



The Fourth Money Laundering Directive (MLD4)

How it affects your Business

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“A good decision is based on knowledge and not on numbers.”

Plato

Preface

Combatting Money Laundering has been a top priority for the European Union for over two decades. Nevertheless, the fight against Money Laundering is still not effective enough. “Although a majority of countries legally comply with current AML / countering terrorism financing (CTF) standards, they fall short in the effective implementation and enforcement of these laws”, writes the Basel Institute of Governance commenting its 2016 Basel AML Index.

Hopes lie in the implementation of the Fourth Money Laundering Directive (MLD4) in 2017. In the wake of financial crises, scandals, and massive tax evasion, the EU took its fight against Money Laundering to the next level. On June 26th, the MLD4 came into force. It will replace the Third Money Laundering Directive and its implementing directive. Member States will have to bring the laws and regulations necessary to comply with the MLD 4 into force by June 26th, 2017.

Fueled by terror attacks in several western countries, the EU is stepping up its efforts in the fight against Money Laundering even more. The EU is calling upon its Member States to implement the MLD4 by the end of 2016. Financial institutions and a growing number of companies are under increasing pressure to properly identify the beneficial ow-

ners of funds they accept while doing business. If they fail to do so, they will face drastic penalties.

OECD countries including those with large financial centres such as Luxembourg (5.89), Japan (5.76), Switzerland (5.46), Italy (5.36), Germany (5.33), US (5.17), France (5.03) and UK (4.77) have not demonstrated much progress to improve their rating.

(Source: “The 2016 Basel AML Index”, Basel Institute of Governance, 2016)



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The latest Money Laundering Directive

The MLD4 seeks to strengthen the regimes against money laundering and terrorist financing, across the European Union while also ensuring that the EU framework matches the recommendations of the OECD's Financial Action Task Force (FATF).

The directive applies to a range of businesses. The MLD4 brings into force new customer due diligence requirements, together with new obligations to report suspicious transactions and maintain records of payments. Businesses subject to the rules will also have to install internal controls to combat money laundering and terrorist financing.

All companies doing business in the EU need to know how the implementation of the MLD4 will affect their business in their respective country. Companies without subsidiaries in the EU that are doing business exclusively in Switzerland do not have to comply with the MLD4. However, law experts agree that it is only a matter of time until Swiss laws and regulations will align with the new European directive. Informed institutions and companies anticipating the impact of the MLD4 and adapting their best practices accordingly will benefit substantially.

What lead to the MLD4

The EU published its first Money Laundering Directive in 1991 and it was aimed at drugs-related crimes. Financial institutions had to verify the identity of their customers and report suspicious transactions.

In 2001, the MLD2 replaced its predecessor. The goal was to ensure that Member States implement the FATF recommendations.

The MLD3 followed the MLD2 in 2005, extending the scope of the previous directives to cover lawyers and accountants. The MLD3 introduced the risk-based approach to customer due diligence (CDD) and the concepts of simplified and enhanced due diligence (SDD and EDD).

