



HM TREASURY

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# Informal consultation on the Third EC Money Laundering Directive

May 2004

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**Informal consultation document on the Third  
EC Money Laundering Directive (MLD3)**

<b>I. Introduction</b> .....	2
<b>II. Initial Regulatory Impact Assessment</b> .....	4
(A) Title of the proposed directive.....	4
(B) Purpose and intended effect of the measure .....	4
(i) Objective .....	4
(ii) Background .....	4
(iii) Risk assessment .....	4
(C) Options.....	5
(D) Costs and benefits.....	6
(E) Other issues.....	8
(i) Equity and fairness issues .....	8
(ii) Competition issues .....	8
(F) Consultation .....	8
(i) Within government.....	8
(ii) Public consultation.....	8
<b>III. Key issues addressed in the Third Money Laundering Directive</b> .....	10
(A) Coverage and supervision of sectors .....	10
(B) General changes and definitions.....	11
(C) Customer due diligence provisions.....	12
(i) General provisions .....	12
(ii) Beneficial ownership.....	13
(iii) Simplified due diligence .....	14
(iv) Enhanced due diligence.....	15
(v) Politically Exposed Persons (PEPs).....	16
(vi) Anonymous accounts .....	17
(vii) Casinos .....	17
(viii) ‘Introducers’ and mutual recognition of CDD procedure.....	18
(D) Miscellaneous.....	19
(a) Restrictions on criminals .....	19
(b) Register of bank accounts .....	19
(c) Restrictions on large cash payments.....	19
(d) Personal liability of money laundering reporting officers .....	20
<b>IV. General questions</b> .....	21
<b>Glossary</b> .....	22

## **I. Introduction**

1. This document is a **guide** to the forthcoming Third Money Laundering Directive (MLD3). It is not intended to be an exhaustive explanation of all the provisions. It highlights some of the key proposals, particularly for those less familiar with the subject-area, and seeks to elicit **feedback** from the sectors affected on the practical implications, costs and benefits. It is also intended as an initial **regulatory impact assessment** (RIA). The feedback that we obtain from the consultation will inform the UK's negotiations at European level and enable us to carry out a full RIA. This approach is consistent with the commitments made in two recently-published government documents: *The EU Financial Services Action Plan: Delivering the FSAP in the UK* and *After the EU Financial Services Action Plan: A new strategic approach*<sup>1</sup>.
2. The timetable for consultation looks to be relatively tight, particularly as the European Commission will not be running its own consultation exercise. The UK Government will continue to stress in discussions with the Commission and other Member States the importance of adequate time for consultation, and is committed to making the most of the time that is available.
3. The European Commission issued preliminary draft articles for this directive on 22 March 2004. We have made preliminary comments on these proposals to the Commission, but have made it clear that we are running our own consultation exercise. The draft articles are not the formal proposal and it is important to note that the text of that formal proposal will be different from this first draft, although the substance of the proposals is likely to be broadly similar. The Commission is planning to issue the proposal in late June 2004, and the Presidency of the Council of the European Union is planning to initiate negotiations between Member States in July 2004.
4. We have already consulted our public- and private-sector stakeholders on the Commission's emerging proposals. We are now in the process of a more detailed consultation phase. In addition to circulating the Commission's draft and sending a consultation letter to key stakeholders, we have been holding a series of sectoral **round-table discussions** during May and intend to hold further meetings in due course. We encourage all stakeholders to send us their **written comments** as soon as possible, but at the very latest by **18 June**. **The more these comments are backed up by detailed facts, figures and examples, the more likely they are to be persuasive.**
5. The way this guide is structured is to set out an initial Regulatory Impact Assessment, followed by details of some of the key proposals and questions on which we would be interested to hear your views. Some general questions are then listed at the end of the document. You are invited to read this document alongside the text of the draft directive, which has already been sent out to a

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<sup>1</sup> HM Treasury, FSA and Bank of England, May 2004; available at [http://www.hm-treasury.gov.uk/documents/financial\\_services/eu\\_financial\\_services/fin\\_euf\\_actionplan.cfm](http://www.hm-treasury.gov.uk/documents/financial_services/eu_financial_services/fin_euf_actionplan.cfm)

number of stakeholders and is available on request (please see contact details on p.20 below).

