MLD 4: publication of UK draft implementing regulations

On 15 March 2017, H.M. Treasury published its long-awaited consultation draft of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the Money Laundering Regulations 2017), the legislation that will implement the EU Fourth Money Laundering Directive (MLD 4) into UK law as from 26 June 2017.

The draft regulations are now open for consultation, but for four weeks only - the Treasury has called for responses by 11.45 p.m. on Wednesday 12 April 2017 at the latest. In this briefing note we focus on some of the key headline changes for firms.

GREATER EMPHASIS ON RISK ASSESSMENT

Firms must carry out a business wide risk assessment of AML/CFT risks, taking into account risk factors (including prescribed risks published by the European Supervisory Authorities (ESAs)). This must take into account the size and nature of their business. Firms will be required to make a written record of the risk assessment and make it available to their

THE HEADLINES

- Firms need to conduct a **business-wide risk assessment**, which must be made available to their supervisory authority on request
- The concept of **"automatic" simplified due diligence is discontinued** – risk factors must be used to determine whether a customer is lower risk
- The concept of **"equivalent jurisdictions" is discontinued**
- CDD includes an express requirement to **identify and verify customer representatives**
- More prescription around when a circumstance is **higher risk requiring enhanced due diligence**
- **Data protection notices** must be sent to customers which are individuals
- **Personal data** collected as part of CDD must be deleted after a prescribed period
- The implementation of **group wide AML/CFT policies** may be required

supervisory authority (e.g. the FCA) on request. The only exception to this record keeping requirement will be if the supervisory authority has notified that such a record is not required in the case of the sector in which the firm operates, because the risks of money laundering and terrorist financing are clear and understood in that sector.

NO "AUTOMATIC" SIMPLIFIED DUE DILIGENCE

The Money Laundering Regulations 2017 will revoke and replace the current Money Laundering Regulations 2007 (the MLRs). Under the existing MLRs firms may automatically disapply customer due diligence measures in certain specified circumstances (provided there are no indications of higher risk). The Money Laundering Regulations 2017 remove "automatic" SDD. Instead they require firms to *assess* whether a business relationship or transaction presents a lower degree of risk, taking into account at least a number of risk factors specified in the Money Laundering Regulations 2017 (as derived from Annex II, MLD 4) and in the ESAs' Risk Factor Guidelines. For example:

- In terms of *customer* risk factors, these include whether the customer is a credit institution or financial institution which is subject to MLD 4, or a company whose securities are listed on a regulated market.

- In terms of *geographical* risk factors, these include whether an individual customer is resident in a geographical area of lower risk. Examples include an EEA state or a third country which has effective systems to counter money laundering and terrorist financing or which is identified by credible sources as having a low level of corruption or other criminal activity or AML/CFT requirements consistent with FATF recommendations.

IDENTIFICATION AND VERIFICATION OF SIGNATORIES

There is a new, express requirement for the firm to verify that any person purporting to act on behalf of a customer, such as a signatory, is duly authorised to act as such and to identify and verify the identity of that person. The way in which the firm complies with this particular requirement must reflect its overall risk assessment and the risk faced in a particular case.

NO "EQUIVALENT JURISDICTIONS" - HIGH-RISK THIRD COUNTRIES

The concept of "equivalent jurisdictions" no longer exists and firms will not be able to make any presumption of equivalence. The European Commission will now publish, from time to time, a "black list" of "high-risk third countries" (the current version is here). Firms will be required to apply enhanced due diligence in relation to any transaction or business relationship with a person established in a high-risk jurisdiction. They will also be banned from relying on CDD checks performed by any third party established in such a jurisdiction.

ENHANCED DUE DILIGENCE

In addition to mandatory EDD measures in respect of persons established in high-risk third countries, firms will, as now, be required to apply EDD measures and enhanced monitoring in relation to correspondent relationships, PEPs or potential PEPs, any case where a transaction is complex and unusually large or there is an unusual pattern of transactions and there is no apparent legal or economic purpose behind the transaction(s), and in any other case which by its nature can present a higher risk of money laundering and terrorist financing. EDD is also mandatory under the Money Laundering Regulations 2017 in any case where the customer has provided false or stolen identification documentation or information.

The general assessment as to whether there is a higher risk of money laundering must take account of at least those risk factors referred to in the Money Laundering Regulations 2017 and the ESAs' Risk Factors Guidelines.

BENEFICIAL OWNERS - TRUSTS

The beneficial owner provisions of the Money Laundering Regulations 2017 are broadly the same as under the MLRs, except that there are now more detailed provisions defining the beneficial owners of a trust. In addition to the class of persons in whose main interest the trust is set up or operated (the beneficiaries), the settlor, the trustees and any individual who has "control" over the trust (a term that is further defined) will be beneficial owners.

