DLA PIPER

SPRING 2017

AML BULLETIN

Regulatory News Update from DLA Piper

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INTRODUCTION

WELCOME

DLA Piper's Financial Services Regulatory team welcomes you to the Spring 2017 edition of our Anti-Money Laundering (**AML**) Bulletin.

In this issue, we provide updates on AML developments and enforcement actions in the UK and internationally. This issue includes an update on the implementation of the Fourth Money Laundering Directive, the progress of the Fifth Money Laundering Directive, the proposal for a Counter Money Laundering Directive and the ESAs' joint opinion on money laundering and terrorist financing risks.

We hope that you find this update helpful. Your feedback is important to us, therefore if you have any comments or would like further information, please contact one of our specialists detailed at the end of the Bulletin.

UK NEWS & ENFORCEMENT ACTION

HM TREASURY UPDATES ADVISORY NOTICE ON MONEY LAUNDERING AND TERRORIST FINANCING CONTROLS IN OVERSEAS JURISDICTIONS

On 2 November 2016, Her Majesty's Treasury (**HM Treasury**) updated its advisory note on money laundering and terrorist financing controls in overseas jurisdictions. The advisory note was initially published on 6 July 2016, following two statements published by the Financial Action Task Force (**FATF**) on 24 June 2016. Further information on the advisory note of July 2016 can be found in the autumn 2016 issue of 'AML Bulletin'. HM Treasury updated its advisory note after FATF published two new statements identifying jurisdictions with strategic deficiencies in their anti-money laundering (**AML**) and counter-terrorist financing (**CTF**) regimes on 21 October 2016.

The first FATF statement is a public statement that addresses the AML and CTF regimes in two jurisdictions, the Democratic People's Republic of Korea (**DPRK**) and Iran.

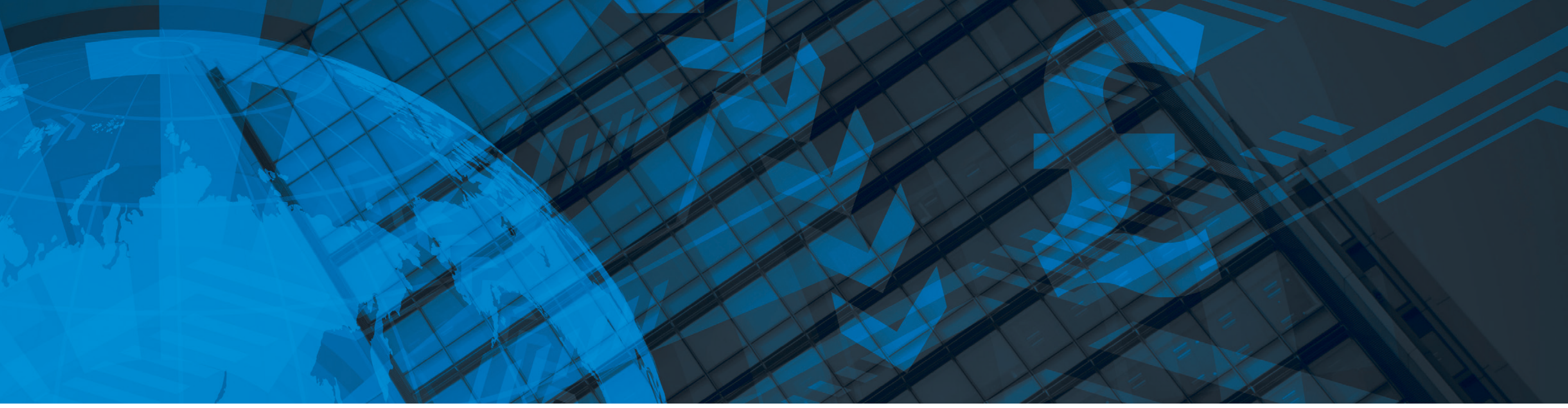
More specifically:

- FATF remains concerned by the DPRK's failure to address the significant deficiencies in its AML and CTF regime and urges it to take immediate and meaningful steps. FATF is also concerned about the proliferation of weapons of mass destruction and their financing. FATF reaffirmed its call, made on 25 February 2011, to its members to give special attention to business relationships and transactions with the DPRK.
- FATF recognised Iran's adoption of a high-level political commitment to an Action Plan addressing its AML and CTF deficiencies and welcomes its decision to seek technical assistance in the Action Plan's implementation. FATF noted that starting from June 2016 counter-measures were suspended for Iran in order to monitor its progress implementing the Action Plan. Iran will remain on the FATF Public Statement until its full Action Plan has been implemented. Financial institutions are therefore advised to apply enhanced due diligence to business relationships and transactions with natural and legal persons from Iran.

The second FATF statement focuses on improving global AML and CTF compliance on an ongoing basis.

More specifically, FATF made the following points regarding certain countries:

- **Afghanistan**, in June 2012, made a high-level political commitment to work with FATF and the Asia/Pacific Group on Money Laundering (**APG**) and since June 2016 has taken significant steps to improve its AML and CTF regime. FATF takes the view that Afghanistan should provide additional information on the implementation of its legal framework for identifying, tracing and freezing terrorist assets.
- **Bosnia and Herzegovina** made a high-level political commitment in June 2015 to work with FATF and the Committee of Experts on the Evaluation of AML Measures and the Financing of Terrorism, and since June 2016 has taken steps to improve its regime. However, FATF noted that Bosnia and Herzegovina still needs to address a number of deficiencies.
- **Iraq** made a high-level political commitment in October 2013 to work with FATF and the Middle East & North Africa Financial Action Task Force (**MENAFATF**) and since June 2016 has taken steps to improve its regime. However, FATF noted that there are some remaining deficiencies to be addressed and encourages Iraq to continue implementing.
- **Lao PDR**, in June 2013, made a high-level commitment to work with FATF and APG to address its strategic AML and CTF deficiencies. Although steps have been taken since June 2016, FATF takes the view that Lao PDR should continue implementing its action plan in order to address the remaining deficiencies.
- **Syria**, in February 2010, made a high-level political commitment to work with FATF and MENAFATF and in June 2014 it was determined that Syria had substantially implemented its action plan at a technical level. Due to the security situation, FATF has been unable to assess the process of implementing the required reforms and actions.
- **Uganda**, in February 2014, made a high-level political commitment to work with FATF and the Eastern and Southern Africa AML Group. Since its original evaluation, Uganda was subject to a mutual evaluation during which further deficiencies were identified and subsequently included in an Action Plan. Since



June 2016, Uganda has taken steps to address the existing deficiencies but FATF takes the view that further work needs to be undertaken.

- **Vanuatu**, in February 2016, made a high-level political commitment to work with FATF and APG to address its strategic deficiencies, and has since June 2016 passed amendments to improve obligations to obtain beneficial ownership information and prohibit bearer shares and bearer share warrants for international companies. FATF took the view that further improvements are necessary to address the remaining deficiencies.
- **Yemen**, in February 2010, made a high-level political commitment to work with FATF and MENAFATF and has since made progress to improve its AML and CTF regime. In June 2014, FATF determined that Yemen has substantially addressed its action plan at a technical level, but due to the security situation, FATF has been unable to assess the process of implementing the required reforms.
- **Guyana** has met its commitments – as described in its action plan of October 2014 – and is thus no longer subject to FATF's monitoring process under its on-going global AML and CTF compliance process. Guyana will continue working with the Caribbean Financial Action Task Force to address the issues identified in its mutual evaluation report.

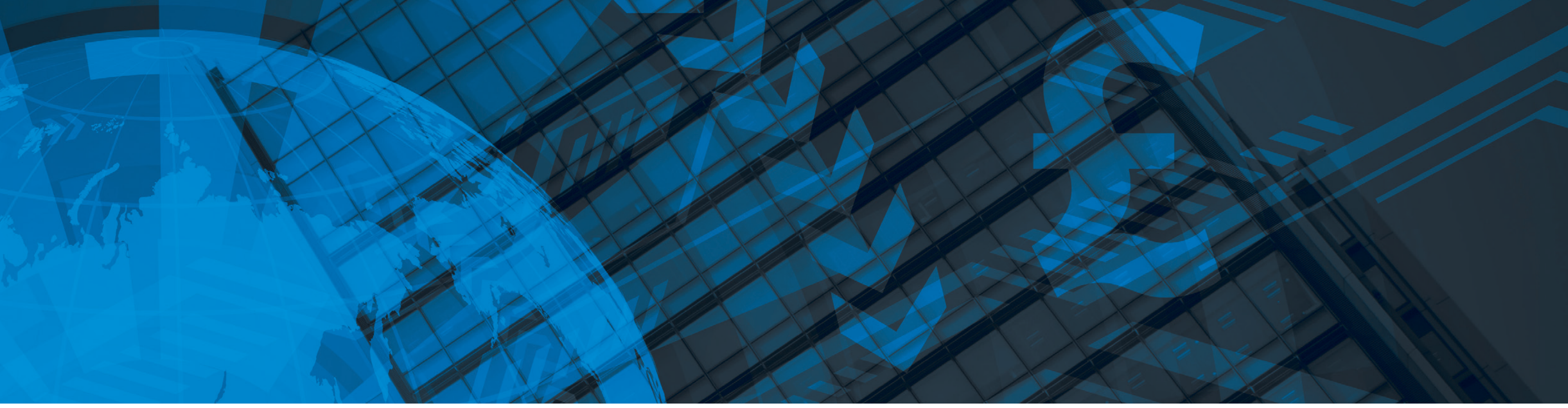
DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY PUBLISHES DISCUSSION PAPER ON THE BENEFICIAL OWNERSHIP PROVISIONS OF MLD4

On 3 November 2016, the Department for Business, Energy & Industrial Strategy (**BEIS**) published a discussion paper on the transposition of article 30 of the Fourth Money Laundering Directive (**MLD4**) with regard to the beneficial ownership of corporate and other legal entities. The UK government has welcomed MLD4 requirements stating that increasing transparency on ultimate ownership and control of corporate structures is vital towards establishing an environment of trust and accountability. BEIS has responsibility for the transposition of article 30, whilst on 15 September 2016 the government separately consulted on the implementation of MLD4 as a whole. MLD4 entered into force on 25 June 2015, with member states being required to implement it by 26 June 2017.

The 'People with Significant Control' (**PSC**) framework in the UK is largely consistent with the MLD4 requirements. Beneficial ownership disclosure requirements are imposed on companies limited by shares, companies limited by guarantee, unlimited companies, community interest companies, limited liability partnerships and European companies. BEIS takes the view that, despite the similarities between the MLD4 and the PSC regime, certain amendments are necessary.

More specifically, BEIS suggests amendments with regard to the following:

1. **Scope of the entities required to obtain and hold information**: BEIS takes the view that MLD4 requirements should not apply to all legal entities, as in certain cases there is no transparency gain. According to BEIS, in order for the entity to fall within the scope of article 30 of MLD4, it must be incorporated in the UK (and thus have a legal personality), it must not have re-domiciled and it must be constitutionally capable of legitimately having a beneficial owner. BEIS has provisionally assigned entities to one of the three categories: UK incorporated entities not already covered by domestic PSC legislation; UK incorporated entities which may fall outside the scope of MLD4; and UK arrangements and unincorporated entities that do not have a legal personality and are not in scope. The suggested scope would include Scottish limited partnerships, Scottish partnerships, unregistered companies and open-ended investment companies. BEIS is also considering bringing companies admitted to trading on prescribed markets within the scope of the PSC regime.
2. **Definition of beneficial owner and the information that needs to be collected**: BEIS is suggesting they retain the PSC regime tests of 'significant control', as provided in Part 1 of Schedule 1A of the Companies Act 2006, but adapt them according to the structure of the new entities brought within scope. BEIS also intends to retain the percentage thresholds prescribed by Schedule 2 to the Register of PSC Regulations 2016 (SI 2016/339) for describing the extent of the control.



According to BEIS, information on ownership and control arrangements for legal entities subject to MLD4 should also be filed at Companies House.

3. **The fact that the information collected must be 'adequate, accurate and current'**: BEIS intends to retain the existing approach to adequate and accurate information. However, BEIS considers that the existing requirement for an annual update of PSC information is inadequate, as it allows for a potential gap of 11 months between a change in PSC information and the notification of the change on the public register. BEIS proposes the introduction of a requirement for all entities to update their PSC information within six months of the change occurring.