HM Treasury  
27 May 2004

## **II. Initial Regulatory Impact Assessment**

### **(A) Title of the proposed directive**

6. The title is likely to be “Directive of the European Parliament and of the Council on prevention of the use of the financial system for the purpose of money laundering and terrorist financing and repealing Directive 91/308/EEC as amended by Directive 2001/97/EC.”

### **(B) Purpose and intended effect of the measure**

#### (i) Objective

7. There are two main aims behind this measure:
  - (a) to consolidate the previous two EC directives on money laundering; and
  - (b) to amend those directives in the light of the revision of the Forty Recommendations of the Financial Action Task Force on Money Laundering (FATF). These Recommendations cover inter alia customer due diligence requirements and set the international standards for combating money laundering and terrorist financing (together with the Eight Special Recommendations of FATF).
8. This measure would affect the United Kingdom of Great Britain and Northern Ireland, as well as Gibraltar, but not the other Overseas Territories or the Crown Dependencies.

#### (ii) Background

9. There are already two EC directives on Money Laundering: see [http://www.europa.eu.int/comm/internal\\_market/en/company/financialcrime/index.htm](http://www.europa.eu.int/comm/internal_market/en/company/financialcrime/index.htm) The last EC directive was implemented in the UK via the Money Laundering Regulations 2003 and the Proceeds of Crime Act 2002.

#### (iii) Risk assessment

10. The revision of FATF Forty Recommendations in June 2003 was based on an assessment of global risks of money laundering and terrorist financing. In implementing the Forty Recommendations, the Third Money Laundering Directive covers the sectors deemed most at risk of money laundering. For details of the Forty Recommendations please see [www.fatf-gafi.org/40Recs\\_en.htm](http://www.fatf-gafi.org/40Recs_en.htm) (or a summary at [http://www.fatf-gafi.org/pdf/PR-20030620\\_en.pdf](http://www.fatf-gafi.org/pdf/PR-20030620_en.pdf)).
11. Although an exact quantification of the benefits of this measure is difficult, a robust money laundering regime is an important plank in the fight against organised crime, which costs the UK billions of pounds every year. The cost and risks of organised crime are discussed in the full regulatory impact assessment for the Money Laundering Regulations 2003, at <http://www.hm->

[treasury.gov.uk/Documents/Financial\\_Services/money/fin\\_money\\_index.cfm](http://treasury.gov.uk/Documents/Financial_Services/money/fin_money_index.cfm), especially paragraph 8:

*“The risk posed by money laundering is twofold: its facilitation of underlying criminal activities, and the threat to economic and financial activity when high flows of laundered money distort normal market incentives. Most crimes are committed for financial gain, and the volume of criminal assets laundered through the UK is undeniably large. Recent estimates indicate that the value of illegal drugs transactions in the UK could be up to £8.5 billion per annum<sup>2</sup> with direct losses from fraud totalling some £10.3 billion per annum.<sup>3</sup> The human cost of underlying criminality is far greater: drug trafficking in particular has a disproportionate effect on deprived communities and young people. Moreover, comparatively small flows of money can facilitate serious offences: efforts to disrupt the funding arrangements of terrorist organisations have led governments around the world to strengthen their anti-money laundering regimes.”*

12. The National Criminal Intelligence Service (NCIS) produces an annual threat assessment of serious and organised crime in the UK, which includes a section on money laundering. The 2003 report is available at <http://www.ncis.co.uk/ukta/2003/default.asp>. Paragraph 6.5 states:

*“The overall size of criminal proceeds in the UK is not known, nor is the amount that is laundered. However, HM Customs and Excise recently estimated the annual proceeds from crime in the UK at anywhere between £19 billion and £48 billion, with £25 billion possibly being a realistic figure for the amount actually laundered. Based on the January 2000 International Monetary Fund estimate of undeclared economic activity in the UK representing around 13 percent of Gross Domestic Product, £25 billion would equate to roughly one fifth of all undeclared economic activity.”*

13. Furthermore FATF holds an annual exercise to examine the international methods and trends (the “typologies”) of money laundering and of terrorist financing. Its 2004 report on money laundering and terrorist financing typologies is available at [http://www.fatf-gafi.org/pdf/TY2004\\_en.PDF](http://www.fatf-gafi.org/pdf/TY2004_en.PDF).

