DLA PIPER

AUTUMN 2017

AML BULLETIN

Regulatory News Update from DLA Piper

CONTENTS

INTRODUCTION

DLA Piper's Financial Services Regulatory team welcomes you to the Autumn 2017 edition of our Anti-Money Laundering (AML) Bulletin.

In this issue, we provide updates on AML developments in the UK and internationally. This issue includes an update on the Money Laundering Regulations 2017, the FCA consultation on the new office for Professional Anti-money Laundering Supervision and the FCA anti-money laundering annual report for 2016/17. We also look at the European Commission's report on the assessment of the risks of money laundering and terrorist finance affecting the internal market and cross-border activity.

We hope that you find this update helpful. Your feedback is important to us, therefore if you have any comments or would like further information, please contact one of our specialists listed at the end of the Bulletin.

UK NEWS & ENFORCEMENT ACTION

MONEY LAUNDERING REGULATIONS 2017 PUBLISHED

On 22 June 2017, the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**MLRs 2017**) were laid before the UK Parliament. The MLRs 2017, which came into force on 26 June 2017, are the means by which the UK government transposed and implemented the Fourth Money Laundering Directive (**MLD4**).

Background

The MLRs 2017 replaced the Money Laundering Regulations 2007, which applied to the conduct of business and transactional work of certain persons acting in the course of business in the UK, including credit and financial institutions, law firms, auditors, insolvency practitioners, external accountants and tax advisers.

On 15 September 2016, HM Treasury issued a consultation paper on HM Government's steps towards transposing the MLD4 and aspects of the Fund Transfer Regulation (**FTR**). The consultation closed on 10 November 2016 and on 15 March 2017, HM Government published its findings along with the draft MLRs 2017. For further information on the draft MLRs 2017, the relevant consultation and the Government findings, as well as the key elements of MLRs 2017, please refer to the AML Bulletin Spring 2017 issue.

Overview of the MLRs 2017

The MLRs 2017 provide preliminary information and definitions, information on applying the MLRs 2017, including necessary risk assessments, customer due diligence provisions, information on the duties of supervisory authorities and registers, the FTR and miscellaneous provisions. The MLRs 2017 also set out the requirements for record keeping and reliance on third parties and beneficial ownership information. They also create the legal framework under which supervisory bodies can obtain information and conduct investigations, they establish the various powers of enforcement and they set out the rights of appeal against the FCA, the Commissioners for HM Revenue and Customs, and other authorities.

It is worth noting that the MLRs 2017 provide for both civil and criminal enforcement powers and provide supervisory bodies with statutory investigation powers. In contrast, the MLRs 2007 contained a single criminal offence in relation to a breach of any of the regulations.

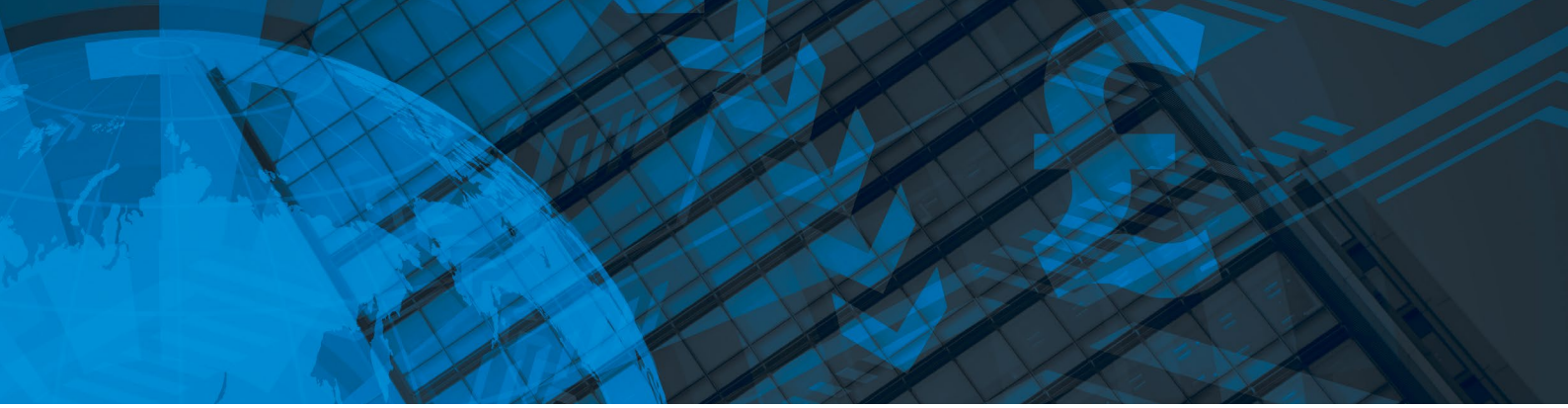
The MLRs 2017 cover relevant persons such as credit and financial institutions, trusts or company service providers which are authorised persons, electronic money institutions and high value dealers. Relevant persons are serviced by the respective authority, i.e. the FCA, the Commissioners for HM Revenue and Customs and the Gambling Commission.

