

# MONEY LAUNDERING LAW

A REGULATORY NEWS UPDATE FROM DLA PIPER



# UK NEWS

## NEW REGULATORY FRAMEWORK BRINGS NEW GUIDANCE FROM JMLSG

Many in the UK financial sector turn to the guidance provided by the Joint Money Laundering Steering Group ("JMLSG") for practical assistance in interpreting current money laundering regulations, including aspects of the Proceeds of Crime Act 2002 ("POCA") and the Terrorism Act 2000, and for providing good industry practice.

With the Money Laundering Regulations 2007 (the 2007 Regulations) due to pass into law on 15 December this year JMLSG has published proposed new guidelines on the prevention and detection of money laundering and terrorist financing (the "Guidance"). Launched on 29 June 2007, the Guidance currently takes the form of a consultation paper on which stakeholders may comment up to 7 September this year.

### REASONS FOR THE REVISION

JMLSG has produced a number of updates to its guidance notes since they were first published in 1990, including a major revision at the end of January 2006. In many ways this last update anticipated the new regulatory regime imposed by the EU Third Money Laundering Directive (itself, incorporating the Financial Action Task Force's - ("FATF") - Forty Recommendations) as its approach was based on the joint principles of senior management accountability and a risk-based approach. Nevertheless, a number of other factors have been brought into play since that time which have necessitated further revision:

- In the draft of the 2007 Regulations issued by the Treasury in January, it was decided to repeal the 2003 Regulations, thereby creating a completely revised framework. This required the text of the Guidance to be reordered so that it was seen to be supporting the 2007 Regulations in the most logical way.
- Guidance material on the EU Wire Transfer Regulation, which came into force in January 2007, has had to be included.

Otherwise, JMLSG considered that the Guidance did not need substantial amendment but took the opportunity to address a limited number of additional points where firms had reportedly had difficulty in following the previous guidance.

### THE MAIN CHANGES

In summary, the main changes introduced by the amendments are:

- a number of new and changed definitions, including "beneficial owners" and "Politically Exposed Persons" ("PEPs");
- the customer due diligence measures to be applied;

- that customer due diligence measures should be applied on a risk-based approach;
- the extent to which reliance may be placed on the work of other regulated firms; and
- situations where simplified due diligence measures may be applied;
- that enhanced due diligence measures must be applied in higher risk situations, such as non- face-to-face, PEPs and correspondent banking.

### REVISED DEFINITIONS

The 2007 Regulations no longer include any references to an "applicant for business", where the emphasis was entirely on identifying the customer. The exemption from identifying the customer in the case of a "one-off transaction" (subject to a monetary limit) is also now changed, being replaced by reference to an "occasional transaction", although such transactions are now excluded from the 2007 Regulations altogether.

The term "beneficial owner" was hardly considered in the 2003 Regulations but its inclusion in the draft 2007 Regulations has been the cause of much lobbying, especially by the legal profession. The 2007 Regulations now incorporate three categories of beneficial owner: a general definition covering individuals who ultimately control the customer, or on whose behalf a transaction or activity is being conducted; a detailed definition of persons who own or control more than 25 per cent of a body corporate; and a detailed definition of the beneficial owner of a legal entity or a legal arrangement (such as a trust). It is this last definition which has proved controversial and

which is now likely to change in both the Regulations themselves and, consequentially, in the Guidance. The proposal promulgated by the Law Society holds that all trustees are beneficial owners. If this definition is accepted, the identities of all trustees will need to be verified.

While not referred to explicitly, the concept of the PEP already exists in the current regime in that firms are recommended to carry out enhanced due diligence on such persons. The new Regulations, however, impose substantial further requirements in respect of PEPs and the Guidance reflects this strengthening of the obligation.

### THE RISK-BASED APPROACH NOW MANDATORY

JMLSG guidance on adopting a risk-based approach has not changed significantly in the amended Guidance, except in the tone adopted. This now mirrors the 2007 Regulations which require a risk-based approach both in respect of risk management generally and, specifically, in respect of customer due diligence procedures.

