FINANCIAL CRIME PREVENTION AND CONTROL: THE REFORMS OF A ‘UNIQUE’ JURISDICTION UNDER EU LAW AND INTERNATIONAL STANDARDS

Francesco De Pascalis*

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Abstract-Between 2011 and 2014 the Vatican City State (VCS) experienced a reform process which dramatically changed its financial system. The process is still ongoing, and its goal is to establish an anti-money laundering and counter-terrorism financing (AML/CTF) system. Importantly, this system will be based on the AML/CTF EU legislation and international standards. These facts are noteworthy. First, the reforms cast light on the main Vatican financial institutions against the background of the secrecy that has always characterized their functioning and business operations. Accordingly, there is now more transparency and information about the Vatican financial system. Second, the relevant EU law and international standards are tools through which the VCS can, for the first time, join an international network of countries sharing and applying the same rules against money laundering (ML) and terrorist financing (TF). This is of extraordinary importance for a jurisdiction like the VCS, which has never referred to European or international principles in its rule-making. In particular, the openness to EU law and international standards stimulates investigating the reasons behind these changes and the impact that these sources of law are having on a jurisdiction regarded as ‘unique’ in the world.

Keywords: Vatican financial system; money laundering and terrorist financing; 3rd AMLD; FATF Recommendations

1. *Introduction*

Money laundering (ML) and terrorist financing (TF) are crimes that pose serious threats to the integrity and stability of a country’s financial sector, with possible spillover effects on the economies of other countries.[1] These systemic implications require a global response through the establishment of an adequate framework of measures. To this end, the Financial Action Task Force (FATF), an intergovernmental body founded in 1989 under the aegis of the G7, is responsible for developing and updating appropriate anti-money laundering and counter-terrorism financing (AML/CTF) standards

* University of Zurich, Institute of Law.

[1] K Alexander, R Dhumale and J Eatwell, *’Global Governance of Financial System, The International Regulation of Systemic Risk’* (OUP 2006), 67.

to be implemented by member and non-member states.[2] The FATF is recognized as an influential standard setter in the fight against ML and TF, and a powerful force able to shape and constrain countries' policies through its 40+9 AML/CTF Recommendations (FATF Recommendations).[3] By liaising with other key international organizations such as the International Monetary Fund (IMF), the World Bank, the United Nations, and the FATF-style Regional Bodies, the FATF conducts mutual evaluation reviews on states' compliance with its principles. To have a sound AML/CTF system in line with the FATF Recommendations, countries may be required to improve or strengthen their domestic legislation. Recently the Vatican City State (VCS) began a significant reforms process to create an AML/CTF regime aligned with international standards. Specifically, the Vatican AML/CTF regime was shaped through the interplay between the European Directive 2005/60/EC on the Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing (3rd AMLD) and the FATF Recommendations. The reliance on these sources triggered unprecedented changes in the financial system of a jurisdiction defined as 'unique' because it is the smallest in the world, with no market economy, and with a specific mission pursued by a special monarch, the Supreme Pontiff.[4] In this context, the VCS also asked the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) to verify the degree to which its AML/CTF system adhered to the EU legislation and the FATF international standards. This means that the current reforms leading to the creation of the AML/CTF regime go hand in hand with the suggestions provided by an external arbiter. This is significant because the structure and operation of the Vatican financial system have always been surrounded by a high level of secrecy. Therefore, the establishment of an AML/CTF

[2] Financial Action Task Force on Money Laundering (FATF), 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation. The FATF Recommendations' (February 2012).
[3] N Beekarry, 'The International Anti-Money Laundering and Combating the Financing of Terrorism Regulatory Strategy: A Critical Analysis of Compliance Determinants in International Law' (2011) 31 JILB 1, 138.
[4] Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval), 'The Holy See (Including the Vatican City State)' (4 July 2012) Mutual Evaluation Report, 18.

regime in the VCS pursuant to EU law and the FATF Recommendations, as well as through the control of a FATF-style regional body like Moneyval, has de facto provided more details on the financial system of a 'peculiar' jurisdiction.

These events give the opportunity to study the VCS from a perspective which is different than the traditional ecclesiastical dimension. The ongoing process of reform has no linkage to the spiritual aims which have always characterized the Vatican legislation. The reliance on EU law and international standards to build up the Vatican AML/CTF system has paved the way for new studies illustrating the contents of the VCS's financial legislation.[5] This article contributes to this new strand of literature by analyzing the impact of EU law and international standards on the Vatican financial system and how the main financial institutions are changing. The analysis will be developed from a number of perspectives. First, historical facts and the Vatican's main sources of law, such as, for instance, the Code of Canon Law of 1983, will provide the essential background to understand the VCS and the peculiarities of its financial system. Second, the information provided by Moneyval on the operation of the Vatican financial institutions will be the basis for a comparative analysis between the way these institutions are regarded in the VCS and the way they are perceived by the financial world. Third, the ML and TF risk posed by the Vatican financial institutions will permit us to illustrate the rationale behind the reforms, the extent to which they adhere to the AML/CTF EU law and international standards, and their evolution in accordance with the suggestions given by Moneyval. Finally, the progress of the reforms and the role played by European and international standards will be the platform to discuss the significance of these events in the context of this special jurisdiction.

[5] F Sgubbi et al, 'La Legislazione Antiriciclaggio dello Stato Città del Vaticano : Una Comparazione con il Sistema Italiano' (2013) 9 Stato, Chiese e Pluralismo Confessionale; M C Folliero, 'La legislazione Vaticana in Materia Finanziaria: Un Banco di Prova dell'articolo 17 del TUE e dei Principi di Collaborazione e Cooperazione tra Chiese, Stato e Unione Europea' (2013) 35 Stato, Chiese e Pluralismo Confessionale; A Sarais,' "Moneyval" e la Santa Sede: Alcune Note Circa le Recenti Disposizioni Normative Riguardo la Trasparenza Finanziaria nella Santa Sede e nello Stato della Città del Vaticano' (2014) Iura Orientalia X; D Durissotto, 'Euro e Stato Città del Vaticano. i rapporti di Valutazione e di avanzamento MONEYVAL e la Riforma della Legge sulla Prevenzione ed il Contrasto del Riciclaggio dei Proventi di Attività Criminose e del Finanziamento del Terrorismo' (2014) AIC Osservatorio Costituzionale.

2. *Setting the Context: A Peculiar Jurisdiction*

The Vatican financial system is composed of two major institutions, namely the Institute for Works of Religion ('Istituto per le Opere di Religione' (IOR)) and the Administration of the Patrimony of the Apostolic See (APSA). In the financial world they are identified, respectively, as the Vatican bank and the Vatican central bank. However, these are particular institutions which cannot be understood without first considering the context in which they exist.

The Vatican financial system is part of a complex pyramidal structure at the top of which is the Pope. The foundation of this structure lies on the Church which was erected for all ages as the pillar and mainstay of the divine truth under the guide and authority of a designated leader. In more detail, this Church is constituted and organized in the world as a society and, according to the Dogmatic Constitution on the Church 'Lumen Gentium' of 21 November 1964, is identified as the Catholic Church governed by the successor of the apostle Peter, the Pope (otherwise defined as the Supreme Pontiff).[6] From a legal perspective, this finds confirmation in Canon 331 of the Code of Canon Law of 1983, which qualifies the Supreme Pontiff as the Vicar of Christ and the Pastor of the Universal Church on earth. This rule gives a spiritual dimension to the Pope in that it underlines that his power is exercised on behalf of Christ, who entrusted his designated Vicar with the mission to govern, control, protect, and extend the Church.[7] Going beyond such a spiritual connotation, a significant aspect which must be emphasized is the authority of the Pope as the sovereign of the Church. As such, the Pope conducts his mission with absolute and unlimited powers.[8] Nonetheless, to pursue his mission and implement his powers, he needs his own apparatus which is identified in

[6] 'Dogmatic Constitution on the Church Lumen Gentium Solemnly Promulgated by His Holiness Pope Paul VI on November 21, 1964' (1964), Ch 1.