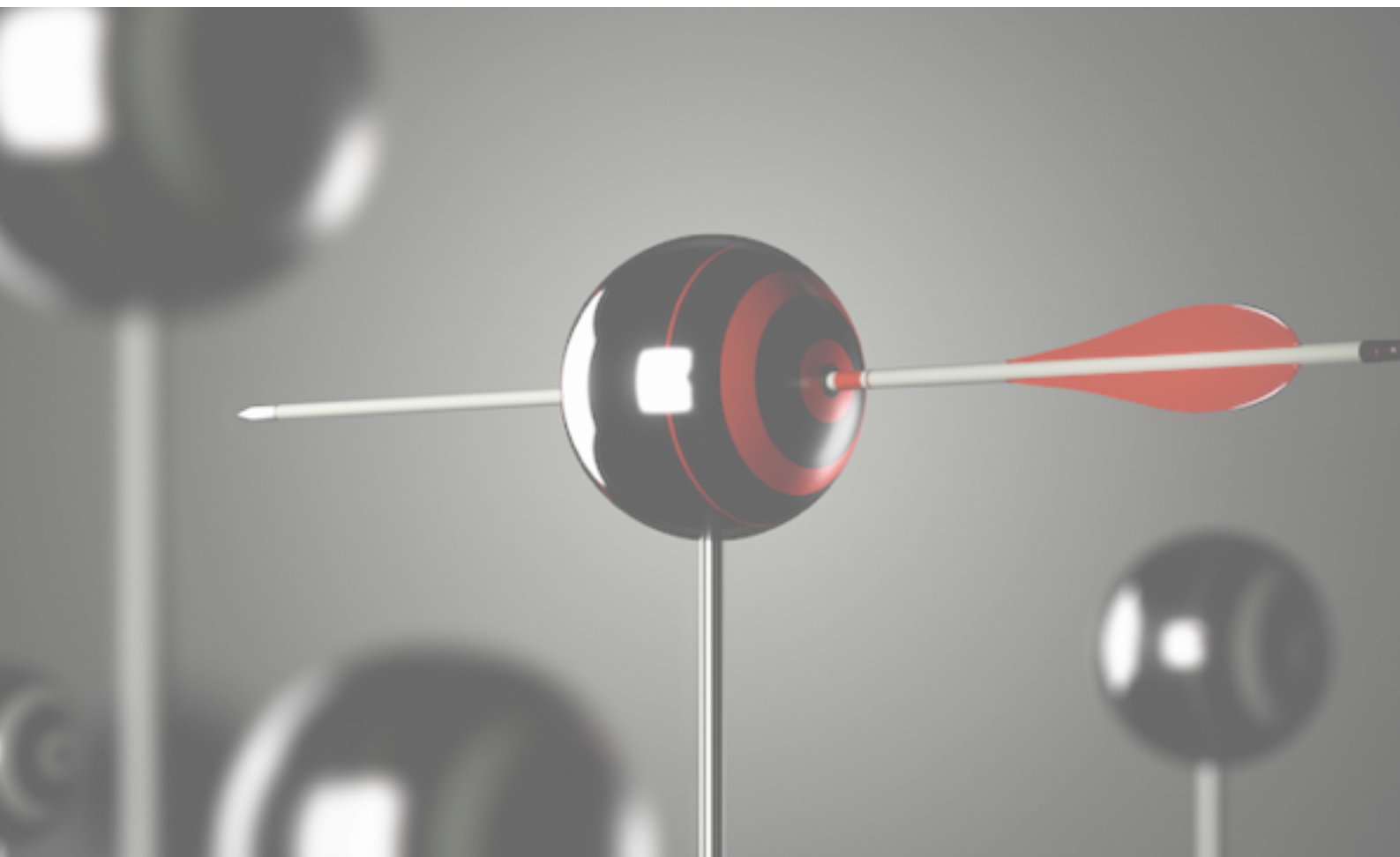
In February 2012, the FATF published further recommendations, among others to address the laundering of the proceeds of corruption and tax crimes. In April 2012, the European Commission published its report on the review of the MLD3. It was felt that parts of the Third Money Laundering Directive were overly lenient and permissive. Together with the updated FATF-recommendations, this report lead to the first draft of the MLD4.



What are the aims of the MLD4?

According to the European Commission, the goals of the MLD4 are, among others:

- ◆ To reach an EU-wide coordination of AML- and CTF standards
- ◆ To provide for a more targeted risk-based approach
- ◆ To clarify the rules of customer due diligence
- ◆ To include tax related crimes
- ◆ To clarify the interpretations of a politically exposed person (PEP)
- ◆ To better cover gambling service providers such as casinos



Obligated Entities

The MLD4 lists the following as obligated entities:

- ◆ Credit and financial Institutions, including branches of third-country firms
- ◆ Auditors, lawyers and similar professionals when carrying out real estate, custody/client money activities, account opening/management, creation of companies, trusts and other vehicles and fund collection
- ◆ Other trust and company service providers
- ◆ Estate agents
- ◆ Any person trading in goods involving cash payments of over 10,000 Euros
- ◆ Gambling service providers

Member States may exempt low risk gambling service providers – except for casinos – and limited ancillary activities in high-value goods.

Under the MLD4 the policies, controls, and procedures of obligated entities have to be fit to mitigate and manage the risks of money laundering and terrorism financing effectively.

Requirements on Obligated Entities

Member States have to ensure that obligated entities identify money laundering and terrorism financing risks accordingly. They have to take into account risk factors relating to customers, geographic areas, products, services, transactions, and delivery channels.

Companies have to document the steps they take, keep them up to date and keep the records available to regulators.



Beneficial Owner

Definition

The MLD4 clarifies the definition of a beneficial owner. A beneficial owner of a corporate entity shall be any natural person with who has ownership or control of the entity in its entirety. A shareholding or ownership of 25% or more assumes beneficial ownership, as was already the case with the MLD3. Member States may choose a lower percentage at their own discretion.

The directive gives instructions for cases in which, after all possible means have been exhausted, the persons in charge could not identify a beneficial owner, or there is doubt as to the person identified. In that case, it is safe to consider the senior managers of the company as beneficial owners.

In the case of a trust, the beneficial owner will be the settlor, trustees, protector, beneficiaries or any alternative of the above, and any other natural person who has control over the trust in its entirety.

