

Implement of the new Fifth Money Laundering

In this briefing note, we set out what we consider to be the key changes for regulated financial services firms.



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Implement of the new Fifth Money Laundering Directive

The EU's deadline for member states to transpose the majority of the Fifth Money Laundering Directive ("MLD5") into local law comes into effect today. Notwithstanding Brexit, the UK has adopted MLD5 which has been introduced as a follow up to its predecessor, MLD4.

MLD5 aims to tighten loop-holes that have enabled financial crime to seep through existing regulations by introducing further clarification to definitions and information gathering requirements.

The key objectives of MLD5 are to improve the transparency of information relating to ownership of different types of legal entity and their underlying assets, to better enable firms' to perform valuable due diligence on their customers and to progress macro efforts to disrupt the finances of money launderers, by hindering their capacity to raise and transfer funds. MLD5 will also facilitate greater cooperation between Financial Intelligence Units (FIUs). While the changes introduced are not significant to many firms, they could still be impactful.

In this briefing note, we set out what we consider to be the key changes for regulated financial services firms.

In most cases, Senior Managers at firms (and any outsourced third party providers that they use) will need to consider whether their existing Anti-Financial Crime (AFC) policies, procedures and controls need to be updated to ensure they have incorporated the requirements of the new Directive. The starting point for this needs to be consideration of both Enterprise-wide and Customer Risk Assessment frameworks. Training will also be required for staff on any relevant areas on MLD5 applicable to your business. Firms should carefully consider the changes, as while there may not be any direct impacts upon their systems and controls, the need may exist to incorporate changes as a result of MLD5 affecting their clients and therefore this could have implications for how your firms need to interact with certain client segments.

The changes fall into the following main categories:

1. Increased measures required in some circumstances when applying "Client Due Diligence" (CDD);
2. Expanded requirement for Enhanced Due Diligence (EDD) measures for:
 - a. Countries that are deemed 'high risk' by the European Commission (EC), and;
 - b. Politically Exposed Persons (PEPs);
3. Extension of European Anti-Money Laundering (AML) legislation to various entities that were previously out of scope. This includes (amongst others) entities such as providers of exchange services between virtual and standard currencies (i.e. cryptocurrency) and various types of trusts;
4. Increased transparency requirements to be met in respect of the beneficial ownership of firms / companies / certain trusts / bank accounts, and;
5. Changes to E-money thresholds for customer due diligence (CDD).



Key changes to note

1. CDD measures

As present identification and verification of customers must be based on documents, data or information from a reliable and independent source, there are a number of updated requirements to CDD as a result of MLD5:

1.1 Obtaining CDD where a customer is a corporate entity

When conducting due diligence on corporate entities, firms must now determine and verify to which legal jurisdiction(s) the corporate entity is subject by cross-checking with that jurisdiction's publicly available records, wherever possible. This may be complicated where the corporate entity operates in more than one jurisdiction in addition to its place of incorporation. This means that the corporate entity may be subject to the laws of more than one jurisdiction. Copies of proof of registration/incorporation from a home state company registry should confirm this information for firms when onboarding body corporates. The material change here is that under MLD4, the requirement was to take reasonable steps and this has been strengthened.

1.2 Understanding customers' business

Regulated firms need to understand their customers' business, their ownership structures and controlling interest. Under the MLD5, new evidential standards include:

- The full names of directors (or members of an equivalent management body) and senior persons responsible for the corporate entity to be obtained, checked and recorded.
- Where beneficial owners cannot be identified, firms must verify the identity of the senior person in the corporate entity and keep written records of these actions as part of the client onboarding record. This extends existing requirements to keep a written record of the steps taken to identify the beneficial owner and the option to treat the senior person in the entity as the beneficial owner.

1.3 Public registers

Under Regulation 30A, MLD5 imposes a requirement to obtain proof of registration where the legal entity is subject to UK company law or partnership registration requirements. Where a firm observes any discrepancy sourced from the applicable register, firms are now required to report any discrepancies to the OPBAS

(Office for Professional Body Anti-Money Laundering Supervision), which sits within the Financial Conduct Authority (FCA) and any discrepancies highlighted with the Persons of Significant Control (PSC) register must be reported directly to Companies House.

1.4 Refreshing CDD

MLD5 extends the requirement for CDD to be reviewed and kept up to date. As well as the existing risk-based trigger events for the review of CDD, new review scenarios include:

- When there is any legal duty on the firm to contact the customer for the purposes of reviewing that customer's relevant beneficial ownership information; or
- Where the firm has a duty under the International Tax Compliance Regulations for identifying new and pre-existing reportable offshore financial accounts for annual reporting, along with details of the account holder (including jurisdiction of tax residence).