4. **Access to information on beneficial ownership**: BEIS suggests that for all new entities brought under the scope of MLD4, information on beneficial ownership is publicly accessible in a way similar to the PSC register. Similarly, all PSC information in respect of these new entities should be without exception available to law enforcement, subject to the protection regime.

5. **Application of legal offences and penalties**: BEIS proposes that the legal offences and penalties which relate to the domestic PSC requirements apply to the new entities brought into scope by MLD4.

FCA SPEECH BY ROBERT GRUPPETTA ON FCA'S FINANCIAL CRIME PRIORITIES

On 10 November 2016, Robert Gruppetta, Head of the Financial Crime Department at the FCA delivered a speech at the FCA Financial Crime Conference in London. Some key points in his speech include:

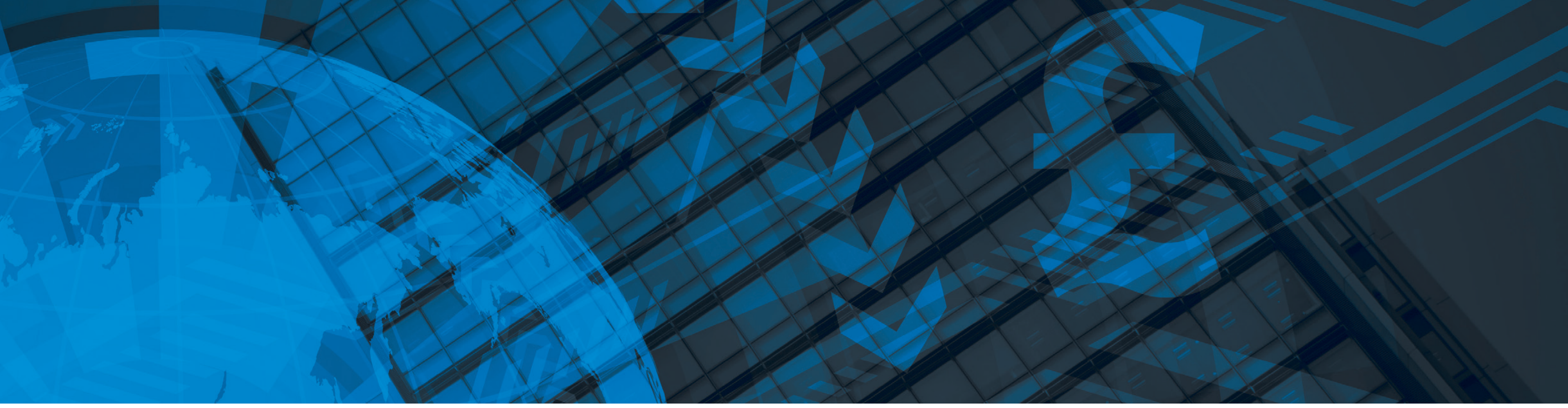
1. **Cost-saving reforms to AML regulation:** Mr. Gruppetta stressed the need for the FCA to be alive to the unintended consequences of regulation, namely that regulation is costly, citing estimates of the British Banking Association (**BBA**) that, collectively, its members spend £5 billion each year on financial crime compliance. He also acknowledged that the measures required by the anti-money laundering regime impose burdens and inconvenience on law-abiding companies and members of the public, with these costs ultimately being borne by customers.

Mr. Gruppetta reported that the FCA is currently in discussions with the government as to the possible measures that regulators, law enforcement and government could take to help cut the costs of compliance. These discussions are focused on three key areas:

- the potential for centralisation of transaction monitoring (whether conducted by the industry, or the public sector) with a view to achieving economies of scale, lessening duplication and helping firms and law enforcement to see the 'bigger picture' more clearly and make more refined judgments as to what is – and what is not suspicious;
- whether the criminal liability currently attached to the Money Laundering Reporting Officer role has the potential to lead to overly conservative or defensive reporting; and
- whether limited relaxation of the reliance provisions in the Money Laundering Regulations 2007 (**MLR**) may reduce the reluctance of firms to share customer due diligence information.

2. **Random sampling:** The FCA will soon begin inspecting a random sample of firms supervised under the MLR, including financial advisers, stockbrokers, safe deposit box providers and life insurers. However, Mr. Grupetta stressed that the exercise was not intended to catch small firms and that any firm, regardless of size, location or business model could face a visit. Mr. Gruppetta explained that the sampling would give a clearer picture of the risks posed in different sectors and help the FCA assure itself that its current assessment of risk is correct.

3. **Financial Crime Data Returns:** Following finalisation of its annual financial crime return (REP-CRIM) policy in July 2016, the FCA plans to begin publishing the aggregated data from these returns in due course. The FCA intends to provide a 'crowd-sourced' picture of risk assessment across the industry which, in time, could assist firms with their country risk assessments.



4. **Financial Crime Guide:** The FCA would be updating its Financial Crime Guide in 2017 in response to the imminent implementation of the Fourth Money Laundering Directive ((EU) 2015/849) which will repeal the existing MLR. The revised Guide will include material on how to distinguish between higher-risk and lower-risk politically exposed persons, as required by section 30 of the Bank of England and Financial Services Act 2016.
5. **Joint Money Laundering Intelligence Taskforce** (**JMLIT**): The JMLIT has made quick progress in aiding voluntary information sharing between industry and the authorities.

HOME SECRETARY GIVES SPEECH ON LEGISLATIVE DEVELOPMENTS AND GOVERNMENT COMMITMENT TO ANTI-MONEY LAUNDERING

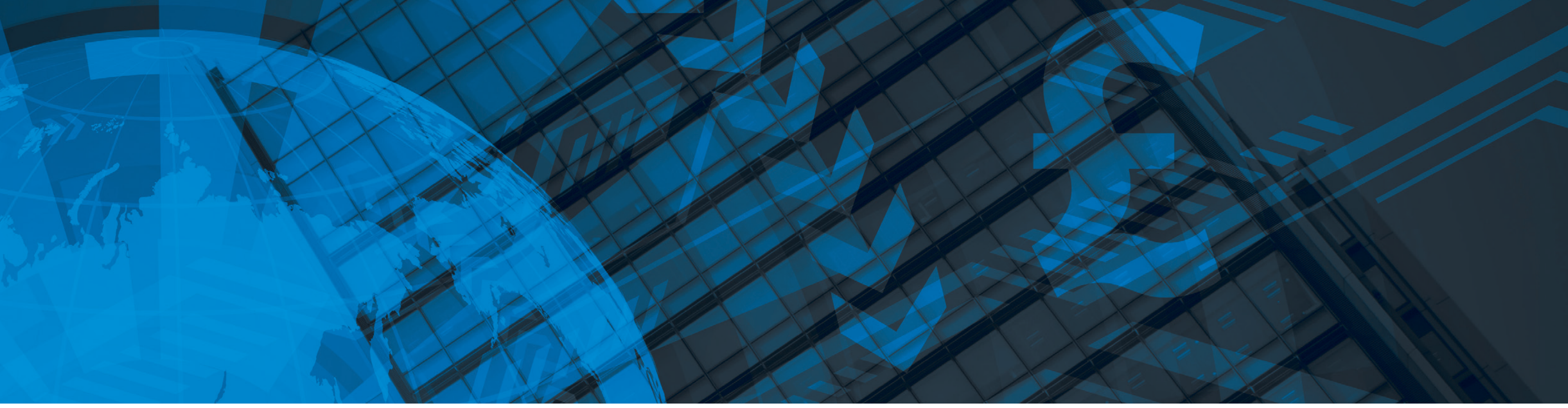
On 10 November 2016, the Home Secretary, Amber Rudd, delivered a speech at the FCA Financial Crime Conference in London. Some key points in her speech were:

1. **Anti-Money Laundering (AML) and counter-terrorist financing (CTF) Action Plan and the Criminal Finances Bill:** Following the publication of its Action Plan for AML and CTF in April 2016, Ms. Rudd reported that the government was working on its implementation. The Criminal Finances Bill (**the Bill**) was identified as one of the keys to the Action Plan implementation. Having entered Parliament, the government plans to deliver the Bill in Spring of 2017. It is envisaged that the Bill will significantly improve the ability of the government to tackle money laundering, corruption, tax evasion and terrorist financing.

In particular, the Bill will:

- give firms immunity from civil and criminal liability when they share information directly with one another on money laundering and terrorist financing;
- enhance the suspicious activity reports regime, allowing courts to freeze funds for longer while law enforcement agencies gather the evidence needed to take action;
- grant new powers to the National Crime Agency to compel the provision of the information; and
- close current gaps in the law preventing enforcement agencies from recovering identified criminal proceeds, where such proceeds of crime are stored in bank accounts or other means, such as precious metals and jewels.

2. **Partnership between the private sector and the government:** Ms. Rudd stressed the importance of public-private information sharing partnerships as a means to ensure that the vast sums invested by the financial services sector on compliance each year are used efficiently. In this regard, she noted that the recently established Joint Money Laundering Intelligence Taskforce (JMLIT) exemplified this approach. She also stated that internationally, the government would continue to work with partners in the US, Switzerland, the UAE, Australia and Singapore to deliver their London Anti-Corruption Summit commitments on the creation of their own public-private information sharing partnerships. She also said that the government would be exploring opportunities for intelligence to be shared internationally between these partnerships in key global financial centres.
3. **Beneficial Ownership Register:** Ms. Rudd reported that the public register of beneficial ownership of UK companies is now live and that, going forward, the government was committed to the development of a new beneficial ownership register for overseas companies. Such a register would, she said, prevent both the purchase of property in the UK and the delivery of government contracts by overseas companies, if the required beneficial ownership information is not first submitted.
4. **Unexplained Wealth Orders:** Ms. Rudd reported that the government has been in consultation and is now legislating for the creation of Unexplained Wealth Orders, based on which individuals will be compelled to explain the source of wealth used to purchase specific assets such as property. If no satisfactory explanation is



provided, the courts will be able to make an assumption that the assets in question are criminal property, with existing civil powers then being available to recover those assets. Citing Transparency International, the leading anti-corruption non-governmental organisation, Ms. Rudd stated that Unexplained Wealth Orders will be 'the most important anti-corruption legislation to be passed in the UK in the past 30 years'.

DEUTSCHE BANK FINED BY FCA FOR AML CONTROL FAILINGS

On 31 January 2017, the FCA published a final notice (**Notice**) imposing a fine of £163,076,224 on Deutsche Bank AG for AML control failings during the period between 1 January 2012 and 31 December 2015.

In early 2015, Deutsche Bank notified the FCA of its concerns regarding its AML controls after it investigated suspicious securities trading by Deutsche Bank's subsidiary based in Moscow (**DB Moscow**). Specifically, Russian customers purchased highly liquid Russian securities from DB Moscow in roubles, at the same time as other non-Russian customers of Deutsche Bank sold the same number of securities to Deutsche Bank in exchange for US dollars (executed by DB Moscow via remote booking). This trading was referred to in the Notice as 'mirror trading'. There were more than 2,400 mirror trades carried out between April 2012 and October 2014, enabling the conversion (for roubles to US dollars) and transfer (via Deutsche Bank in the UK) of more than US$6 billion out of Russia to overseas bank accounts in countries including Cyprus, Estonia and Latvia. The customers on both sides of the mirror trades were connected and the amount and value of the securities was the same on both sides. The FCA noted that the conversion and transfer of these funds is highly suggestive of financial crime.

Deutsche Bank also identified a further US$3.8 billion in suspicious 'one-sided trades'. The FCA stated in the Notice that these further suspicious transactions must have formed one side of an additional 3,400 mirror trades. These trades were often conducted by the same customers involved in the mirror trading.

