13th June 2012

Report to the European Parliament and to the Council on the application of the Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

UK Comments

The following are the UK's comments in response to the European Commission's application report of April 2012 on the revision of the 3rd Money Laundering Directive ('the Directive').

The UK Government considers it important that the Directive aligns as closely as possible with the revised Financial Action Task Force (FATF) standards and encourages consistency with them.

Applying a risk-based approach

The Commission is considering how the risk-based approach could be incorporated into the Directive and, in particular, whether there is opportunity for greater harmonisation of Member States' (MS) application of the approach.

Central to the revised FATF standards is the principle of the risk-based approach, which remains the most effective way to combat money-laundering and terrorist financing. It is, therefore, essential for the Directive to provide sufficient flexibility for MS to adopt a risk-based approach at national level.

The UK's experience and studies by Deloitte and the Anti Money Laundering Committee (AMLC) show that gaps in Europe's anti money laundering (AML) and counter terrorist financing (CFT) defences are not the result of minimum harmonisation and associated levels of national discretion, but instead of legal uncertainty in relation to some of the Directive's key provisions. Additionally, while the UK Government agrees that wire transfers regulations could remain in a regulation, the marked differences in MS' transposition of this demonstrates that great legislative harmonisation does not necessarily correlate with equal implementation. In line with the revised FATF Recommendations, the UK Government, therefore, supports the introduction of an even stronger emphasis on the risk-based approach.

Furthermore, the UK Government does not consider it appropriate for any additional elements of the Directive to be transposed into a regulation. It believes that most value will be derived from maintaining a minimum harmonisation directive, while providing better legal clarity of some of the key terms. This would ensure MS have a more thorough understanding of the requirements and continue to be able to apply them in a risk-based, proportionate way.

National /supranational risk assessments

Given the introduction of FATF's recommendation 1, which requires countries to carry out risk assessments, the Commission has proposed the idea of a supranational risk assessment at EU level.

The UK Government supports the proposed introduction of requirements on MS to carry out risk assessments in line with the new FATF recommendation. The UK Government believes the focus of the Directive should remain on the development of risk assessments at the national level rather than the supranational level. In line with the upcoming FATF guidance, and to be conducive to the production of meaningful risk assessments, there should not be a prescribed common methodology. Instead, this new requirement should afford MS the flexibility to carry out risk assessments in the way most suited to their national circumstances, taking into account existing sources of information and data.

The UK Government believes there could be some benefit in MS sharing their national risk assessments, but does not believe that a supranational risk assessment would be desirable or beneficial. Exposure to financial crime risk and the prevalence of certain types of financial crime is fundamentally different in MS across the EU. It is, therefore, likely that a supranational risk assessment - even if it covered one sector only - would be either too specific for some MS or too high-level to be meaningful for others. For the same reason, a supranational assessment of the risk associated with, for example, payment and e-money institutions is unlikely to produce the desired results.

Criminalisation

The Commission is considering amending the definition of "all serious crimes" in the Directive. The UK adopts an all crimes approach which the UK Government strongly believes provides the best defence against money laundering and terrorist financing. This approach minimises the burden on businesses because it does not require them to determine whether their suspicion of illicit activity is a result of a particular crime. While the UK Government would not oppose changing the language of the Directive to replace 'prohibit' with 'criminalise', it does not think further elaboration of what this means is required or would be helpful.

Real estate/letting agents

It has been proposed that the Directive should include in its scope letting agents as well as estate agents. The UK Government agrees with this proposal. The definition of 'letting agent' needs to ensure that the focus is on legal persons and excludes individuals who informally rent space.

Customer Due Diligence (CDD)

The Commission is proposing a range of clarifications to the CDD requirements, as well as a more harmonised approach to customer identification which could include prescribing a list of EU-wide identification documents MS should use.

CDD is a key component of firms' AML/CFT risk management. It is important, and in line with the FATF's revised Recommendations, that any revision to the Directive leaves sufficient scope for MS and their institutions to decide on the appropriate level of CDD on a risk-sensitive basis. Greater levels of prescription than those currently found in the Directive risk undermining the risk-based approach and may lead to the blanket application of CDD measures, irrespective of the level of risk associated with a situation.
The UK Government, therefore, strongly opposes the introduction of an EU-wide list of

acceptable identification documents, in particular in relation to personal customers. The UK Government believes this is against the risk-based approach; it fails to take account of the technology and documentation available in different MS; and it risks financially excluding those customers who are unable to produce standard forms of identity.