### **(C) Options**

14. The power to propose legislation in this area lies with the European Commission. Once the Commission has made its proposal, Member States begin formal negotiations on the text. The UK will be an important voice at those negotiations, but is one Member State out of 25 in an area where qualified majority voting (QMV) applies: i.e. if a given number of Member States vote for one option, the minority will be overruled. Issues decided by QMV are also voted on by the European Parliament. This means that the Council (representatives of Member States) and Parliament act together in co-decision.

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<sup>2</sup> Economic Trends, ONS, July 1998

<sup>3</sup> “The Economic Cost of Fraud”, National Economic Research Associates, July 2000

15. There is momentum from a sufficient number of Member States to ensure that there will be a Third Money Laundering Directive, and strong preference on the part of a number of Member States for agreement at political level between EU members by the end of 2004.
16. The options are set out in the draft text proposed by the European Commission. These are discussed in more detail below. Although Member States' positions are complex, two broad tendencies can be identified at this stage:
  - (a) preference for a relatively basic implementation of FATF's Forty Recommendations, leaving the detail to domestic implementation;
  - (b) a more ambitious harmonising approach, seeking to add greater detail to the FATF standards.
17. The UK favours the former approach.

#### **(D) Costs and benefits**

18. The Third Money Laundering Directive will directly affect the regulated sector, to whom its provisions will apply. The regulated sector comprises the following **institutions/professions**:
  - (a) credit institutions;
  - (b) financial institutions;
  - (c) auditors, external accountants and tax advisors;
  - (d) notaries and other independent legal professionals;
  - (e) trust and company service providers;
  - (f) life/investment insurance intermediaries;
  - (g) estate agents;
  - (h) money service businesses, including bureaux de change;
  - (i) dealers and auctioneers in high-value goods, whenever payment is made in cash, and in an amount of €15,000 or more; and
  - (j) casinos.
19. Public sector bodies engaged in regulation of any of the institutions or professions listed in paragraph 18, investigation and law enforcement in the area of money laundering will be affected by the Directive. These include: the Financial Services Authority, HM Revenue Agencies, the Gaming Board of Great Britain, the National Criminal Intelligence Service, and police forces. Self-regulating organisations, such as the Law Society and Institute of Chartered Accountants, will also wish to take note.
20. The Directive will also, indirectly, affect individual consumers and businesses who deal with the regulated sector.
21. Because the Commission's proposals have not yet been finalised we are unable to quantify the costs and benefits of the specific measures in the draft directive. As more concrete proposals emerge, we will be able to expand on the cost-benefit analysis. We would, however, like to use this consultation exercise to obtain as much information as possible on the costs and benefits of the

additional measures proposed in the draft. We would particularly welcome information on the numbers affected, the unit cost per company or per employee, and the initial and continuing costs of the proposed measures. A number of the potential new requirements are discussed in section 3 below, together with specific questions about their costs and benefits.

22. There are existing cost-benefit analyses of controls on organised crime and money laundering. Please see in particular:

(a) the Regulatory Impact Assessment carried out prior to the 2003 Money Laundering Regulations, paragraphs 48-79. Some of the benefits of those regulations are highlighted in para.49:

*“The benefit of these regulations will be the reduction in money laundering activity which itself has a significant cost to the UK economy overall, to individual businesses, to individual victims of money laundering, and to society, in the social effects of criminal activity. A recent estimate suggested that annually around £25 billion of criminal money might be available for money laundering in the UK. ... However, it is difficult both to quantify the amount of money laundering activity given that by its very nature it is clandestine, and to quantify the deterrent effect of anti-money laundering procedures on criminal activity, as they cannot be viewed in isolation from other law enforcement measures (or indeed, other changes in society).”*

(b) the provisional full Regulatory Impact Assessment which preceded the Proceeds of Crime Act 2002, <http://www.archive.official-documents.co.uk/document/cm50/5066/5066-13.htm> especially section B (risk assessment), para. 6:

*“The value of criminal proceeds available to be confiscated from those perpetrating acquisitive crime (not including the criminal justice costs of prosecuting such offenders) was estimated in May 1995 as being as much as £650 million per annum. While there is no methodology for gauging the accuracy of this figure or the extent of criminal proceeds, amounts of this order (and anecdotal evidence from the law enforcement agencies is that the amount has grown steadily since 1995) are both unacceptable in themselves and have potentially harmful economic effects. For example, if such money is not targeted in a systematic way, failures of legitimate businesses could occur due to criminally financed competition.”*

(c) the Final Regulatory Impact Assessment of the Money Laundering Regulations 2001: see [http://www.hm-treasury.gov.uk/media/3DB75/money\\_laundering\\_ria.pdf](http://www.hm-treasury.gov.uk/media/3DB75/money_laundering_ria.pdf); and

(d) the Cabinet Office’s Performance and Innovation Unit 2000 report entitled ‘Recovering the Proceeds of Crime’ <http://www.number-10.gov.uk/su/criminal/recovering/default.htm>

## **(E) Other issues**

### **(i) Equity and fairness issues**

23. Although this is matter which will be explored more fully when we have a formal proposal from the Commission, there are at least two potential equity/fairness issues:

- (a) financial exclusion – there has been past criticism that some financial/credit institutions have turned away customers, citing money laundering rules. The industry and government together have sought to resolve through industry guidance notes;
- (b) restrictions on those with criminal convictions – see para. 69 below.

### **(ii) Competition issues**

24. The proposals are at too early a stage for us to carry out a meaningful assessment of the competition issues.

## **(F) Consultation**

### **(i) Within government**

25. The departments and agencies of government, and other public bodies, which have been involved in the initial consultations and who will be associated with the ongoing consultation process are:

Cabinet Office  
City of London Police  
Companies House  
Department of Trade and Industry (DTI)  
Department for Culture, Media and Sport (DCMS)  
Department for Constitutional Affairs (DCA)  
Department of Work and Pensions (DWP)  
Financial Services Authority (FSA)  
Foreign & Commonwealth Office  
HM Customs and Excise  
Home Office  
Inland Revenue  
Metropolitan Police  
National Criminal Intelligence Service (NCIS)  
Serious Fraud Office (SFO)

26. We have also benefited from ongoing discussions with officials from the Regulatory Impact Unit of the Cabinet Office about the proposed consultation procedure.

### **(ii) Public consultation**

27. There has been an ongoing process of seeking the views of key **stakeholders**. The Commission's draft directive has been sent to around 100 private-sector stakeholders so far, with more to follow. We have been in contact with the DTI's **Small Businesses Service** and representatives of small businesses, and will follow up this contact.
28. Please see para. 4 above for practical details of the consultation procedure.

### **III. Key issues addressed in the Third Money Laundering Directive**

29. The draft Third Money Laundering Directive is in the form of a legal text. In this document we have identified what we see as the major new issues for UK businesses in the regulated sector and other interested parties. For each of these key proposals, we have set out below:
- (a) details of the new text;
  - (b) an explanation of the background (including the current situation in the UK);
  - (c) the potential impact of the measure; and
  - (d) some questions to which we seek your answers.

#### **(A) Coverage and supervision of sectors**

30. Those sectors already covered by the Second Money Laundering Directive (“the regulated sector”) will also be covered by the proposed Third Directive. The Third Directive, however, proposes in Article 3 that anti-money laundering controls be extended to the following new sectors:
- (a) life/investment insurance intermediaries; and
  - (b) trust and company service providers.
31. These sectors are already covered under FATF’s Forty Recommendations and by the UK’s Money Laundering Regulations 2003. There will therefore be a limited impact in the UK.
32. However, there is one change, in that the Directive proposes in Article 23 (1) and (2) that trust and company service providers should be registered or licensed, and supervised, which is not currently the case in the UK for all such service providers. This would entail the establishment of a registration or licensing system, and of an authority to monitor trust and company service providers’ compliance with the law.
33. Trust and company service providers are defined in Article 1(I), which mirrors FATF’s definition:

*“Trust and company service providers” means any natural or legal person which as a business provides any of the following services to third parties:*

- acting as a formation agent of legal persons;*
- acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;*
- providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;*
- Acting as (or arranging for another person to act as) a trustee of an express trust;*
- Acting as (or arranging for another person to act as) a nominee shareholder for another person”*

34. In the 2003 Money Laundering Regulations, Regulation 2(2)(m) covers “*the provision by way of services in relation to the formation, operation or management of a company or a trust*”.