There has been much debate regarding the apparently elusive nature of a risk-based approach and the practical steps a firm can take to audit its procedures. The Guidance attempts to pin this down. While allowing a firm latitude in assessing the most cost effective and proportionate way to manage and mitigate risk, it is suggested that firms:

- identify the specific risks relevant to the firm;
- assess the risks presented by the firms':
  - customers;
  - products;
  - delivery channels; and
  - geographical areas of operation;
- design and implement controls to manage and mitigate these assessed risks;
- monitor and improve the effective operation of these controls; and
- record appropriately what has been done.

### CUSTOMER DUE DILIGENCE

The current Guidance also provides firms with much-needed detail missing from the 2003 Regulations on how, practically, to meet their obligations in relation to the identification of customers. The new Guidance provides a similar level of detail but it has been re-organised to follow the order used in the 2007 Regulations. The

measures outlined now include customer due diligence monitoring, which has become mandatory for the first time, together with when these requirements can be relaxed and when enhanced.

Under the existing regime, a number of exemptions from the obligation to identify customers apply. With the revision, these situations - some of which are types of customer and others are types of product - are defined as circumstances in which simplified due diligence may be used. This simplified procedure means not having to identify the customer (or, where relevant, a beneficial owner) nor having to obtain information on the purpose or intended nature of the business relationship. A distinction is made in the verification requirements necessary for a customer and those acceptable for a beneficial owner. The identity of a customer must be verified on the basis of documents, data or information obtained from a reliable independent source. In comparison, a firm may adopt a risk-based approach and will only need to take adequate measures to verify the identity of a beneficial owner. In lower risk situations, therefore, it may be reasonable for the firm to rely on information supplied by the customer as to the identity of the beneficial owner. The obligation to conduct ongoing monitoring of all business relationships will, however, apply in all cases.

The 2003 Regulations are silent on how customer risk should be measured, other than by including a requirement to take account of the higher risk posed by non-face-to-face business. The 2007 Regulations are more explicit and require firms to apply enhanced due diligence measures on a risk-sensitive basis in any situation which, intrinsically, might present a higher risk of money laundering or terrorist financing and, specifically, in non-face-to-face situations, PEPs and correspondent banking.

### RELIANCE ON OTHER REGULATED FIRMS

The 2007 Regulations offer a potentially wide scope for relying on other, appropriately qualified, regulated firms. In comparison, the current regime makes no mention of reliance, except in respect of one-off transactions where the firm being relied upon has given an undertaking that it will carry out customer due diligence on all customers introduced by it. The new Guidance reflects these changes. It should be borne in mind, however, that in all cases the firm relying on due diligence of another firm is ultimately responsible.

### THE FORMAT OF THE CONSULTATION

The Guidance provided by JMLSG is in two parts. The main text in part I contains generic guidance which applies across the UK financial sector. Part II provides guidance for a number of specific industry sectors (retail banking; credit cards, etc; electronic money; credit unions; wealth management; financial advisers; life assurance and life-related pensions and investment products; non-life providers of investment fund products; discretionary and advisory investment management; execution-only stockbrokers; motor finance; asset finance; private equity; corporate finance; trade finance; correspondent banking; syndicated lending; wholesale markets; name-passing brokers in inter-professional markets; and unregulated funds), each section having been written by relevant practitioners, to be used as a supplement to the advice contained in the first part.

### IMPORTANCE OF THE GUIDANCE

The importance of following the Guidance should not be underestimated and firms are reminded of its status in relation to the relevant legislation. POCA requires a court to take account of industry guidance that has been approved by a treasury minister when considering whether a person within the regulated sector has committed the offence of failing to comply with the 2007 Regulations.

### IMPORTANCE OF THE CONSULTATION PERIOD

All firms in the UK financial sector are encouraged to consider the draft Guidance and to raise any concerns they might have with JMLSG. Once the consultation period has closed, JMLSG will invite the Government to approve the Guidance and it will then take on its quasi-statutory role as outlined above.

### HMRC ISSUES REVISED DRAFT GUIDANCE

HM Revenue & Customs has also updated its "Guidance for business on the prevention of money laundering and the financing of terrorism" which currently exists in draft form. The text will be finalised in time for 15 December 2007.

# Control of Cash

## Regulations announced for individuals

The Control of Cash (Penalties) Regulations 2007 (the “Control of Cash Regulations”) came into force on 15 June 2007 to give effect to Community Regulation 1889/2005 (the “Community Regulation”).