Risk Assessment

According to Regulation 16 of the MLRs 2017, HM Treasury and the Home Office must, by 26 June 2018, undertake a risk assessment to identify, assess, understand and mitigate the risks of money laundering and terrorist financing (**ML**/**TF**) affecting the UK. The supervisory authorities must identify and assess the international and domestic risks of ML/TF to which the relevant persons are subject to and subsequently, take the necessary steps to identify and assess the ML/TF risks which the business under review is subject to (Regulations 17 and 18 respectively).

INFORMATION ABOUT PEOPLE WITH SIGNIFICANT CONTROL (AMENDMENT) REGULATIONS 2017 PUBLISHED

On 23 June 2017, HM Government published the Information about People with Significant Control (Amendment) Regulations 2017 (**Regulations 2017**). The Regulations 2017, which were laid before Parliament on 23 June 2017 and came into force on 26 June 2017, introduced into the UK regime the changes required under article 30 of the Fourth Money Laundering Directive (**MLD4**).



Background

The Regulations 2017 largely reflect HM Government's proposals as set out in the Discussion Paper on the transposition of article 30 of the MLD4 published in November 2016. For further information on the Discussion Paper, please refer to the AML Bulletin Spring 2017 Issue.

Overview

The Regulations 2017 modified the existing national measures in relation to the legal entities covered, i.e. companies, LLPs and Societas Europaea (SEs or European Companies), that required the register of people with significant control (**PSC register**) to be updated at least every 12 months. According to the Regulations 2017, legal entities have to update the PSC register within 14 days of becoming aware of any changes and subsequently, provide the updated information to Companies House within 14 days of updating the PSC register. The stricter time limits reflect the requirement that the information on the register is kept "adequate, accurate and current". The Regulations 2017 mark a significant departure from the six months notification period proposed in the Discussion Paper.

The Regulations 2017 also reduce the scope of the exemption in relation to the requirement to maintain a PSC register. Previously, the exemption applied to the issuers with voting shares admitted to trading on a regulated market or on a prescribed market (DDR5 issuers). It has been amended by the Regulations 2017 so that it applies to companies with "voting shares admitted to trading on a regulated market which is situated in an EEA State". This change means that companies listed on a prescribed market, such as the Alternative Investment Market or the NEX Exchange, are no longer exempt.

HM Government has also updated its non-statutory Guidance on the Register of People with Significant Control, as well as its statutory Guidance on the meaning of "significant influence or control" in the context of companies as required by paragraph 24 of Schedule 1A of the Companies Act 2006.

The Regulations 2017 came into force alongside the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 that implement other aspects of Article 30 of the MLD4, including the provisions on beneficial ownership and customer due diligence.

FCA PUBLISHES FINAL GUIDANCE ON THE TREATMENT OF POLITICALLY EXPOSED PERSONS FOR AML PURPOSES

On 6 July 2017, the FCA published its finalised guidance on the treatment of Politically Exposed Persons (**PEPs**) for anti-money laundering purposes, as well as a summary of the feedback received to the relevant consultation published in March 2017.