**Questions:**

1. **Is the Commission’s definition satisfactory?**
2. **Which institutions/businesses would fall within this definition and what would be the impact of this?**
3. **What would be the costs and benefits of introducing registration and supervision of trust and company service providers?**
4. **Which body do you think would most effectively supervise trust and company service providers?**

**(B) General changes and definitions**

35. The previous directives only covered suspicions, risks and controls against money laundering. The new directive includes **terrorist financing** for each of the provisions mentioning money laundering. The definition of terrorist financing is an amalgamation of text from existing EU and UN measures. In the UK there are already strict controls on terrorist financing through the Terrorism Act 2000, as amended. This aspect of the draft directive would therefore involve minimal change in the UK.

36. The definition of “criminal activity” has been widened to include all offences involving a sentence of at least 6 months to 1 year; the exact amount depends on the national system. Because the UK already considers all crimes to be predicates for money laundering offences, this provision would have no impact in the UK.

37. The draft directive proposes a definition of business relationship:

*“Business relationship” means a business, professional or commercial relationship which is expected, at the time when the contact is established, to have an element of duration.*

38. The definition of “business relationship” in the 2003 Money Laundering Regulations is:

*“any arrangement the purpose of which is to facilitate the carrying out of transactions on a frequent, habitual or regular basis where the total amount of any payments to be made by any person to any other in the course of the arrangement is not known or capable of being ascertained at the outset”*

39. The FSA’s Handbook states (at para. ML 3.1.8R) that relevant firms must comply with the obligation to identify a client “*as soon as reasonably practicable after it has contact with a client with a view to (a) agreeing with the client to carry out an initial transaction; or (b) reaching an understanding (whether binding or not) with the client that it may carry out future transactions.*”

**Question: What are the implications for particular sectors of the Commission's proposed definitions?**

**(C) Customer due diligence provisions**

**(i) General provisions**

40. The directive overhauls previous provisions on customer due diligence (CDD); these now largely mirror FATF's Recommendations. Article 5 of the draft directive makes clear that all of the regulated sector will be required to carry out certain customer due diligence procedures whenever they:
- (a) establish a business relationship;
  - (b) carry out occasional transactions amounting to €15,000 or more (whether a single operation or linked operations);
  - (c) there is a suspicion of money laundering/terrorist financing or
  - (d) doubts about the veracity or adequacy of previously obtained customer identification data.
41. The CDD requirements are set out as follows in Article 5(3):
- (a) *Identifying the customer and verifying the customer's identity;*
  - (b) *Identifying the beneficial owner and taking reasonable measures on the basis of a risk-based approach to verify the identity of the beneficial owner such that the institution or person is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include taking reasonable measures to understand the ownership and control structure of the customer;*
  - (c) *Obtaining information on the purpose and intended nature of the business relationship;*
  - (d) *Conducting, on the basis of a risk-based approach, ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's or person's knowledge of the customer, the business and risk profile, including, where necessary, the source of funds.*
42. There are two references – in sub-paragraphs 5(3)(b) and 5(3)(d) - to the need to take a **risk-based approach** (which has been strongly promoted by the UK), but there is no general application of the risk-based approach to the whole of Article 5(3). However, FATF's Recommendation has a more general rider stating that all of these procedures should be applied but the institution concerned "*may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction*".
43. The current position in the UK is to be found in Regulation 4(3) of the 2003 Money Laundering Regulations (where A stands for regulated professions/companies and B represents the customer):

*“A must maintain identification procedures which -*  
*(a) require that as soon as is reasonably practicable after contact is first made between A and B -*  
*(i) B must produce satisfactory evidence of his identity; or*  
*(ii) such measures specified in the procedures must be taken in order to produce satisfactory evidence of B's identity;*  
*(b) take into account the greater potential for money laundering which arises when B is not physically present when being identified;*  
*(c) require that where satisfactory evidence of identity is not obtained, the business relationship or one-off transaction must not proceed any further; and*  
*(d) require that where B acts or appears to act for another person, reasonable measures must be taken for the purpose of establishing the identity of that person.”*