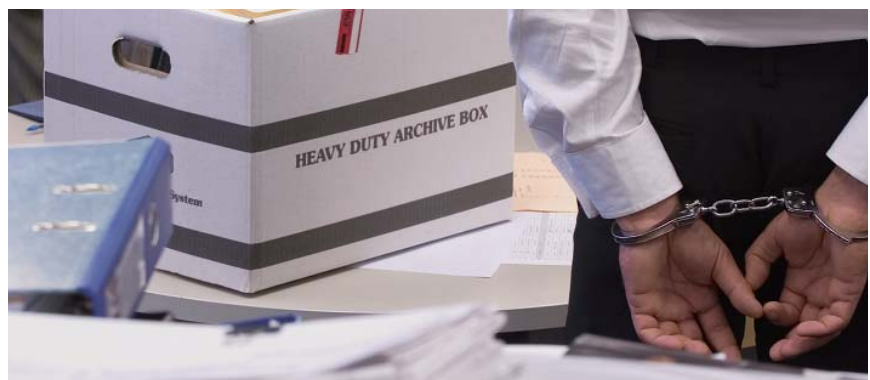
The main provision of the Community Regulation is contained in article 3:

*“Any natural person entering or leaving the Community and carrying cash of a value of €10,000 or more shall declare that sum to the competent authorities of the Member State through which he is entering or leaving the Community in accordance with this Regulation.”*

Travellers entering or leaving the EU are now required, therefore, to make a declaration to customs authorities if they are carrying the designated amount of cash (or its equivalent in other currencies or easily convertible assets such as non-crossed cheques). Member States must then record information obtained through declaration or seizure and make it available to the authorities responsible for fighting money laundering and the financing of terrorism.

The objective of this measure is, by controlling physical cross-border cash movements, to prevent this option being used as a conduit for the laundering of money. As such, it is to be seen as complementing other money laundering directives which have focused on transactions through financial and credit institutions (and certain professions). The new legislation also has the effect of harmonising the rules at Community level as, currently, not all Member States monitor cash movements across their national frontiers and in those that do, the national rules vary greatly.

The Community Regulation also provides for penalties for failing to declare movements of cash as required under article 3. The UK’s resulting Control of Cash Regulations, therefore, permit HMRC’s Commissioners to impose penalties of such amount as they consider appropriate, but not to exceed £5,000. The statutory instrument also introduces a review and appeals procedure.



# REGULATED SECTOR EXTENDED UNDER THE THIRD MONEY LAUNDERING DIRECTIVE

One important change to be enacted by the 2007 Money Laundering Regulations in December is that certain types of business will have their anti-money laundering controls monitored by a supervisory authority for the first time. Under the Treasury proposals, the FSA will continue to supervise all FSA-authorized firms. The OFT and local authority Trading Standards Services will take on the new role of supervising the relevant procedures of certain consumer credit businesses and estate agents, while HMRC and the Gambling Commission also have supervisory responsibilities. The OFT is currently working with HM Treasury and

other stakeholders on the design and implementation of a system of OFT-supervision of compliance.

## ACCOUNTANCY PROFESSION

For the first time, all accountants offering advice to the public will need to be supervised under the 2007 Regulations and failure to do so will be a criminal offence. The accountancy associations will supervise their own members under delegated powers from the Government but all those carrying out accounting work, even if not members of a professional body, will be supervised by HMRC, with which they will have to register.

Many have identified this new role for HMRC as creating a potential conflict of interest as money laundering reporting is meant to be confidential. A spokesman for the Association of Chartered Certified Accountants has said:

*"When an accountant or a solicitor reports a suspicion of wrongdoing to a law enforcement authority, if that same law enforcement authority is at the same time going out and regulating in the same way as other accountancy bodies, then it may find itself in the invidious position of simultaneously acting as poacher and gamekeeper."*

## FSA publishes review of private banks AML systems and controls

In response to a report from the FSA's intelligence team which highlighted the money laundering risk within private banking, a review was undertaken at a number of FSA-regulated banks during December 2006 and January 2007. The characteristics which make this sector particularly vulnerable to money laundering relate to the provision of banking and investment services to high net worth individuals, such services typically being provided with a high level of discretion, and including non-standard investment solutions; business conducted across different jurisdictions and offshore and overseas companies; and trusts or personal investment vehicles.