The UK Government also believes that a move to less prescriptive enhanced due diligence (EDD) provisions would be beneficial, in particular in relation to customers who are not physically present for identification purposes. Consideration should be given to re-drafting the EDD requirement in line with the first part of Art 13(1), the Directive: '*Member States shall require the institutions and persons covered by this Directive to apply, on a risk-sensitive basis, enhanced customer due diligence measures, in addition to the measures referred to in Articles 7, 8 and 9(6), in situations which by their nature can present a higher risk of money laundering or terrorist financing'.*

Finally, the UK Government welcomes the Commission's proposal to improve the clarity of simplified due diligence (SDD) measures. The UK Government considers that it would be against the risk-based approach for the Directive to prescribe specific cases in which SDD can apply, or prescribe exactly which risk factors firms must consider when determining whether SDD is appropriate. Instead, the Directive should make clear that each firm has to decide, based on its assessment of the risk associated with a situation, whether SDD would be appropriate and it should clarify the distinction between simplified due diligence and a full exemption from CDD.

Politically Exposed Persons (PEPs)

The Commission is proposing to clarify the Directive to ensure it reflects the changes FATF has made with regard to PEP requirements. The UK Government supports this proposal. It does not, however, believe the adoption of 'supporting measures', such as a narrowing of the (deliberately wide) PEP definition or the creation of PEP lists, would be valuable. Such measures would discourage firms from properly considering the risks associated with a customer or beneficial owner and from taking risk-sensitive steps to determine whether a customer or beneficial owner is a PEP. Additionally, the UK Government does not believe that prescribing a one year cut off by which a PEP is no longer considered a PEP is appropriate. In practice, the risk of a PEP laundering money is unlikely to decrease substantially after one year. Furthermore, to place obligatory time frames on PEPs measures would contradict the risk-based approach.

Beneficial Ownership

FATF requires beneficial ownership information to be identified in a number of areas. The UK Government supports the proposed revision of the Directive's beneficial ownership requirements to provide greater legal certainty across the EU about who the beneficial owner is while maintaining a risk-based approach to identifying, and verifying the identity of, beneficial owners. This includes firms taking reasonable and risk-sensitive steps to understand the customer's ownership and control structure.

On the 25 % threshold: the EU has already determined a 25% threshold of ownership or voting rights as a sufficient threshold to regard a person as a beneficial owner for AML/CFT purposes. The UK Government considers that this threshold should remain at 25% and should continue to be indicative rather than absolute.

The revised FATF recommendations set out a range of options countries can adopt with regard to the identification of beneficial ownership. The UK Government believes the Directive should be consistent with the FATF with regard to this and, therefore, set out the same range of measures. The UK Government believes that the Directive should not prescribe that any one of the measures is more preferred than the other.

Of key importance regarding beneficial ownership is the identification of legal ownership. The UK Government would consider it valuable for the Directive to require MS to have a registry of legal ownership which would not be burdensome to MS but which would add great value.

Financial agents

The UK Government views with concern the suggestion to bring financial agents directly within scope of AML/CFT legislation and regulation. Financial agents provide financial services on behalf of a regulated financial institution, which is ultimately responsible for anything the agent does or does not do on its behalf. The UK Government believes this is a proportionate and effective approach, which does not need to be reviewed. The benefit of bringing financial agents directly within the scope of AML/CFT legislation would have to be balanced against the significant cost this change would impose on industry and regulators. The UK Government does, however, strongly encourage the Commission to clarify the application of AML/CFT obligations to agents and e-money distributors in a cross-border context.

Supervision

The Commission is considering providing further clarification in the Directive regarding supervision in cross border situations.

The UK Government welcomes the proposed clarification of the regulatory powers which home and host AML supervisors have in cross-border situations. The UK Government urges the Commission to consider these with regard to payment and e-money institutions, their agents and, where applicable, their distributors.

The UK Government is open to considering a possible role for the AMLC in providing guidance to financial services supervisors on supervisors' adoption of the risk-based approach. Additionally, the AMLC could provide guidance to supervisors on their supervision of financial institutions' adoption of the approach.

Sanctions

The Commission is proposing greater harmonisation of MS' administrative sanctions regimes.

Financial penalties and other administrative sanctions are very important regulatory tools. They play a central role in the UK financial services regulator's pursuit of market confidence and deterrence of financial crime, which includes money-laundering, sanctions breaches and terrorist financing. For administrative sanctions to be effective, any penalty imposed should not only adequately penalise the wrongdoing but also deter others from committing further or similar breaches; yet a lack of severity in the

sanctioning powers of some Competent Authorities may encourage regulatory arbitrage and risk undermining the EU regulatory regime.

The UK Government believes it would valuable for all MS to have the legal basis to apply countermeasures if they consider it appropriate to do so. However, the Directive should not prescribe to MS what, if any, countermeasures are applied. Instead, each MS should retain the ability to apply countermeasures they consider most appropriate given the specific risks they face from a particular jurisdiction. Prescription of the countermeasures at EU level would greatly undermine the risk-based approach and would grant excessive decision-making power to the International Co-operation Review Group (ICRG) since it decides which jurisdictions are placed on the Public Statement.