[7] 'The bishop of the Roman Church, in whom continues the office given by the Lord uniquely to Peter, the first of the Apostles, and to be transmitted to his successors, is the head of the college of bishops, the Vicar of Christ, and the pastor of the universal Church on earth. By virtue of his office he possesses supreme, full, immediate, and universal ordinary power in the Church, which he is always able to exercise freely'.

[8] See Art 1 of Fundamental Law of Vatican City State of 26 November 2000:'The Supreme Pontiff, Sovereign of Vatican City State has the fullness of legislative, executive and judicial powers'.

the Holy See (HS), namely the Roman Curia. According to Canon 360, the Roman Curia consists of the Secretariat of State, the Council for the Public Affairs of the Church, congregations, tribunals, and other institutes. The Roman Curia helps the Pope run the businesses of the Universal Church and performs its functions on the name and authority of the Pope. To underline the interconnection between the Pope and the Roman Curia in the sense that the latter is the operative arm of the former, Canon 361 specifies that both can be regarded as the HS.[9] In a narrow sense the term HS refers to the Pope, while broadly speaking it refers to both the Pope and the apparatus through which he governs the Church. When referring to the Roman Curia, HS is the 'See of Rome', that is, the central government of the Roman Catholic Church, governed by the Pope. As such, it is a sovereign entity under international law, diplomatically representing the whole Catholic Church.[10] In this context, the Supreme Pontiff appears to be the same as an absolute monarch.

In addition to the Roman Curia apparatus, the Pope is supposed to have a territory as expression of his sovereignty and guarantee of immunity. Historically, this territory had Rome as the epicentre of the Christian faith and included some territories in the Italian Peninsula and in France. These territories were governed by the Pope and were known as the Papal States. In 1861, the unification of the Italian Peninsula created disputes between Italy and the papacy as to the legal and political status of the Pope and his Catholic Church. Known as the 'Roman Question', this dispute culminated in the occupation of Rome by the Italian Army in 1870. The Roman Question ended in 1929 through the Lateran Treaty entered into between the HS and the Italian Government.[11] Under the Lateran Treaty, the Italian government acknowledged the international legal personality of the

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[9] 'The Supreme Pontiff usually conducts the affairs of the universal Church through the Roman Curia which performs its function in his name and by his authority for the good and service of the churches. The Roman Curia consists of the Secretariat of State or the Papal Secretariat, the Council for the Public Affairs of the Church, congregations, tribunals, and other institutes; the constitution and competence of all these are defined in special law' (Can 360). 'In this Code, the term Apostolic See or Holy See refers not only to the Roman Pontiff but also to the Secretariat of State, the Council for the Public Affairs of the Church, and other institutes of the Roman Curia, unless it is otherwise apparent from the nature of the matter or the context of the word' (Can 361).

[10] C Cardia,*'Manuale di Diritto Ecclesiastico'* (Il Mulino 1996).

[11]W C Mills, 'Unity Deferred: The "Roman Question" in Italian History, 1861-82' (1995) 4 Past Imperfect, 31.

HS and marked the boundaries between the Italian State and the VCS. This was the territory over which the Pope would have absolute sovereignty through the exercise of legislative, executive, and judicial powers. The creation of the VCS enhanced the immunities guaranteed to the Supreme Pontiff. In this respect, the Lateran Treaty recognized the Pope's sacredness and inviolability as being at the same level as sovereigns and heads of states.[12]

Based on this, the context of the Vatican is now clearer. It is characterized by an absolute monarch (the Pope) who has his court (the HS) and his territory (the VCS). The VCS is functionally dependent on the HS; they are jointly referred to as the HS/VCS to identify the Vatican as a jurisdiction. However, they must not be confused. The HS and the VCS are two distinct entities which trace their existence back to the Supreme Pontiff and which possess legal personality under international law.[13]

3. *The Vatican Financial System and its Main Institutions*

A. *The IOR*

(i) Introductory remarks

With a resident population of 595 and an area of 44 hectares, the HS/VCS is the smallest state in the world and is a walled enclave located in the city of Rome. These territorial characteristics, combined with the spiritual dimension of its sovereign, make the HS/VCS a peculiar jurisdiction. For instance, the independence and autonomy accorded to the Pope, as well as the religious purpose of his mission, would prevent the HS/VCS from being subject to EU institutions and their legislation.[14] Furthermore, the very small size and population make the HS/VCS a jurisdiction in which there is no market economy and minimal crime.[15] However, to carry out the mission to govern, protect, control, and

[12] 'Treaty Between the Holy See and Italy in the Name of the Most Holy Trinity' (1929).
[13] J L Kunz, 'The Status of the Holy See in International Law' (1952) 46 AJIL 308, 309.
[14] Cardia, 'Benedetto XVI-Finanze della Chiesa: Una Piccola Rivoluzione. Le Nuove Norme Vaticane' (2011) 4 Il Regno, 73.
[15] Moneyval (n 4), para18.

extend the Church, solid economic bases are also needed. These are ensured through the Vatican financial institutions (the IOR and the APSA).

Within the Vatican financial system, the IOR is the most well-known to outsiders, but its legal status is widely misunderstood. The Vatican's representatives have always maintained a high level of secrecy about the IOR's structure and operations. This raises significant interest in its legal status. In the financial world, the IOR is identified as a bank, namely the Vatican bank, while in the HS/VCS, the IOR is regarded as an institution created in relation to the HS's universal mission.[16] There is therefore a marked contrast between the way the IOR is considered within the HS/VCS and the way it is perceived externally. The following sections of this paper examine what the IOR is and whether it has all the characteristics to be considered a bank.

(ii) Purpose and Mission of the IOR

To begin, it is necessary to analyse the IOR's legal founding documents. Like all the entities which operate in the HS/VCS, the IOR is a creature of the Pope. In other words, it could not exist without the input of the Supreme Pontiff. Historically, the IOR was the evolution of the early Commission for Pious Causes created by Pope Leo XIII in 1887. The Commission then became the Administration of the Works of Religion (AOR), which had the task of administering the Pope's assets. Finally, by Chirograph of 27 June 1942, Pope Pius XII renamed the AOR as the IOR and gave it juridical canonical personality within the HS/VCS.[17] The IOR's purpose was concerned with the management and custody of personal and real property intended for religious work or charity. Clearly, Pope Pius XII gave the IOR's activities the connotation of financial services. In fact, this was consolidated 50 years later through the modernization reforms under the sovereign of Pope John Paul II, who kept the name and purpose of the institute but reformed it to render its structure and activities more adequate to the needs of the times. The main normative source for these reforms is the

[16] Spiegel Online, 'Vatican Financial Oversight Director: Church Strengthens Position by Combating Money Laundering' (3 March 2013), <http://www.spiegel.de/international/europe/interview-with-vatican-financial-oversight-director-rene-bruelhart-a-889560.html>.
[17] E Vitali, 'L'Istituto per le Opere di Religione (IOR) e il Diritto Italiano' (1987) 1 DE, 1171.