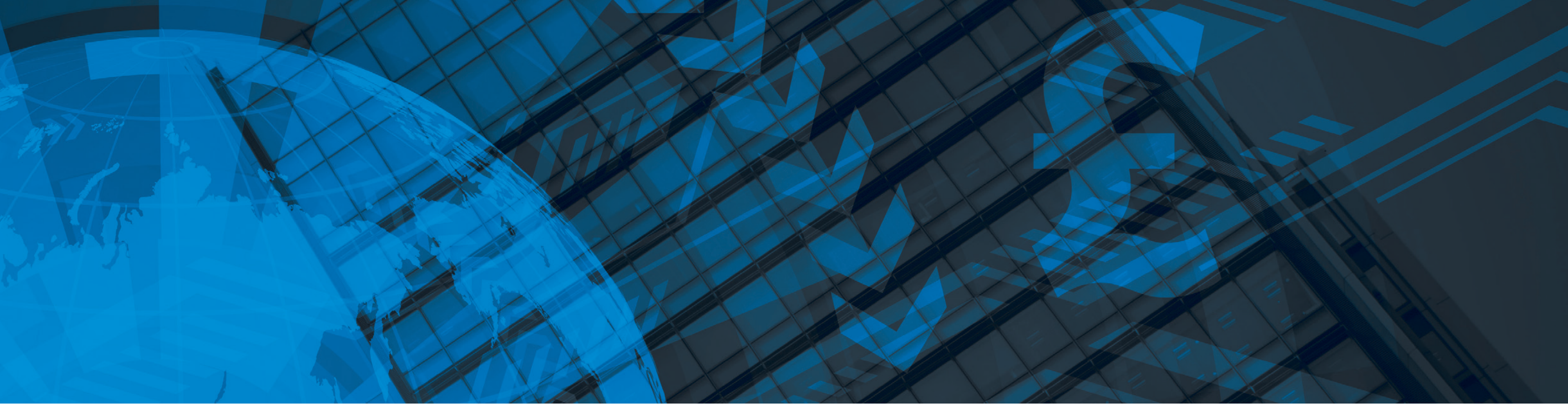
Following an investigation, the FCA found that Deutsche Bank had significant deficiencies in its AML control framework. The FCA found that these deficiencies were the reason why the mirror trades and one-sided trades were not detected. The FCA found that Deutsche Bank:

- performed inadequate customer due diligence;
- failed to ensure that its front office took responsibility for 'Know-Your-Customer' obligations;
- had inadequate AML policies and procedures, IT infrastructure, and automated monitoring systems; and
- failed to provide adequate oversight of trades booked in the UK by traders outside of the UK.

Deutsche Bank breached Principle 3 (taking reasonable steps to organise its affairs responsibly and effectively, with adequate risk management systems) of the FCA's Principles of Business and also the SYSC rules 6.1.1R and 6.3.1R.

The fine consisted of disgorgement of £9,076,224 and a penal element of £154,000,000. Deutsche Bank agreed to settle at an early stage of the FCA's investigation and therefore qualified for a 30% discount. The FCA identified that the AML control failings were not committed deliberately or recklessly and also appreciated Deutsche Bank's co-operative approach and the timeliness of notification following the discovery of the mirror trades. The FCA took into account the steps Deutsche Bank has taken to assist it in its investigation and the remedial action and resources committed to improving its AML control framework.

The FCA reminded firms of the importance of minimising money laundering risks in order to safeguard the UK financial system against financial crime. In a press release accompanying the Notice, Mark Steward, Director of Enforcement and Market Oversight at the FCA, warned firms to take notice of the fine and that firms should "look again at their own AML procedures to ensure they do not face similar action."

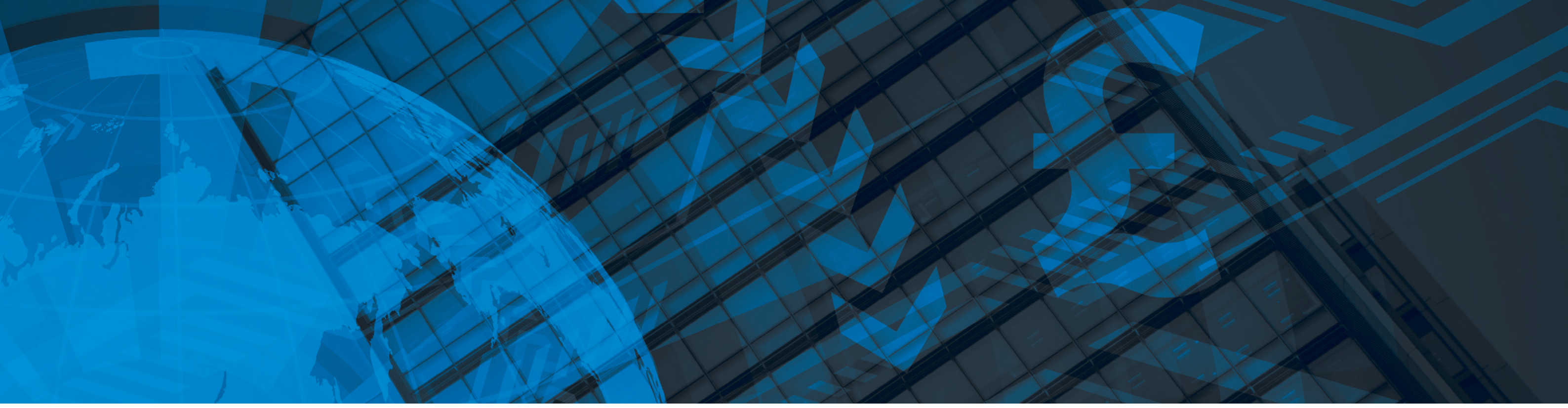


CUTTING RED TAPE REVIEW OF THE UK'S ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING REGIME

On 15 March 2017, Her Majesty's Government published the Cutting Red Tape (**CRT**) review on the impact of the UK's Anti-Money Laundering and Counter Financing of Terrorism Regime, which was originally launched in 2015. The review undertaken focused on evidence of potentially ineffective or unnecessary burdens on legitimate and law-abiding businesses and cases where requirements are unclear, unnecessarily cumbersome, conflicting or confusing. The CRT review summarised the findings and identified the impact and consequences of the current supervisory regime without however, making specific recommendations.

The findings of the CRT review can be summarised as follows:

1. **Guidance**
   - The large volume of the guidance issued by the supervisors creates confusion and unnecessary costs for businesses
   - The structure of the regime leads to overlapping and duplicated guidance
   - Multiple pieces of guidance do not distinguish clearly between legal requirements and additional good practice suggestions
   - Her Majesty Treasury's (**HM Treasury**) guidance approval process is reported to take over a year to report and only covers checking the guidance's compliance with the law
   - Some large financial institutions appreciate the existing guidance, but some smaller businesses find the existing guidance complex, confusing and hard to understand
   - Multiple firms report feeling forced to hire consultants to help them navigate through the regime
2. **Overall approach to compliance and its impact on the effectiveness of the regime**
   - The current policy approach is at odds with the approach that many supervisors take
   - The perceived prescriptive approach, combined with fear for the consequences of making a mistake, results in the industry's unwillingness to challenge the advice and guidance provided by supervisors
   - FinTech companies report that their growth is hampered by the inability and unwillingness of banks to adapt to their companies' new business models and they also state that companies do not adopt new technological solutions due to the supervisors' apparent preference for traditional methods
   - Businesses feel unable to act in accordance with their own risk assessments because of the supervisors' focus on customer due diligence
   - There is a lack of consistent approach to the separation of enforcement/ supervision and representation functions
3. **Overall approach to compliance and its impact on the economy**
   - Due diligence requirements hit small businesses and limit competition in the provision of services
   - Customers are discouraged from moving their bank accounts to more competitive providers and from using different financial products
   - The cost of complying with customer due diligence checks on new clients can outweigh the value of doing business with them
   - Banks are unwilling to accept companies or individuals in high risk sectors as customers
4. **Duplication of costly checks**
   - Businesses feel unable to adopt the system of reliance
5. **Other findings**
   - The perceived reluctance of parts of the government to share information with business supervisors on aspects of the regime such as sanctions, politically exposed persons, and high risk country data is reducing their effectiveness at identifying and preventing wrongdoing
   - Businesses and supervisors reported that there was insufficient dialogue with or feedback from HM Treasury and the FCA.



HM TREASURY'S SECOND CONSULTATION ON MONEY LAUNDERING REGULATIONS 2017

On 15 March 2017, Her Majesty's Treasury (**HM Treasury**) published its second consultation on the Money Laundering Regulations 2017 (**the MLR 2017**), which, amending and replacing the Money Laundering Regulations 2007 (**the MLR 2007**) and the Transfer of Funds (Information on the Payer) Regulations 2007 (SI 2007/3298)), will transpose the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**) in the UK.

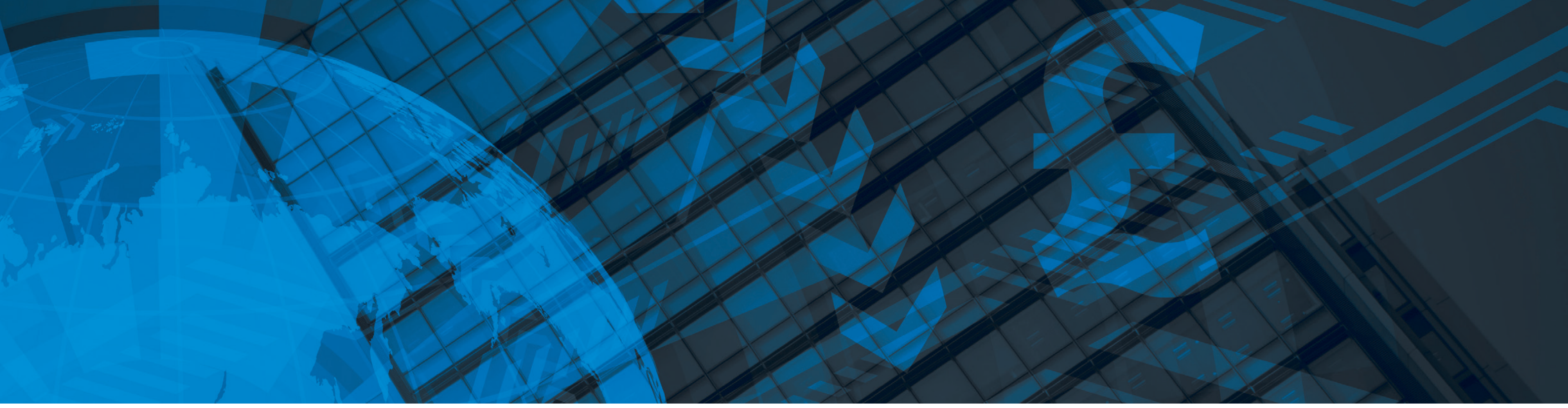
The first HM Treasury consultation was published on 15 September 2016 and outlined the government's intentions with regard to the implementation of MLD4. For further information on the first HM Treasury consultation please refer to the autumn 2016 issue of the 'AML Bulletin'. Through the second consultation the government seeks views on whether the draft regulations deliver their stated aims. Interested parties can submit their responses to aml@hmtreasury.gsi.gov.uk until 12 April 2017. The final policy decisions must be implemented by 26 June 2017.

The government announced a number of key decisions:

1. HM Treasury will act as the registry authority for all trust and company service providers who are not registered by HM Treasury themselves or the FCA.
2. The fit and proper test will be extended to agents of money service businesses and carried out by HM Treasury.
3. Letting agents will be retained within the scope of the new regulations where they carry out estate agency work within section 1 of the Estate Agents Act 1979 (as amended).
4. All gambling service providers will be exempt from the requirements of the directive, except for remote and non-remote casinos.
5. Pooled client accounts are not automatically subject to simplified due diligence.

The second HM Treasury consultation touches on the following:

1. **Scope**: Credit institutions, financial institutions, auditors, insolvency practitioners, external accountants and tax advisers, independent legal professionals, trust or company service providers, estate agents, high value dealers and casinos are identified as relevant persons under the MLR 2017. The government proposes adopting a turnover threshold of £100,000 for persons engaging in financial activity on an occasional or very limited basis, aiming to reduce the administrative burdens on businesses while retaining a 'sufficiently low' figure.
2. **Due diligence requirements and reliance** *(including a risk-based approach and ongoing monitoring obligations, one-off company formation, simplified customer due diligence, simplified due diligence and pooled client accounts and reliance on third parties):* Relevant persons will need to apply different levels of due diligence measures in order to manage the risk of money laundering and terrorist financing. Customer due diligence (**CDD**) will be retained by the MLR 2017 and the government has decided to include a summary of the risks as set out in Annex I of MLD4 in the MLR 2017, in line with a risk-based approach. The government also clarified that obliged entities can use an outsourcing service provider, but they will still remain liable for ensuring that the necessary requirements are met.
3. **Gambling providers**: The scope of the MLR 2017 extends to the entirety of the gambling industry. This is a significant extension, as previously under the MLR 2007, only the holders of a casino operating licence were in scope. Exemptions can only be allowed on the basis of the proven low risk posed as a result of the nature and the scale of operations of such services. The Gambling Commission will remain the supervisory authority for overseeing compliance in the casino sector and is also expected to continue to address money laundering risks in the remainder of the industry using a combination of requirements under the Proceeds of Crime 2002 and existing regulatory and criminal investigation powers. The government will regularly review its position on the money laundering and terrorist financing risks that gambling providers present.