The FSA has identified the following factors as being likely to increase the risk of money laundering within private banking businesses:

- an international customer base which includes people or organisations from jurisdictions with:
  - relatively weak legal structures and/or economies, from which residents are likely to "shelter" funds overseas;
  - a reputation for providing secretive or discrete company and trust formation and administrative services; and
  - a poor record on the implementation of measures to prevent and enforce against financial crime, including corruption;
- a failure by private banks' senior management to communicate and enforce high ethical standards, particularly in relation to financial crime, within the business;
- a failure to obtain sufficiently detailed, accurate or up-to-date customer information, or review this at an appropriately senior and independent (from relationship managers) level within the organisation;
- inexperienced and/or relatively autonomous relationship managers operating in locations or markets with which the firm is unfamiliar, which may increase the risk of customers misleading, exerting undue influence over or colluding with relationship managers; and
- a lack of a means of monitoring customer transactions, including a robust independent process for querying and investigating unusual activity on accounts.

As London's, and the UK's, position as an international financial centre continues to grow, the FSA has warned private banks that they need to become more vigilant.

# GOOD PRACTICE NOTES ON AUTOMATED AML TRANSACTION MONITORING SYSTEMS FROM THE FSA

The draft 2007 Money Laundering Regulations, to be laid before Parliament in advance of the summer recess, will make transaction monitoring ("TM") compulsory. More specifically, firms will have to conduct ongoing monitoring of a business relationship, focusing both on scrutinising transactions and keeping the documentation and customer information up to date. In preparation for this, the FSA conducted some work to look at how firms currently use automated TM systems and has published good practice guidelines which firms may find helpful in ensuring compliance with the new regulations.

To have an effective TM system, the FSA recommends firms should:

- analyse system performance at a sufficiently detailed level, for example, on a rule-by-rule basis to understand the real underlying drivers of the performance results;
- set systems so they do not generate fewer alerts simply to improve performance statistics. There is a risk of inflating the number of alerts which translate into suspicious activity reports without actually bringing about an improvement in the quality and quantity of the alerts;
- deploy analytical tools to identify suspicious activity that is not currently being flagged by existing rules or profile-based monitoring;
- allocate adequate resources to analysing and assessing system performance;
- monitor consistently rather than on an intermittent basis to ensure that performance data is not distorted;
- measure performance as far as possible against like-for-like comparables, eg peers operating in similar markets and using similar profiling and rules; and
- have a clear allocation of responsibilities for reviewing, investigating and reporting details of alerts generated by TM systems.

It is also recommended that senior management should be in a position to monitor the performance of TM systems.



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# EU AND INTERNATIONAL NEWS

## European court clarifies obligation on lawyers to help combat Money Laundering

The question before the Grand Chamber of the European Court of Justice<sup>1</sup> in June was whether the imposition of obligations upon lawyers to inform authorities if they suspected money laundering was an unjustifiable intrusion into legal professional privilege and the independence of lawyers, both of which are vital if the right to a fair trial under article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms is to be upheld.

The court held that the reporting obligations imposed upon lawyers only apply in so far as they advise their clients in certain financial or real estate transactions. As these activities take place outside judicial proceedings, they fall outside the scope of the right to a fair trial. Lawyers are exempted from the obligation to provide information to the authorities as soon as they become involved in instituting or attempting to avoid legal proceedings. This exemption applies whether the information is obtained before, during or after the judicial proceedings. Such an exemption was held by the European court to be sufficient to safeguard the right to a fair trial.

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<sup>1</sup> Judgment in *Ordre des barreaux francophones et germanophone and Others v Conseil des Ministres* (C-305/05)

# FATF NEWS

## **GUIDANCE ON A RISK-BASED APPROACH TO AML**

In an attempt to clarify what a risk-based approach involves, the Financial Action Task Force has published its "Guidance on the Risk-based Approach to Combating Money Laundering and Terrorist Financing: High Level Principles and Procedures". The Guidance is primarily addressed to public authorities and financial institutions and aims to indicate good public and private sector practice in the design and implementation of an effective risk-based approach.

## **CHINA JOINS FATF**

Although recognising that much work needs to be done in key areas, the People's Republic of China has been admitted as a full member and has proposed a detailed programme of further work to address issues raised in FATF's assessment of the country's systems for combating money laundering and terrorist financing.

