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The fourth anti-money laundering and terrorist financing directive - Key aspects and changes

Introduction

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 decision will enable the European Parliament, with which a political agreement was reached on December 16th 2014, to adopt the final version of the text at a forthcoming plenary session. Member States will then have two years to implement the 4th AML Directive into national law.

On April 20th 2015, the Council has also adopted its position at first reading of a regulation which will revise Regulation (EC) No 1781/2006 on information on the payer accompanying transfers of funds. This regulation is also still subject to adoption by the European Parliament.

Objectives and main points of interest of the 4th AML 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 defense 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 4th AML 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. On some issues, the new rules expand on the FATF requirements and provide additional safeguards.

The 4th AML Directive also takes into account the recent evolutions in terms of new technologies, which may offer criminals additional means to carry out money laundering and/or terrorist financing.

The main changes brought by the 4th AML Directive include, *i.a.*:

- new definitions;
- an extended scope of the persons and activities subject to the 4th AML Directive;
- the inclusion of "tax crimes" within the definition of predicate offenses;
- the development and slight reshaping of the risk based approach;
- the extension of enhanced customer due diligence measures to domestic politically exposed persons;
- enhanced transparency with regards to beneficial owners;
- new provisions regarding the sanctioning powers of the competent authorities.

The Luxembourg legislator and financial regulator have already, at least to a certain extent, paved the way to the implementation of the Directive into national law with the law of 27 October 2010[1] enhancing the anti-money laundering and counter terrorist financing ("**AML-CTF**")[2] legal framework (the "**Law of 2010**") as well as the CSSF Regulation N°12-02 of 14 December 2012 on the fight against money laundering and terrorist financing (the "**CSSF Regulation n°12-02**")[3]. These texts already take into account some of the FATF recommendations.

In this context, this newsflash reflects the status of the 4th AML Directive as of 28th April 2015, and only aims at presenting some of the key aspects of the 4th AML Directive, and in particular the key changes brought by this text.

I. Definitions (Article 3)

The 4th AML Directive expands on the definitions set out in the 3rd AML Directive in order to specify certain elements and thus enhance the level of legal certainty. In this context, the Directive provides for a definition of gambling services and correspondent relationships, which were not yet defined in the 3rd AML Directive.

Moreover, the definitions of politically exposed persons ("**PEPs**") and beneficial owners will differ from those contained in the 3rd AML Directive.

1. In relation to PEPs, as already provided under the law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the "**Law of 2004**") [4], the 4th AML Directive now lists[5], on a non-exhaustive basis, the persons who are considered as having prominent public functions, including, *i.a.* 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

[1] Law of 27 October 2010 enhancing the anti-money laundering and counter terrorist financing legal framework; organising the controls of physical transport of cash entering, transiting through or leaving the Grand Duchy of Luxembourg; implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing

[2] Note that the main objective of the Law of 2010 was to address the issues raised by the FATF in its mutual evaluation report on Luxembourg

[3] The CSSF circular letter 13/556 relating to the entry into force of the CSSF Regulation n°12-02 indicates that this text "*already takes into account some new recommendations of the FATF adopted in February 2012 which will be referred to in a European directive to be transposed into Luxembourg law*"

[4] Article 1§10 of the Law of 2004 contains a list of natural persons who are or have been entrusted with prominent public functions which is very similar to the list contained in the 4th AML Directive

[5] Note that this list did not exist under the 3rd AML Directive

Directive and the Law of 2004, which only required enhanced customer due diligence measures in relation to foreign PEPs[6].

2. 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 4th AML Directive provides that such a threshold is merely an indication of direct or indirect ownership, to be considered among other factors. In this respect, the CSSF Regulation n°12-02 already provided that a person may be considered as the beneficial owner even if the thresholds of the ownership or control provided for in the Law of 2004 are not met.

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 4th AML Directive, after having exhausted all other means of identification, and provided there are no grounds for suspicion, may now consider the senior managing official(s) to be the beneficial owner(s) of the entity.

II. Extended scope of the 4th AML Directive

The 4th AML 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. The threshold was lowered from EUR 15.000 to EUR 10.000 after discussions between the European institutions. In this respect, Member States should also be able to adopt lower thresholds, additional general limitations to the use of cash and further stricter provisions (recital n°6);
- estate agents, which are no longer limited to real estate agents[7] but now could be understood to include letting agents of real estate property (recital n°8);
- whereas the 3rd AML Directive only applied to casinos, all providers of gambling services[8] are now included in the scope of the 4th AML 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 (Article 11(d)). However, in proven low risk circumstances, except in relation to casinos, Member States 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 offenses: the inclusion of "tax crimes" within the list of predicate offenses

"Tax crimes" relating to direct or indirect taxes are now included within the list of predicate offenses 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 (Article 3§4 (f)). However, the 4th AML Directive does not provide for a harmonized 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.

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[6] *i.e.* residing in another Member State or in a third country (recital n°25 of the 3rd AML Directive)
[7] *i.e.* intermediaries which represent a buyer or seller in a real estate transaction
[8] Defined by the Directive as a "*service which involves wagering a stake with monetary value in games of chance, including those with an element of skill such as lotteries, casino games, poker games and betting transactions that are provided at a physical location, or by any means at a distance, by electronic means or any other technology for facilitating communication, and at the individual request of a recipient of services*"

In this context, it remains to be seen which tax offense(s) will be retained by the Luxembourg legislator to be included in the list of predicate offenses.

IV. Risk assessment and customer due diligence measures

(1) The risk assessment

The 4th AML Directive emphasizes on the risk-based approach in order to better target risks and develops a reshaped approach to risk assessment, requiring the distribution of the risk assessment process between three levels of competence.

1. 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 (Article 6). 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 (Article 9). 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.