4. **Electronic money**: MLD4 limits the circumstances in which e-money issuers can be exempt from CDD. The government took the view that the limits set out under MLD4 are sufficiently high to mitigate the money laundering and terrorist financing risks and that exemptions should be applied.

5. **Estate agent businesses** *(including appointment of professional or self-regulatory body supervisors of estate agents, letting activity, application of CDD and sub-agents and reliance)*: The government decided that in cases where a self-regulatory body can demonstrate that it can meet the supervisory standards in the regulations, HM Treasury may appoint the relevant professional body as a supervisor of estate agents.

6. **Correspondent banking**: This includes an overview of money laundering risk, CDD and enhanced due diligence requirements, payable through accounts, shell banks, definitions and consultation responses.

7. **Politically exposed persons (PEPs)**: This includes guidance on the treatment and definition of PEPs, family members, known close associates and former PEPs, access to redress, international sporting federations and amendments to the MLD4.

8. **Beneficial Ownership** *(including company beneficial ownership and trust beneficial ownership)*: Article 31 of MLD4 requires trustees to hold adequate, accurate and up-to-date information on the beneficial ownership of their trust and make this information available to law enforcement and the UK Financial Intelligence Unit. They are also required to disclose their status as a trustee when entering into business relationships or conducting transactions in their capacity as a trustee. The government proposed the broad adoption of article 31.

9. **Reporting obligations** *(including UK Financial Intelligence Unit, reporting requirements and data retention)*: The government decided to extend the responsibilities of the National Competent Authorities, so that they are able to accept protected disclosures from whistleblowing workers for money laundering purposes.

10. **Supervision of obliged entities**: This includes the Call for Information, supervisory regime, identifying and assessing risk, registration, fit and proper tests, criminality tests and information.

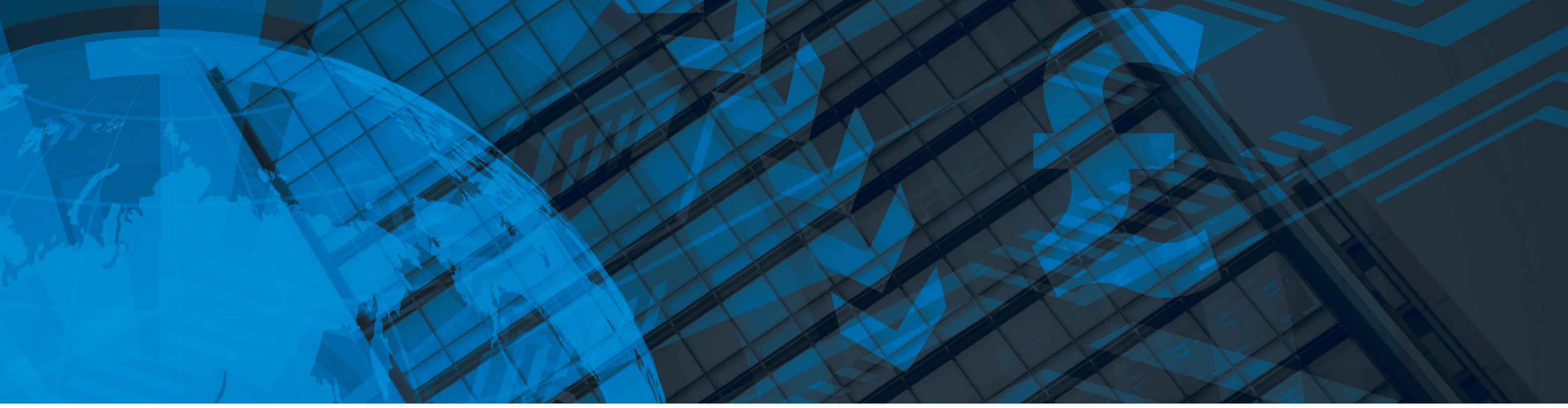
11. **Administrative sanctions and criminal penalties**: MLD4 requires obliged entities to be held liable for potential breaches. Both administrative and criminal sanctions are available for the relevant breaches of the MLR 2007. The draft MLR 2017 also provides designated supervisory authorities with the power to impose civil penalties on any person who has contravened a relevant requirement. The government is not seeking any further consultation on the criminal penalties. It should be noted that there is no record of any prosecutions for breaches of the relevant provisions under the MLR 2007.

HM GOVERNMENT TO CREATE OFFICE FOR PROFESSIONAL BODY ANTI-MONEY LAUNDERING SUPERVISION

On 15 March 2017 HM Treasury announced plans to create a new anti-money laundering (**AML**) watchdog, the Office for Professional Body Anti-Money Laundering Supervision (**OPBAS**). It is intended that the new watchdog will help improve the overall standards of supervision, ensure supervisors and law enforcement authorities work together more effectively and complement the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**the MLR 2017**). These were published in draft on 15 March 2017 and are due to come into force on 26 June 2017.

HM Treasury notes that sectors at risk of being used to facilitate money laundering and terrorist financing are currently supervised by 25 organisations, 22 of which are accountancy and legal services providers' professional bodies. While HM Treasury recognises that these supervisory professional bodies bring substantial benefits to the regime (being closest to the innovations and emerging risks in their respective sectors), it notes that, as a consequence of multiple supervisory bodies supervising the same sectors, conflicts and inconsistencies may arise in relation to the issued guidance and supervisory approaches of these bodies, which criminals may seek to exploit.

The creation of OPBAS seeks to ensure consistent high standards across the regime, whilst imposing the minimum possible burden on legitimate business. OPBAS will set out



how professional body AML supervisors should comply with their obligations under the MLR 2017 and ensure they do so, with the powers to penalise any breaches. It will be funded through a new fee on professional body AML supervisors.

HM Treasury states that as guidance is updated to reflect the requirements of the MLR 2017, the government will work towards approving a single AML guidance document for each sector, in order to reduce and simplify the guidance firms need to follow. This tailored guidance will complement the Joint Money Laundering Steering Group Guidance (JMLSG) and the FCA's Financial Crime guide.

The proposed changes are being introduced in response to the government's Call for Information on the AML Supervisory Regime and Cutting Red Tape's Review of the UK's Anti-Money Laundering and Counter Financing of Terrorism Regime (which was published in March 2017). These identified ways to improve the effectiveness of the supervisory regime by removing unnecessary burdens without having a material impact on the fight against money laundering.

HM Treasury's decision to establish OPBAS also comes in the context of a wider review of the UK's ability to tackle money laundering and terrorist financing, with the Cabinet Office currently undertaking an audit of the funding, performance and staffing (among other areas) of all agencies tasked with countering financial crime, including the FCA, Serious Fraud Office, HM Revenue & Customs and the National Crime Agency.

It is expected that legislation to establish OPBAS will be introduced by the end of 2017 and that it will commence operations by the start of 2018, operating within the FCA's existing governance arrangements.

FCA ISSUES GUIDANCE CONSULTATION ON TREATMENT OF POLITICALLY EXPOSED PERSONS UNDER DRAFT MONEY LAUNDERING REGULATIONS 2017

On 16 March 2017, the FCA published a guidance consultation (**GC17/2**) on the treatment of politically exposed persons (**PEPs**) under the proposed Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**the MLR 2017**). HM Treasury published the draft MLR 2017 for consultation on 15 March 2017. The MLR 2017 will transpose the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**) and the Fund Transfer Regulation which accompanies it.

The current regime under the Money Laundering Regulations 2007 (**the MLR 2007**) requires firms to apply extra measures, called 'enhanced due diligence' (**EDD**) when dealing with PEPs in a state other than the UK, as well as their 'family members' and 'known close associates'. Among other things, MLD4 requires the UK to expand the current definition of a PEP under the MLR 2007 to include PEPs in the UK.

The FCA's proposed guidance is intended to give firms clarity on its expectations for how they should treat the varying risks posed by PEPs, whether they are based in the UK, another EU member state, or in a country outside the EU.

The proposed guidance clarifies who should be considered a PEP, who are family members and known close associates of a PEP and the measures firms should take once they have identified that a customer is a PEP or family member or known close associate of a PEP. It also sets out a number of geopolitical and personal and professional indicators which, in the FCA's view, would tend to indicate either a higher risk or lower risk in respect of a PEP and their family members and known close associates. The FCA expects firms to take a proportionate, risk-based and differentiated approach to meeting their money laundering obligations.

In the proposed guidance, the FCA explains that it has been prepared based on its understanding of the risks and experience of cases where firms have applied EDD measures that were not commensurate with the risks posed by the particular PEP in question. The FCA further states that the proposed guidance should be read in conjunction with guidance on PEPs produced by the Joint Money Laundering Steering Group (JMLSG) and guidelines issued jointly by the European Supervisory Authorities.

Comments may be made on the draft guidance until 18 April 2017. The FCA will consider feedback and issue a response, together with the final version of the guidance before 26 June 2016, which is the date that HM Treasury has advised that the MLR 2017 will come into force.

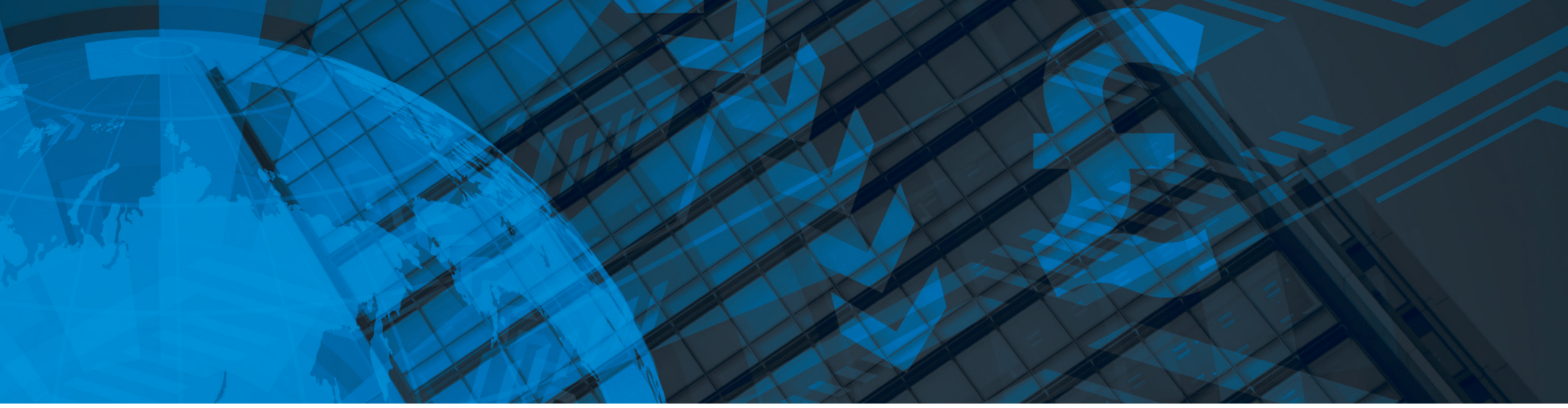
INTERNATIONAL NEWS

FATF GUIDANCE ON CRIMINALISING TERRORIST FINANCE

On 21 October 2016, the Financial Action Task Force (**FATF**) published its guidance on criminalising terrorist finance. The guidance relates to FATF Recommendation 5 (**R.5**) and Interpretative Note 5 (**INR.5**) which set out the specific elements required towards criminalising terrorist financing (**TF**). Countries enjoy a degree of flexibility regarding implementation, but the guidance aims to assist them by providing interpretation and examples.

