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4MLD – a year in review

More than 12 months after the Fourth Anti-Money Laundering Directive was implemented in the United Kingdom, the current AML regime is acknowledged as woefully inadequate for the extent of the challenge. **Nicola Finnerty** provides an update of current problems and coming changes.

Lack of progress?

The economic crime inquiry currently being undertaken by the Treasury Committee was told in no uncertain terms about the scale of money laundering and the UK's commitment to fighting it. The National Crime Agency's director for prosperity command (covering economic crime) stated that "Money laundering is a facilitator of almost all serious, organised and major crime. Tackling it is absolutely a strategic priority for law enforcement for the UK, and that is agreed across policing, the National Crime Agency and all of the law enforcement agencies." [1] However, evidence given to the same committee prior to this by Transparency International and Global Witness gave a different picture. [2] They gave a scathing review of the UK's fight against economic crime and, in particular, money laundering. It was suggested that there is no sign that the scale of money laundering in the UK is diminishing and that many countries point the finger at the UK as being a facilitator of money laundering.

So why is this when the UK is, more often than not, the front runner in terms of implementing anti-money laundering legislation? Is it the case that despite the legislation we have in place, there is, as was suggested, a lack of awareness, data and resources, as well as deterrent in the form of accountability and enforcement?

The current regime – Fourth Anti-Money Laundering Directive

The implementation of the Fourth Anti-Money Laundering Directive (4MLD) in June 2017 marked a significant overhaul of the previous regime. The directive was intended to bring the UK into line with international standards (set by the Financial Action Task Force) on fighting money laundering in all its various guises. This directive was transposed into UK law by *The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* (MLR 2017). [3]

The regulations – overview

The regulations apply to most, if not all, financial institutions and designated non-financial businesses and professions who are considered 'gatekeepers' of the financial system (including accountants, some lawyers, estate agents, trust companies, casinos and high value dealers). In brief, the regulations stipulate that those who are subject to them must:

- **Conduct and document a risk assessment** in respect of their business and the risks it faces from money laundering and terrorist financing.
- **Adhere to significant customer due diligence (CDD) requirements** (including establishing and documenting beneficial ownership of corporates and trusts). Simplified due diligence will now only be permitted where a firm has individually assessed the relevant risks.
- **Enhanced due diligence (EDD) is now required in a wider range of circumstances**, including, for example, when dealing with persons or legal entities from a new list of 'high risk' countries; or when dealing with politically exposed persons (PEPs).
- **Policies and procedures must be in place and maintained to manage and mitigate the risk of money laundering**. Importantly, policies must be approved by a senior manager. The key features include: appointing a director to be responsible for compliance; establishing an independent audit function to examine and evaluate the controls; train relevant employees; and ensure controls are applied to subsidiaries and branches outside the UK.

Civil and criminal offences in the regulations

There are a number of criminal offences (some of which were in the previous 2007 Regulations, but some are new). For example, there is a new offence for failing to comply with the regulations. Individuals will be held accountable where "if in purported compliance" with obligations set out under the investigation and enforcement provisions (ie, compelled interviews) that individual not only makes a statement that they **know** to be false or misleading but where they **recklessly** make a statement that is false or misleading. If they do so they are committing an offence

that is punishable by a fine or up to two years' imprisonment. There are also civil offences that carry unlimited fines.

AML supervisors

Under the regulations (as under the predecessor 2007 Regulations) HM Treasury is responsible for appointing AML supervisors to police and enforcing the regulations. There are no fewer than 25 different supervisors. Three are statutory supervisors: HM Revenue & Customs, the Financial Conduct Authority and the Gambling Commission. The remaining 22 are professional associations, such as the Institute of Chartered Accountants in England and Wales as well as the Law Society of England and Wales.

Earlier this year, the Treasury set up a new body at the FCA, called the Office for Professional Body Anti-Money Laundering Supervision (OPBAS), [4] to act as a 'supervisor of supervisors' for the non-statutory AML supervisors. The aim is to raise the standards of AML supervision among the professional bodies.

Central register of beneficial ownership of legal entities

The 4MLD requires each European Union member to have a central register of beneficial owners for legal entities incorporated in that jurisdiction. This applies to companies and trusts.

- **Beneficial ownership register – corporates**
  A register of Persons with Significant Control (PSC Register) has been in existence at Companies House since June 2016 (Small Business, Enterprise and Employment Act 2015) and is publicly accessible. When a company is first registered and with each annual return it is required to state who the beneficial owners are. Beneficial owners are defined as individuals who exercise management control or who ultimately own or control more than 25 per cent of the voting share or rights.
- **Beneficial ownership register – trusts (articles 44 and 45 MLR 2017)**
  Trustees of an 'express trust' (where all trustees reside in the UK or the income is from a source in the UK or it has assets in the UK) must hold adequate, accurate and up to date information on beneficial owners including: settlors, trustees, protectors, beneficiaries, and any other natural person exercising ultimate control of the trust. HMRC maintains a register of the details of the beneficial owners as long as they incur UK tax liabilities. This register is only accessible to UK law enforcement agencies. This is to be amended by the Fifth Anti-Money Laundering Directive (see below).

