities, are the shareholders or bondholders called *investors*. These persons conclude legal complex documents, called financial transactions, as they suppose main and related operations meant for the transfer of the right over the security, these being *intangible goods* forming the *fiduciary assets*.

Simplifying, we must retain that the fiduciary company has full powers on the securities, specific powers to the owner and acts in the interest and for the profit of the constituent *investors,* in exchange of a remuneration with a commission.

So we can state that the trust does not create, mainly, a property right over the security of the fiduciary company, but only a transfer of the *so-called fiduciary property,* that is of certain goods, which as the Civil Code describes, forms a "total of dedicated assets".

Regarding certain measures which would prevent the situations in which the fiduciary companies or other participants in the market of capital transactions to use the trust for money laundering, the special law is silent, the total of the provisions being directed and essentially motivated to comply with the participants' obligations to act in favor of the market and investors, including the description of the method of the financial-accounting evidence having the same goal.

In the same idea, the legislator has appreciated that certain actions has a reduced social danger, considering them contraventions sanctioned with a warning or a fine, even though materially they configure the violation by the intermediate-fiduciaries (and by other participants in the capital market transactions) of the prudential and behavior regulations, of the regulations regarding the cross-border operations, of the obligation to register in the Registry kept by the Financial Surveillance Authority, of those regarding the public offers and the withdrawal operations of the shareholders from a commercial company, of the violation of the provisions regarding the security transaction admission.

In the presented profile, we believe that the special law is tributary for the way in which it regulates the procedure of establishing the real identity of all the participants in the capital transaction market (of high value), including those involved in the cross-border transactions, not only the customers, but also the one related to the elaboration and archiving the registers regarding the participants and the operations for at least during the validity of the fiduciary contract.

So we believe that the need to protect the European Union's internal market imposes the re-evaluation and accommodation at a national level but also at a cross-border level of the measures which should prevent and combat the cross-border operations presenting capital laundering and terrorism financing risk.

The first measure is to rethink the text of the law on the security market to make as accessible as possible to the public targeted to be investors[9], and so, the "legislative tasks" must be removed which were inherited (from CVMN) by the Financial Surveillance Authority and exercised with more opacity by ambiguity.

In detail, it is necessary to strengthen the diligence obligation, so, *de lege ferenda*, measures and procedures of registration and identification of the *real beneficiary of the trust* must be adopted, trust having the object security transaction and those permitting the possibility to access this information in all cases and to all person having a legal interest.

On the other hand, considering that the trust is the mean which allows the private capital transfer *on the and from the* market of other county than the issuing country and of the fiduciary, the law must impose the obligation of maximum diligence as task of the intermediate fiduciaries in the obtaining of enough information about an institution, to verify its reputation and to take "alert" measures to stop any correspondence relationship with a bank company which is presumed to be fictive or with a financial services company permitting to a fictive bank to use its accounts.

Under the presented aspects and in a lot other regards, the present law did not give the proper attention to the risks that can appear during the financial operations on the capital market and did not transpose clearly enough the provisions of the Directive regarding the prevention of the use of the financial system for money laundering and terrorism financing[10], as they were interpreted by the *Court of Justice of the European Union (CJUE*).

In the presented sense, CJUE decided relatively recently that a company providing financial or credit services must transmit information regarding the operations made on the territory of another member state even if he does not have the head office in the state, such a regulation being according to the free circulation of the services.

Concretely, CJUE established that „*Article 22 paragraph (2) of the Directive 2005/60/CE of the European Parliament and Council from 2005 the 26th of October regarding the prevention of the use of the financial system for money laundering and terrorism financing must be interpreted in the sense that it is not opposed to the regulation of a member state which imposes to the credit institutions to communicate the requested information to combat money laundering and terrorism financing directly to the financial information unit of the state when these institutions perform their activities within the country in the regime of free service providing...".*

The Court of Justice decided the harmonization with art. 56 TFUE regarding the free service providing as it targets the strengthening of the respect towards the law of the Union and the efficiency to fight against financial criminals, but the *imperative reasons of general interest, which should guarantee the accomplishment of the goal without exceeding in what is necessary to accomplish it and its non-discriminatory application must be verified by the national court"*[11].

