

GLOBAL INVESTIGATIONS & COMPLIANCE

NEW EU RULES TARGET TERRORIST FINANCING AND OWNERSHIP OF OFFSHORE ASSETS

Fifth Anti-Money Laundering directive imposes greater transparency around beneficial ownership and restrictions on virtual currencies

By Mark Daws, Robert Dedman, and James Robertson

BACKGROUND

In 2015, the European Union (EU) strengthened its rules on anti-money laundering and terrorist financing by introducing the Fourth Anti-Money Laundering Directive (MLD4), which incorporated previous recommendations made by the Financial Action Task Force (FATF). Member states were given two years to bring their existing laws and regulations into compliance with the new requirements.

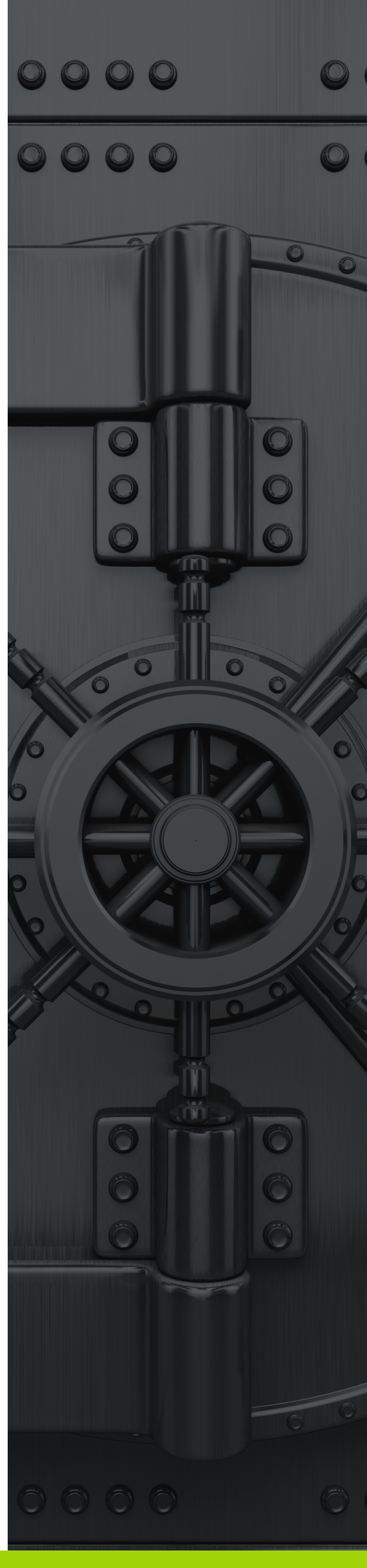
However, following a surge in terrorist attacks across Europe and the release of the Panama Papers in 2016, European governments responded by proposing further legislation, resulting in the Fifth Anti-Money Laundering Directive (MLD5).

Commenting on the proposed measures, the EU Council noted:

“Recent terrorist attacks have brought to light emerging new trends, in particular regarding the way terrorist groups finance and conduct their operations. Certain modern technology services are becoming more and more popular as alternative financial systems and remain outside the scope of Union legislation or benefit from exemptions that may no longer be justified. In order to keep pace with evolving trends, further measures to improve the existing preventive framework should be taken.”¹

Given the pressing nature of the issue, it was decided to give the same effective date for both directives. The proposed date for implementation of MLD4 is 26 June 2017. The December 2016 compromise text from the EU Council suggested MLD5 should be transposed within 6 months of its publication in the Official Journal. As such, the time period for firms making changes to their financial crime systems and controls is likely to be relatively short.

1. The Council of the European Union, 5th Anti-money Laundering Directive: 2nd Presidency Compromise Text (November 2016), paragraph 2, <http://data.consilium.europa.eu/doc/document/ST-14433-2016-INIT/en/pdf>.



PROPOSED CHANGES AND LIKELY IMPACT ON FINANCIAL INSTITUTIONS

The provisions of MLD5 include five important changes to the previous standard. In this section, we examine each one individually, the likely impact on financial institutions, and the steps they can take to prepare for the new obligations.

1. Tackling terrorist finance risks relating to virtual currencies

Under the proposed directive, providers engaged in exchange services between virtual currencies² and fiat currencies³ and custodian wallet providers will be required to conduct ongoing monitoring of such services and report suspicious activity to regulators. Additionally, member states must ensure providers of exchange services between virtual currencies, fiat currencies, and custodian wallet providers are registered.

In October 2015, the FATF published a case study demonstrating the use of virtual currencies to finance terrorism:

On 28 August 2015 Ali Shukri Amin was sentenced to 11 years in prison to be followed by a lifetime of supervised release and monitoring of his internet activities for conspiring to provide material support and resources to the ISIL. [...]. He admitted to using Twitter to provide advice and encouragement to ISIL and its supporters. Amin, who used the Twitter handle @Amreekiwitness, provided instructions on how to use bitcoin, a virtual currency, to mask the provision of funds to ISIL, as well as facilitation to ISIL supporters seeking to travel to Syria to fight with ISIL. [...]