Fifth Anti-Money Laundering Directive (5MLD)

The 5MLD amends the 4MLD. The changes are intended to fortify the current legislation as a result of the November 2015 Paris attacks, and subsequent incidences of terrorism in Europe, together with the release of the Panama Papers. The amendments address the money laundering risks presented by new technologies and more stringent beneficial ownership thresholds. This entered into force on 9 July 2018 and national governments are required to enact the changes into national law by 10 January 2020.

The amendments

- **Crypto currencies** – Virtual currency exchange platforms and custodian wallet providers are brought within the regulations;
- **Prepaid cards** – these are already covered by the 4MLD, however the limit for CDD exemption is €250. The threshold is to be lowered to €150. In addition, prepaid cards issued outside the EU will only be allowed for use in the EU if the place of issue has a compliance regime that is equivalent to the EU;
- **High risk countries** – there will be a prescriptive list of EDD for transactions to and from high risk countries;
- **Creation of centralised national bank and payment account registers** that can be accessed directly by financial investigators, which show the identity of holders and controllers of bank accounts and payment accounts;
- **Beneficial ownership** – the threshold of voting rights/shares when defining beneficial ownership is to be lowered from 25 per cent to 10 per cent in respect of some types of entities that present a specific risk of money laundering and/or tax evasion. These are referred to as 'passive non-financial entities', which are entities that have no economic activity. For example, those that are used as intermediaries and serve to distance the beneficial owners from the assets (it was considered that the 25 per cent threshold was easy to circumvent); and
- **Greater transparency in respect of trusts**: the definition of a trust is widened; registration of the beneficial ownership of a trust will be required in the member state in which a trust is administered; access to such information is expanded to include any person who can demonstrate a legitimate interest.

In the pipeline

It is worth noting that with the ink barely dry on the 5MLD, further amendments are under discussion at EU level. Unsurprisingly dubbed the Sixth Anti-Money Laundering Directive, proposals under this instrument seek to:

- establish minimum rules concerning the definition of criminal offences and sanctions relating to money laundering;
- remove obstacles to cross-border judicial and police cooperation by setting common provisions to improve the investigation of money laundering related offences; and
- bring EU rules in line with international obligations, in particular those arising from the Council of Europe

Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Warsaw Convention) and the relevant Financial Action Task Force (FATF) Recommendations.

Whether this and indeed the 5MLD will apply in the UK post-Brexit is up in the air as the transition arrangements and future relationship are far from certain. However, what is clear is that the UK will be under pressure to maintain standards and take action in this area, not retreat.

What is the criticism?

The UK clearly has a comprehensive armoury of AML so why is it the subject of such criticism? The problems appear to fall into the following categories:

Lack of accountability

It is argued that a lack of accountability means there is no deterrent to ensure compliance with AML rules. The following reasons are seen as factors in this apparent dearth of impetus or concern among those subject to the regulations:

a) **No prosecutions** – for breach of the regulations by either corporates or individuals. This is seen by many as a position of weakness and providing little deterrent for those who are slack with their systems and procedures. Part of the problem is the difficulty faced by prosecutors in prosecuting a corporate under the current legislation and so Transparency International has called for a strict liability offence of failure to have adequate AML procedures, similar to those offences in the Bribery Act and the Criminal Finances Act. This, it is argued, would have the same effect of making senior managers and boards more compliant and weed out wrongdoing within a firm. The Ministry of Justice has held a series of consultations on corporate liability for economic crime and while the Anti-Corruption Plan 2017-20 confirms the Government will "consider the findings of the Call For Evidence that in January 2017 proposed extending corporate criminal liability beyond bribery and tax evasion to wider economic crimes", no concrete progress has yet been made. This is and remains a source of frustration for the Serious Fraud Office. Rehearsing the view long-held by former SFO director David Green QC, interim director Mark Thompson told the Treasury Committee, "We have maintained that that is something where we are in favour of reform. Tackling companies is difficult."

b) **Low maximum sentences** – while there have been no prosecutions, there are some commentators who believe that in any event the punishments for the MLR offences are low. Even if prosecution was made easier against corporates, many would nonetheless see the reward as outweighing the risk. This of course does not take into account the reputational issues that can be devastating to a corporate.

c) **Lack of enforcement by regulators** – moreover those punishments that are levied are considered far too low for the scale of the problem. Until the recent FCA fine on Canara Bank, [5] the past five years has seen the FCA impose just seven regulatory fines on banks for money laundering, totalling £263 million. In comparison, over the period 2009 to 2015, the United States has imposed penalties for equivalent AML breaches of $5.2 billion. In addition, the recent supervision report for 2015-17 published by the Treasury in March 2018, [6] reveals that the number of professionals fined for money laundering in 2016-17 fell by 20 per cent compared with the previous year.

