Developments in EU Anti-Money Laundering Regulation

The 5th Anti-Money Laundering Directive (MLD5)

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On 9 July 2018, the 5th Anti-Money Laundering Directive (MLD5) entered into force. The MLD5 will introduce some significant changes to EU anti-money laundering regulation. This briefing highlights some of the major aspects for the financial services sector.

Background

The European Commission (EC) proposed the MLD5[1] in the context of its "Action Plan for strengthening the fight against terrorist financing" in February 2016 in light of a renewed wave of terrorist attacks and the Panama Papers publication.[2] Moreover, given recent institutional shortcomings in the Eurozone in respect of preventing money-laundering and terrorist financing the changes introduced by the MLD5 are significant.

The MLD5 does not provide for a complete revision of the existing EU anti-money-laundering regime. It rather sets out "additional measures to better counter the financing of terrorism and to ensure increased transparency of financial transactions and legal entities".[3] In precise legal terms, the MLD5 is an amending directive, i.e. it supplements and amends the 4th Anti-Money-Laundering Directive[4] (MLD4) which EU Member States had to implement in national law by 26 June 2017.

The MLD5 entered into force on 9 July 2018, i.e. on the twentieth day following that of its publication in the Official Journal of the EU. It must be transposed in Member State law by 10 January 2020.

Significant changes – an overview

The MLD5 will entail some significant changes for financial institutions and further entities engaged in the financial services sector, a selection of which is provided below:[5]

Extended scope

The MLD5 will bring into the scope of EU anti-money laundering regulation providers engaged in exchange services between virtual currencies and fiat currencies as well as custodian wallet providers. Both will in particular be subject to a registration requirement in the EU Member States.[6]

In favor of a more illustrative understanding, the EC pointed out in its July 2016 Q&A on the Anti-Money Laundering Directive that "virtual currency exchange platforms can be considered as 'electronic' currency exchange offices that trade virtual currencies for real currencies (or so-called 'fiat' currencies such as the euro)". Further, custodian wallet providers "in the 'virtual currency world' (...) are the equivalent of a bank or payment institution offering a payment account" according to the EC.[7]

The legislative intention for this extension of the EU anti-money laundering regime's scope is to prevent terrorist groups from feeding money into the EU financial system or within virtual

1 Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2018/849 (...).
2 See European Commission – Fact Sheet, Q&A: Anti-Money Laundering Directive, 5 July 2016 (EC Q&A), p. 1.
3 EC Q&A, p. 1.
4 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (...).
5 This briefing does not comment on which Member States' AML frameworks already provide for measures and instruments newly introduced by the MLD5 on an EU-wide scale.
6 See art. 1(1) (c) and art. 1(29) MLD5.
7 EC Q&A p. 2 et seq.

currency networks "by concealing transfers or by benefiting from a certain degree of anonymity on those platforms".[8] All of this extension of the existing EU-regime to digital assets and cryptocurrency also fits in with the EU's priorities laid out in its "FinTech Action Plan" (please see our dedicated Client Alert coverage on this).

Anonymous safe-deposit boxes no longer permitted

Under the MLD5, credit institutions and financial institutions will no longer be allowed to keep anonymous safe-deposit boxes. The MLD4 has already provided for the prohibition of keeping any anonymous accounts and anonymous passbooks.

Furthermore, the MLD5 introduces credit institutions' and financial institutions' obligation to conduct customer due diligence measures (CDD measure) on the owners and beneficiaries of existing anonymous safe-deposit boxes. The MLD4 has already provided for this requirement in respect to the owners and beneficiaries of existing anonymous accounts and anonymous passbooks.

Electronic money products – limited exemption from certain CDD measures

The MLD5 tightens the requirements to conduct CDD measures in respect of electronic money[9] products by reducing the thresholds and maximum amounts for the application of exemptions set forth in the MLD4.[10]

Under the MLD4, Member States may allow those persons that MLD5 refers to as "obliged entities" not to apply certain customer CDD measures with respect to electronic money where the payment instrument (inter alia) has a maximum monthly payment transaction limit of EUR 250, which can be used only in that Member State, and where the maximum amount stored electronically does not exceed EUR 250. The MLD5 lowers both thresholds to EUR 150.

Compared to the MLD4, which excludes the application of the exemption in case of redemption in cash or cash withdrawal of the monetary value of the electronic money where the amount redeemed exceeds EUR 100, the MLD5 lowers this threshold to EUR 50. As a further restriction, the MLD5 prohibits the application of the exemption in case of remote payment transactions[11] where the amount paid exceeds EUR 50 per transaction.

Further, the MLD5 makes the use in the EU of anonymous prepaid cards issued outside the EU subject to an equivalence requirement: Credit institutions and financial institutions acting as acquires can only accept payments carried out with anonymous prepaid cards issued in third countries where such cards meet the requirements under the MLD5.

Under the MLD5, EU Member States can further opt not to accept on their territory payments carried out by using anonymous prepaid cards. This may prove a barrier to a number of business and distribution models currently used by a breadth of market participants. That being said, policymakers are increasingly becoming supportive of the benefits of online-CDD, including video-identification methods as part of digital distribution models (please see our standalone coverage on this development).

Clarification of enhanced CDD measures

The MLD4 has introduced the obligation to apply enhanced CDD measures in respect of high-risk third countries. To streamline the approach in the application of these measures between the Member States, the MLD5 specifies a catalogue of enhanced CDD measures obliged entities must apply (e.g. obtaining information on the source of funds and source of wealth of the customer and of the beneficial owner(s) and obtaining the approval of senior management for establishing or continuing the business relationship).