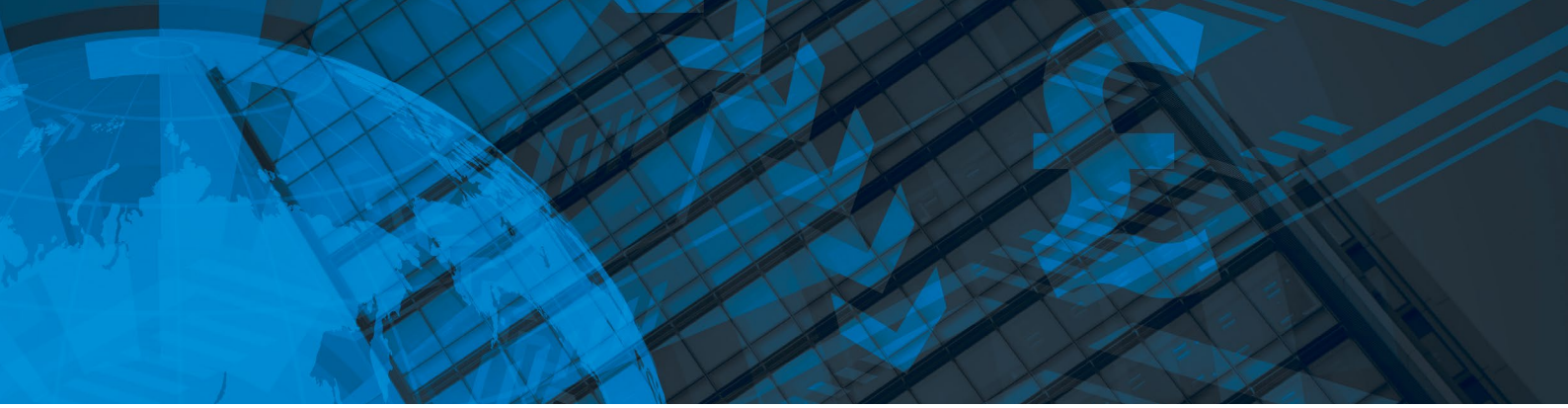
Background

The FCA had previously, on 16 March 2017, published a guidance consultation on the treatment of PEPs under the proposed Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. The FCA made a number of amendments to the draft guidance and warned that the amendments to the Fourth Money Laundering Directive (MLD4), as currently negotiated within the EU, may have an impact on the guidance. For further information on the guidance consultation, please refer to the AML Bulletin Spring 2017 issue.

Overview

The guidance applies to any institution that has its AML systems and controls overseen by the FCA and is exclusively relevant to business relationships undertaken in the course of business in the UK. It provides input in relation to how firms can meet their obligations when opening new relationships or monitoring existing ones.

The FCA expects firms to take appropriate but proportionate measures in meeting their financial crime obligations and apply a risk sensitive approach when



identifying PEPs and applying enhanced due diligence measures (**EDD**). The risk of individual PEPs should be assessed on a case by case basis rather than by applying a generic approach.

According to the FCA, the number of UK customers to be treated as PEPs is not likely to be high, as firms are advised to apply the relevant definition only in relation to persons who hold truly prominent positions as PEPs. Moreover, even if a UK customer meets the PEP definition because of the position they hold, or where another country has been assessed as having similarly transparent anti-corruption regimes, firms are still required to recognise the potentially lower risk of such a customer and apply the guidance by choosing measures that do meet their EDD obligations, but proportionately to the lower risk situation at hand. Equally, firms are expected to take a more stringent approach where the customer is assessed as having a greater risk and therefore, take steps to verify information about the customer and the proposed business relationship.

FCA PUBLISHES GUIDANCE CONSULTATION ON OFFICE FOR PROFESSIONAL ANTI-MONEY LAUNDERING SUPERVISION

On 24 July 2017, the FCA published a guidance consultation on the Office for Professional Body Anti-Money Laundering Supervision (**OPBAS**) (**GC17/7**).

OPBAS was announced in March 2017 (for further information please refer to the AML Bulletin Spring 2017 issue) and will operate within the FCA's existing governance arrangements, overseeing 22 professional body anti-money laundering supervisors, including the Law Society/ Solicitors Regulation Authority, General Council of the Bar/ Bar Standards Board and Institute of Chartered Accountants in England and Wales.