Chirograph issued by Pope John Paul II in 1990.[18] Pursuant to Article 1 of the Chirograph, the purpose of the IOR is as follows: 'The purpose of the Institute is to provide for the custody and administration of moveable and immovable property transferred or entrusted to the Institute by natural or legal persons and destined for religious works or charity'. Importantly, Article 1 brings to attention two significant features. First, the IOR was created to carry out a mission. This aspect has relevant implications regarding the legal status of the IOR. Specifically, under Canon Law a line of demarcation must be drawn between missions and competences. The latter have relevance under administrative law because they are assigned to the dicasteries constituting the Roman Curia's core administrative departments.[19] Even though the IOR is part of the Roman Curia, it does not have any administrative competence and, for this reason, it cannot be regarded as a Roman Curia dicastery; rather, it is an independent institution within the Roman Curia which was tasked with a mission under Article 1 of the 1990 Chirograph. This mission is the reason why the IOR exists. Under Canon 114 of the Code of Canon Law of 1983, missions are assigned to legal persons in their founding documents.[20] Consequently, the IOR must be defined as a legal person. Second, its stated purpose identifies the IOR as a financial institution. This is confirmed by analysing the contents of Article 1 of the 1990 Chirograph in combination with the rules of another relevant legislative document: the IOR By-Laws. Article 2 of the IOR By-Laws completes Article 1 of the 1990 Chirograph by specifying that the IOR performs its mission through accepting deposits of assets from entities or persons of the HS and of the VCS.[21] Furthermore, according to the guidelines provided by the FATF to verify states' compliance with the FATF Recommendations and the effectiveness of their AML/CTF regimes, the acceptance of deposits for or on behalf of a customer is one of four activities

[18] 'Chirograph on Institute for Religious Work 1 March 1990'(1990), Act of the Apostolic See Official Commentary.
[19] M Sitarz, *'Competences of Collegial Organs in a Particular Church in the Exercise of Executive Power According to the Code of Canon Law of 1983'* (KUL 2013).
[20] 'Juridic persons are constituted either by the prescript of law or by special grant of competent authority given through a decree. They are aggregates of persons (*universitates personarum*) or of things (*universitates rerum*) ordered for a purpose which is in keeping with the mission of the Church and which transcends the purpose of the individuals'.
[21] 'Institute for Works of Religion By-Laws' (1990).

that characterize a financial institution.[22] Hence, the acceptance of deposits under Article 1 of the 1990 Chirograph and Article 2 of the IOR By-Laws is sufficient to qualify the IOR as a HS/VCS financial institution.

(iii) Is the IOR a Bank?

Having clarified the purpose of the IOR and its status as a financial institution, it is now important to examine whether it can be categorized as a bank in the normal sense of the financial world. Generally speaking, activities such as deposit taking and lending characterise the banking business. This is also confirmed by the European banking legislation. Specifically, Article 4 of the European directive 2006/48/EC states that deposit taking and credit granting are requirements necessary to define the business of credit institutions.

Consequently, banks would fall within the definition of credit institutions set out in Article 4 of directive No 2006/48/EC.[23] This is an adequate framework to apply in assessing the extent to which the IOR's business matches the two requirements and thus it can be defined as a bank. The IOR's legislative founding documents emphasize only the deposit-taking aspect, with no reference to the granting of loans. In reality, through their on-site visits Moneyval observers learned that the IOR does extend credit. However, this is only in the form of courtesy to Vatican employees and qualified ecclesiastical institutions. Only modest credit is extended against salaries received and paid out by the IOR.[24] Significantly, lending is an ancillary activity. It does not constitute a core, relevant financial activity like the acceptance of deposits. Based on this, a conclusion is easily drawn: the IOR is not truly a bank (or 'credit institution'), because it does not fully match the requirements set out in EU law to be regarded as such. Clearly, if EU law is used as a standard to confirm whether the IOR

[22] The others are 'lending', 'financial leasing' and 'money or value transfer services', see Financial Action Task Force (FATF), 'Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems' (February 2013) glossary, 131 <http://www.fatf-gafi.org/media/fatf/content/images/FATF%20Methodology%2022%20Feb%202013%20.pdf>.
[23] 'Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions' (2006) OJEU L 177/1, Art. 4.
[24] Moneyval (n 4), para 85.

is a bank, the outcomes are negative. As explained above, lending does not have the same importance as deposit taking within the IOR's business activities. Deposit taking is the only main activity characterising the IOR's business. Based on this, the IOR fulfils only one of the two requirements and thus is not a bank.[25]

The EU legislation is not, however, the only framework which may lead to this conclusion. Outcomes are no different when we use other standards. For example, relevant to the present discussion is the English common law definition of 'bank', as stated in the landmark case *United Dominion Trust v Kirkwood*.[26] This case was based on the same question that the present analysis is trying to answer, that is, whether a legal entity (UDT) should be considered a bank. As is known, Lord Denning concluded that UDT was a bank in that it fulfilled the three core characteristics of the business of banking he identified: 1) deposit function; 2) cheque services; and 3) bookkeeping. Significantly, Lord Denning appeared to focus on the deposit and payment services of banks, and to exclude lending.[27] At first glance, this might be an adequate framework to support the assertion that the IOR is a bank vis-à-vis the EU law standard. During their face-to-face dialogue with IOR representatives, Moneyval observers had the opportunity to bring to light a number of aspects as to the operation and activities of the IOR. For example, the IOR's customers are entitled to open accounts in the institute. Moreover, debit cards and cheques are provided as payment means for the funds deposited in the institute, and cash can be withdrawn through an automated teller machine (ATM) system which is only available to IOR's customers. Also, the IOR invests, administers, and manages its customers' funds, and keeps record of the transactions it performs through a network of foreign banks when it has to invest and transfer assets.[28] These services appear to be in line with the business of banking as defined in *United Dominion Trust v Kirkwood*. Accordingly, drawing on the English case law, it could be affirmed that the IOR is a bank. However, there is a specific aspect of

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[25] See also I Cortesi, 'La Finanza Vaticana: Obiettivi Istituzionali e Profili Ordinamentali' (2012) 2 REDEM.
[26] *United Dominion Trust v Kirkwood* [1966] 2 QB 431 (CA).
[27] E P Ellinger, E Lomnicka and C Hare, 'Modern Banking Law' (OUP 2011), 82.
[28] Moneyval (n 4), paras 80, 81, 84.

the IOR's activities which prevents it from being considered as such. As is known, the relationship between a bank and its customer is contractual. In practice, this is a debtor–creditor relationship according to which the bank is liable to repay the amount being deposited to the customer.[29] As to the relationship with its customers, the IOR has an interesting characteristic. To begin, the IOR's customers can be only selected natural or legal persons in accordance with a specific list set out under Articles 2 and 3 of the IOR By-Laws. In more detail, the IOR can only establish relationships with clergy and laymen. Broadly speaking, 'laymen' also includes diplomatic corps and embassies accredited to the HS, other than HS, Vatican, or IOR employees. The IOR can only operate accounts for these categories of legal or natural persons which, in turn, are entitled to 'hold a position in the IOR fund'. The Moneyval observers specified that this expression is IOR jargon used to identify the relationship between the IOR and its customers. Holding a position in the IOR fund may be interpreted as similar to holding an account in a bank. However, the difference is that the customers who hold a position in the IOR fund do not have any contractual relationship with the IOR as would normally happen in a bank–customer relationship:

> [The] IOR representatives stress that the (natural or legal) person, who holds a position has not contractual relationship with the IOR in the nature of a bank and a title to a specific fund 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.[30]

The reasons why there is not a contractual relationship between the IOR and its customers have not been explained to the Moneyval observers. In any case, the specific type of customers eligible to make deposits and, above all, the absence of any contractual relationship are strong elements against defining the IOR as a bank, even if the IOR seems to match the requirements of the banking business identified by the UK case law. In light of these aspects, the IOR might only be defined as a *sui generis* bank.

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[29] R Cranston, '*European Banking Law: The Banker Customer Relationship*' (Routledge 1999).
[30] Moneyval (n 4), para 79.