Under the MLD5's enhanced CDD measures regime, Member States have the option to require obliged entities to ensure, that the first payment be carried out through an account in the customer's name with a credit institution subject to CDD standards that are equivalent ("not less robust") to those set forth in the MLD5.

In addition to the enhanced CDD measures, the MLD5 will newly introduce "mitigating measures" obliged entities must apply (where applicable) to persons and legal entities carrying out transactions involving high-risk third countries. Those measures comprise inter alia the introduction of enhanced relevant reporting mechanisms or systematic reporting of financial transactions.

Further, the MLD5 specifies a set of countermeasures EU Member States must apply in respect of high-risk third countries in compliance with the EU's international obligations (e.g. refusing the establishment of subsidiaries, branches or representative offices of obliged entities from the country concerned or requiring increased external audit requirements for financial groups with respect to any of their branches and subsidiaries located in the country concerned).[12]

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8 See recital (8) MLD5; however, the EU legislator admits that this extension of the scope "will not entirely address the issue of anonymity attached to virtual currency transactions, as a large part of the virtual currency environment will remain anonymous because users can also transact without such providers" (see recital (9) MLD5).

9 The MLD5 narrows the scope of the definition of "electronic money" by excluding instruments and transactions that are excluded under the Payment Services Directive II.

10 See art. 1(7) MLD5.

11 "Remote payment transaction" means a payment transaction initiated via internet or through a device that can be used for distance communication (see Point (6) of Article 4 of the Directive (EU) 2015/2366 of the European Parliament and of the Council).

12 See art. 1(11) MLD5.

List indicating prominent public functions

Under the MLD4 obliged entities must, in addition to the CDD measures, apply additional measures in respect of transactions and business relationships with politically exposed persons (PePs). Some of these include obtaining senior management approval for establishing or continuing business relationships with such persons. A PeP is a natural person who is or who has been entrusted with "prominent public functions".[13] Under previous iterations of the law, the definition of who qualified as a PeP was not fully clear.

In order to identify PePs in the EU, the MLD5 sets forth a procedure for establishing lists indicating the exact functions which qualify as prominent public functions on Member State and EU levels. Once these lists have been set up the EC will combine them in a single list and make this list public.[14]

Strengthening of Financial Intelligence Units' (FIUs) powers and cooperation

The MLD5 extends the investigative powers of the FIUs. The latter will be entitled to request, obtain and use information from "any obliged entity" for the prevention, detection and effective combat of money laundering and terrorist financing.[15] FIUs are able to exercise these powers even if no prior suspicious transaction report has been filed, e.g. on the basis of a "FIU's own analysis, intelligence provided by competent authorities or information held by another FIU".[16] Further, the MLD5 strengthens the cooperation and exchange of information between FIUs and between FIUs and other competent authorities in respect of the fulfilment of tasks under the MLD.

Centralized automated mechanisms for identifying holders and controllers of payment and bank accounts

The MLD5 requires Members States to put in place centralized automated mechanisms (e.g. central registries or central electronic data retrieval systems) for the timely identification of any natural or legal persons holding or controlling payment accounts and bank accounts as well as safe-deposit boxes held by a credit institution within their territory. The information stored in the centralized mechanisms must be "directly accessible in an immediate and unfiltered manner" to national FIUs. The latter are also entitled under the MLD5 to provide information held in these mechanisms to any other FIU in a timely manner.

Further, national competent authorities must be able to access the information for the fulfilment of their obligations under the MLD5.[17]

Beneficial ownership regime

The MLD5 expands and strengthens the beneficial ownership regime founded in the MLD4. By way of an example, the access right to information on the beneficial ownership register is extended to "any member of the general public"[18] whereby Member States can make this access subject to an online registration and the payment of a fee.[19] To mention another example, the scope of the beneficial ownership's regime will in future –besides the express trusts – also apply in respect of "other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso", where such arrangements have a structure or functions similar to trusts.[20]

Outlook and next steps

Obliged entities should carefully analyze the impact of the MLD5 on their AML arrangements and processes set up under the MLD4, or earlier anti-money laundering legislation, and make amendments, where required. In particular, organizational arrangements and procedures around the electronic money products business should be reviewed and made compliant with the tightened requirements of the MLD5.

Entities engaged in virtual currency trading activities should analyze their business models and identify if they qualify as providers engaged in exchange services between virtual currencies and fiat currencies or custodian wallet providers within the meaning of the MLD5 and are thus subject to EU anti-money laundering regulation. This should be done as soon as possible, given that the MLD5 must be transposed in Member State law by 10 January 2020 and that MLD4/5-compliant structures and procedures might need to be set-up from scratch.[21]

As the MLD5 offers a number of options to EU Member States, obliged entities should carefully monitor the national implementation of the MLD5 and take into account local peculiarities when reviewing and updating their anti-money laundering arrangements.

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Should you wish to continue the conversation on the subjects raised herein, please do get in touch with any of our Eurozone Hub key contacts on the next page.

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13 See art. 3(9) MLD4.
14 For further details, in particular as regards international organizations accredited on Member States' territories and representatives of third countries and of international bodies accredited at Union level, see art. 1(13) MLD5.
15 See art. 1(18) MLD5.
16 See recital (17) MLD5.
17 See in particular art. 1(19).
18 The right of access at least extends to the name, the month and year of birth and the country of residence and nationality of the beneficial owner as well as the nature and extent of the beneficial interest held (see art. 1(15) (c) MLD5).
19 See art. 1(15) (d) MLD5.
20 See in particular art. 1(15) and (16) MLD5.
21 In respect of particular requirements deviating transposition dates apply.

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