SENIOR MANAGEMENT PEP APPROVAL

Senior management approval (subject to the FCA guidance on lower-risk situations) is required not only for the establishment of a relationship with a PEP, but for any continuation of that relationship. Firms will need to set out in their procedures which situations will require renewed approval from senior management as part of a continuing relationship.

DOMESTIC AND OTHER PEPS

MLD 4 extends the definition of PEP to include *domestic* PEPs. Aside from domestic PEPs, the definition of "PEP" has been expanded under the Money Laundering Regulations 2017 to include members of governing bodies of political parties and the directors, deputy directors and members of the board or equivalent function of an "international organisation".

DATA PROTECTION: NOTICES TO NEW CUSTOMERS

Firms are required to send a data protection/information notice to all new "customers" that are individuals, stating that any personal data received from the customer will be processed only for the purposes of preventing money laundering and terrorist financing (or for some other use to which the data subject agrees).

"REFRESHING" CDD: EXISTING CUSTOMERS

Firms must re-apply CDD measures on a risk sensitive basis and where they become aware that the customer's circumstances have changed. The firm must take into account any indication that the identity of the customer (or of the underlying beneficial owner) has changed, any transactions which are not reasonably consistent with the firm's knowledge of the customer, any change in the purpose and intended nature of the firm's relationship with the customer and any other matter which might affect the assessment of the risk.

INTERNAL CONTROLS

Where appropriate with regard to the size and nature of its business, a firm must:

- appoint a member of the board or management body to be responsible for the firm's compliance with the Money Laundering Regulations 2017;
- carry out screening of employees and other persons which carry out work relevant to the firm's compliance with the Money Laundering Regulations 2017 and/or its AML/CFT procedures; and
- establish an independent audit function to assess the adequacy of the firm's AML/CFT policies and procedures, to make recommendations and to monitor compliance.

These requirements are subject to proportionality: the size and nature of the firm's business may not justify all (or any) of these measures.

GROUPS

Firms which are parent undertakings will be required to apply their policies, controls and procedures to all subsidiary undertakings and non-UK branches which carry out any activity in respect of which the firm is subject to the Money Laundering Regulations 2017. In such a situation, the firm will also be required to establish and maintain through its group policies, controls and procedures for data protection and the sharing of information among members of the group for the purposes of preventing money laundering and terrorist financing.

RECORD RETENTION AND DELETION OF DATA

Firms will be required to retain records of CDD documents and supporting evidence for at least five years after the end of the business relationship or occasional transaction. At the end of five years, firms will be required to delete personal data, unless the relevant data subject has given express consent to the retention of that data or the firm is otherwise required to retain the personal data records in accordance with any enactment or for the purposes of court proceedings. Firms will need to amend their systems and procedures to ensure that, unless an exemption applies, such personal data is duly deleted.

TRAINING

Existing training procedures will need to be enhanced to take account of the changes introduced by the Money Laundering Regulations 2017.

WHAT ARE WE STILL WAITING FOR?

The publication of the draft Money Laundering Regulations 2017 enables firms to make their final preparations in earnest to ensure compliance by 26 June 2017. However, even at this late stage it should be noted that we are still awaiting the publication of some key documents which will be highly relevant and which should be taken into account as soon as they are available:

- **ESA Risk Factor Guidelines**: the European Supervisory Authorities are due to publish their final Risk Factor Guidelines shortly. These will include guidance on simplified due diligence and enhanced due diligence and the factors firms should consider when assessing the money laundering and terrorist financing risks associated with customers. It is possible that the JMLSG will incorporate the Risk Factor Guidelines into its 2017 revisions of the JMLSG Guidance Notes (see below).

- **JMLSG Guidance Notes and other sectoral guidance**: a revised version of the JMLSG Guidance Notes is expected. It is thought this will include revisions to Part I and at least to some of the sectoral guidance in Part II. In its response to the consultation on the anti-money laundering supervisory regime published on 16 March 2017, H.M. Treasury said that it will work with a reformed Money Laundering Advisory Committee to approve *one piece of AML guidance for each sector*. This will be complemented by the JMLSG Guidance and the FCA's Financial Crime Guide.

HOW WE CAN HELP

We are working with a number of our clients to update their AML/CFT and financial crime documentation to comply with the new requirements (including their policies and procedures, descriptions of the law, KYC materials, template MLRO reports, reporting procedures and the content of their training programmes). If you would like advice or assistance with the review and redrafting of your documentation, please contact any one of the partners below, or your usual Travers Smith contact.

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