For example, Amin tweeted a link to an article he had written entitled “Bitcoin wa’ Sadaqat al-Jihad” (Bitcoin and the Charity of Jihad). The article discussed how to use bitcoins and how jihadists could utilise this currency to fund their efforts. The article explained what bitcoins were, how the bitcoin system worked and suggested using Dark Wallet, a new bitcoin wallet, which keeps the user of bitcoins anonymous. The article included statements on how to set up an anonymous donations system to send money, using bitcoin, to the mujahedeen.⁴

The proposed directive incorporates the council’s approach to aligning with the FATF goal of preventing virtual and cryptocurrencies being used to finance terrorism. Providers of these financial services will need to familiarise themselves with the new regulations to mitigate the money laundering and terrorist-financing risks inherent in virtual currency transactions and prevent their institutions being used as a terrorist-financing vehicle.

2. Tackling risks linked to anonymous prepaid instruments (e.g., prepaid cards)

MLD5 introduces a new obligation on acquirers that they do not accept payments carried out with prepaid cards issued in third countries where such countries do not meet requirements equivalent to the prevention of money laundering under MLD5. Acquirers will no longer be able to accept any payment cards from countries deemed high-risk by the EU Council, which noted:

“Anonymous prepaid cards are easy to use in financing terrorist attacks and logistics [...] thus it is essential to lower the existing thresholds for general purpose anonymous prepaid cards and to identify the customer in the case of remote payment transactions where the amount paid exceeds EUR 50.”⁵

The European e-money business is likely to feel the greatest impact from this obligation. MLD5 significantly restricts the legal requirements that allow the issuance of anonymous e-money products compared with MLD4. Under MLD5, member states will need to identify the customers involved in remote-payment transactions where the amount paid exceeds EUR 50. Member states will be required to identify customers involved in all remote payment transactions 36 months after the transposition date.

Article 12 of MLD4 allows member states to exclude some low-risk e-money products from certain customer due diligence measures. For instance, customer identification and verification is not required for e-money products with a maximum stored value of EUR 250. However, MLD5 will lower this threshold to EUR 150 and no threshold will apply to e-money products that are used for online payments. This means full Know Your Customer (KYC) will be required in all circumstances that an e-money product is used for an online product.

2. “A virtual currency is a type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community,” Virtual Currency Schemes, European Central Bank (October 2012), p. 13, <https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf>.

3. “Paper money or coins of little or no intrinsic value in themselves and not convertible into gold or silver, but made legal tender by fiat (order) of the government,” Definition of fiat money, Financial Times Lexicon, <http://lexicon.ft.com/Term?term=fiat-money>.

4. The Financial Action Task Force, Emerging Terrorist Financing Risks, The Financial Action Task Force Report (October 2015), p. 36, <http://www.fatf-gafi.org/media/fatf/documents/reports/Emerging-Terrorist-Financing-Risks.pdf>.

5. The Council of the European Union, 5th Anti-money Laundering Directive: 2nd Presidency Compromise Text (November 2016), paragraph 11, <http://data.consilium.europa.eu/doc/document/ST-14433-2016-IN1/en/pdf>.

3. Stronger checks on high-risk third countries

Member states are required to adopt a set of enhanced due diligence (EDD) measures for transactions involving counterparties on a list of high-risk third countries provided by the European Commission. The required measures are aligned with the measures provided by the FATF. The creation of a set of EDD rules that are consistent across member states and the FATF will lessen the difference in regulatory obligations across member states in the hope of preventing terrorists exploiting weaknesses that such differences are likely to foster.

Firms will be required to review and adopt the Commission's list of high-risk third countries and incorporate the revised set of EDD measures into their internal KYC systems. It is likely that current KYC systems and procedures will need to be updated to incorporate the requirements effectively. Firms must also be prepared to expand their transaction monitoring processes to capture any new countries that are considered high-risk by the Commission.

4. Full public access to the beneficial ownership registers

The April 2016 release of the Panama Papers drew global attention to the use of obfuscation techniques, such as shell companies, to hide assets from tax authorities. The leak highlighted the tight confidentiality laws that offshore jurisdictions provide to individuals or corporations operating there. Jurisdictions such as Panama provide lenient company incorporation laws and are not legally obliged to disclose beneficial ownership information to authorities.

The UK has already taken some steps toward implementing this requirement. Since April 2016, most UK companies are required to compile a list of the persons who own or control the company on a publicly available "persons of significant control" register (PSC Register). The PSC Register is designed to "increase transparency over who owns and controls UK companies and... will also support law enforcement agencies in money laundering investigations.

To improve transparency around ownership of companies and trusts, MLD4 requires member states to disclose the beneficial ownership by individuals of corporate bodies and other legal entities on a centralised beneficial ownership register. Beneficial owners are typically defined as an individual (natural person) who either directly or indirectly owns a shareholding of 25 percent or greater.