Central Registers

The MLD4 aims to enhance corporate transparency through Member States having to establish central registers containing current information on the beneficial ownership of corporate and legal entities. The companies under the jurisdiction of a Member State should obtain and hold adequate, accurate and current information on their beneficial ownership.

The information contained in the registers shall be made available in all cases to competent authorities and financial intelligence units and to those entities subject to the directive undertaking due diligence under the MLD4 framework. This information shall also be made available to any person or organisation able to demonstrate a “legitimate interest”.

However, the storing of beneficial ownership information shall not relieve obliged entities of their customer due diligence (CDD) obligations, which they will be required to continue to fulfill using a risk-based approach.



Politically Exposed Persons (PEPs)

The new Money Laundering Directive removes any distinction between domestic and foreign PEPs. Therefore, companies will need to review clients and ensure that domestic persons holding prominent public functions are categorized as such.

This includes heads of state and government, ministers, their deputies and assistants, members of parliament and members of governing bodies and parties, members of supreme courts, members of courts of auditors or boards of central banks, ambassadors, high-ranking military staff and managers of state owned enterprises, directors, deputy directors and board members of international organizations.

The provisions will similarly apply to “close associates” and family members of PEPs. The MLD4 also clarifies that PEPs will always be subject to enhanced due diligence (EDD) and that senior management approval is required before establishing or continuing a business relationship.

Cash Transactions

Although there remains a level of 15,000 Euros at which the CDD is required, the MLD4 reduces the threshold in relation to individuals dealing in goods for cash payments of 10,000 Euros or more.

This shall apply whether the transaction is carried out in a single operation or in several operations, which appear to be linked.



Customer Due Diligence Requirements

Obligated entities have to identify their customers and verify their identity with documents, data and information from reliable and independent sources. The identification of the beneficial owner and the verification of his identity are a must. Obligated entities should also assess the purpose of the business relationship and ensure an ongoing monitoring of the relationship, including scrutiny of the transactions.

Entities should apply the CDD to all customers, including the existing ones, on a risk-sensitive basis. In doing so they should consider the purpose of the account or relationship, the level of assets and the size of transactions, and the duration of the relationship. The CDD should take place before the business relationship is established or soon thereafter if the relationship is low-risk.

Simplified Due Diligence

The MLD3 took a more permissive approach to simplified due diligence (SDD), allowing blanket exemptions for certain entities, such as financial institutions and listed companies whose securities are admitted to trading on a regulated market.

While the MLD4 still allows the SDD to take effect, firms will be required to ascertain that the business relationship or transaction presents a lower degree of risk. Annex II of the directive provides a non-exhaustive list of factors to consider when determining a potentially lower risk situation. Customer related factors are, for example, listed public companies with appropriate disclosure of beneficial owners, public administrations or companies or customers from countries with low corruption.

Entities must still monitor relationships and transactions to detect any suspicious activity.

The European Supervisory Authorities (ESAs) will issue guidelines on risk factors to consider and measures to take to national authorities by June 26, 2017.



Enhanced Due Diligence

When dealing with individuals or companies in high-risk third countries, the MLD4 takes note of the need for the EDD. Obligated entities have to take into account factors such as unusual circumstances, cash intensive businesses, complex structures, payments from unknown parties, and countries known to support terrorism.

Reliance on third parties

The Fourth Money Laundering Directive allows obliged entities to rely on third parties to carry out the CDD in order to ease the burden of compliance.

Third parties in a non-EU Member State must apply the equivalent CDD and record keeping requirements to those in the MLD4.



Criteria for Exemptions

All of the following criteria have to apply for Member States to exempt legal and natural persons:

- ◆ The financial activity must be limited in absolute terms and on a transaction basis
- ◆ The financial activity must not be the persons main activity and must be directly related to it
- ◆ The person must provide the financial activity only to customers of its main activity
- ◆ There is no exemption for trusts, company service providers, estate agents, providers of gambling services, auditors, external accountants, tax advisors, notaries, and independent legal professionals

Penalties

The directive contains a range of sanctions for systematic breaches by obliged entities of the key requirements, such as customer due diligence, record-keeping, suspicious transaction reporting and internal controls.

In relation to financial institutions, the penalties may include public reprimands, withdrawal of authorization, and a temporary ban from managerial functions. A maximum administrative pecuniary sanction of at least 5,000,000 Euros or 10% of total annual turnover in the case of a legal person, and at least Euro 5,000,000 in the case of a natural person may be imposed.

Other obliged entities face a penalty of at least twice the amount of the benefit derived from the breach (where that benefit can be determined) or at least 1,000,000 Euros.