2. In addition to this assessment at the European level, Members 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 (Article 7). This assessment[9] must then serve as a basis to *i.a*. 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.

3. Finally, as provided for under CSSF Regulation n°12-02, obliged entities are required to take appropriate steps to identify and assess the risks of money laundering and terrorist financing (Article 8)[10]. 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[11].

This risk assessment must be documented, kept up-to date and made available to the relevant competent authorities and self-regulatory bodies concerned.

In this respect, Member States shall ensure that obliged entities have in place policies, controls and procedures to mitigate and manage effectively the risks of ML-TF identified at the level of the European Union, the Member State and the obliged entity (Article 8§3).

[9] Which is also based upon the findings of the report set out by the European Commission
[10] We understand this risk assessment to be general and not related to a specific relationship of the obliged entity with one of its customers
[11] Note that this list of risk factors is almost identical to the list provided for under Article 5 of CSSF Regulation n°12-02

These policies, controls and procedures, include *i.a.* a model risk management practice[12], reporting and record-keeping obligations, internal control, compliance management, employee screening and customer due diligence measures.

(2) The customer due diligence ("CDD") 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 n°12-02 (Article 5(2)).

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 4th AML 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. This was already anticipated by the Law of 2010 which provided that obliged entities could only reduce, and not exempt, obliged entities from their CDD measures in case of a low-risk relationship.

In this context, it should be noted that the 4th AML 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[13].

To the contrary of the 3rd AML Directive and current Luxembourg legal and regulatory framework, the 4th AML 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[14]. 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[15].

[12] We understand that this model risk management practice refers to a standard "evaluation grid" which each obliged entity will be required to draft

[13] Including the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Market Authority (ESMA) (together the "**ESAs**")

[14] In this respect, it should be noted that this list of factors does not classify regulated entities as a type of evidence of a potentially lower risk

[15] The 3rd AML Directive provides that obliged entities were not required to carry out customer due diligence measures where the customer is a credit or financial institution covered by the 3rd AML Directive or a credit or financial institution situated in a third country which imposed requirements equivalent to those laid down in the 3rd AML Directive and supervised for compliance with those requirements. Member States were also authorised, to their discretion, to exempt obliged entities from the requirements contained in the 3rd AML Directive where the customer fell within one of the categories such as listed under the 3rd AML Directive (Article 2§2)

- Enhanced CDD measures

Although most of the categories of persons triggering an automatic application of enhanced CDD measures remain[16], the Directive focuses 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).

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Pursuant to the above, it may be concluded that 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

After numerous discussions at the European Union level and pressure from the European Parliament, 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 (Article 30) 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 4th AML Directive also enables any person or organization which is able to demonstrate a legitimate interest to access certain information relating to the relevant beneficial owner[17]. However, the 4th AML 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.

Furthermore, the 4th AML Directive also provides for a similar but less stringent regime in relation to information regarding the beneficial owner(s) of a trust[18] (Article 31).

[16] The Directive provides that Member States shall require obliged entities to automatically apply enhanced CDD measures with respect to cross-border correspondent relationships with a third country respondent institution (Article 19), transactions or business relationships with PEPs (Article 20), when dealing with natural or legal persons established in the third countries identified by the European Commission as high-risk countries (Article 18§1), and categories of higher risks which are identified by Member States or obliged entities (Article 18§1). However, enhanced customer due diligence measures need not be applied automatically with respect to branches or majority-owned subsidiaries of obliged entities established in the European Union which are located in high-risk third countries, where those branches or majority-owned subsidiaries fully comply with *i.a*. the group-wide policies and procedures

[17] Such person is required to demonstrate a legitimate interest with respect to money laundering, terrorist financing, and the associated predicate offences such as corruption, tax crimes and fraud (recital n°14)

[18] This information includes the identity of the settlor, trustee, the protector, beneficiaries or class of beneficiaries, and any other natural person exercising effective control over the trust

VI. Cooperation between the Financial Intelligence Units and the European Commission (Articles 51 to 57)

The 4th AML Directive contains provisions which aim at reinforcing the cooperation between the different national FIUs (Article 52). 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 organization of meetings of the European Union FIUs' Platform[19].

The 4th AML 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 October 2000 concerning arrangements for cooperation between FIUs[20] and which, to a certain degree, had been the cause for the ruling in a recent decision of the European Court of Justice[21].

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 1.000.000 (Article 59).

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 5.000.000 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 (Article 60). 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.

VIII. Conclusion: which are the impacts on the Luxembourg anti-money laundering and terrorist financing framework?

Although Luxembourg has already adapted its legal and regulatory framework in view of implementing the FATF recommendations and preceding the introduction of the 4th AML Directive, the impact of the 4th AML Directive on the Luxembourg AML-CTF sphere should not be

[19] The European Union Financial Intelligence Units' Platform is an informal group composed of representatives from European Union FIUs, and has been active since 2006. This platform is used to facilitate the cooperation among the different FIUs and the exchange of views on cooperation-related issued, such as, for instance, joint analysis of cross-border cases and trends and factors relevant to assessing the risks of ML-TF at national and supranational level

[20] Council Decision 2000/642/JHA of 17 October 2000 concerning arrangements for cooperation between financial intelligence units of the Member States in respect of exchanging information

[21] ECJ, Jyske Bank Gibraltar Ltd vs. Administración del Estado, 25 April 2013, C-212/11

underestimated. This observation stems from the fact that the Directive tends to go further than the FATF recommendations as well as its potential impact on the practice of obliged entities, in particular in relation to CDD measures. In this respect, it is most likely that obliged entities will be required to update their internal AML-CTF policies and procedures as well as re-train their employees in order to ensure compliance with the amended CDD obligations.

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