The 2012 FATF recommendations state that countries should ensure that there is adequate, accurate and timely information available on the beneficial ownership of all legal persons, and that the authorities should be able to access this information in a timely manner.⁶

MLD5 reinforces this requirement by providing a time frame for the creation of the register. Access to the information recorded in the registries should be granted within 18 months after the implementation date. Central registers for each member state should be interconnected via the European Central Platform within 24 months after the implementation date.⁷

The European Central Platform will necessitate the coordination of the national systems with varying technical characteristics. To ensure uniform conditions for the implementation of this directive, the commission will be in charge of the technical and operational issues arising from the implementation of the platform.

In exceptional circumstances, EU member states may provide for exemptions to the disclosure of - and access to - beneficial ownership information in the registers, where the information would expose the beneficial owner to the risk of fraud, kidnapping, blackmail, violence, or intimidation.⁸

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6. The Financial Action Task Force, FATF Guidance – Transparency and Beneficial Ownership (October 2014), p. 14, <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>.

7. The Council of the European Union, 5th Anti-money Laundering Directive: 4th Presidency Compromise Text (December 2016), paragraph 41, <http://data.consilium.europa.eu/doc/document/ST-15605-2016-INIT/en/pdf>.

8. *Ibid.*

9. Companies House, PSC requirements for companies and limited liability partnerships, Summary Guide for Companies – Register of People with Significant Control (January 2016), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555657/PSC_register_summary_guidance.pdf.

MLD4 goes further than the PSC Register by requiring all legal entities, rather than just corporate bodies, to disclose beneficial ownership on a publicly accessible register. Thus, it is unlikely this requirement will be satisfied by merely maintaining the PSC Register in its current form. Given the Council's desire for uniformity across member states, the UK will need to consider whether further amendments are required to the PSC framework to bring it in line with the Directive.

Nonetheless, should the directive require UK firms to implement a new beneficial ownership register synchronised with other member states, firms will need to have implemented, updated and connected their beneficial ownership registries within 18 months of the implementation date.¹⁰ Public access will be granted to individuals or organisations that are able to demonstrate a legitimate business interest in the beneficial ownership information.

5. Enhancing the powers of EU Financial Intelligence Units

MLD5 increases the powers of financial intelligence units (FIUs) to request information from institutions subject to the directive. In order to facilitate this, MLD5 obliges member states to implement internal centralised automated systems to identify payment accounts and bank accounts held by a credit institution. This will enable a central source to identify all bank accounts for individuals to be developed. The information that must be readily accessible through the registry includes, but is not limited to, account holder name and identification number, beneficial owner name and identification number, and bank account IBAN number and account open and close dates.

Prior to the directive, a request for information could only be made in response to the submission of a suspicious activity report or identification of a predicate offence. These enhanced powers allow FIUs to obtain information more easily and align the approach of FIUs with the FATF.

WHAT EFFECT WILL BREXIT HAVE?

Now that the UK has begun the Brexit process by invoking Article 50, the UK and EU have two years to negotiate the terms of the UK's departure. The UK will cease to be a member of the EU in March 2019, by which time MLD5 will have been transposed into UK law.

In March 2017, the UK Government published the draft Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the Money Laundering Regulations 2017). This legislation will transpose MLD4 into UK law. The draft regulations state the objective of the transposition is to ensure that the UK's anti-money laundering and counter-terrorist financing regime is kept up-to-date, and is effective and proportionate.¹¹

The Treasury launched an 8-week policy consultation the Money Laundering Regulations 2017 (the Consultation) seeking views from financial institutions on the steps it proposed to take to transpose MLD4 into UK law. In this Consultation, the Treasury notes that until exit negotiations from the EU are completed, the UK remains a full member of the EU and all the rights and obligations of EU membership remain in force, including the duty to transpose MLD4 and MLD5 into UK law.¹²

Furthermore, the Consultation notes that since the negotiations around MLD5 are still ongoing, the government will separately consult on the directive once it has been published in the Official Journal of the European Union and has come into force. The government intends to transpose MLD4 through the Money Laundering Regulations 2017 by 26 June 2017.

10. The Council of the European Union, 5th Anti-money Laundering Directive: 4th Presidency Compromise Text (December 2016), paragraph 29, <http://data.consilium.europa.eu/doc/document/ST-15605-2016-INIT/en/pdf>.

11. Publication of draft Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017: Written statement – HCWS537, <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-03-15/HCWS537/>.

12. Consultation on the transposition of the Fourth Money Laundering Directive, p. 5, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/553409/4mld_final_15_sept_2016.pdf

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COMMENT

The proposals set out in MLD5 demonstrate the Council's determination to fully align itself with the FATF anti-money laundering recommendations and create a consistent approach across member states in the detection and prevention of terrorist financing. The proposals also highlight the growing concern over ownership obfuscation. MLD5 represents a move to a truly European approach to tackling money laundering, terrorist financing, and concealment of funds through offshore structures and virtual currencies.

MLD5 will grant enhanced powers to regulators and FIUs in the ongoing struggle against terrorist financing. In order to be ready for the 26 June 2017 deadline, UK firms should ensure they have strong and robust compliance regimes to address and mitigate the risk of their institutions being used for money laundering or terrorist financing purposes under MLD4. Due to the potentially short transposition period for MLD5, firms should consider the implications of that directive for their business at the same time.

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