The guidance provides interpretation on the following:

- **The offence must cover all types of wilful TF activity**: An activity is considered wilful when the conduct is deliberately committed with an unlawful intention. Unlawful intention is calculated in relation to a terrorist act, or in relation to financing a terrorist organisation or individual terrorist. Countries are not required to criminalise TF as a strict liability offence, nor reckless or negligent TF, or unwitting acts of TF.
- **The offence must cover the financing of terrorist acts with an unlawful intention**: The person providing the funds must unlawfully intend that these funds will be used to carry out a terrorist act, regardless of whether that terrorist act is eventually carried out. Terrorist acts cover both specific terrorist acts and any other unspecified acts carried out with the intention to cause death or serious bodily injuries towards intimidating the population, the government or an international organisation (catch-all provision).
- **The offence must cover the financing of terrorist organisations and individual terrorists with an unlawful intention**: R.5/ INR.5 go beyond the international legal obligations and expect countries to criminalise the financing of terrorist organisations and individuals terrorists even without a link to a specific terrorist act. The prosecutor must prove that the terrorist financier knew that the funds were being collected for or provided to a terrorist organisation or individual terrorist, or unlawfully intended to do so. The guidance also touches on other questions of scope, including questions on the concept of recklessness, the overlap with targeted financial sanctions, the principle of guilt, trivial offences and limitations on the scope of TF offences.
- **The offence must cover financing the travel of foreign terrorist fighters**: Countries are required to criminalise the financing of the travel of individuals who travel to a state, other than their states of residence or nationality, for the purpose of perpetration, planning or preparation of or participation in terrorist acts or the providing or receiving of terrorist training.
- **Terrorist financing should be criminalised on a stand-alone basis**: TF should be criminalised as a separate offence and not merely an ancillary offence related to the primary offence of committing a terrorist act. Countries have the discretion to criminalise all TF activities either with a single offence, or with several separate ones.
- **Broadest possible definition of funds or other assets, regardless of their origin**: The definition goes far beyond the typical definition of funds and is not limited to financial assets, but covers every possible kind of property, regardless of whether they originate from legitimate or illegitimate sources.
- **The TF offence should include a range of circumstances**: The offence should not be restricted to cases where the funds were used to carry out or attempt a terrorist attack, and should not require prosecutors to prove a link to a specific terrorist attack.
- **The terrorist financier's intent and knowledge may be inferred**: Prosecutors are able to infer the mental element of a TF offence from objective factual circumstances without that being explicitly stated in the TF offence.
- **Sanctions that apply to natural persons**: The potential penalties should be proportionate to other serious criminal offences within each country. Effective, proportionate and dissuasive criminal sanctions should apply to natural persons convicted of terrorist financing.
- **Sanctions should apply to legal persons**: Legal persons should be subject to criminal prosecution, if not contrary to a fundamental principle of their domestic law, including the national Constitution or binding decisions of the country's highest court. Where not possible, civil or administrative liability and sanctions should be applicable.



- **A full range of ancillary offences to the TF offence**: The activities of attempting, participating in, organising, directing or contributing to a TF offence as part of a group are criminalised.
- **Jurisdictional issues**: TF offences should apply, regardless of whether the person alleged to have committed the offence is in the same or different country from the one the terrorist organisation is located or the terrorist act occurred.
- **TF should be a predicate offence for money laundering**: Countries should ensure offences are designated as money laundering predicate offences.

The guidance provides some examples of various implementation approaches, which are neither exhaustive nor binding for countries. They are meant to provide some insight on how different countries, either common or civil law ones, choose to criminalise terrorist financing.

EUROPEAN COMMISSION'S ROADMAP ON PROPOSAL FOR DIRECTIVE ON CRIMINALISATION OF MONEY LAUNDERING

On 25 October 2016, the European Commission (**Commission**) published a roadmap on its proposal for a Directive on the criminalisation of money laundering. The proposed Directive is part of the Commission's Action Plan against terrorist financing which was published on 2 February 2016. The proposal aims to introduce the minimum rules regarding the definition of the criminal Money Laundering (**ML**) offences and the approximation of sanctions. In its proposal, the Commission considers the relevant international standards of both the Financial Action Task Force (**FATF**) and Warsaw Convention of 2005 (**Warsaw Convention**).

Problems identified

The Commission notes that the existing criminal framework against ML is neither comprehensive nor sufficiently coherent resulting to enforcement gaps and obstacles in terms of information exchange and cooperation between the competent authorities in different countries across the EU. Instruments at the EU level are limited in scope and EU countries do not share the same definitions of what constitutes ML, which are the predicate offences and what is the level of sanctions imposed. Even though ML has been identified as a crime of potentially cross-border nature, there is no common EU definition. This allows room for forum shopping with criminals choosing to carry out financial transactions in jurisdictions with the weakest anti-money laundering measures.

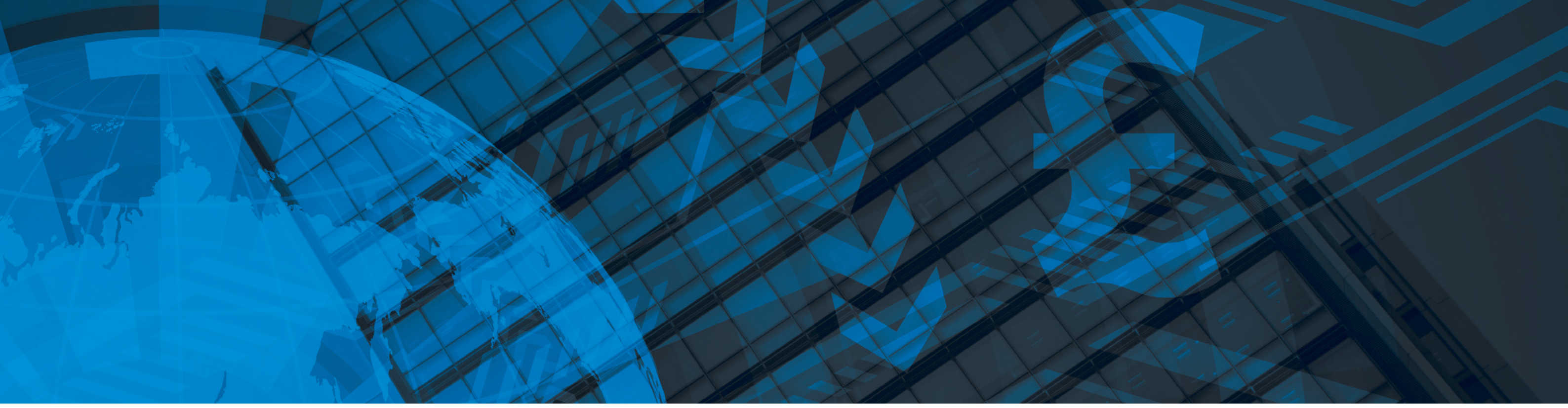
Minimum actions to be considered

The Commission lays down the minimum options that need to be considered in order to tackle ML as effectively and uniformly as possible:

1. non-legislative action at the EU or national level, including guidelines on effective cooperation between competent authorities;
2. comprehensive legislative solution that transposes international standards and treaties into EU law, including:
    a. harmonisation of the definition of ML in line with FATF recommendations, allowing however members states for a margin of discretion;
    b. harmonisation in line with the Warsaw Convention;
    c. harmonisation going beyond international obligations by defining the conditions and concepts of money laundering.

Next Steps

The Commission states that a targeted consultation will take place, including specific discussions with the Commission Expert Group on ML and terrorist financing. Member states will need to provide information on national provisions on the criminalisation of ML, the compliance with international standards and the cross-border dimension. The roadmap also states that a dedicated expert meeting will be organised and the Commission will also draw on the expertise of relevant agencies. The Commission clarified that a full Impact Assessment will not be carried out, but the Commission services will support the proposal with a document analysing



the problems and options. The Commission can also rely on the draft study elaborated in 2013-2014 and the recent mutual evaluation reports of FATF and MONEYVAL.

JOINT COMMITTEE OF ESAS PUBLISHES FINAL GUIDELINES ON RISK-BASED SUPERVISION UNDER MLD4

On 16 November 2016, the Joint Committee of the European Supervisory Authorities (**ESAs**), i.e. The European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, published the final version of their guidelines (ESAs 2016 72) on risk-based supervision under the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**). The guidelines, as per article 48(10) of MLD4, are meant to assist the National Competent Authorities (**NCAs**) responsible for supervising the compliance of credit and financial institutions with their anti-money laundering and counter-terrorist financing (**AML/CTF**) obligations. The final guidelines will apply a year from the date they were issued.

Background

The Joint Committee of ESAs had previously launched a consultation on the draft version of the guidelines which ran from 22 October 2015 to 22 January 2016. During that consultation, respondents supported the development of an effective risk-based approach to AML/CTF across the EU, but they also raised certain concerns. The respondents were worried about the ability of NCAs to apply the guidelines in a consistent manner. They also highlighted the need for the guidelines to be consistent with the Financial Action Task Force (**FATF**) standards, as well as for relevant information to be shared by NCAs with firms.

According to the Joint Committee of ESAs, the above concerns have been appropriately addressed in the final version of the guidelines. The final ESAs' guidelines aim to provide a common European basis for the application of the risk-based approach to AML/CTF supervision and they are based on the ESAs' *Preliminary report on anti-money laundering and counter financing of terrorist Risk Based Supervision* (published in October 2013).

Risk-based approach

The final guidelines provide clarifications about the characteristics of a risk-based approach and set out what NCAs should do to ensure that their allocation of supervisory resources is proportionate to the level of money laundering and terrorist financing (**ML/TF**) risk associated with credit and financial institutions in their sector. The risk-based approach to AML/ CTF supervision is described as an ongoing and cyclical process of four steps. The ESAs expect NCAs to identify and assess the ML/TF risks to which their sector is exposed and adjust the focus, intensity and frequency of supervisory actions in line with the risk-based approach.

More specifically, supervisors should take the following steps when conducting AML/CTF supervision on a risk-sensitive basis:

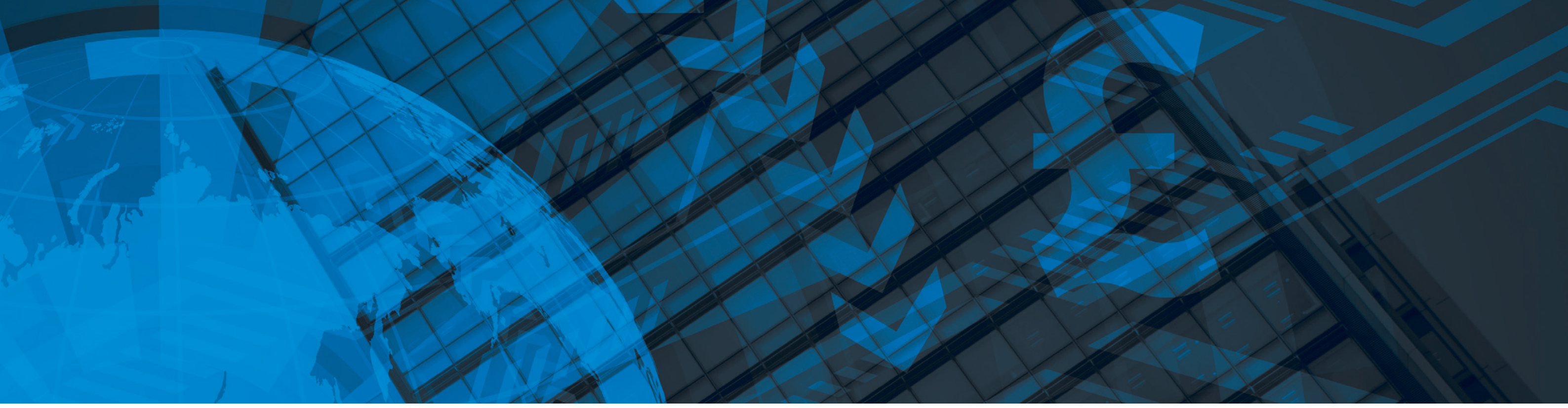
1. Identification of ML/TF factors

NCAs should identify the risk factors based on information obtained from a variety of sources. The type and number of these sources should be determined on a risk-sensitive basis. NCAs should have adequate knowledge and understanding of the ML/TF risks identified at the national level and consequently be able to identify the ML/TF risk factors associated with any domestic financial activities. In cases where a subject of assessment is exposed to ML/TF risks originating in other member states or third countries, NCAs should also identify these risks. NCAs should also have a good understanding of the risk factors that are relevant separately for each sector and gather sufficient, relevant and reliable information to develop an overall understanding of the subject of the assessment.