1.5 Electronic identification

MLD5 specifically states that where available, firms should include electronic checks as means of identification, in addition to any manual reviews of more traditional identification and verification documentation. The standards on electronic identification processes set out in the Joint Money Laundering Steering Group (JMLSG) guidance and firms should refer to this guidance to ensure that they are in compliance with the standards expected under MLD5 relating to electronic verification checks.

2. EDD measures in high-risk third countries

To close the loop-hole on entities being 'established' in one jurisdiction but carrying out financial crime in another, MLD5 requires firms to not just consider the physical location of their customers (i.e. where they are 'established'), but also whether any of their connected business relationships "involve" high risk countries. Established high risk countries are defined by reference to the European Union (EU) list which confirms that "established" means being incorporated or having a principal place of business or principal regulator in that jurisdiction, or being resident in that jurisdiction if an individual.

The Treasury is currently consulting on the definition of "involvement" but firms should identify any existing

clients which have a connection or relationship with a high risk third country. Firms should review their existing customer risk assessments to ensure they include geographical risk factors relative to the nature of the business. Connections to consider may include:

- Whether there are relevant transactions between parties based in high-risk third countries;
- If the customer is the beneficiary of a life insurance policy;
- If the customer is a third-country national seeking residence rights or citizenship in exchange for transfers of capital, purchase of a property, governments bonds or investment in corporate entities;
- Any non-face to face business relationships or transactions without certain safeguards, for example, as set out in regulation 28 (19) concerning electronic identification processes;
- Any transactions related to oil, arms, precious metals, tobacco products, cultural artefacts, ivory or other items related to protected species, or archaeological, historical, cultural and religious significance, or of rare scientific value.

Where these connections indicate a potential higher risk connection, EDD should be applied and existing risk ratings and monitoring updated to reflect the connection and potentially increased risk.

3. EDD for Politically Exposed Persons (PEPs)

Although the current approach to PEPs remains unchanged, MLD5 introduces a new requirement for each member state and any international organisations accredited (such as regulatory bodies) to it to issue and keep up to date a list indicating the exact functions which qualify as prominent public functions. Firms have often relied on PEPs to self-report, given that their status is not always immediately evident, so firms' KYC procedures and controls should continue to request this information.

4. Extension of AML requirements to Crypto assets organisations and wider classes of Trust

4.1 Cryptoasset organisations

MLD5 also addresses financial crime issues raised by Cryptocurrencies and other electronic money products, such as custodian wallet providers and Crypto asset exchange providers, Peer to Peer providers, and Crypto ATMs. Entities providing these services will need to review their status and if necessary, apply to the FCA for registration.

On 15 April 2019, the UK government's Cryptoasset Taskforce, published its Consultation Paper on the transposition of the MLD5 into UK law. All of those firms who were subject to the Consultation Paper, as a result

of undertaking Cryptoasset related activities (as defined in the Consultation) should assume they must comply with The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR) from 10 January 2020, although the Treasury may decide to reduce or extend the range of activities they oversee when they issue their final policy statement.

The FCA Gateway opens for firms to submit applications for entry to the register today (10 January). However, there are a number of other key dates to consider when submitting an application:

- New Cryptoasset businesses that intend to carry on a Cryptoasset activity after 10 January 2020 must be registered before they can carry on the activity.
- Existing Cryptoasset businesses which were already carrying out Crypto asset activity before 10 January 2020 may continue their business, in compliance with MLR, but they must register by 10 January 2021 or stop all Crypto asset activity. The FCA will start supervising businesses under the MLR from 10 January 2020, irrespective of whether those businesses have registered or applied to be registered.

4.2 Inclusion of wider classes of Trusts

MLD5 makes it a requirement for any express / charitable trust to be registered on the Trust Registration Service (TRS). The Society of Trust and Estate Practitioners (STEP) estimates that the changes required by MLD5 will increase the number of registrable trusts from around 200,000 to two million.

Under MLD5, the following types of trust will apparently require registration on the TRS:

- A trust holding the family home;
- Discretionary trusts (including presumably pilot trusts), life interest trusts, charitable trusts, employee ownership trusts and even bare trusts;
- Non EU express trusts acquiring UK land or property either on or after 10 March 2020;
- Non-EEA express trusts entering a new business relationship with a UK entity on or after 10th March 2020; and
- Overseas and non-express trusts that are eligible for UK tax (whether or not they are express trusts or have UK trustees).