The publication of GC17/7 follows the publication by HM Treasury on 20 July 2017 of the draft Oversight of Professional Body AML Supervision Regulations 2017, that will give powers and responsibilities to OPBAS.

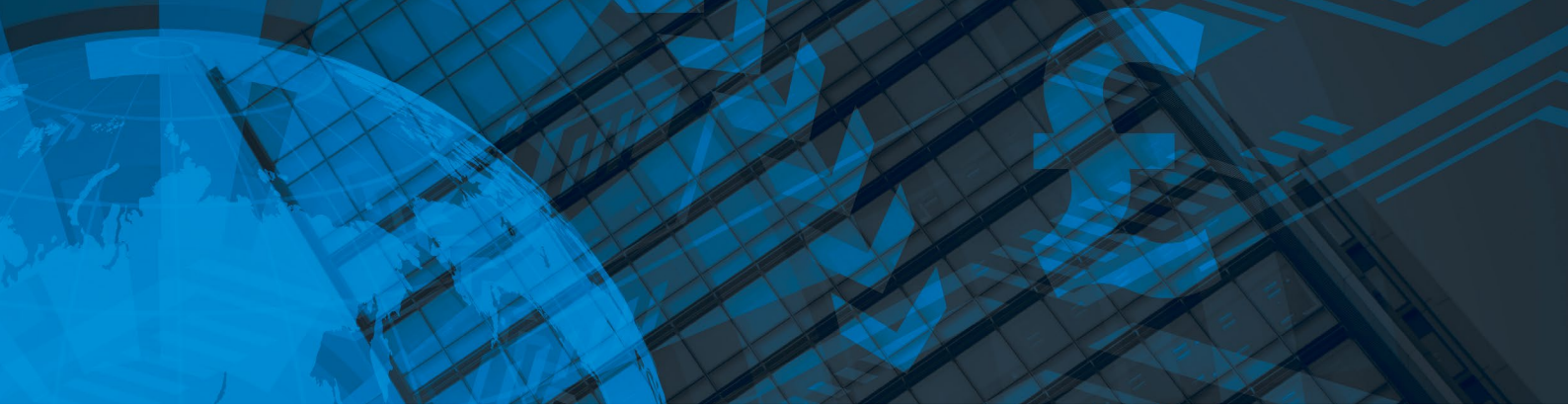
GC17/7 sets out the draft text for an FCA sourcebook for professional body supervisors. The sourcebook discusses how professional body supervisors should carry out their anti-money laundering supervision work and provides details on the requirements incumbent on them under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.

The sourcebook also draws on existing resources, such as the European Supervisory Authorities' (ESAS) recent guidance on risk-sensitive supervision published in November 2016 and UK guidance prepared by the Anti-Money Laundering Supervisors' Forum members in 2008.

The FCA also contemporaneously published a letter to the relevant professional body supervisors, including a description of the supervisory approach the FCA intends OPBAS to adopt once it is operational. In the letter, the FCA states that OPBAS will seek to:

- develop a sound understanding of the workings of the different bodies and sectors it will scrutinise, in order to foster a cooperative and open dialogue with those it oversees;
- adopt a risk-based approach that concentrates its supervisory resources where the risk is greatest (OPBAS' judgments about the risks posed by each professional body will be influenced by its supervisory findings and other information sources, such as the UK National Risk Assessment and liaison with law enforcement agencies, complainants, members of the professions and whistle-blowers.); and
- liaise with other bodies with oversight roles for the professions (such as the Legal Services Board, Insolvency Service and Financial Reporting Council) to share good practice and avoid supervisory conflicts.

GC17/7 is open for comment until 23 October 2017, with guidance due to come into effect on 1 January 2018. The FCA plans to consult on an approach to levying fees on professional body supervisors in autumn 2017 as part of its usual consultation on fees.



FCA PUBLISHES ANTI-MONEY LAUNDERING ANNUAL REPORT FOR 2016/2017

On 5 July 2017, the FCA published its anti-money laundering (AML) annual report for 2016/17.