The ESAs stated that NCAs should be proportionate in their supervision of subjects of assessment for AML/ CTF purposes. NCAs should take into account the risk profile as determined on the basis of previous risk assessments and consider the context in which the subject of assessment operates. The ESAs clarify that the size or systemic importance of a credit or financial institution may not in itself be indicative of the extent to which it is exposed to ML/TF risks, and added that smaller firms can nevertheless pose a high ML/TF risk.

2. Risk assessment

NCAs are expected to assess the extent to which the inherent risk factors identified affect the subject of the assessment and determine the extent to which the AML/ CTF systems and controls which the subject of assessment



has in place are adequate to effectively mitigate them. The ESAs also expect the NCAs to weigh risk factors and mitigate risk differently, depending on their relative importance. The NCAs should aim to assign an overall risk profile to the subject of assessment in order to facilitate a comparison between subjects of assessment and in order for the supervisor to consider the appropriate action.

3. Allocation of AML/CTF supervisory resources

Supervisory resources should be allocated to each subject of assessment in a way that is proportionate to the risk profile of the assessment subject. The NCAs should ensure that subjects associated with higher ML/TF risks are subject to more frequent and intrusive supervision. In their assessment of risks and subsequent allocation of supervisory resources, the NCAs should use both their own assessments and their broader understanding of the potential ML/TF risks to which the sector is exposed. The ESAs stated that the NCAs should ensure that staff with direct or indirect AML/CTF responsibilities have appropriate knowledge and understanding of the applicable legal and regulatory AML/CTF framework and are suitably qualified and trained.

4. Monitoring and follow-up actions

The ESAs proposed that the NCAs carry out periodic reviews of their risk assessments in order to ensure their relevance. Moreover, ad hoc reviews of the risk factors, the risk assessment, and the supervisory plans should take place in case significant changes occur which may affect the subject of assessment of the risk profile. Internal procedures, including ML/TF risk assessment methodology should be applied consistently and effectively and the risk-based model should be periodically reviewed to ensure it delivers the intended outcome. The ESAs suggested that the AML/CTF risk-based model, its implementation and the subsequent reviews are appropriately documented for the purposes of its institutional memory. The ESAs also suggested that a record of outcomes and decisions, along with their underlying rationale, is produced.

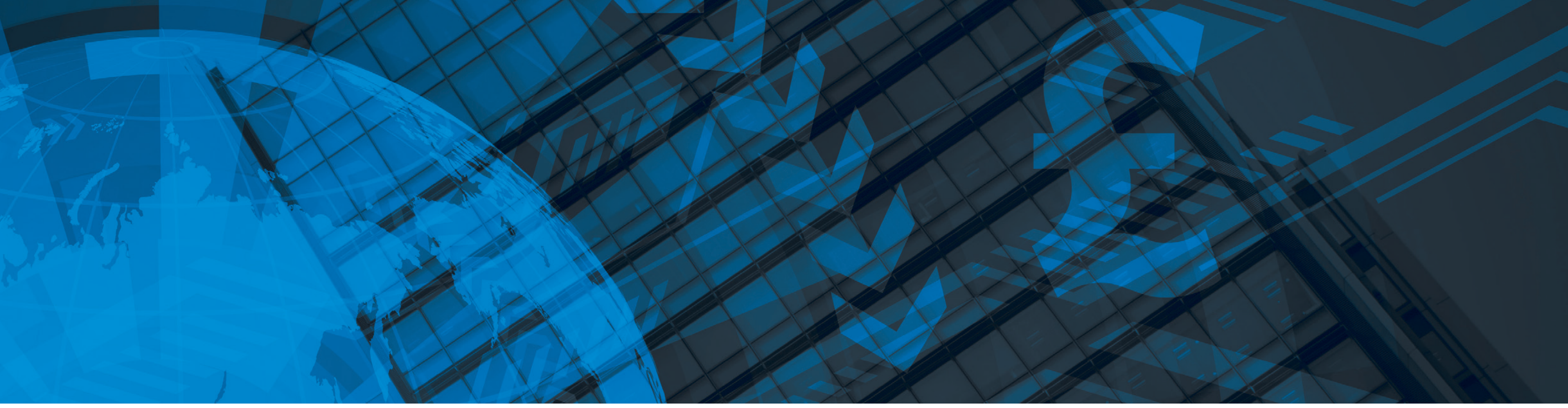
BASEL COMMITTEE ON BANKING SUPERVISION ISSUES CONSULTATION DOCUMENT ON REVISIONS TO CORRESPONDENT BANKING GUIDANCE

On 23 November 2016, the Basel Committee on Banking Supervision (**BCBS**) issued a consultation document, seeking views on proposed revisions of its guidelines on correspondent banking. The proposed revisions focus on Annexures 2 and 4 of the BCBS Guidelines on the 'sound management of risks related to money laundering and the financing of terrorism', first issued in January 2014 and revised in February 2016.

Correspondent banking is the provision of banking services by one bank (the correspondent bank) to another (the respondent bank), enabling the respondent bank to conduct business and provide services that it cannot otherwise offer (owing to the lack of an international presence and cross-border payment systems). A correspondent bank executes and/or processes transactions for customers of a respondent bank, but does not have direct relationships with the customers. Because of the remoteness of the correspondent bank from the customers and the limited information available regarding the nature or purposes of the underlying transactions, correspondent banks may generally be exposed to money laundering and financing of terrorism risks.

The proposed revisions are a response to growing concerns in the international community that banks are avoiding anti-money laundering and counter-terrorist financing risks by 'de-risking' and by withdrawing correspondent banking services entirely. This may in turn affect the ability to send and receive international payments in entire regions, and drive payment flows underground and out of sight of international detection and supervision. The BCBS believes that a greater degree of clarity with regard to the applicable rules may serve to mitigate this decline.

The proposals, which follow those of the Financial Action Task Force (FATF) in its Guidance on Correspondent Banking published on 21 October 2016, aim to clarify the risk-based approach that correspondent banks must employ when assessing transactions, recognising that not



all correspondent banking relationships bear the same level of risk. In undertaking this risk-based assessment, the proposals require that regard be given to:

- **The inherent risk resulting from the nature of the services provided**, in particular: (i) the purpose of the services provided to the respondent bank (e.g. trading on a recognised exchange or payments between a respondent's group within the same jurisdiction may constitute indicators of lower risk); (ii) whether different entities of the group to which the respondent bank belongs would have access to the account; and (iii) the ability of other third parties to have access to the correspondent account;
- **The characteristics of the respondent bank**, in particular: (i) the respondent bank's major business activities including target markets and overall types of customers served; (ii) the respondent bank's management and ownership (including the beneficial owners) and whether they represent specific money laundering/ terrorist financing risks (e.g. politically exposed persons); (iii) the respondent bank's money laundering prevention and detection policies and procedures; and (iv) whether any civil, administrative or criminal actions or sanctions, including public reprimands, have been applied to the respondent bank; and
- **The environment in which the respondent bank operates**, in particular: (i) the jurisdiction in which the respondent bank is located (and its parent company when the respondent bank is an affiliate); (ii) the jurisdictions in which subsidiaries and branches of the group may be located as well as the jurisdictions in which third parties having access to the correspondent account may be located; and (iii) the quality and effectiveness of the banking regulation and supervision in the respondent's country and the respondent's parent company's country when the respondent is an affiliate.

ECB PUBLISHES OPINION ON PROPOSED DIRECTIVE AMENDING MLD4

On 17 October 2016, the Council of the European Union published a cover note dated 14 October 2016, attaching a copy of an opinion issued by Mario Draghi, President of the European Central Bank (**ECB**), dated 12 October 2016.

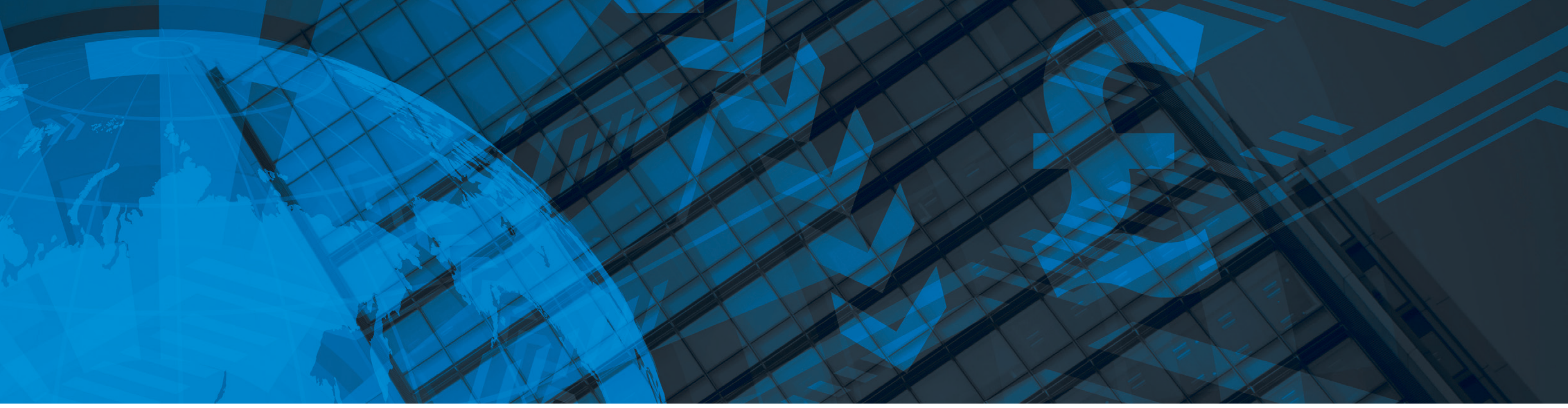
The opinion comments on the proposed Directive amending the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**), known as the Fifth Money Laundering Directive or MLD5.

The ECB was asked to provide an opinion by the Council and the European Parliament in August 2016 and September 2016 respectively. In its opinion, the ECB sets out its observations on the following areas covered by the proposed MLD5:

1. **Extension of list of entities obliged to comply with MLD4 to include virtual currency exchange platforms and custodian wallet providers:** While the ECB strongly supports the proposed extension of MLD4 to cover virtual currency exchange platforms and custodian wallet providers (noting that terrorists and other criminal groups are able to transfer money within virtual currency networks by concealing the transfers or by benefiting from a certain degree of anonymity on such exchange platforms), it stresses that EU legislative bodies should take care not to inadvertently promote the use of privately established digital currencies, as such alternative means of payment are neither legally established as currencies, nor do they constitute legal tender issued by central banks.

The opinion outlines the ECB's principal concerns with virtual currencies; namely, that there is no guarantee that a virtual currency will continue to function as a medium of exchange in the future and that the reliance on virtual currencies, could in principle affect central bank control over the supply of money with potential risk to price stability. In this regard, the ECB proposes the removal of certain sentences in Recital 7 of the proposed Directive which it considers to 'promote a wider use of virtual currencies'. The ECB also proposes certain amendments to the definition of 'virtual currencies' in the proposed Directive in order to clarify that virtual currencies do not possess the legal status of currency or money.

Central registers of bank and payment accounts: Pursuant to the proposed Directive, member states are required to put in place centralised data retrieval or automated mechanisms which would allow the identification, in a timely manner, of any natural or legal person holding or controlling accounts held by a credit institution within their territory. The ECB states that,



for the purposes of assessing whether the prohibition on monetary financing under Article 123 of the Treaty on the Functioning of the European Union is infringed, tasks entrusted to a national central bank (NCB) in the European System of Central Banks (ESCB) relating to the establishment of a central register of bank accounts are not to be considered central bank tasks, nor do they facilitate the enforcement of such tasks. As such, the ECB proposes that, if member states choose to use their national central bank to set up the suggested centralised data retrieval or automated mechanisms, there should be a clear mechanism to allow for recouping of costs.

The Presidency of the Council subsequently published a compromise proposal for MLD5 on 13 December 2016, which, among other things, confirms the original planned implementation date for MLD4 on 26 June 2017.

DEVELOPMENTS ON FIFTH MONEY LAUNDERING DIRECTIVE

Fifth Presidency Compromise Proposal

On 20 December 2016, the Council of the EU (**Council**) published its fifth Presidency compromise proposal (15605/16) on the proposed Fifth Money Laundering Directive (**MLD5**). MLD5, which amends the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**), was published on 5 July 2016 by the European Commission (**Commission**). The Commission's proposal has been examined by the Working Party on Financial Services in eight meetings during the Slovak Presidency. The compromise proposal of 20 December 2016 is the fifth and last one with a view to reaching an agreement regarding the Council's negotiating mandate.

