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The 4th EU Anti Money Laundering Directive: The future Transparency Rules

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On April 20th 2015, the Council adopted its position at first reading on the revised directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the **"4th AML Directive"** or **"Directive"**), which repeals Directive 2005/60/EC of the European Parliament and of the Council (**"the 3rd AML Directive"**) and Commission Directive 2006/70/EC. The European Parliament, adopted the final version of the text on 20th May 2015. Member states will then have two years to implement the 4th AML Directive into national law.

Objectives and main points of interest on the Directive:

The proposal was adopted by the European Commission to update and improve the European Union framework in order to further strengthen the European Union's defence system against money laundering and terrorist financing (**"ML-TF"**), to ensure the soundness, integrity and stability of credit institutions and financial institutions and to ensure confidence in the financial system as a whole. To this effect the Directive implements the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation, adopted by the Financial Action Task Force (**"FATF"**) in February 2012.

The key changes brought by the Directive are outlined below.

Key Changes:

I. Definitions (Article 3):

The Directive expands on the definitions set out in the 3rd AML Directive and provides a definition of gambling services and correspondent relationships, which were not yet defined in the 3rd AML Directive.

In relation to PEPs, the Directive now lists on a non-exhaustive basis, the persons who are considered as having prominent public functions, including inter alia members of governing bodies of political parties, members of supreme courts and members of the boards of central banks. Furthermore, the Directive also includes domestic PEPs within

this definition, bringing a substantial change in relation to the 3rd AML Directive which only required enhanced customer due diligence measures in relation to foreign PEPs.

In relation to the definition of beneficial owners, in cases involving corporate entities, whereas the 3rd AML Directive provided that a percentage of 25% plus one share, was sufficient to prove ownership or control, the Directive provides that such a threshold is merely an indication of direct or indirect ownership, to be considered among other factors.

The Directive however now specifies that where no natural person is identifiable who ultimately owns or controls a corporate entity, obliged entities subject to the Directive, after having exhausted all other means of identification, and provided there are no grounds for suspicion may now consider the senior managing officials to be the beneficialowners of the entity.

II. Extended Scope of the Directive:

The Directive extends the scope of the persons qualifying as obliged entities and which are thus subject to the obligations resulting therefrom, by including the following persons:

- Persons trading in goods where payments, amounting to EUR 10.000 or more are made or received in cash;

- Estate agents, which are no longer limited to real estate agents but now could be understood to include letting agents of real estate property;

- Whereasthe 3rd AML Directive only applied to casinos, all providers of gambling services are now included in the scope of the Directive. In this context the Directive requires obliged entities to conduct due diligence upon the collection of winnings, the wagering of a stake or both, when carrying out transactions of EUR 2.000 or more. However in proven low risk circumstances, except in relation to casinos, Member Stares are authorised to exempt, in full or in part, providers of certain gambling services from the national provisions implementing the Directive.

III. Extended scope of the AML/CTF predicate offences: the inclusion of "tax crimes" within the list of predicate offences:

"Tax crimes" relating to direct or indirect taxes are now included withinthe list of predicate offences to a money laundering, where they are punishable by deprivation of liberty or a detention order for a maximum of more than one year or, as regards Member States that have a minimum threshold for offences in their legal system all offences punishable by deprivation of liberty or a detention order for a minimum of more than six months. However the Directive does not provide for a harmonised

definition of "tax crimes" and it will be incumbent on Member States to define under national law which tax offense should amount to a predicate offense.

IV. Risk assessment and customer due diligence measures:

(1) The Risk assessment:

The Directive emphasizes on the risk-based approach requiring the distribution of the risk assessment process between three levels of competence.

a. On a supranational level the European Commission has been entrusted with the task of assessing the risks of ML-TF affecting the internal market and relating to cross-border activities. The latter will provide a report on these risks, accessible to national authorities and obliged entities in order to assist them in identifying, understanding, managing and mitigating the risk of ML-TF. Based upon this report, the European Commission will make recommendations to Member States on the measures which it considers suitable for assessing the identified risks.

   In addition to this general risk assessment, the European Commission will also have the task of identifying high-risk third countries and adopting delegated acts in relation to its findings. The qualification as a high-risk third country will trigger the obligation for the Member States to require the application of enhanced customer due diligence measures by obliged entities when dealing with natural or legal persons established in such countries.

b. In addition to this assessment at the European level, Member States have also a role to play as the latter are required to take measures to identify, assess, understand and mitigate the risks of ML-TF within their state. This assessment must then serve as a basis to inter alia better determine the sectors of higher and lower risk in the relevant Member State and modulate and improve the AML-CTF rules accordingly. This provision will thus have a direct impact on the AML-CTF rules applicable to the obliged entities, in particular for entities acting in sectors which could potentially be considered by Member States as representing a higher risk of ML-TF.

c. Finally as provided for under CSSF Regulation no. 12-02, obliged entities are required to take appropriate steps to identify and assess the risks of money laundering and terrorist financing. When carrying out such an assessment, obliged entities shall take into account risk factors including those relating to its customers, products, transactions, delivery channels or relevant geographic areas or countries.