The UK case law opens another interesting line of discussion. In *United Dominion Trust v Kirkwood*, Lord Denning held that, when in doubt, a financial institution's long acceptance and reputation in the financial markets as a bank can tilt the balance in favour of this categorization.[31] As mentioned above, the financial world considers the IOR a bank such that it is usually called the Vatican bank. This name has been used in numerous contexts. For example, it is common for the press to introduce the IOR as the 'Vatican bank'.[32] This name also has significant influence in case law. For example, in the *Emil Alperin* case the US judges referred to the institute as 'the Vatican bank aka Istituto per le Opere di Religione (IOR)'.[33] Furthermore, the Bank of Italy (BoI) recently addressed the business relationships between the IOR and some major Italian investment banks. In this context, the IOR was defined by the BoI as an 'extra-community bank'.[34] Undoubtedly, these examples show that the IOR has the reputation of a bank outside the HS/VCS. Nonetheless, the reputation argument appears to be too weak. In general, scholars agree that the distinction between banks and non-bank financial institutions should only be based on verifying the existence of activities which are commonly recognized as banking business. In this context, the mere reputation of doing so should not have any relevance.[35] In the case of the IOR, the reputation argument is weakened by the different views which can be brought forward as valid counterarguments. First, within the HS/VCS, the IOR has never been defined as a bank. Second, this view finds valid support even outside the Vatican. For example, under the monetary agreement entered into between the HS/VCS and the European Commission in 2009, it is stated that the HS/VCS does not have a banking sector.[36] It is therefore hard to characterize the IOR as a bank operating in a jurisdiction which, according to European institutions, lacks a banking sector.

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[31] [1966] 2 QB 431 (CA).
[32] See G Posner, 'God's Bankers. A History of Money and Power at the Vatican' (S&S New York, NY 2015).
[33] *Emil Alperin et al. v Vatican Bank, aka Institute of Religious Works aka Instituto per le Opere di Religione (IOR)*, [2005] 410 F.3d 532.
[34] Banca D'Italia (BoI),'Rapporti con lo IOR' (2011), Prot No 0348868/11.
[35] Ellinger et al (n 29), 84.
[36] 'Monetary Agreement between the European Union and the Vatican City State' (2009), Article 8(1)(b).

All things considered, it is a mistake to define the IOR as a bank. The IOR is a special financial institution whose peculiarity can be traced back to the unique character of the HS/VCS as a jurisdiction. In some of its operations the IOR resembles the banking business, but it cannot be properly defined as a bank. In other words, the IOR cannot fall into a specific category of financial institution. More appropriately, it can be characterized as the HS's necessary instrument to deal with the financial aspects relating to carrying out its universal mission. Even though it performs some of the financial services provided by banks, the IOR does not fit easily into the category.

B. *The APSA*

The APSA is the other main institution of the Vatican financial system. Whereas the IOR is commonly defined as the Vatican bank, the APSA is instead referred to as the Vatican central bank.[37] However, its structure, operations, and legal status are less complex than those of the IOR. To understand the role and functions of the APSA in the HS/VCS, it is necessary to start from its legal founding documents. The first normative basis is the Apostolic Constitution Pastor Bonus (ACPB) issued by Pope John Paul II in 1998. Pursuant to Article 2 of the ACPB, the APSA is identified as a dicastery of the Roman Curia.[38] This means that the APSA is part of the Roman Curia's administrative apparatus. In accordance with its administrative nature, the APSA must serve the Roman Curia in its purpose to help the Pope exercise his supreme pastoral office for the benefit of the Church worldwide. Unlike the IOR, which is defined as a legal person carrying out a specific mission, the APSA has administrative competences. In this respect, prior to the ongoing process of modernizing the Vatican financial system, its structure and operation were governed by the 2010 APSA Regulation issued by Pope Benedict XVI. Under Article 1 of these regulations it is specified that the APSA is entrusted with the management of the HS's real estate and securities assets. These

[37] I Bufacchi, C Marroni, 'Finance and the Holy See: Creating a Central Bank' (2014), <http://www.centralbanking.com/central-banking-journal/feature/2343225/finance-and-the-holy-see-creating-a-central-bank>.

[38] 'Apostolic Constitution Pastor Bonus of the Holy Father John Paul II, Administration of the Patrimony of the Apostolic See' (1988).

assets, in turn, are to be used to provide the funds needed by the Roman Curia to fulfil its functions.[39] In essence, the APSA must manage the entire HS's patrimony and ensure that it generates income to keep an adequate balance between asset returns and expected returns. This task is performed through two internal divisions, namely the Ordinary Section and the Extraordinary Section. Pursuant to Article 174 of the ACPB and Article 8(1) of the APSA Regulation, the Ordinary Section has administrative and management duties over the real estate entrusted to it. It also purchases the goods the other dicasteries need and keeps record of the expenditure, and it is responsible for the legal and administrative requirements of the HS's employees.[40] On the other hand, the Extraordinary Section is in charge of the administration of the moveable goods resulting from the financial convention annexed to the 1929 Lateran Treaty. The moveable goods under the administration of the Extraordinary Section consist of cash, financial instruments, and other valuables. Subject to the approval of the Cardinal President, the Extraordinary Section can also carry out financial transactions on behalf of individuals who are not members of the APSA's staff. Moreover, the Extraordinary Section has the power to execute payments on behalf of various institutions of the HS. Furthermore, the Extraordinary Section can invest in financial markets or in real estate abroad (France, Switzerland and England) for the management of the patrimony which falls under its responsibility. In this context, it manages the accounts and deposits that the APSA holds with many central banks.[41] Finally, the Extraordinary Section is entrusted with pension administrative functions since it manages the salary payments of HS employees and the payment of pensions to former HS and VCS employees.[42]

Overall, these functions appear not to have a strict connection with central banking functions. Central banking functions include a wide range of roles and tasks, such as issuing notes, supervising and regulating banking practices, being a lender of last resort, ensuring smooth operations of payment

[39] 'Administration of the Patrimony of the Apostolic See Regulations' (26 November 2010).
[40] Article 8, para 1 APSA Regulations.
[41] These include Bank for International Settlement (BIS), Bank of Italy, Federal Reserve Bank, Bank of England, Deutsche Bundesbank, etc., see Moneyval (n 4), para 113.
[42] Article 8, para 2, APSA Regulations.

systems, managing gold and foreign reserves, conducting foreign exchange operations, managing debt, controlling exchanges, other than monetary policy and financial stability functions.[43] The question, therefore, is why the APSA is referred to as the Vatican central bank. Singularly, while the Vatican's representatives have never characterized the IOR as the Vatican bank, the identification of the APSA as the Vatican central bank is accepted. This is explained by the ongoing process of legislative reforms aimed at establishing an AML/CTF regime in the HS/VCS. As is discussed below, the current process of reforms in accordance with the FATF Recommendations and the 3rd AMLD overhauled the APSA with the view to developing it into the Treasury of the HS/VCS, responsible for guaranteeing the HS's liquidity and financial stability. To this end, the APSA will be operating exclusively through the Extraordinary Section. This will be the only interlocutor on behalf of the APSA and have dealings with central banks within and outside the EU. Ensuring liquidity and maintaining the HS/VCS's financial stability, as well as relationships with the foreign countries' central banks, explains why the APSA is identified as the Vatican central bank.

However, this connotation is inappropriate, and the Vatican central bank is only a nickname. Taking again support from the fact that under the 2009 monetary agreement between the VCS and the EU, European institutions do not recognize the existence of a Vatican banking sector, the APSA could not exercise any supervisory functions as central banks normally do. Moreover, given that the HS/VCS is a peculiar jurisdiction in which there is no market economy, the APSA could not have any mandate with regard to inflation and price stability, as central banks are mandated with. These ideas are sufficient to argue that the APSA is not and will never be a central bank, even though the current reforms are trying to give it a more central role within the Vatican financial system. The APSA maintains its status of a dicastery of the Roman Curia with administrative competences. Its tasks have a financial connotation so that it can fall within the definition of financial institution under

[43] R M Lastra, 'Central Bank Independence and Financial Stability' (2010) 18 Revista de Estabilidad Financiera, 49.

the FATF Methodology,[44] and as such, its operations require adequate monitoring and control in relation to ML and TF risks.