The fifth Presidency compromise proposal amends the previous (fourth) one, which was published on 14 December 2016. The Council requires member states to ensure that their competent authorities supervise that the national provisions that transpose MLD5 are complied with and suggests that, as part of that supervision, appropriate and proportionate measures are taken to address serious failings that require immediate remedies. The measures must be temporary and terminated when the failings previously identified are addressed.

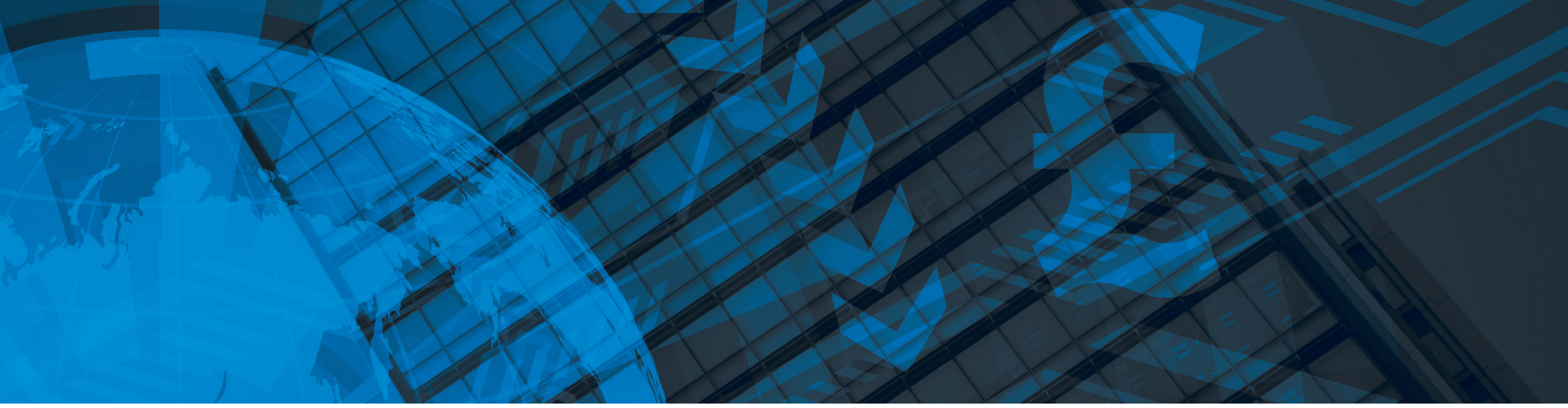
The Council suggests that member states introduce laws, regulations and administrative provisions necessary to comply with MLD5 by 26 June 2017. Within the 24 months following MLD5's entry into force, member states must have set up the beneficial ownership registers and put in place the necessary arrangements for the organisation of and access to the information necessary for the interconnection of all the registers. Within the 36 months following MLD5's entry into force, member states must put in place automated centralised mechanisms to allow the identification of any natural or legal persons holding or controlling payment accounts and bank accounts held by a credit institution within their territory. Within the 36 months following MLD5's entry into force, member states must introduce the necessary laws, regulations and administrative provisions to ensure that registers are interconnected via the European Central Platform established by Article 4a(1) of Directive 2009/101/EU.

COREPER agreement on the Council's negotiating mandate on MLD5

On 20 December 2016, the Council published a note from the General Secretariat to the Permanent Representative Committee (**COREPER**) with regards to its negotiating mandate on the proposed MLD5. Following the Council's fifth compromise proposal, as well as the Council Legal Service's opinion, the Presidency of the Council takes the view that the current compromise reflects the best possible balance and could be supported as the Council's negotiating mandate.

The Presidency suggests that the Permanent Representatives Committee:

- Agrees on the negotiating mandate with regard to the proposed MLD5 as set out in the fifth compromise proposal;
- Enters into its minutes the statements set out in Addendum to the note, including a declaration by Austria, a statement by Poland and a statement from the Republic of Slovenia. It should be noted that on 21 December 2016, the Council published an updated Addendum including a statement by France and Italy.
- Invites the incoming Maltese Presidency to pursue negotiations with the European Parliament (**the Parliament**) on the basis of the mandate with a view to reaching an agreement at first reading.



On 20 December 2016, the Council published a press release agreeing on the negotiation approach regarding MLD5 as suggested in the fifth Presidency compromise proposal.

ECON and LIBE draft report on MLD5

On 7 November 2016, the European Parliament (**Parliament**) published a draft report produced by the Committee on Economic and Monetary Affairs (**ECON**) and its Committee on Civil Liberties, Justice and Home Affairs (**LIBE**) on the proposed Fifth Money Laundering Directive (**MLD5**).

The legislative proposal for MLD5 was initially published on 5 July 2016 by the European Commission, and according to the Parliament's procedure file, ECON and LIBE are responsible for MLD5. The draft report, which was produced by rapporteurs Krišjānis Kariņš and Judith Sargentini, includes the Parliament's legislative resolution which sets out suggested amendments to the Commission's original MLD5 proposal.

The procedure file initially stated that a vote on the draft report would take place on 25 January 2017. However, this vote was postponed and eventually took place on 28 February 2017. On 28 February 2017, the Parliament published a press release stating that ECON and LIBE voted by 89 votes to adopt an amended version of their draft report on MLD5. ECON and LIBE also voted by 92 votes to enter into negotiations with the Council.

PROPOSAL FOR A COUNTERING MONEY LAUNDERING DIRECTIVE ISSUED BY THE EUROPEAN COMMISSION

On 21 December 2016, the European Commission (**Commission**) published a proposal for a Counter Money Laundering Directive. The proposal is part of the broader EU framework, and is aligned with the global fight against money laundering (**ML**) and terrorist financing and implements Recommendation 3 of the Financial Action Task Force (**FATF**). The proposed Directive follows the EU policy aims, including the fight against crimes affecting the EU's financial interests, the fight against drug trafficking, consumption and availability and combating criminal activities such as wildlife trafficking. It should be noted that, in accordance with Protocol 21 on the areas of freedom, security and justice, the United Kingdom may opt in to the proposed Directive either before or after its adoption.

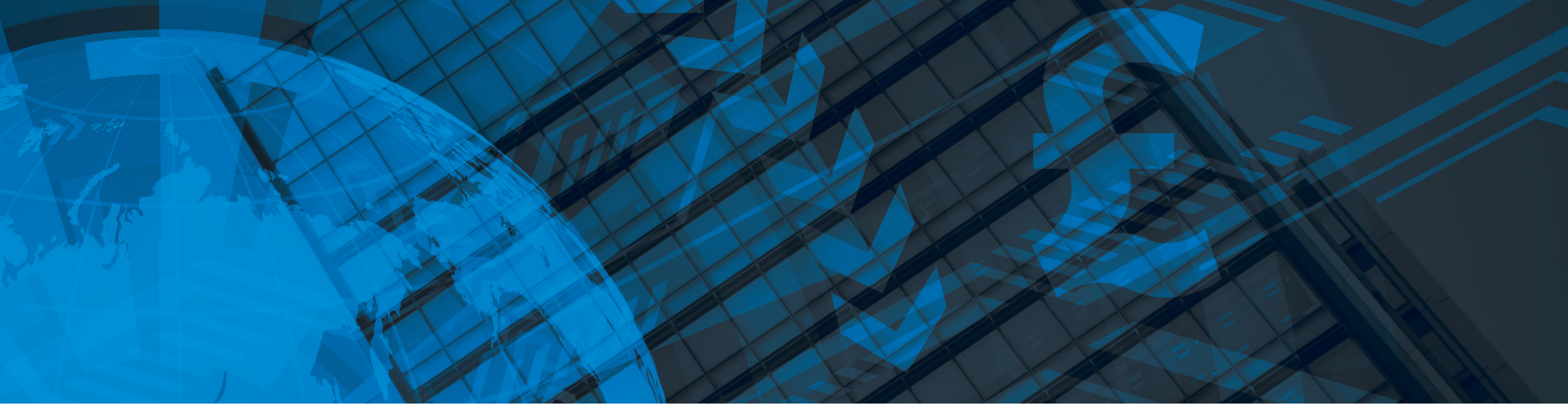
Context of the proposal

The Commission states that, following the recent terrorist attacks in Europe and considering that terrorist organisations need financing to support their operations, the EU needs to modernise its legislation, ensure uniform implementation and identify and address the existing gaps. The Commission also noted that cooperation and information sharing between the competent national authorities need to be improved and stated that existing instruments at the EU level are limited in scope. Moreover, differences in definitions, scope and applicable sanctions render the existing legislative framework neither comprehensive nor coherent enough.

The Commission takes the view that the introduction of minimum rules regarding the definition of the criminal offence of ML, the application of that definition to terrorist offences and the approximation of the sanctions involved will strengthen the existing criminal framework against ML across Europe. The Commission's proposal goes beyond both FATF recommendations and the Warsaw Convention of 2005 by establishing the minimum level of the maximum sanctions and criminalising self-laundering. Additionally, the list of predicate offences included in the proposal, is not restricted to the offences established by FATF and the Warsaw Convention, but also includes cybercrime and crimes where there is legislation at EU level.

Specific provisions of the proposed Directive

The proposal establishes minimum rules regarding the definition of criminal offences and sanctions in the area of ML offences (article 1). It also provides definitions for 'property' in line with EU 'acquis' and 'legal persons', as well as definitions of the term 'criminal activity' which is used to constitute predicate offences for money laundering (article 2). The list of criminal activities includes cyber-crime as a predicate offence. The proposal defines which offences should be considered as ML offences rendering the criminalisation of the acquisition, possession or use of the property derived from criminal activity obligatory (article 3). Member states are also required to criminalise self-laundering. Forms of aiding and abetting, inciting and attempting shall also be



criminalised by member states in order for the proposed Directive's provisions to be aligned with the definitions under international standards (article 4).

The proposal requires member states to apply effective, proportionate and dissuasive criminal penalties and also establishes the minimum level of the maximum sanctions (article 5). The proposal provides for aggravating circumstances (article 6) and requires member states to ensure the liability of legal persons, while excluding that such liability is alternative to that of natural persons (article 7). Both the liability and the sanctions applicable for legal persons follow a standard formula to be found in other EU instruments (article 8). The proposal requires the existence of competence bases for the judicial authorities which allow them to initiate investigation, pursue prosecutions and bring to judgment the offences (article 9). Investigative tools provided for under national law for organised crime or other serious crime cases may also be used in cases of ML (article 10).

DELAY OF MLD4 RTS CONFIRMED BY THE EUROPEAN SUPERVISORY AUTHORITIES

On 22 December 2016, the European Supervisory Authorities (**ESAs**), in their letter addressed to the European Commission, explained the reasons why the submission of the draft Regulatory Technical Standards (**RTS**) – as required under the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**) – will be delayed.

Under article 45 of MLD4, the ESAs (i.e. the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority) were required to submit the RTS on the measures that credit and financial institutions will be required to take in order to manage money laundering and terrorist financing risks where they have branches or majority-owned subsidiaries in third countries that prohibit the implementation of MLD4 consistent anti-money laundering and counter-terrorist financing measures by 26 December 2016. The ESAs decided to deprioritise this RTS because it was suggested by national competent authorities and the ESAs' stakeholder groups that there are no third countries that met the definition in article 45 of MLD4 and such RTS would therefore have limited application in practice.