In its fourth AML annual report, the FCA sets out how it has sought to achieve its AML objectives over the past year. Key topics in the report include:

- **Developments in AML supervision strategy:** The FCA continues to implement and develop its AML supervision strategy. This includes its existing proactive AML supervisory programmes, which assess firms' controls against money laundering, terrorist financing and financial sanctions risks. The FCA has recently introduced a programme of sample checking across all regulated firms.

  The quality of firms' AML systems and controls remains high on the FCA's agenda. Its financial crime specialists continue to carry out extensive work on both AML and anti-bribery and corruption, as these are the aspects of crime where the market incentives for firms are weakest. In some firms, the FCA found serious deficiencies in key areas of their systems and controls. In others, the picture was more positive. In the firms with serious deficiencies, the FCA has taken steps to mitigate the risk, including early intervention through restrictions on the firm's business while improvements are made. It has also required substantial changes to be made to ensure firms are meeting the requirements and, in certain cases, has required the appointment of skilled persons to ensure that this is done.

- **Findings and outcomes from recent specialist supervision work:** The FCA found that, in general, steps being taken by the industry to manage the risks presented by most standard-risk customers were broadly adequate. Where issues were identified, the two most common root causes of such issues were weaknesses in governance and longstanding and significant under-investment in resourcing. With respect to the latter, this under-investment may affect key tools in firms' control frameworks, such as transaction monitoring systems that are not kept up to date. With smaller firms, the challenges often relate to ensuring that they understand their obligations and that their response is proportionate to the business models they operate.

  The FCA also receives intelligence and information about financial crime risks from a variety of sources, including whistle-blowers, law enforcement agencies and other regulators. In 2016/17, it considered over 150 referrals of this sort and took action in nearly 90 cases. In most of these cases, the FCA used close ongoing supervision including site visits, to mitigate and monitor the risks. In six cases the FCA took more formal action, for example, restricting the firm's business. The number of enforcement cases for AML has increased in 2016/17. The FCA has a number of formal investigations underway, with several others being considered for referral.

- **New technology and effectiveness:** The FCA is keen to encourage the industry to take steps to lessen compliance burdens. Firms and technology providers are exploring many innovative methods of streamlining AML activity in the sector. The FCA is keen to stay abreast of developments in this regard and has commissioned a consulting firm to carry out a survey. It also notes that many applications to the FCA's regulatory sandbox initiative have been from businesses with new ideas about customer due diligence or transaction monitoring.

- **Looking ahead:** The FCA will continue to review its supervision strategy, using the information from its new financial crime data return to target its work on the highest-risk firms and sectors. It also aims to have the Office for Professional Body AML Supervision (under which it will be the supervisor of professional body AML supervisors), operating on an initial basis by the end of 2017. It is currently working closely with HM Treasury and other partners to prepare for the Financial Action Task Force's forthcoming UK evaluation, which will take place in late 2017 and early 2018. As the biggest AML supervisor in the UK, the FCA will play a major part in the assessment.

INTERNATIONAL NEWS

REPORT ON THE ASSESSMENT OF THE RISKS OF MONEY LAUNDERING AND TERRORIST FINANCE AFFECTING THE INTERNAL MARKET AND CROSS-BORDER ACTIVITY

On 26 June 2017, the EU Commission published a report on the assessment of the risks of money laundering and terrorist finance (**ML**/**TF**) affecting the internal market and cross-border activities. The report, being the first one on this topic to be carried out at a supranational level in the EU, analyses the risks of ML/TF faced by the EU and proposes a comprehensive approach to address them.

Sectors exposed to significant ML/TF risks

The report aims to identify circumstances in which the services and products delivered or provided could be abused for TF/ML purposes and describes the areas in which the EU legal framework is not currently harmonised. Forty products or services in eleven professional sectors are found to be potentially vulnerable to ML/TF risks affecting the internal market, including the financial sector and particularly certain segments of it, such as private banking and institutional investment, electronic money or money value transfer services (i.e. money remittances), crowdfunding platforms and virtual currencies. The gambling sector, designated non-financial businesses and professions, including trust and company services providers, tax advisors, auditors, external accountants, notaries and other independent legal professionals, cash and cash-like assets, as well as non-profit organisations, Hawala banking and currency counterfeiting are also considered to be among the areas and services exposed to significant ML/TF risks.