4. The Vatican Financial Reforms: Rationale and Normative Bases

The HS/VCS is a peculiar jurisdiction, as connoted by a spiritual dimension and religious mission. Every HS/VCS institution must serve the purpose of protecting, promoting, and extending the Church worldwide. In particular, the Vatican financial system must ensure a solid economic basis. This context raises the question of why the smallest jurisdiction in the world, with the lowest crime rate and lacking a proper market economy, is at the centre stage of unprecedented reforms leading to the creation of an AML/CTF regime. An answer to this question is provided by looking at data in the first Moneyval evaluation report (MER). Specifically, the observers noted that the Vatican financial system is characterized by a high volume of cash transactions and wire transfers, worldwide financial activities, and lack of sufficient information on the non-profit organizations operating in the HS/VCS.[45] Although these activities are meant to relate to the global mission of the Church, there is risk of facilitating ML and TF crimes where an adequate system of prevention, control, and punishment is not in place. The current status of the Vatican legislative reforms shows that the HS/VCS did not have to reinforce an existing AML/CTF regime, but had to create a new one from the fundamentals. Before analysing the ongoing reforms, it is important to understand the rationale behind them, and in particular which factors made it necessary for the HS/VCS to set up a new regime at all.

As mentioned above, in 2009 the HS/VCS and the EU, represented by the European Commission and the Italian Republic, stipulated a monetary agreement which entitled the HS/VCS to use the euro as its official currency and granted legal tender status to euro notes and coins within the VCS.[46] This agreement is the cornerstone of the present reforms. Indeed, the adoption of the euro

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[44] FATF Methodology (n 19); see also Moneyval (n 4), para 117 in which it is underlined the deposit taking service that the APSA provide to natural persons that are not part of the HS.
[45] Moneyval (n 4) para 7.
[46] Art 1 of 2009 Monetary Agreement.

as official currency entails, among other things, being compliant with the EU AML/CTF regulations. In this regard, Annex 1 of the monetary agreement refers to the 3rd AMLD and successive implementing legislation.[47] Importantly, following the stipulation of the monetary agreement the HS/VCS should have started a process of implementing the EU AML/CTF legislation. Whereas the 2009 monetary agreement provided input for the reforms at stake, the 3rd AMLD gave the reforms a start through its normative framework. To have a better understanding, it is helpful to analyze the rules of this directive in conjunction with some recent facts involving the business relationships between the IOR and certain major Italian credit institutions.

The 3rd AMLD sets out a number of customer due diligence (CDD) measures that Member States' firms must adopt for preventing ML and TF. In essence, firms must verify their customers' identity, request and obtain all the necessary information, and conduct ongoing monitoring of their business relationships.[48] In the event that the identification and verification measures cannot be applied before the establishment of a business relationship or the carrying out of a transaction, Member States' firms may have several options such as, for example, terminating the business relationship or making a report to the financial intelligence unit (FIU). The FIU works as the central national unit responsible for receiving, analysing, and disseminating information on potential ML or TF cases to a competent judicial authority.[49] Recently, this legislative framework affected the business relationship between the IOR (a non-Member State firm) and certain major Italian banks (Member State firms). As outlined above, the IOR relies on foreign banks to transfer funds. In the case at issue, the IOR held a bank account with an Italian bank and asked to transfer 20 million euros to an account it held with a German investment bank, and 3 million euros to another account it held

[47] See also Article 8 of 2009 Monetary Agreement: 'The Vatican City State shall undertake to adopt all appropriate measures, through direct transposition or possibly equivalent actions, with a view to implementing the EU legal acts and rules listed in the Annex to this Agreement, in the field of: a) euro banknotes and coins; b) prevention of money laundering, prevention of fraud and counterfeiting of cash and non-cash means of payment, medals and statistical reporting requirements'.
[48] Art 8 of Directive 2005/60/EC.
[49] Arts 9 and 22 of Directive 2005/60/EC.

with another Italian bank. However, difficulties arose as to the possibility of obtaining information on the origin, ownership, and destination of the sum, as prescribed by Article 8 of the 3rd AMLD. In the end, the bank did not carry out the transaction and informed the Italian FIU that it was unable to apply the CDD measures provided by the 3rd AMLD and, above all, by Legislative Decree No 231 of 2007, which implemented the European directive at the national level. Given the lack of transparency, the FIU froze the sum and informed the Italian judicial authority which, in turn, began investigating on suspicion of a violation of the AML/CTF European and national rules.[50] In reality, this was one of the last of a series of investigations that the Italian magistrates conducted in early 2010 as to the business relationships between certain major Italian banks and the IOR, for alleged violation of the AML/CTF rules.

In this context, the BoI characterized the IOR as a non-Member State bank to which enhanced CDD measures must be applied.[51] To grasp the legal implications of this characterization, the 3rd AMLD is again the primary normative reference. Article 11 allows Member States' firms to apply simplified due diligence measures (SDD) to those firms which are subject to the provision of the directive or firms in non-member countries adopting due diligence obligations which are equivalent to those laid down in the directive. Specifically, this rule introduces the principle of equivalent jurisdictions, according to which firms may apply SDD to customers which are subject to the rules of the ML directive, or are situated in non-EU states which impose requirements equivalent to those set out in the European directive. Countries that meet these requirements are identified as equivalent jurisdictions.[52] Consequently, to apply SDD measures, firms have to determine whether their customers belong to a jurisdiction which meets equivalence requirements. Even though equivalence

[50] C Hornby,'Vatican Bank Head Blames "Error" for Probe' (2010), <http://ca.reuters.com/article/topNews/idCATRE68L12V20100922>.
[51] BoI (n 34).
[52] EU Member States which take part in the EU Committee on the Prevention of Money Laundering and Terrorist Financing have issued a list of 'equivalent' countries under the 3rd money laundering directive. This list is non-binding and represents the common understanding of Member States, <seehttp://.europa.eu/internal_market/company/docs/financial-crime/3rd-country-equivalence-list_en.pdf>.

does not exempt firms from conducting ongoing monitoring of the business relationships with their customers, it lessens the identification and verification obligations which would otherwise apply in the case of non-equivalence. In fact, firms have to apply enhanced customer due diligence (EDD) measures when they believe they are dealing with situations which present a higher risk of ML or TF. This means strengthening the controls on the identity of the customers, applying stricter monitoring on the transactions and, where necessary, liaising with the FIU which, in turn, may prompt the judicial authority's intervention.[53] Significantly, the CDD measures of the 3rd AMLD have the potential to trigger criminal prosecutions. By applying these normative principles to the recent facts relating to the business relationships between the IOR and certain Italian credit institutions, the picture is clearer. The Italian banks entered into a business relationship with a financial institution belonging to a jurisdiction whose AML/CTF framework was not equivalent to EU Member States applying the 3rd AMLD. Given the impossibility of conducting appropriate customer identification and verification procedures in accordance with the directive and national legislation, the banks had to alert the FIU. This, in turn, triggered supervisory controls by the BoI, as well as criminal investigations by the Italian authorities. Through its controls, the BoI warned the Italian credit institutions about the status of the Vatican financial institutions: they were extra-community, non-equivalent customers to which EDD measures must be applied under legislative decree No 231 of 2007.[54] This means that the VCS did not have an adequate AML/CTF system, and therefore its financial institutions' operations had high vulnerability to ML and TF crimes. As a result, EU Member States' financial institutions would have to apply EDD measures to the Vatican financial institutions, or could terminate any business relationship with them.

These facts illustrate how the HS/VCS had an AML/CTF that was not aligned with the European standards set out in the 3rd AMLD directive. The judicial investigation began a year after the signing of the monetary agreement, and at that time, the obligation to implement the European

[53] Art 13 of Directive 2005/60/EC.
[54] BoI (n 34).