Third Country Equivalence

The EU Common Understanding on Third Country Equivalence ('the Equivalence List') lists third countries which MS consider to have AML/CFT regimes which are as equally stringent as those of MS. As a result, lighter measures can be applied to institutions from those listed countries.

The UK Government does not consider the Equivalence List to add value to MS' implementation of AML/CFT measures. Financial institutions often use the Equivalence List as a short cut to applying SDD instead of assessing the risks presented to them by a new potential business relationship. Additionally, the Equivalence List has increasingly become perceived as a political mechanism. The UK Government, therefore, considers it appropriate for the Equivalence List to be discontinued. The UK Government also does not consider it appropriate for a separate 'black listing' process to be developed at EU level; any listing of countries should only be in the form of the FATF Public Statement (which could be endorsed, but not added to, at EU level).

Data protection

The Commission is considering introducing clearer rules on the handling of data and greater data protection provisions.

Consideration of the need to protect personal data is important in the AML/CFT context. The revision of the Directive provides the Commission with the opportunity to bring greater clarity to the interaction between AML/CFT legislation and data protection obligations. However, the UK Government views with concern the proposed inclusion of more detailed data protection provisions. Greater levels of prescription do not equal a more effective data protection regime and little would be gained from duplicating, in a revised Directive, provisions that are already found elsewhere in EC legislation. An approach which acknowledges the importance of protecting personal data but allows the flexibility to adopt a risk-based and proportionate AML/CFT regime would produce the best results.

Reliance

In Article 18, the Directive imposes an obligation on relied upon third parties to forward, on request, relevant copies and documentation of customer identification to the relying firm. This means that the third party will have to consent to being relied upon and retain relevant information for a period of at least five years. This timeframe

commences on the date of the information being shared. The UK Money Laundering Regulations makes this clear. A similar clarification could be considered at EU level.

The UK Government views with some concern the suggestion that consideration could be given to how Article 18 might be expected to operate when banking secrecy legislation in the third party's jurisdiction makes compliance with the requirements of Article 18 difficult or impossible. The Directive sets out conditions for reliance, which are important safeguards. Where these are not met, reliance must not take place.

Self-regulatory bodies

The Commission is considering allowing self-regulatory bodies to provide guidance to their sectors regarding AML compliance and reporting, in line with the FATF standards. It has also been proposed that the Directive extends self-regulation to the real estate sector.

The UK Government believes that self-regulatory bodies are a valuable element of AML regime and can provide useful guidance or indeed endorse guidance written by others. It also considers it appropriate for the real estate sector to assume self-regulatory responsibilities.

Definition of a 'transaction'

It has been proposed that the definition of 'transaction' be amended. The UK Government would caution against restricting the definition of those involved in a transaction to those that physically handle cash. One example of this is the activity of estate agents. Estate agents do not routinely handle cash but are party to the transaction and are best placed to identify the customer and any suspicious activity. This is because they have a face-to-face relationship with the customer and understand the business. For example, red flags such as the customer offering more than market value for a property, wishing to buy it without seeing it, or buying and selling in quick succession may not be picked up by banks and lawyers, despite it being they who are more involved in handling cash than the estate agents.

The UK Government also considers the FATF definition to cover more than just those handling monies and, therefore, it would be appropriate for the definition in Directive to cover the same range of activity.

Pooled accounts

The UK Government understands that pooled accounts (accounts which hold funds from multiple investors) present challenges for both solicitors and banks. Solicitors consider there to be a conflict between the information required to identify beneficial owners and issues of client confidentiality. The UK Government is happy for this issue to be explored further and at this time reserves judgement about whether any change to the Directive is necessary.

Group-wide AML policies

The UK Government supports the introduction of a requirement for financial groups to implement group-wide AML/CFT programmes. However, the UK Government calls on the Commission to consider the impact of data protection rules on the sharing of CDD

information between members of the same group before the drafting of the new requirement is finalised.

Thresholds

The UK Government strongly supports consistency with the FATF recommendations and, therefore, believes that the current EUR1,000 threshold for wire transfers, below which information is included but not verified, should be maintained. The UK Government would not support the removal of this threshold.

The UK Government also considers that consistency with the FATF recommendations should be maintained regarding thresholds for CDD implemented by casinos. Therefore, it suggests that the Directive should increase the threshold from the current EUR2,000 to be in line with FATF's EUR3,000.

Financial Intelligence Unit (FIU) Co-operation

It has been proposed that measures could be taken to improve co-operation between national FIUs and the UK Government agrees that co-operation of FIUs across the EU is important. However, it does not believe that the Directive should go beyond the international standards regarding international co-operation by calling for harmonisation. It is unclear what value a harmonised FIU process would add and how national FIU systems would interact with it. The UK Government, therefore, believes that the revised FATF standards are sufficient in requiring effective international co-operation and information sharing.