

The 4th EU Money Laundering Directive: key changes

The European Commission published the Fourth Money Laundering Directive and the new Wire Transfer Regulation, which if enacted will impact online financial service and payments services providers. Rachpal Thind and Kai Zhang, of Sidley Austin LLP, discuss the key changes proposed and what they mean for service providers within the context of customer due diligence requirements and cross-border operations.

On 5 February 2013, the European Commission adopted two legislative proposals for a new Money Laundering Directive¹ (the 'Fourth MLD') and a new Wire Transfer Regulation² (the 'New WTR'). Once passed into law, the Fourth MLD will repeal the current Money Laundering Directive³ (the 'Third MLD') and the New WTR will replace the existing Wire Transfer Regulation⁴ (the '2006 WTR').

The framework and requirements of the Fourth MLD are generally the same as what currently stands under the Third MLD, in that it is a minimum harmonisation directive⁵ requiring firms to maintain internal policies and procedures covering risk-based customer due diligence and transaction monitoring requirements, reporting of suspicious transactions, staff training and record keeping requirements. However, there are some areas in which the Fourth MLD has introduced new requirements and revised existing ones in an attempt to strengthen anti-money laundering ('AML') co-operation and harmonisation across the EU Member States.

Customer due diligence

A number of changes are being proposed to the customer due diligence requirements that will require firms to revisit their due diligence procedures. These are discussed in turn below:

Risk-based approach

The Fourth MLD enshrines the risk-based approach formed under the Third MLD, but also introduces a requirement for firms to have written assessments of their money laundering and terrorist financing risks, as well as processes for keeping the assessments up to date. The impact of this requirement should not be significant, given that firms will have generally undertaken this exercise in connection with their existing customer due diligence procedures. However, unlike the Third MLD, the Fourth MLD embodies guidance on the various risk variables that firms will need to consider. There will also be supplementary assessments of the risks affecting the internal market undertaken by the European Supervisory Authorities⁶ and national risk assessments by Member States that firms will need to build into their internal assessments. Although this process should provide firms with greater guidance going forward, it remains to be seen how firms operating on a cross-border basis will address diverging risks across the various countries they service.

Occasional transactions

There are proposals to reduce the threshold for occasional transactions that are exempt from the customer due diligence requirements from €15,000 to €7,500. Firms that have structured their products around the exemption will need to consider the implications of the proposals not just from a systems perspective

but also how the reduction in the threshold may impact the marketability of the relevant product lines.

Simplified due diligence ('SDD')

The Fourth MLD proposes to revise the structure of the SDD regime by replacing the circumstances in which (i) firms are exempt from undertaking due diligence; and (ii) Member States have the discretion to apply a derogation in respect of the due diligence requirements (as is the case with e-money products meeting specified value and redemption thresholds⁷) with guidance issued by Member States and the European Supervisory Authorities on low risk relationships that may be eligible for SDD. Going forward, firms will need to consider their customer relationships and transactions within the context of the guidelines and determine whether they qualify for SDD.

The Fourth MLD identifies a non-exhaustive list of factors that would point to low risk situations including transactions with listed companies and customers in lower risk geographical locations. However, the Fourth MLD does not provide any detail on the level of due diligence that will be required in such circumstances. The devil will be in the detail of the guidance provided by the European Supervisory Authorities.

Enhanced due diligence ('EDD')

Like the Third MLD, the Fourth MLD will specify the circumstances in which EDD will be mandatory and the measures that should be applied in those circumstances (e.g. transactions with politically exposed persons). However, a proposed amendment that will be of particular interest to firms providing online services is the removal of non face-to-face

transactions from the list. Whilst non face-to-face business relationships and transactions will still be identified as potentially high risk scenarios (and thus, firms will still need to consider whether a particular relationship or transaction requires EDD) they will not warrant mandatory EDD. This will provide firms with some flexibility as regards the level of due diligence required for their online customer base.

As will be the case with the SDD, firms will also be required to follow guidance issued by the Member States and the European Supervisory Authorities on the types of high risk factors (e.g. geography, customer type, delivery channel) that may give rise to EDD.

Reliance on third parties

As under the Third MLD, the Fourth MLD will continue to allow firms to rely on others for customer due diligence purposes in order to ease the burden of AML compliance. However, there will be a reversal in terms of the parties' obligations; currently under the Third MLD, the relying party is ultimately responsible for compliance, yet the Third MLD imposes (conflictingly) the relevant requirements on the third party. The Fourth MLD proposes to clarify this by requiring the relying party to ensure it obtains all the relevant information from the third party. The Fourth MLD will also permit groups to rely on the due diligence undertaken by other group companies in circumstances where the group policy follows either the Fourth MLD or equivalent rules.

The new WTR

The 2006 WTR (Wire Transfer Reports) impose requirements as to payer information that must accompany electronic transfers of

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money. Additional information requirements are being proposed under the new WTR that will require the payer's payment service provider to provide information in respect of both the payer and payee going forward. The scope of the new WTR will also be extended to include credit and debit card, mobile phones and other electronic devices when used to transfer funds.

Cross-border provisions

Currently, there are significant inconsistencies amongst the EU Member States in their implementation and application of the Third MLD with respect to firms providing services cross-border⁸.

The Fourth MLD proposes to reduce such inconsistencies by clarifying that branches or subsidiaries of firms in the host Member States will need to comply with the rules of the host Member States implementing the Fourth MLD⁹. Although it is not expressly provided for, this seems to suggest that firms providing services on a purely cross-border basis will only need to comply with their home Member States rules.

Timing

The European Commission is aiming for the European Parliament and the Council to adopt the Fourth MLD and the new WTR by the end of 2013. The European Supervisory Authorities will then need to issue various guidance and technical standards as required under the Fourth MLD within two years of the Directive coming into force¹⁰. This will consequently mean that there will be a large degree of uncertainty as to precisely what the Fourth MLD will and will not require of firms until the European Supervisory Authorities publish their guidance and technical standards.

A final thought

The Fourth MLD is proposing the introduction of a three-tier approach to risk assessment:

- the European Supervisory Authorities will assess risks faced by the European Union as a whole;
- each Member State will assess the risks faced at national level taking into account the assessment of European Supervisory Authorities; and
- individual firms will be required to assess their own risks taking into account their Member State assessments.

It remains to be seen whether such an approach will actually foster the convergence and harmonisation it anticipates across the EU Member States or whether it will just add to the current uncertainties and inconsistencies between the Member State AML regimes.

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1. <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013PC0045:EN:NOT>

2. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013PC0044:EN:NOT>

3. Directive 2005/60/EC.

4. (EC) No 1781/2006.

5. This will allow Member State discretion to impose stricter national provisions.

6. The European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority.

7. The Third MLD currently permits Member States to apply a derogation in respect of e-money products.

8. See the joint report of the European Supervisory Authorities published on 7 December at: https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/JC_2012_086__E-Money_Report_-_December_2012.pdf

9. Art. 45(4) of the Fourth MLD.

10. The New WTR being a regulation will be directly applicable in the Member States and thus will not need national implementation.