AML/CFT legislation was still on paper. Furthermore, the BoI continued warning the Italian banks that the HS/VCS did not have an EU-equivalent AML/CTF regime in place.[55] Undoubtedly, this was detrimental to the reputation of the HS/VCS. ML and TF are problems of 'global concern'.[56] Countries are encouraged to align their AML/CTF systems to recognized international standards. Moreover, the FATF warns its members not to have business relationships with those countries which do not apply the FATF Recommendations.[57] Regarding the Vatican, its lack of an AML/CTF regime would have hampered its business relationships with those countries that had a system compliant with the rules recognized and accepted internationally, in particular the FATF Recommendations and the 3rd AMLD.[58]

Accordingly, the HS/VCS's path towards the creation of its own AML/CTF regime will have EU law and the international standards elaborated by the FATF as main normative sources. The establishment of this regime is essential to giving the Vatican the international image of a 'virtuous' state in the fight against ML and TF and consolidating its business relationships in Europe and worldwide. All things considered, the regime which is under development in the HS/VSC found its input in the 2009 monetary agreement, had its impetus in the 3rd AMLD, and will be shaped under the FATF Recommendations. The level of adherence to the 3rd AMLD and to international standards will be evaluated by an external arbiter (Moneyval).[59] This evaluation will include monitoring and giving suggestions on the necessary improvements to the AML/CTF regime of the HS/VCS.

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55 BoI, 'Operatività tramite POS nello Stato della Città del Vaticano' (2013).
56 International Monetary Fund (IMF), 'IMF Executive Board Discusses Money Laundering' (2001) Public Information Notice (PIN) No 01/41.
57 Alexander et al (n 1), 73.
58 The EU AML/CTF legislation draws on the FATF Recommendations, see Recital 5 of Directive 2005/60/EC: 'Money laundering and terrorist financing are frequently carried out in an international context. Measures adopted solely at national or even Community level, without taking account of international coordination and cooperation, would have very limited effects. The measures adopted by the Community in this field should therefore be consistent with other action undertaken in other international fora. The Community action should continue to take particular account of the Recommendations of the Financial Action Task Force, which constitutes the foremost international body active in the fight against money laundering and terrorist financing. Since the FATF Recommendations were substantially revised in 2003 this Directive should be in line with that new international standard'.
59 Moneyval was founded in September 1997 by the Committee of Ministers of the Council of Europe. It conducts self and mutual evaluation review of the AML measures in place in Council of Europe' member

5. *Towards the Creation of the Vatican AML/CFT System*

A. *The Original AML/CFT Law*

The reform process for creating an AML/CTF system within the HS/VCS began in 2011 and is estimated to be completed by 2017. To take stock of this process, it is useful to subdivide the reforms into four groups. The first set of reforms concerns 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 of 1 April 2011 (the Original AML/CTF Law). This legislation was the stepping stone towards the successive legislation which was enacted between 2012 and 2013 following Moneyval's observations. The Original AML/CTF Law tried to create the 'optimal' AML/CTF regime which, in accordance with the FATF Recommendations and the 3rd AMLD, was to be based on four pillars: 1) criminalization and prohibition of ML and TF; 2) a robust system for customer verification and identification; 3) effective and ongoing control for preventing the crimes in question and punishing them through, inter alia, the confiscation and seizure of the criminal proceeds; and 4) an adequate mechanism to facilitate cooperation at the domestic and international levels in the fight against ML and TF.[60] In accordance with Article 1 of the 3rd AMLD and FATF Recommendation No 1, the Original AML/CTF Law provided for the criminalization of ML and TF, and for the inclusion of these crimes on a list of predicate offences.[61] This is an important achievement for the HS/VCS in that the Vatican Criminal Code had never previously included a provision punishing ML and TF. This was therefore the first step towards alignment with the international understanding of ML and TF as crimes requiring a coordinated global response. Furthermore, FATF Recommendation No 1 states that ML is to be criminalized under the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (the Vienna

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states which are not members of the FATF. The HS/VCS is a Council of Europe's non-member state to which observer status with the organisation was granted on 7 March 1970, see <http://www.coe.int/t/dghl/monitoring/moneyval/About/MONEYVAL_in_brief_en.asp>.

[60] Sarais (n 5), 135.

[61] Arts 3 and 4 of Act No CXXVII.

Convention) and the United Nations Convention against Transnational Crime of 2000 (the Palermo Convention). By criminalizing ML, the HS/VCS also became, for the first time, a party to these UN Conventions. This contributed to building up the fourth pillar of the 'optimal' AML/CTF regime, relating to strengthening international cooperation against ML and TF. In practice, by ratifying the UN Conventions, the HS/VCS entered a network of nations cooperating with each other through exchange of information and mutual judicial legal assistance.[62]

The Original AML/CTF Law also followed the pattern provided by the FATF Recommendations and the 3rd AMLD regarding the other two pillars. As to the customer identification and verification obligations, CDD measures were introduced under Vatican law. Specifically, in accordance with the FATF Recommendations and the 3rd AMLD SDD measures vis-à-vis EDD measures were provided that draw on the FATF standards and on the CDD rules of the 3rd AMLD.[63] These rules were important to restoring the reputation of the HS/VCS as a jurisdiction 'equivalent' to EU Member States applying the 3rd AMLD. Accordingly, the CDD measures set out in the Original AML/CTF Law were intended to facilitate the application of the SDD measures which, as illustrated above, could not be applied to the Vatican financial institutions. The most important aspect of this legislation was the creation of a supervisory authority, namely the Financial Information Authority (FIA). Under Article 33 of the Original AML/CTF Law, the FIA is the equivalent of the FIU required by FATF Recommendation No 13 and Article 9 of the 3rd AMLD. In accordance with these provisions, the FIA is the FIU of the VCS and acts as an AML/CFT supervisor. It has investigative powers, and it liaises with judicial authorities by reporting suspicious transactions.[64] Overall, the Original AML/CTF Law tried to create the fundamentals of an AML/CTF regime to align the HS/VCS with those countries applying the standards recognized at the European and international levels. This early regime, however, needed to be certified as being compliant with EU law and

[62] Moneyval (n 4), para 1028.
[63] Arts 29, 30 and 31 of Act No CXXVII.
[64] Arts 33 and 34 of Act CXXVII.

international standards. As of 2012, this was the task of Moneyval, whose MER triggered a second set of reforms.

B. *Moneyval's Scrutiny Over the VCS's AML/CTF*

Moneyval's evaluation had a broad scope, because it included an analysis of the HS/VCS's adherence to the Vienna Convention and the Palermo Convention in addition to the FATF Recommendations and the 3rd AMLD. The first MER was issued in July 2012, following two on-site visits that Moneyval observers paid between November 2011 and March 2012. Interestingly, following the first visit, the Original AML/CTF Law was fully amended and replaced by Decree No CLIX (Revised AML/CTF Law).[65] Consequently, the 2012 MER was not concerned with the early regime set out under the first law, but with the new regime which the Revised AML/CTF Law outlined following the suggestions given during the two on-site visits. The Revised AML/CTF Law strengthened the CDD measures laid down in the Original AML/CTF Law by introducing EDD measures for business relationships established with politically exposed persons and relationships that are not face-to-face.[66] However, according to the MER there were still some deficiencies to overcome. As to the criminalization of ML, the MER stressed the need to reformulate the definition of the crime to better reflect the wording of the Vienna Convention and the Palermo Convention.[67] On the other hand, regarding the criminalization of TF, the observers noted that despite the HS/VCS becoming party to the UN Terrorist Finance Convention, the HS/VCS was not party to any of the counter-terrorism conventions annexed to it. This could create interpretative problems between the definition of TF included in the Vatican Criminal Code and the FATF definition, which draws upon the mentioned conventions. Furthermore, the MER stated that the legislation was incomplete in that it did not cover the financing of individual terrorists or terrorist organizations disguised as non-profit organizations.[68]

[65] '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'.
[66] Art 31 of Decree CLIX.
[67] Moneyval (n 4), para 197.
[68] Ibid para 230.