ML/TF vulnerabilities

The report sets out a number of vulnerabilities that are common to all sectors. Such vulnerabilities include anonymity in financial transactions, identification and access to beneficial ownership information, supervision within the EU internal market, lack of cooperation between EU Financial Intelligence Units (**FIUs**), infiltration by criminals, forged documents, insufficient resources information-sharing between the public and the private sector, insufficient resources, risk-awareness and know-how to implement anti-money laundering and counter terrorist financing (**AML**/**CFT**) rules and new risks emerging from FinTech.

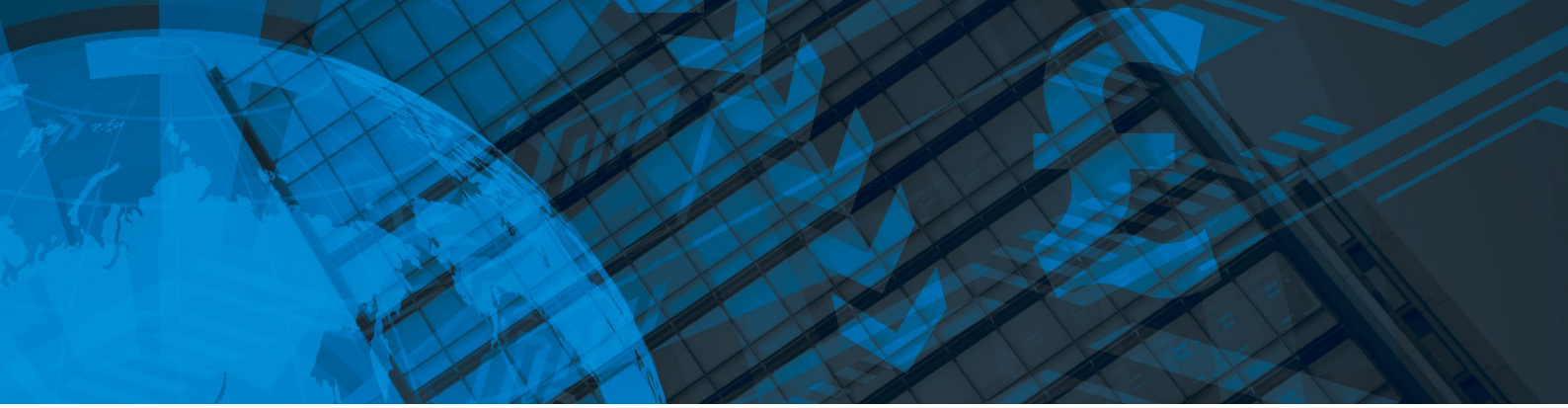
Mitigating Measures

Having identified the potential risks and vulnerabilities, the report sets out recommendations and mitigating measures to be pursued at an EU and national level towards ensuring that the risks identified do not materialise. The report puts forward legislative measures, policy initiatives and further supporting mitigating measures that should be launched at EU level.

The EU Commission made a number of recommendations to the European Supervisory Authorities. These include raising awareness regarding the ML/TF risks, identifying the appropriate actions to further build supervisors' capacity in AML/CFT supervision and providing updated guidance for internal governance and beneficial ownership investigation. The report also includes recommendations for non-financial supervisors, urging self-regulatory bodies to increase the number of thematic inspections, reporting and organising training to develop a better understanding of the risks and AML/CFT compliance obligations. Lastly, the Commission makes recommendations to Member States in relation to, among other things, the scope of national risk assessments, beneficial ownership, appropriate resources for supervisors and FIUs, increased on-site inspections by supervisors and thematic inspections.

Next Steps

The EU Commission will monitor the actions taken by Member States based on supra-national risk assessment findings and report accordingly at the latest by June 2019. The review will reflect an assessment of how measures implemented at EU and national level impact on risk levels.



FINAL REPORT ON DRAFT RTS ON MLD4 CENTRAL CONTACT POINT ISSUED BY ESAS' JOINT COMMITTEE

On 26 June 2017, the Joint Committee of the European Supervisory Authorities (**ESAS**) issued their final report on the draft regulatory technical standards (**RTS**) on the criteria determining the appropriateness of the appointment of a central contact point (**CCP**) under article 45(9) of the Fourth Money Laundering Directive (**MLD4**) and the functions of the CCP. The relevant consultation process ran between February and May 2017 and, following the feedback received, minor changes were introduced to the draft.