Key dates applicable to trusts are:

- For unregistered trusts in existence on 10 March 2020, the government proposes a deadline of 31 March 2021 for them to be registered on the TRS;

- For trusts created after 1 April 2020, the government proposes that the trust should be registered within 30 days of its creation.

The government is still consulting about aspects of the transposition of MLD5 in respect of trusts and in particular will consult further in relation to a proposed new penalty regime for late registration.

5. E-money thresholds for CDD

MLD5 amends Regulation 38 for electronic money (E-money). Firms can now only forego CDD measures in situations where:

- I. The maximum amount that can be stored electronically is reduced to €150 (previously €250)

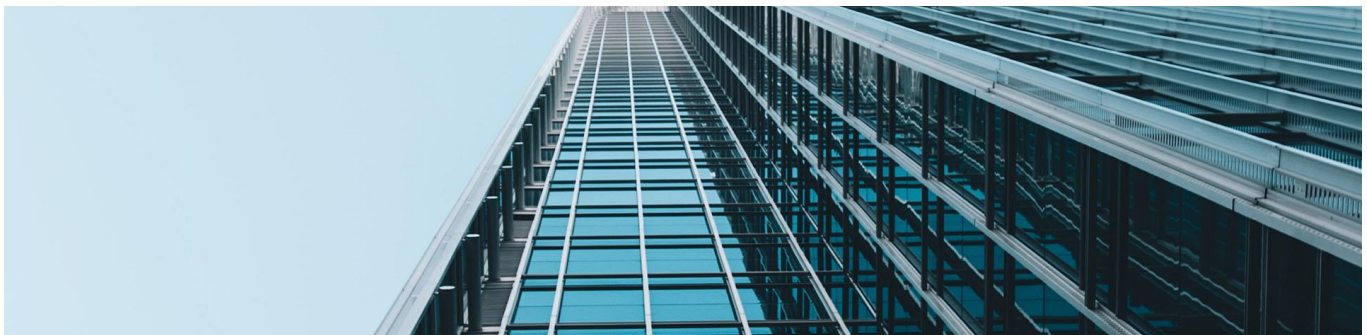
- II. The payment instrument used in connection with the electronic money (the relevant payment instrument) is not reloadable, or is subject to a maximum limit on monthly payment transactions of €150, which can only be used in the UK (previously €250)
- III. The relevant payment instrument is used exclusively to purchase goods or services
- IV. Anonymous electronic money cannot be used to fund the relevant payment instrument.

E-money firms should consider reviewing existing policies and procedures to reflect the changes in thresholds, including amending any threshold limits that are built into monitoring systems and controls.

Suggested action

1. All Firms should review their existing procedures and controls relating to CDD, to ensure that the new requirements and evidential standards are being met and also that CDD is being refreshed in line with the new requirements. Firms should also consider whether they need to review their existing procedures and controls to determine the criterion to use for the adoption of electronic identification verification methods, as per JMLSG guidance. This may also extend to considering whether firms have the technology and associated infrastructure to obtain and record electronic identification, or whether they need to plan to do so in the future.
2. Firms must ensure that they are undertaking the appropriate checks in respect of the jurisdiction from which their client's operate and able to evidence the increased requirements.
3. Firms must also ensure that public sources or information and registers are being checked more closely and that the sources of information consulted are being cross-referenced, with a new reporting mechanism adopted to report discrepancies to the relevant UK body.
4. Firms undertaking Crypto asset activity must ensure that they are undertaking the appropriate registration steps and implementing new systems and controls to comply with the MLR, and finally,
5. E-money providers should consider the new requirements and ensure that they are incorporating the restrictions accordingly and most importantly, that clients are made aware of the changes to payment instruments that they may use regularly.

Similarly, trustees should consider if they are now included within the TRS as a result of MLD5 requirements and ensure that they register to avoid financial penalties.



How we can help

We have assisted many firms with the implementation of previous Money Laundering Directives and continue to support firms with the implementation of MLD5 and preparations for MLD6. Our team have also lead a number of significant reviews and projects in respect of Anti-Financial Crime, including FCA Skilled Persons reviews.

Our services include providing insight in respect of firms' Enterprise-wide risk assessments, reviews of Client Risk assessments and Onboarding processes, re-drafting of policies and procedures, undertaking gap analysis and providing support in respect of implementing findings and solutions.

For more information on how MLD5 may impact on you, or any other AFC matters, please contact Andrew Jacobs or Charlie Baillie at DWF Regulatory Consulting.

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