## **RELEASE OF TWO SECTOR STUDIES**

Part of FATF's remit is to explore the methods used by money launderers and terrorist financiers and, to this end, it has recently published two reports which investigate such methods and the particular vulnerabilities in given sectors: "Money Laundering and Terrorist Financing through the Real Estate Sector" and "Laundering the Proceeds of Illegal Drug Trafficking".



## PAKISTAN TO TIGHTEN **AML LAWS**

Pakistan's new Finance Bill, which has gone before Parliament, contains various provisions intended to strengthen existing anti-money laundering and anti-terrorist financing legislation. Under section 93E of the Bill, banking and financial institutions would be bound to pass on information to the Central Bank, on a confidential basis, about suspicious transactions, as well as information about the relevant client.

It is also understood that the bill includes provisions for a maximum five-year prison sentence and a PKR100,000 (\$1,650) fine for employees of banking and financial institutions if they are found guilty of tipping-off. Employees of financial institutions are, however, to be protected should they choose to make a "whistle-blowing" disclosure to the Central Bank. The Central Bank may then send any relevant information

to the country's law enforcement agencies if it has reasonable grounds for suspicion. After an investigation, the Central Bank may impose an asset freeze on any account under suspicion for a period of up to 130 days while the investigation continues.

### **Court date set for former Milosevic officials' \$164m money laundering trial**

The high-profile trial of Mihalj Kertes, the former director of the Yugoslav customs administration, will begin in the Belgrade District Court in Serbia on 5 September. Serbia's special prosecutor's office for organised crime issued indictments in March concerning a money laundering operation

that allegedly moved nearly \$164m to Cyprus. The original indictment had included the names of Slobodan Milosevic, the former Serbian and Yugoslav president, and Jovan Zebic, the former Serbian deputy prime minister, but these cases have been closed as both are now dead.

## **JERSEY DRAFTS NEW AML RULEBOOK**

Despite the fact that the Jersey Financial Services Commission now has on its website a draft of the "Money Laundering Handbook", it is not clear when the jurisdiction will finally enact proposed new anti-money laundering legislation and have available the finalised guidance. The website mentions a proposed Money Laundering (Jersey) Order 2007 but the

statutory instrument is still only available in draft form and gives no clear date for when it will come into force. Until this is clarified, the Money Laundering Order 1999 remains applicable and the commission says firms will have a six-month period in which to obey the new rules, once they are presented in their final form.

## AUSTRALIA INTRODUCES STAGE 2 OF REVISED AML REGIME

On June 12 2007, Australian money lenders, casinos and bullion dealers came under the country's AML regime for the first time as part of the second phase (of four) in the introduction of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006. Under this stage of the implementation programme, firms in "high-risk" sectors must begin reporting to the Australian Transaction Reports and Analysis Centre ("AUSTRAC"), as well as complying with stringent record-keeping and due diligence provisions.

In addition, correspondent banking obligations were introduced. The financial intelligence unit of AUSTRAC made the following statement:

*"From June 12, before a financial institution provides banking services to a financial institution located in another country, it must carry out a preliminary assessment of the risk that the relationship may involve money laundering or the financing of terrorism. It may then be necessary for the financial institution to carry out further investigations before entering into the correspondent banking relationship. Civil penalties (fines of up to A\$11m) apply for breaches of these new correspondent banking provisions."*

## Russia's struggle with money laundering and terrorist financing of crime

Russia's Interior Ministry admitted recently that the country had lost 413m roubles (\$16m) in the first five months of 2007 through money laundering activities.

Yevgeny Shkolov, head of the Economic Security Department, told reporters that his unit had investigated 2,680 money laundering incidents between January and May, which represented a 14 per cent increase over 2006. He also said that, during this period, 4,390 such crimes had been investigated, of which 1,257 were "large-scale", involving 854 people who had been held to be criminally responsible.

These statistics follow on the heels of the murder last September of Andrei Kozlov, the Russian central bank director who had been a vigorous persecutor of money laundering through the banking system. Mr Shkolov has also admitted that the low number of criminal cases launched under anti-terrorist financing laws - 13 in 2005 and 16 in 2006 - was due to the applicable article of Russia's criminal code being, "still very difficult to apply, because there have been too few precedents so far".

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**If you would like further advice, please contact Daren Allen.**

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