

CLIENT ALERT

The Fifth EU Money Laundering Directive: What Does This Mean for the “Risk-Based Approach” to Due Diligence?

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The EU continues to draft and redraft its money-laundering framework in an effort to create greater barriers to the exploitations of its financial systems for the purpose of laundering the proceeds of crime. Two new directives came into force in the EU in 2018 (the Fifth and Sixth Anti-Money Laundering Directives), with EU member states being required to implement these by 10 January 2020 and 3 December 2020, respectively, although the UK, Ireland and Denmark are not adopting the latter.

In this article we focus on what has changed at a practical level under the Fifth Anti-Money Laundering Directive in terms of the approach that will be mandated for due diligence in certain circumstances. We have also published a separate article considering the impact of the further changes brought by the Sixth Anti-Money Laundering Directive on a European level and how these might impact a post-Brexit UK. That article is available [here](#).

The Fifth Anti-Money Laundering Directive and the “Risk-Based Approach”

The EU Fourth Anti-Money Laundering Directive (EU) 2015/849 (“4AMLD”) came into force on 26 June 2017 and advocated a “*holistic, risk-based approach*” involving the use of “*evidence-based decision-making*”. Its provisions were given effect in English law in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.

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The EU Fifth Anti-Money Laundering Directive (EU) 2018/843 (“5AMLD”) came into force on 9 July 2018 and provides for certain amendments to the risk-based approach of 4AMLD by mandating that certain situations are so high-risk that a defined list of measures, set out in more detail below, must be taken to mitigate money laundering risk. EU member states must give effect to the provisions of 5AMLD under local law by 10 January 2020. It is expected that the UK will bring these provisions into force under English law despite Brexit, as the deadline falls within the proposed transition period for leaving the EU. However, if there is a no-deal Brexit, it remains to be seen whether the UK will implement 5AMLD.

What does this mean on a practical level for compliance professionals?

First, AML-regulated entities¹ are now expected to examine the background and purpose of a wider range of transactions, encompassing those which are at least one or more of the following:

- i. Complex;
- ii. Unusually large;
- iii. Conducted in an unusual pattern;
- iv. Without apparent lawful or economic purpose.

Previously, under 4AMLD, entities were obliged to apply additional scrutiny only to all transactions with no apparent legal or economic purpose which either:

- i. Were complex and unusually large; or
- ii. Demonstrated unusual patterns.

In addition, 5AMLD prescribes the following specific enhanced due diligence (“EDD”) measures for business relationships and transactions involving high-risk third countries² (where such measures were not prescribed under 4AMLD):

- obtaining additional information on the customer, ultimate beneficial owner (“UBO”) and the intended nature of the business relationship;
- obtaining information on the source of funds and wealth of the customer and UBO and the reasons for the intended or performed transactions;
- obtaining approval of senior management for establishing or continuing the business relationship; and

¹ See Annex 1

² See Annex 1

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- conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied and selecting patterns of transactions that need further examination³.

To a large degree these mirror the steps UK financial institutions already take regarding politically exposed persons, but these checks now apply to anyone from a high-risk country.

A further set of risk-mitigating measures will also need to be applied to transactions involving high-risk third countries requiring at least one of the following further steps to be taken:

- additional elements of enhanced due diligence;
- enhanced reporting mechanisms or systematic reporting of financial transactions; or
- limiting business relationships with persons or legal entities from high-risk third countries.

5AMLD requires EU member states to notify the Commission before enacting or applying any of these three risk-mitigating measures under local law. The precise nature of the requirements that will be imposed in the UK and other EU member states therefore remains to be seen.

As of 13 February 2019, the European Commission considers the following to be high-risk third countries: Afghanistan; American Samoa; The Bahamas; Botswana; DPR Korea; Ethiopia; Ghana; Guam; Iran; Iraq; Libya; Nigeria; Pakistan; Panama; Puerto Rico; Samoa; Saudi Arabia; Sri Lanka; Syria; Trinidad and Tobago; Tunisia; US Virgin Islands; Yemen. The US Treasury Department has objected to the inclusion of American Samoa, Guam, Puerto Rico and the US Virgin Islands on the grounds that the European Commission did not follow the methodology used by FATF in developing its own list of high-risk third countries, and that FATF standards apply to all US territories.

5AMLD will therefore require an EU-based company subject to AML regulation to follow the above defined EDD measures when entering into a transaction with any company or individual from these jurisdictions, or involving a transaction with links to these jurisdictions more generally, without regard to its specific risk profile.

On a practical level, organisations subject to 5AMLD will need to consider whether or not their existing business relationships with customers in high-risk jurisdictions will require further EDD measures and, potentially, risk-mitigation measures to be applied. Further amendments to existing policies and procedures may be necessary to ensure that appropriate EDD and risk-mitigating measures are applied to new relationships with customers in high-risk jurisdictions.

To read about the changes to the EU AML framework that will be brought about by the Sixth EU Anti-Money Laundering Directive, see our separate article [here](#).

³ See Annex 1

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Annex 1

Article 2(1) 4AMLD –

- (1) *credit institutions;*
- (2) *financial institutions;*
- (3) *the following natural or legal persons acting in the exercise of their professional activities:*
 - (a) *auditors, external accountants and tax advisors;*
 - (b) *notaries and other independent legal professionals, where they participate, whether by acting on behalf of and for their client in any financial or real estate transaction, or by assisting in the planning or carrying out of transactions for their client concerning the:*
 - (i) *buying and selling of real property or business entities;*
 - (ii) *managing of client money, securities or other assets;*
 - (iii) *opening or management of bank, savings or securities accounts;*
 - (iv) *organisation of contributions necessary for the creation, operation or management of companies;*
 - (v) *creation, operation or management of trusts, companies, foundations or similar structures;*
 - (c) *trust or company service providers not already covered under point (a) or (b);*
 - (d) *estate agents;*
 - (e) *other persons trading in goods to the extent that payments are made or received in cash in an amount of EUR 10,000 or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked;*
 - (f) *providers of gambling services.*

Article 9(2) 4AMLD –

The Commission shall be empowered to adopt delegated acts in accordance with Article 64 in order to identify high-risk third countries, taking into account strategic deficiencies in particular, in relation to:

- (a) *the legal and institutional AML/CFT framework of the third country, in particular:*
 - (i) *criminalisation of money laundering and terrorist financing;*
 - (ii) *measures relating to customer due diligence;*

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(iii) requirements relating to record-keeping; and

(iv) requirements to report suspicious transactions;

(b) the powers and procedures of the third country’s competent authorities for the purpose of combating money laundering and terrorist financing;

(c) the effectiveness of the AML/CFT system in addressing money laundering or terrorist financing risks of the third country.

Article 1(11) 5AMLD –

(1) With respect to business relationships or transactions involving high-risk third countries identified pursuant to Article 9(2), Member States shall require obliged entities to apply the following enhanced customer due diligence measures:

(a) obtaining additional information on the customer and on the beneficial owner(s);

(b) obtaining additional information on the intended nature of the business relationship;

(c) obtaining information on the source of funds and source of wealth of the customer and of the beneficial owner(s);

(d) obtaining information on the reasons for the intended or performed transactions;

(e) obtaining the approval of senior management for establishing or continuing the business relationship;

(f) conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination.

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