As to the CDD measures, the MER identified the need to create a more robust CDD framework in which the application of SDD controls vis-à-vis EDD controls is the result of a stronger, risk-based approach, that is, based on a thorough assessment of the risks and vulnerabilities that the HS/VCS financial system may have. Even though the rules set out in the Revised AML/CTF Law represented a significant improvement in comparison to the Original AML/CTF Law, they were still insufficient to guarantee a higher level of control. The MER also recommended the drafting of additional CDD measures that clarify the categories of clients eligible to hold accounts with the IOR.[69] In substance, as to transparency and customer controls, further improvements were necessary for creating an adequate AML/CTF system. The MER also suggested widening the supervisory powers of the FIA. While the establishment of the FIA was a major step towards a supervisory system in accordance with the FATF Recommendations and the 3rd AMLD, the powers of the FIA needed to be better defined. Crucially, the MER underlined how the power and function of the FIA appeared to be reduced under the Revised AML/CTF law due to a subdivision of responsibilities between the FIA and the Secretariat of State. In essence, under the Revised AML/CTF law, the FIA would have maintained control powers as to the financial institutions' compliance with the CDD obligations, while the prevention and intervention duties would have been jointly performed with the Secretariat of State.[70] The MER pointed out that in the Revised AML/CTF law the FIA had supervisory powers limited to internal control measures and the monitoring and verification of activities such as the selection of employees, with no clarity as to the powers to carry out inspections and enter the premises of institutions subject to supervision. Undoubtedly, the Revised AML/CTF had reshaped the powers, operation, and functions of the FIA in a less clear way than the Original AML/CTF Law did. Consequently, the MER suggested that the powers of the FIA be redefined to give it exclusive supervisory powers encompassing all aspects of AML/CTF.[71] This also would have given the FIA a

[69] Ibid para 481.
[70] Art 2 septies of Decree CLIX; see also Annex VI of Decree CLIX, 'Statute of the Financial Intelligence Authority (FIA)'.
[71] Moneyval (n 4) para 17.

better-defined role in its relationship with FIUs in other countries, particularly regarding international cooperation and exchange of information. In this respect, the Revised AML/CTF Law reduced the supervisory powers of the FIA to the extent that its ability to liaise internationally with other FIUs was jeopardized.[72] Furthermore, the MER emphasized the weaknesses of the FIA's supervisory powers in relation to the main Vatican financial institutions, the IOR and the APSA. Regarding the former, the MER recommended the creation of an independent prudential supervisor, because the IOR poses larger risks to the stability of the HS/VCS financial system. In this regard, the FIA's supervisory powers under the Revised AML/CTF law would have not guaranteed independent and effective supervision.[73] As to the latter, the MER indicated that the main lacuna was the fact that no sanctions for breaches of AML/CTF legislation were provided for APSA employees. As explained above, the APSA is a dicastery of the Roman Curia with administrative competences. Its employees are public officials which were shielded from sanctions for violating the Vatican's AML/CTF legislation. In this regard, the MER recommended the introduction of provisions setting out sanctions for directors, senior managers, and employees at all levels in the Vatican financial institutions.[74] Moreover, the Moneyval observers suggested widening the FIA's spectrum of sanctioning powers. In particular, the FIA should have been given, inter alia, the power of withdrawing, suspending, or restricting a financial institution's licence.[75] Overall, the Vatican's regime under the Revised AML/CTF Law had a rating of 'partially compliant' with the international standards. This was remarkable but still insufficient. Further efforts had to be taken to reach the rating of 'compliant' jurisdiction.

C. *Law No XVIII*

Moneyval's rating is the basis of the third round of reforms, which took place in 2013. New legislation was issued. First, through Law No VIII on Supplementary Norms on Criminal Matters and Law No

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[72] Ibid para 21.
[73] Ibid para 48.
[74] Ibid para 49.
[75] Ibid.

IX on Amendments to the Criminal Code, important improvements were made to the Vatican Criminal Code and to the Code of Criminal Procedure. Prosecution is now extended to the HS's public officials for ML and TF offences committed while performing their duties within or outside VCS territory.[76] Moreover, the scope of TF crimes was broadened to encompass, among other things, the financing of individual terrorist and terrorist organizations disguised as non-profit organizations. Significant changes also occurred regarding ML offences to better clarify the definition and the physical and material elements of the crime in line with the wording provided by the Vienna Convention and the Palermo Convention.[77] Furthermore, the domestic confiscation procedure was strengthened by clarifying key concepts such as property, value confiscation, and protection of bona fide third parties, and by repealing some exceptions which could prejudice the ability to recover the property subject to confiscation.[78] However, the most important step towards the creation of a robust AML/CTF system was taken through the 8 October 2013 issuance of Law No XVIII on transparency, supervision, and financial intelligence. Importantly, this legislation replaced the Revised AML/CTF Law. The new law provides for the creation of a single national list of subjects who are regarded as threatening international peace and security.[79] It also makes the rules on CDD more stringent by reducing the number of exceptions to the application of SDD. In this regard, the new law introduces a direct requirement to pay special attention to complex and unusual transactions, and to transactions with customers in or from countries which do not or insufficiently apply the FATF Recommendations.[80] The new law considerably enhanced the Vatican financial institutions' transparency duties. For example, following the new law, the IOR set up, for the first time, its own website where information is provided about its structure and operations and, most importantly, on the categories of clients entitled to hold a position in the IOR's fund.[81]

[76] Arts 1, 2 and 3 of Law No IX.
[77] Art 23 of Law No VIII.
[78] Arts 8 and 9 of Law No IX.
[79] Art 71 of Law No XVIII.
[80] Art 41.
[81] See <https://www.ior.va/>.

Under Law No XVIII, the supervisory framework also went through a second overhaul process. In line with the deficiencies highlighted by the Moneyval observers, the powers of the FIA were rewritten through the attribution of prudential supervisory powers. Under Law No XVIII, the FIA is now more than an intelligence unit: the FIA is designated as a prudential supervisor and regulator responsible for the supervision of all the Vatican financial institutions, including the IOR.[82] Importantly, the new AML/CTF law strictly demarcates the dual competences of the FIA as intelligence unit and AML/CTF supervisor. In this respect, two separate departments, the Office of Supervision and Regulation and the Office of Financial Intelligence, were established.[83] Through this demarcation, when acting as a supervisor the FIA can carry out off-site and on-site inspections and impose a full range of administrative sanctions on senior managers and beneficial owners of obligated entities.[84] The new supervisory powers of the FIA also strengthened its cooperation with other countries' FIUs. To this end, the FIA is now part of the Egmont Group of Financial Intelligence Units an informal network of FIUs for enhancing international cooperation against ML and TF.[85] Finally, the reforms process resulted in the creation of a new authority, the Financial Security Committee (FSC), which coordinates the activities of the competent authorities of the HS/VCS for the prevention and countering of ML, TF, and the financing of proliferating weapons of mass destruction.[86]

D. *An Ongoing Process of Modernization*

All these reforms were analyzed in the progress report that Moneyval issued in December 2013. The 2013 progress report underlined the significant progress that the HS/VCS made following the 2012 MER. According to the report, most of the reforms were satisfactory, though time is still needed to evaluate their effectiveness in practice.[87] A new progress report by Moneyval is due by the end of

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[82] Art 46.
[83] See 'Statues of the Financial Intelligence Authority' (2013), Art. 3(2)(a)(b).
[84] Arts 65 and 66 of Law No XVIII.
[85] See <http://www.egmontgroup.org/>.
[86] Art 9.
[87] Moneyval, 'The Holy See (Including the Vatican City State)' (9 December 2013) Progress Report and Written Analysis by the Secretariat of Core and Key Recommendations.