At a glance: Differences between MLD3 and MLD4

	MLD3	MLD4
Risk-Based Approach	<p>Compliance program based upon factors like customer, geography, products.</p> <p>White List of countries outside of the EU.</p> <p>SDD possible with customers in certain categories.</p>	<p>Include national risk assessment in the company's compliance program.</p> <p>No more white-listed jurisdictions. Financial institutions must assess the risk of doing business with every country outside the EU,</p> <p>Obligated entities have to determine the risk posed by a customer prior to perform SDD and document their decision</p>
Beneficial Owner	CDD on any beneficial owner in control of more than 25%	Additionally maintain registers of beneficial owners and submit information to a central register accessible to interested parties.
Bearer Shares	Permitted	Prohibited. Bearer Share holders will have nine months to turn their shares into registered shares.
PEPs		Broader definition of PEPs including domestic PEPs
Cash Payments	Threshold of 15,000 Euros	Threshold of 10,000 Euros (single or multiple transactions)
Penalties for failure in the CDD	At discretion of the Member States	For financial institutions maximum pecuniary sanctions of at least 5 million Euros or 10% of the total annual turnover and at least 5 million Euros for a natural person. For non-financial institutions, penalties can amount to twice the amount of the benefit derived from the breach, or at least 1 million Euros.

(The full directive can be found here: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_2015_141_R_0003&from=EN)



What happens next?

In the wake of the terror attacks in France in November 2015 and the Panama Papers, the European Commission has called for stronger measures to protect against terrorism financing and money laundering and proposed amendments to the MLD4 as a result.

According to the European Commission, the amendments will strengthen the following points:

- ◆ Apply enhanced checks (“due diligence measures/counter-measures”) towards high risk third countries;
- ◆ Bring virtual currency exchange platforms under the scope of the directive;
- ◆ Strengthen transparency measures applicable to prepaid instruments, such as prepaid cards, by lowering thresholds for identification from 250 Euros to 150 Euros and widening customer verification requirements;
- ◆ Enhance the powers of Financial Intelligence Units and facilitate their cooperation by further aligning the rules for such units with the latest international standards;
- ◆ Give Financial Intelligence Units swift access to information on the holders of bank and payment accounts, through centralized registers or electronic data retrieval systems

The European Commission called on national governments to implement the MLD4 by the end of 2016, rather than by June 2017 as originally planned

“The pressure on national governments will no doubt trickle down to organisations in the form of more stringent laws and regulations, as well as harsher consequences for violations.”

Thomson Reuters, May 03, 2016

(Source: European Commission, Jul 05, 2016, http://europa.eu/rapid/press-release_MEMO-16-2381_en.htm)



Choosing the right Partner

The fourth Money Laundering Directive will increase the complexity of customer due diligence for all obliged entities. As mentioned before, it does not matter much if a company is doing business in the EU or exclusively in Switzerland. Swiss laws and regulations will have to adapt to EU laws and regulations sooner than later, especially when it comes to effectively combating Money Laundering.

Once Member States start implementing national laws pursuant to the MLD4, obliged entities will have to consider the nuanced requirements of the Member States they are operating in and adjust their compliance programs accordingly.



Given the possibility of drastic sanctions in case of failures to comply with the requirements of the MLD4, it is vital that businesses have robust procedures and resources to ensure compliance. Equally, vitality and cost-effectiveness is the choice of the right partner to advise you in all customer due diligence related issues.



Who are we

Through its state-of-the-art Due Diligence solutions, **Global Risk Profile** helps its clients to mitigate risks and comply with regulatory standards.

From simple screening to thorough investigations, our reports are effective means to **assess risks** associated with every kind of third party involved in your business model.

Based in Switzerland and mastering over twenty languages, our core team of experienced analysts, perform quality research **world-wide**.

Our network of local informants (i.e. former police or military force members, lawyers, private investigators and journalists) enables us to gather information from the target's immediate environment.

The Information you need

Risks may arise at any step of a business process.

We offer exhaustive checks on:

- ◆ Suppliers / Subcontractors / Distributors
- ◆ M&A and Joint-Ventures
- ◆ Existing and potential clients (**KYC reports**)
- ◆ Current staff and potential hires (**Background Checks**)
- ◆ Any other person / corporation of your interest

On demand, we also provide our clients with specific tailor-made services.

Get the Most out of the “Big Data”

Our reports comprise all legally available information on individuals or companies around the world, retrieved from thousands of sources at our disposal:

- ◆ Commercial Registers
- ◆ Official Gazettes
- ◆ PEP Databases
- ◆ Sanction & Regulatory Enforcement lists
- ◆ Court files
- ◆ Media archives
- ◆ Proprietary Archives
- ◆ Local Search Engines
- ◆ Web Analytics
- ◆ Monitoring Technologies

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