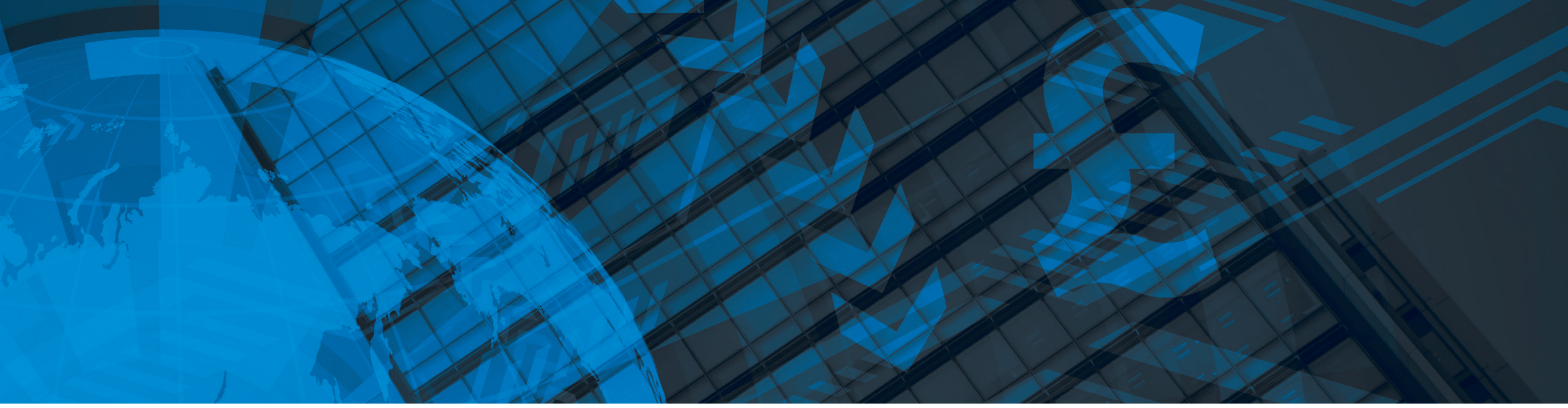
The ESAs noted that, if the amendments to article 45 of MLD4 are adopted, its scope will be extended to countries not currently captured. They also confirmed that they are ready to work on their mandate in 2017 and expect to submit the final draft RTS by 31 December 2017.

TRANSPARENCY INTERNATIONAL PUBLISHES REPORT ON PUBLIC DISCLOSURE OF AML STATISTICS

On 15 February 2017, Transparency International, a non-profit, non-governmental organisation dedicated to fighting corruption, published a report, Top Secret: Countries keep financial crime fighting data to themselves. In this report Transparency International recommended improvements to the public disclosure of anti-money laundering (**AML**) statistics by national authorities.

The report follows the analysis conducted by Transparency International on the public availability of AML data in 12 countries (including the UK, the US, France, Germany, Italy and Switzerland). Transparency International selected 20 data items relevant to AML enforcement (out of a total of 38 data items that were identified by the Financial Action Task Force (**FATF**) as indicators relevant to money laundering) and grouped them in five areas:

1. **International cooperation:** indicators include data on the number of AML-related mutual legal assistance (**MLA**) requests made, the average time to provide a response on the merits of MLA requests received and the average time taken to process extradition requests received.
2. **AML/CTF Supervision:** indicators include data on the number of on-site monitoring or analysis visits, the number of regulatory breaches identified, the total number of sanctions and other remedial actions applied and the value of financial penalties.
3. **Legal Persons and Arrangements:** indicators include data on beneficial ownership and on the average time taken to provide a requesting country with basic or beneficial ownership information.



4. **Financial Intelligence:** indicators include data on the number of suspicious transaction reports (**STRs**) and the value of transactions in STRs received.
5. **Anti-Money Laundering Legal System and Operations:** indicators include data on the number of criminal investigations, prosecutions and convictions for money laundering activities, the total number of sanctions imposed for money laundering offences, the value of proceeds of crime confiscated and the value of criminal assets seized or frozen.

Transparency International found that across all 12 countries, just 36 % of AML indicators are fully disclosed to the public and kept up-to-date.

Transparency International further found that where data was public, it was often provided by international AML bodies such as FATF, rather than by national authorities. Without FATF and its regional bodies including this data in their public evaluation and follow up reports, data availability would be reduced to just one in five indicators across all countries assessed.

Transparency International recommended that:

- financial supervisors collect and publish AML enforcement statistics on a yearly basis, in accordance with the list of indicators recommended by FATF;
- the requirement to publish yearly AML enforcement statistics should become a standard recommendation of international bodies including FATF and the G20. TI notes that the Fourth Money Laundering Directive ((EU) 2015/849) already includes a requirement for EU member states to publish AML statistics; and
- financial intelligence units should publish comprehensive AML statistics, in order to provide a solid basis for public monitoring of a country's AML efforts.

JOINT COMMITTEE OF ESAS PUBLISHES OPINION ON MONEY LAUNDERING AND TERRORIST FINANCING RISKS

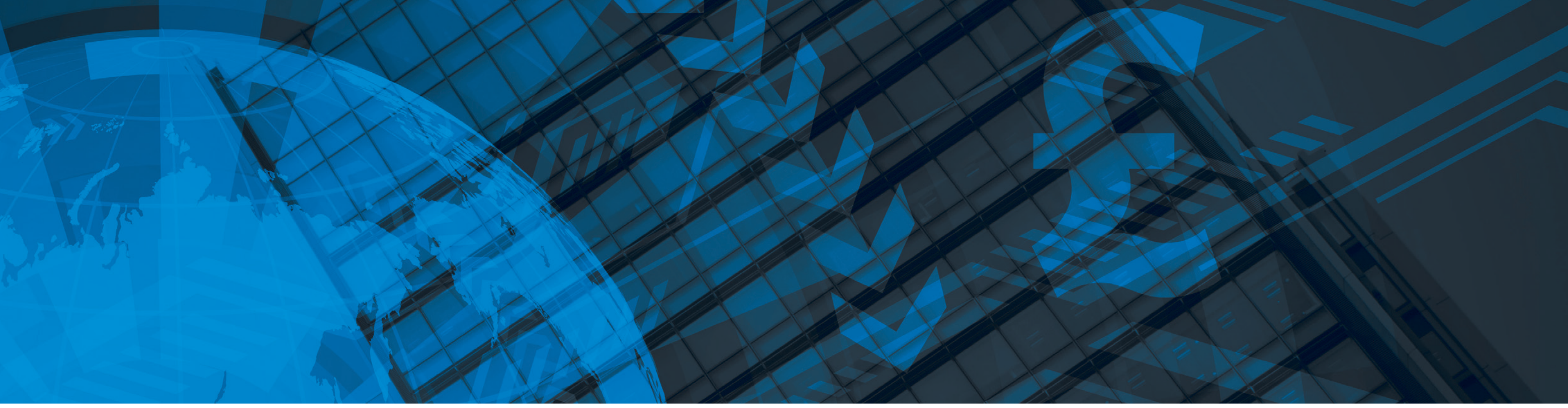
On 20 February 2017, the Joint Committee of the European Supervisory Authorities (**ESAs**), i.e. the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, issued a joint opinion addressed to the European Commission (**Commission**). According to article 6(5) of Directive (EU) 2015/849, another opinion will be issued by the ESAs in two years.

The opinion outlines the risks of money laundering and terrorist financing (**ML/TF**) which affect the European financial sector. These risks relate to the Commission's cross-border activities, the ESAs' work on fostering supervisory convergence, as well as a level playing field in the area of anti-money laundering and on countering terrorism financing (**AML/CTF**). The risks also relate to the application of the risk-based approach to AML/CTF supervision by the national competent authorities.

The ESAs focus on fostering effective and consistent regulation and oversight against AML/CTF, as well as coherent implementation of the relevant framework across the EU. In drafting this opinion, the ESAs considered the views expressed by the AML/CTF competent authorities and the responses to a self-assessment questionnaire. Competent authorities identified compliance issues with regard to the quality of firms' ML/TF risk assessments, the implementation of the AML/CTF policies and the payment institutions' oversight of agents and agent networks. Supervisory findings identified potential causes for these problems including the lack of prioritisation of AML/CTF issues by firms' senior management, the insufficient awareness and expertise due to inadequate training and the inadequate business-wide risk assessments.

According to ESAs' joint opinion, the effectiveness of a risk-based approach depends on a timely access to relevant information on ML/TF threats; a common understanding of ML/TF risk factors and of the steps required to identify and assess them; the availability of sufficient and suitably-qualified staff to make informed judgements on the level of the risk and its management; sufficient human and financial resources to ensure that policies and procedures designed to address these risks are adequate and implemented effectively; consistent interpretation of European law by national authorities; and a coherent approach to supervising and assessing the adequacy of firms' AML/CTF in an EU context.

ESAs take the view that ineffective AML/CTF systems and controls, differences in member states' approaches to AML/CTF regulation and oversight, lack of access to intelligence on terrorist suspects and high risk



transactions being driven underground give rise to risks for the European financial sector. The ESAs also noted that the value of the CTF controls lies in the post facto identification of terrorist networks. They also confirmed that the cost of compliance continues to be challenging for smaller firms. The ESAs noted that such cost may have led to some firms' withdrawal from offering services to higher-risk customers on the basis that they were not sufficiently profitable. As a result of derisking, these higher risk customers may have alternatively chosen to use informal payments channels avoiding AML/CTF controls and oversight.

The ESAs conclude that more needs to be done in order to ensure that the European defences against ML/TF are effective, particularly as member states move towards a more risk-based regime. Although certain initiatives are already underway, the ESAs take the view that:

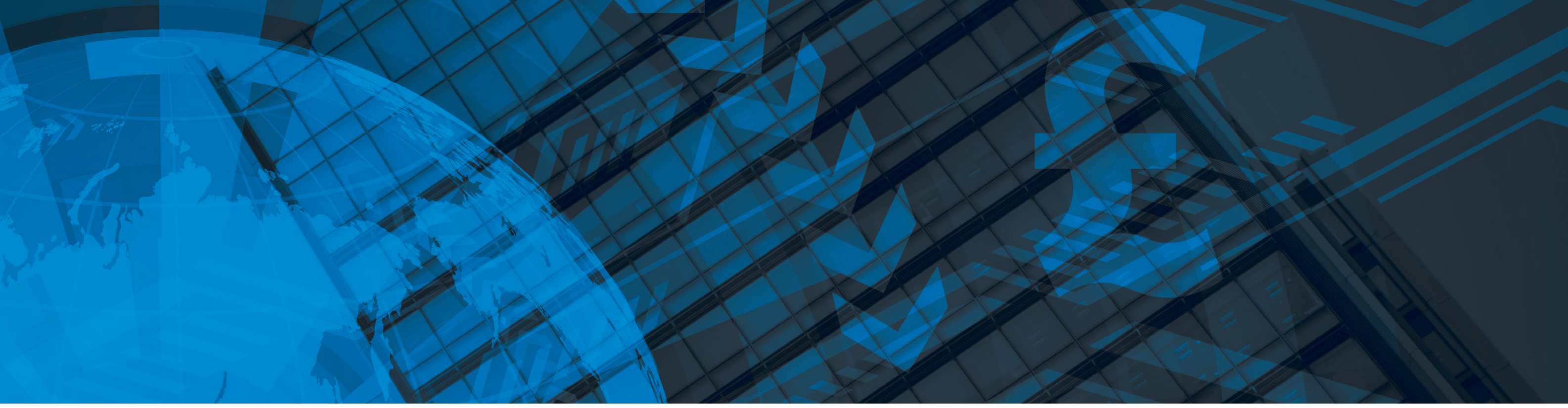
- Enforcement agencies must work more closely with firms to facilitate the identification of ML/TF risks and provide feedback on threats and typologies
- Enhanced steps should actively be taken to raise awareness of supervisory expectations
- AML/CTF supervisory data should be collected in a more consistent way to facilitate comparisons and track progress
- The Commission, EU legislators and the ESAs should give further thought to more efficient ways to consistently implement the European AML/CTF law and the ESAs' relevant guidelines.

EXTENSION OF SANCTIONS OVER ACTIONS AGAINST UKRAINE'S TERRITORIAL INTEGRITY

On 13 and 14 March 2017, the Council of the EU (**Council**) issued Council Implementing Regulation (EU) 2017/437and Council Decision 2017/445/CFSP respectively, prolonging the restrictive measures over actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine until 15 September 2017.

The restrictive measures, which include asset freezes and travel bans, were initially imposed in March 2014 and, having last been extended in September 2016, were due to end in 15 March 2017. The Council decided that the situation did not justify a change in the sanctions regime and therefore prolonged the measures for another six months until 15 September 2017. The list of sanctions was reviewed and updated and the restrictive measures now apply to 150 persons and 37 entities.

It should be noted that in response to the crisis in Ukraine, economic sanctions targeting specific sectors of the Russian economy are currently in place until 31 July 2017 and restrictive measures in response to the illegal annexation of Crimea and Sevastopol, limited to the territory of Crimea and Sevastopol, are currently in place until 23 June 2017.



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