2015, and new views will be provided as to the implementation process of Law No XVIII. Nonetheless, the reform process is still ongoing, and a fourth round of reforms took place in 2014. This round finds its source in the 2014 Apostolic Letter in the form of *motu proprio* whereby Pope Francis established the Council for the Economy and the Secretariat for the Economy.[88] Through these two authorities, oversight and control over the whole Vatican financial system are enhanced. Pursuant to Article 1 of the 2014 Apostolic Letter, the Council for the Economy is tasked with supervising the administrative and financial structures and activities of the dicasteries of the Roman Curia, as well as of the institutions connected to the HS/VCS. On the other hand, the Secretariat for the Economy is a new dicastery of the Roman Curia which, following the policies set out by the Council for the Economy, will exercise economic control and vigilance over the agencies mentioned in Article 1 of the Apostolic Letter.[89] The establishment of the Council for the Economy and the Secretariat for the Economy gave impetus to further changes within the major Vatican financial institutions. In particular, the APSA has been restructured. The historical twin-peak structure (Ordinary/Extraordinary Sections) has been replaced through the incorporation of the Ordinary Section within the Secretariat for the Economy. Consequently, the Extraordinary Section is now the main department within the APSA in charge of the administration of the HS's patrimony so as to provide the funds necessary for the functioning of the Roman Curia.[90]

These are the contours of the new reforms which will be evaluated in the next Moneyval progress report. At the same time, there will be room to provide guidance on future reforms which are expected to be finalized by 2017. For example, current proposals are concerned with the amendments of the IOR's statutes through the creation of a new entity: the Vatican Asset Management (VAM). The creation of the VAM will likely reduce the functions of the IOR. In

[88] 'Apostolic Letter issued Motu Proprio Fidelis Dispensator et Prudens of His Holiness Pope Francis Establishing a New Coordinating Agency for the Economic and Administrative Affairs of the Holy See and the Vatican City State' (24 February 2014).
[89] Art 3 of Apostolic Letter.
[90] 'Press Conference for the presentation of the New Economic Framework for the Holy See' (9 July 2014) Holy See Press Office B0509.

practice, the task of managing assets for charity purposes should shift from the IOR to the VAM. As a result, the former will be in charge of only financial consultancy duties and payment services for the HS/VCS's employees.[91]

6. Outcomes and Future Developments

The establishment of the Vatican AML/CTF regime stimulates a number of reflections. From the HS/VCS perspective, the reforms represent an interesting process of modernizing a jurisdiction which is trying to gain reputation as a 'virtuous' state in the fight against ML and TF. The HS/VCS had a proactive approach to the suggestions provided by Moneyval observers. Indeed, new legislation was issued promptly to apply the necessary amendments. Also, the constant dialogue between HS/VCS representatives and the Moneyval observers provided significant information on the Vatican financial system, in particular, on the structure and operations of its main financial institutions. Previously, the legal founding documents of the IOR and the APSA were the only sources to provide an understanding of their legal status. In any case, before the current reforms, their operations and governance were a grey area because of the high level of secrecy that the Vatican had always maintained about them. Significantly, the need to create an AML/CTF regime aligned with EU law and international standards made it necessary for the HS/VCS to open the gate. Moneyval's observers had the opportunity to know and bring to light what has never been shared before. Consequently, there is now much more information and transparency about the Vatican financial system. The Vatican financial system, in turn, is going through unprecedented changes. As discussed above, new authorities such as the FIA have been created, and new ones such as the VAM will be set up in the coming years. Furthermore, the existing financial institutions have been restructured. As illustrated, a more central role has been attributed to the APSA vis-à-vis the IOR. Undoubtedly, through the creation of the VAM, the IOR will be downsized so as to be strictly concerned with its own mission and cease some of those activities which gave it the reputation of the Vatican bank. Essentially, the

[91] Ibid.

creation of the AML/CTF regime paved the way for a new financial architecture in the HS/VCS. EU legislation and FATF soft-law principles are at the heart of these changes. The 2009 monetary agreement between the EU and the VCS is the first normative source of the Vatican's AML/CFT, because it specified the European legislation that the HS/VCS had to implement. Then, the creation of the AML/CTF system is the result of the interplay between the 3rd AMLD and the FATF Recommendations. These are the two pillars the AML/CTF regime of the HS/VCS lies on, and which led to the restructuring of the Vatican financial system.

All this process has a profound meaning. As explained, the HS/VCS is a 'unique' jurisdiction set up as an enclave within the Italian Republic. This jurisdiction has always been reluctant to submit to external rules and controls, particularly regarding its institutions. Its legislation has always found its source in the Supreme Pontiff and had a spiritual connotation in accordance with the universal mission that the Pope has to pursue. Creating an AML/CTF regime aligned with EU law and FATF international standards made it necessary to rely on new sources of law. Now, and for the first time, the HS/VCS's regulator, the Supreme Pontiff, is guided by external regulators and standard setters. This has de facto marked the beginning of a new era in the HS/VCS's international relationships. Through the criminalization of ML and TF, and the ratification of the Vienna Convention and the Palermo Convention, the HS/VCS stepped into international forums in which coordination and cooperation among countries is encouraged in the global fight against ML and TF. This development raises the question of which role the HS/VCS will play in the international arena setting out the policy to properly deal with these crimes. This question can be answered once the reform process is completed and the effectiveness of the AML/CTF regime of the HS/VCS is tested. At this stage, it can be said that the efforts to create a regime through the interplay between EU legislation and soft-law principles give the Vatican two advantages. First, the regime will easily adapt to the forthcoming changes in the EU AML/CTF legislation. In particular, the 4th AMLD is expected to be issued and implemented at the national level by Member States quite soon.[92] Even though the HS/VCS is not an EU Member State, it is bound under the 2009 monetary agreement to implement current and future EU legislation on ML and TF. Therefore, prospective changes following the issue of the 4th AMLD may be applied smoothly to a regime which already draws upon the EU legislation. Second, the adherence to the FATF standards will enhance the reputation of the HS/VCS. This will benefit the business relationships with those countries sharing the same international obligations.[93] While the HS/VCS was previously earmarked as lacking any AML/CTF system, now such a system has been established through numerous legislative reforms issued within a short time. This is a remarkable achievement.

7. Conclusions

This paper analyzed the rapid and unprecedented changes that occurred in the Vatican financial system following the establishment of an AML/CFT regime in accordance with the 3rd AMLD and FATF international standards. These legal sources make the Vatican reforms very interesting in that the HS/VCS has always been reluctant to incorporate external rules and permit controls on its institutions. The ongoing reform process, which is also based on Moneyval's advice, stimulates analysis of the HS/VCS beyond the traditional context of ecclesiastical law. The new Vatican financial legislation provides an opportunity to study the HS/VCS from an international perspective, that is, in relation to its contribution to the fight against crimes which are of global concern. So far, the reforms are showing the AML/CTF international arena that this jurisdiction is proactive in

[92] European Commission, 'Proposal for a Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing' (2013), COM (2013) 45 final; see also 'Proposal for a Regulation of the European Parliament and of the Council on information accompanying transfers of funds' (2013), COM (2013) 44 final.

[93] In fact, one of the results of the set up of the AML/CFT regime was the restitution of the sum of 23 million which were blocked during the recent criminal investigations, see P Pullella, 'Vatican Bank Gets Asset Back, Wants New Footing with Italian Banks' (2014) <http://www.reuters.com/article/2014/11/18/vatican-bank-idUSL6N0T82BC20141118>.

applying the recognized standards, is willing to break with a past characterized by a secular protectionism to its institutions, and is ready to undertake a significant path to modernization. Once the process is completed, there will be opportunity to discuss the effectiveness of the HS/VCS's AML/CTF regime, whether the HS/VCS can be regarded as a 'virtuous' jurisdiction in the fight against ML and TF, and how this regime affects its business relationships with other countries. The path is still long, but worthy of attention.