Payment service providers and electronic money issuers with a head office in an EU Member State may be able to operate establishments in other host Member States, including agents or distributors, but they still have to comply with the anti-money laundering and countering the financing of terrorism (**AML/CFT**) regime of the Member State in which they are based, even if they are not obliged entities themselves.

As a way to facilitate AML/CFT supervision, a number of Member States have introduced a requirement for service providers or electronic money issuers to appoint a CCP. The CCP would act as a point of contact between the payment service provider or electronic money issuer and the host Member State's competent authority. However, the absence of a common European approach to CCPs allows for regulatory arbitrage and increases the risk that legal uncertainty can prevent payment service providers and electronic money issuers from providing services on a cross-border basis.

The draft RTS set out the criteria that Member States will use to determine the necessity of a CCP appointment and identify the functions a CCP must have in order to fulfil its duties. In accordance with Article 45(10) MLD4, the RTS do not however specify the form a CCP must take, nor do they determine when payment service providers or electronic money issuers provide services in another Member State through establishments.

The ESAS are required to submit the draft RTS to the European Commission for approval.

FINAL REPORT ON MLD4 AML AND CTF RISK FACTOR GUIDELINES PUBLISHED BY THE JOINT COMMITTEE OF ESAS FINAL REPORT

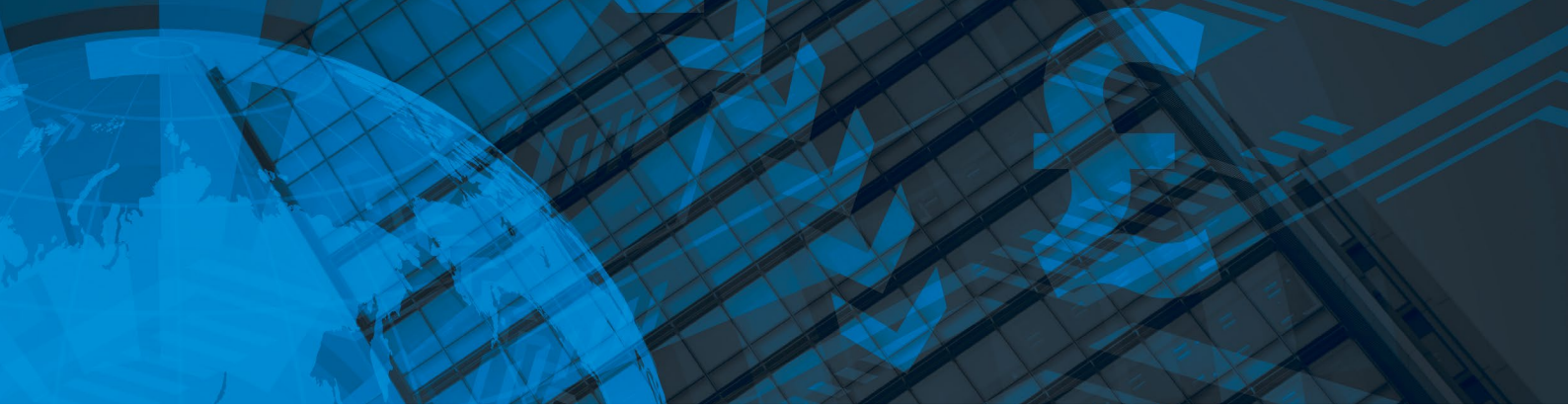
On 26 June 2017, the Joint Committee of the European Supervisory Authorities (**ESAS**), i.e. the European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority) issued a Joint Report on the Final Joint Guidelines on simplified and enhanced customer due diligence.

The non-exhaustive guidelines set out the factors that credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions. They also advise firms how to adjust the extent of their customer due diligence (**CDD**) measures in a way that is commensurate to the level of risk they have identified.