In the same time, it is necessary to implement by law the obligation of every fiduciary-intermediate, of the financial investment services companies and of other participants in the capital transaction market, to issue and trade exclusively *nominative* shares and bonds, and a fortiori, it should be forbidden to issue and trade *at the carrier* securities.

Lastly, the regulation of the criminal liability and of the insuring measures should be imposed applicable to the companies participating in the capital market transactions which, directly or indirectly, intentionally or guiltily, prevents or makes impossible to gather evidence regarding the capital laundering criminal act performed by operations made on a regulated market related to the facts provided by art. 6 paragraphs 1 and 2 of the Convention no. 141 of the European Council approved by Romania[12] .

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[9] *Nota bene:* Law 74/2015 is difficult to access because its fussy elaboration and because of the (inadmissible) use of acronyms in the text and not lastly, because of the very technical language. This concept proves that the legislator himself failed to break into the legal significance and clear meaning of the regulated institutions.

[10] We refer to *Directive 2005/60/CE of the European Parliament and Council from 2005, the 26th of October regarding the prevention of the use of the financial system for money laundering and terrorism financing.*

[11] CJUE – Third room -, Decision of 2013, the 25th of April, *Jyske Bank Gibraltar Ltd vs. Administración del Estado (Spain*), C-212/11, posted online here: http://curia.europa.eu/juris/documents.jsf?num=C-212/11.

[12] The Convention is approved by Law nr. 27 from 2002, the 16th of January *for the approval of the Criminal convention regarding corruption,* adopted at Strasbourg in 1999, the 27th of January Published in the Official Gazette no. 65 from 2002 the 30th of January.

3. Conclusions

Summarizing, we point out the fact that the activity of the fiduciary company on a capital market highlights the specificity of trust, as the mandate contract involves the administration by special means of the goods (rights) of the constituents who are investors on the market, beneficiary of the trust and customers of the fiduciary.

The existence in the present of the lacks in the specialized laws creates favorable conditions for the use of the fiduciary mechanism by the investment companies or by other entities acting on the capital market with the goal of money and capital laundering, the most close example being the hiding of the investor when acquiring the securities, the way of the money laundering having an illegal source.

In the discussion, it is questioned the legality of the contract of which main and characteristic performance defines it as being a mandate simulated by person interposal, or a *prête-nom* contract (name borrowing), in virtue of which the trustee remains secret, and the agreement apparently hides the secret act, so being proved a fraud of the law. So being, to prevent or to eliminate any kind of capital laundering risk by financial transaction, including *trust*, it is required in the future to adopt a clear and accessible national legislation, appropriate to the European Union's legal exigencies and particularly to those stated by Directive (EU) 2015/849, to which it should be added the interpretative solutions of CJUE to assure effective cooperation instruments at an international level targeting the protection of the capital market and of the Romanian investors.

Without doubt, the fight against laundering capitals illegally acquired and against terrorism financing can't ignore the protection of the fundamental values of the Rule of law which implies the warranty of the professional secret having a filter role of any excess and mark for the appreciation of the adequacy of the measures[13].

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[13] For an exposure of the relationship between the fight against money laundering and the protection of the fundamental human rights see: "*Directives de l'Union européenne relatives a la lutte contre le blanchiment d'argent et le financement du terrorisme, La position de l'Union Internationale des Avocats,* I Sous-comité GAFI de l'UIA,comité GAFI de l'UIA, president Corrado DE MARTINI, *Italie, Membres:* Beatriz GARCIA, *Luxembourg,* Francis GERVAIS, *Canada,* Jean-Pierre GROSS, Elveția, Bernard VATIER, *France. Posted online here: http://www.uianet.org/sites/default/files/JI_GAFI_UIA.pdf.*