(2) The customer due diligence ("CDDD") measures:

Pursuant to the risk-based approach, the obliged entities shall take into account at least the variables set out in Annex I of the Directive, i.e. (1) the purpose of an account or relationship, (2) the level of assets to be deposited by a customer or the size of the transactions undertaken and (3) the regularity or duration of the business relationship. Such variables have already been set out under the CSSF Regulation no. 12-02.

In addition the obliged entities have to establish rules in order to determine which specific simplified or enhanced due diligence measures are to be taken to reduce or prevent the identified risks.

- **Simplified CDD measures:**

Pursuant to the Directive, in situations presenting a lower risk of ML-TF, Member States may allow obliged entities to apply simplified due diligence measures. Therefore rather than exempting these entities from any CDD measures, as provided for under the 3rd AML Directive, the Directive now enables obliged entities to merely adapt their measures to such situations.

In this regards, it should be noted that the Directive does not specify the measures to be taken in this respect which are to be detailed in guidelines to be issued shortly by the European Supervisory Authorities.

To the contrary of the 3rd AML Directive, the Directive has removed the categories triggering an automatic application of simplified due diligence measures. In practice, an obliged entity will thus determine on a risk sensitive basis, whether the relevant relationship or transaction may trigger the application of simplified CDD measures. In carrying out such assessment, the obliged entities will be required to take into account the factors set out under Annex II of the Directive. Therefore the mere fact of carrying out a transaction with a specific type of customer, for instance a credit institution established in another Member State, no longer automatically entails the ability for the relevant obliged entity to apply simplified CDD measures.

- **Enhanced CDD measures:**

Although most of the categories of persons triggering an automatic application of enhanced CDD measures remain, the Directive focusses again on a risk based approach. To that effect, in order to determine whether enhanced CDD measures should be applied, obliged entities must take into account a non-exhaustive list of factors and types of evidence of potentially higher risk (Annex III).

In this context, it should be noted that non-face-to-face relationships are no longer considered as systematically requiring enhanced due diligence measures and are only relevant as a factor which could evidence a potentially higher risk of ML-TF (Annex III).

The Directive has rendered obliged entities accountable in the entire risk process as the latter will now have limited recourse to automatic categorization of clients. Furthermore obliged entities will be required to justify their classification and extent of CDD measures.

V. Information relating to beneficial owners:

The Directive provides that beneficial ownership information on corporate and other legal entities established within their territory will have to be held in a central register in each Member State and should therefore not only be available at the respective corporate and other legal entities registered office. This central register should be accessible to competent authorities and financial intelligence units (**"FIUs"**) without restrictions and to obliged entities within the framework of their customer due diligence measures. The Directive also enables any person or organisation which is able to demonstrate a legitimate interest to access certain information relating to the relevant beneficial owner. However the Directive does not go so far as to enable obliged entities to rely solely on the information in the central register to fulfil their customer due diligence requirements. The obliged entity will in fact still be required to identify the beneficial owner and verify its identity using a risk-based approach.

Further the Directive also provides for a similar but less strict regime in relation to information regarding the beneficial owner of a trust.

VI. Cooperation between the Financial Intelligence Units and the European Commission:

The Directive contains provisions which aim at reinforcing the cooperation between the different national FIUs. The latter are required to exchange information spontaneously or upon request from another FIU. Refusal to exchange information is only possible in very limited and exceptional circumstances although FIUs are authorised to impose restrictions and conditions for the use of such shared information.

The Directive also aims at reinforcing the cooperation between the FIUs and the European Commission. In this context, the latter may provide assistance to facilitate coordination and exchange of information between the different FIUs for instance through the organisation of meeting of the European Union FIUs platform.

The Directive thus creates a mandatory framework for cooperation within the European Union which will replace the informal framework for cooperation which existed under Council Decision of 17/10/2000 concerning arrangements for cooperation between the FIUs and which to a certain degree had been the cause for the ruling in a recent decision of the ECJ.

VII. Sanctioning powers of the competent authorities:

The Directive provides a list of administrative sanctions and measures which must at least be applied in certain circumstances for instance, for serious, repeated and/or systematic breaches of customer due diligence measures. This list includes a maximum administrative pecuniary fine of at least twice the amount of the benefit derived from the breach where that benefit may be determined or at least EUR 1 million.

Specific sanctions are provided for breaches involving credit or financial institutions. In this case the maximum administrative fine must amount to no less than EUR 5 million or 10% of the total annual turnover (according to the latest available accounts approved by the management body) of the institution responsible for the breach.

Moreover all decisions imposing an administrative sanction or measure based on breaches to the requirements laid down in the Directive must be published by the competent authorities on their website. Unless overriding reasons require otherwise, the identity of the person responsible for the breach as well as the nature of the breach must be mentioned in the publication.

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