The ESAS provide two kinds of guidance. Title II of the guidelines is general and applies to all firms, providing them with the tools they need to make informed, risk-based decisions when identifying, assessing and managing the money laundering and terrorist financing risk associated with individual business relationships or occasional transactions. On the contrary, title III is sector-specific setting out risk factors that are of particular importance in certain sectors and providing guidance on the risk-sensitive application of CDD measures by firms in those sectors.

The ESAS initially consulted on the draft guidelines in October 2015 with respondents generally welcoming their proposals. Some concerns were raised in relation to the ability of national competent authorities to apply the guidelines consistently with international AML and CTF standards and relevant clarifications were requested. The feedback received to the consultation along with ESAS' response is set out in section 4 of the Joint Report published.

The guidelines will come into force on 26 June 2018 and will be kept under the ESAS' review and updated as appropriate. The first update of the guidelines, following the relevant consultation, is likely to take place once the amendments to the Fourth Money Laundering Directive (MLD4) are agreed upon.



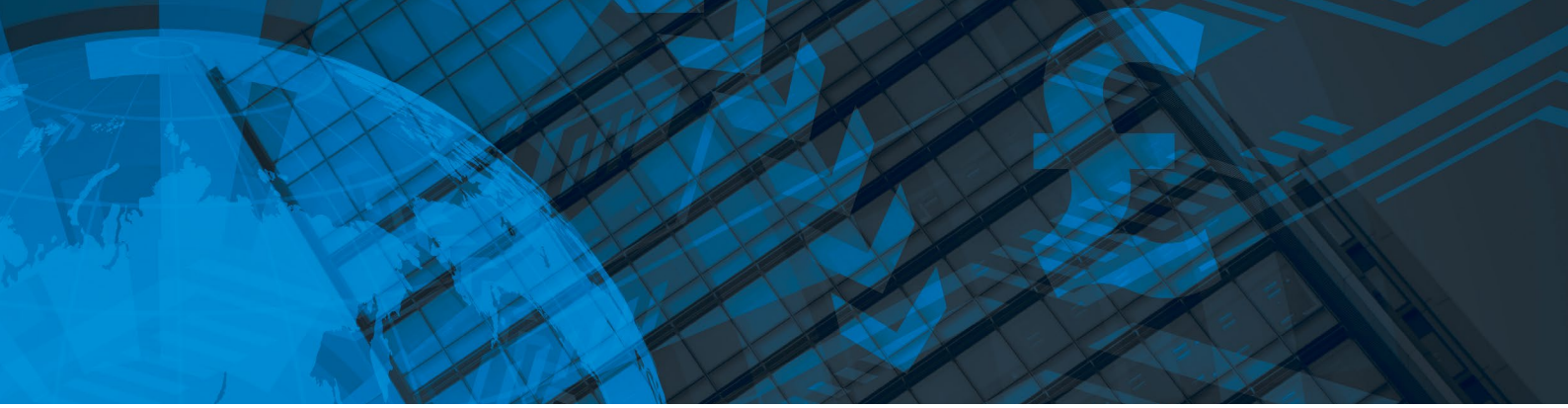
OFFICE OF FINANCIAL SANCTIONS IMPLEMENTATION IDENTIFIES HIGH-RISK COUNTRIES WHERE ENHANCED DUE DILIGENCE IS REQUIRED

On 26 June 2017, through HM Treasury's Office of Financial Sanctions Implementation (**OFSI**), the Financial Action Task Force (**FATF**) issued an advisory notice identifying countries with strategic deficiencies in their anti-money laundering and counter-terrorist financing regimes.

Under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**MLRs 2017**), which came into force on 26 June 2017, regulated firms are required to apply enhanced customer due diligence and enhanced ongoing monitoring on a risk-sensitive basis in certain defined situations and in "any other case which by its nature can present a higher risk of money laundering and terrorist financing".

The Democratic People's Republic of Korea and Iran are both identified by the FATF as high risk and accordingly, enhanced due diligence measures must be applied in accordance with the risks.

FATF also advises firms to take appropriate actions with regard to Bosnia and Herzegovina, Ethiopia, Iraq, Syria, Uganda, Vanuatu and Yemen in order to minimise the associated risks, which may include enhanced due diligence measures in high-risk situations.



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