Register of beneficial owners

a) **UK companies – PSC Register at Companies House** – The UK was the first of the G20 countries to have a register of beneficial owners (some EU countries still don't have such registers). However, the PSC Register at Companies House is heavily criticised as ineffective because Companies House is a registry not a regulator and, as such, the data provided is not verified. [7]

Analysis of the data has identified that nearly one in ten UK companies (350,000) does not name a person of significant control. There is clear evidence of nominees being used, as research has revealed that five beneficial owners were found to control more than 6,000 companies. 7,000 companies have declared they are controlled by companies registered in overseas jurisdictions that do not share PSC information (again, this is prohibited by the rules). Companies House has the power to impose fines and a prison sentence of two years but to date there have been no such fines or criminal proceedings around beneficial ownership information.

b) **Beneficial ownership of companies in Crown Dependencies or Overseas Territories** – There are currently no reliable estimates of the scale of money laundering through companies incorporated in the Overseas Territories or Crown Dependencies. Part of the problem has been the anonymous nature of those companies and so it has been attractive to those seeking secrecy. For example, more than half of the companies exposed in the Panama Papers were registered in the British Virgin Islands.

On 1 May 2018, Parliament passed an amendment to the Sanctions and Anti-Money Laundering Bill requiring the UK to ensure that the Overseas Territories establish publicly accessible registers of the beneficial ownership of companies by 2020. This is seen as a massive step in the fight against money laundering. However, the bill does not extend to Crown Dependencies (ie, the Isle of Mann, Guernsey and Jersey).

UK property owned by overseas entities

The purchase of property through offshore companies still presents a significant money laundering risk to the UK. London's high-end property market has increasingly become a go-to destination for criminals. It has been reported that billions of pounds worth of property in England and Wales is owned by offshore companies. In 2017, that figure was estimated to be close to £170 billion. Of that figure, a portion is alleged to be the proceeds of crime; for example, the 2016 discussion paper by the Department for Business, Energy and Industry Strategy suggested that £135 million was under criminal investigation.

In 2015 the Government first stated its intention to set up a register of the beneficial ownership of all property owned by overseas entities. That register was supposed to be up-and-running in 2018. However, the Government's current timetable will not see the legislation passed until the summer of 2019, and the register will not come into effect until 2021.

In addition, there has historically been a perception of inertia by estate agents towards money laundering – for example, from October 2015 to March 2017, estate agents submitted just 0.12 per cent of Suspicious Activity Reports. Since the MLR 2017, estate agents have been required to conduct CDD on both the buyers and vendors of property. However, it remains to be seen if the sector has adapted accordingly by implementing their new due diligence requirements, especially in light of the concern over lack of accountability.

Other issues

a) **Lack of data** – The National Strategic Assessment of Serious and Organised Crime, published by the NCA in May, [8] states, "There is no reliable estimate of the total value of laundered funds that impacts on the UK." The obvious questions have been raised about how money laundering can be tackled when there is a lack of intelligence about how resources should be targeted.

b) **Quality of AML supervisors** – The recent Treasury supervision report referred to above has observed that there are discrepancies in the standard of enforcement and the effectiveness of some of the supervisors (for example, there has been criticism of HMRC as a supervisor because it supervises a wide number of areas that it has no specialist knowledge of, eg, art dealers). There is also no transparency about enforcement. The OPBAS is in its infancy but, again, a criticism is that it will only be responsible for supervising the non-statutory supervisors. The review of progress and effectiveness will not take place until June 2022.

c) **High end money laundering** – The NCA has highlighted that money laundering is more and more sophisticated – for example, the use of capital markets to facilitate high-end money laundering. However, there is a lack of awareness and knowledge among regulators as well as law enforcement agencies.

Conclusion

There is certainly a political will to stamp out money laundering in the UK (and globally) but with the UK being seen as having weak AML controls, it will continue to attract those who want to launder the proceeds of their wrongdoing. Until this changes the UK will remain a 'magnet'. The outstanding issues appear to centre around accountability and enforcement. Hence, it is anticipated that going forward the authorities (both criminal and regulatory) will seek to penalise both corporates and their senior executives properly for their role in money laundering. This will entail much larger fines and imprisonment. This, it is hoped, will have a deterrent effect on others and ensure that corporate governance across every industry is taken more seriously. So, compliance is ever more critical and must be top of the agenda for every business. To turn a blind eye is a high-risk option.

Notes

[1] *http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/economic-crime/oral/86570.html*.
[2] *http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/economic-crime/oral/83084.pdf*.
[3] *www.legislation.gov.uk/uksi/2017/692/pdfs/uksi_20170692_en.pdf*.
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[5] *www.fca.org.uk/news/press-releases/fca-fines-and-imposes-restriction-canara-bank-anti-money-laundering-systems-failings*.
[6] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685248/PU2146_AML_web.pdf*.
[7] *https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8259*.
[8] *http://nationalcrimeagency.gov.uk/publications/905-national-strategic-assessment-for-soc-2018/file*.

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