44. Further to this, the regulated sector in the UK has expounded industry best practice in Guidance Notes, such as the Joint Money Laundering Steering Group's Guidance Notes for the financial services sector. These Guidance Notes set out possible procedures for conducting customer due diligence, for example on Know Your Customer and Know Your Customer's Business.
45. To an extent, the proposals in the Third Directive may appear simply to set out in law what is already widely practised in the UK and set out in Guidance Notes. While this may mean that the Third Directive might have limited impact in some sectors, we would like to understand the proposals' wider impact, and also the ramifications of moving from flexible and amendable Guidance Notes to statute.

**Questions:**

- 1. How far do these proposals, in your view, go beyond current UK standards and practice?**
- 2. What will be the impact of setting out these standards in statute rather than guidance?**
- 3. What will the more detailed provisions on customer due diligence mean in practice and what are the likely costs and benefits?**
- 4. Are there any further obligations which should be included, and what would be the costs and benefits?**
- 5. What are the advantages and disadvantages of a risk-based approach?**
- 6. Should the customer due diligence provisions be subject to a general rider stating the need for a risk-based approach?**

(ii) Beneficial ownership

46. Beneficial ownership is a concept that recognises that the apparent owner of a company or other structure may not be person who owns or controls that structure in practice. The Commission's definition is set out in Article 1(H); this covers trusts as well as companies and other legal persons.

*“(H) ‘Beneficial owner’ means:*

*1. the natural person(s) who own(s) or control(s) directly or indirectly 10 % or more of the shares of a legal person, not being a company listed on an official stock exchange;*

2. *the natural person who directly or indirectly is beneficiary to 10 % or more of the property of a legal person or a trust, not being a company listed on an official stock exchange; or*
3. *the natural person(s) on whose behalf a transaction or activity is being conducted.”*

47. The UK’s current Regulations already state that where an applicant for business “acts or appears to act for another person, reasonable measures must be taken for the purpose of establishing the identity of that person”. This standard has been developed in the Guidance Notes for the Financial Sector of the Joint Money Laundering Steering Group. These Notes stress the importance of looking behind the corporate entity to identify those who have ultimate control and suggests that “Identification evidence will normally need to be obtained from those shareholders with interests of 20% or more; however, in some circumstances any proportion of capital over 10% might be applicable.”
48. As set out in para. 41 above, the obligations proposed by the draft directive on the regulated sector are to identify the beneficial owner and use a risk-based approach in verifying that identity. The draft directive makes clear that for companies and other legal persons (i.e. not individuals) this means taking “reasonable measures to understand the ownership and control structure of the customer”. All businesses in the regulated sector would be covered by this obligation.
49. Although this obligation stresses the importance of the risk-based approach and the need to look beyond beneficial ownership to control, there are a number of Member States who favour more formal obligations to ensure transparency of beneficial ownership. More formal obligations might include obliging all businesses or legal persons to disclose to a register their beneficial owner.

**Questions:**

1. **What are the advantages and disadvantages of the Commission’s proposed definition, for trusts and also for companies and other legal persons?**
2. **What are the costs and benefits associated with the 10% percentage limit and can you suggest any alternative approaches (with costs and benefits)?**
3. **How do these proposals differ/exceed/fall below existing UK standards?**
4. **What are the strengths and weaknesses of the Commission’s current approach on beneficial ownership?**
5. **Would you be in favour of more stringent transparency requirements on beneficial ownership?**
6. **Are there some sectors for which this definition and obligation on beneficial ownership are not appropriate? If so, please suggest an alternative.**

(iii) Simplified due diligence

50. The draft directive proposes that Member States allow the regulated sector to reduce the due diligence requirements, subject to certain conditions, in certain low-risk situations. It sets out in Article 8 a non-exhaustive indicative list of

situations when this might be appropriate, many of which were mentioned in previous directives:

- (a) *credit and financial institutions, where they are subject to requirements to combat money laundering and terrorist financing consistent with this Directive and equivalent international standards and are supervised for compliance with those controls;*
- (b) *public companies that are subject to regulatory disclosure requirements;*
- (c) *government administrations or enterprises;*
- (d) *the beneficial owners of pooled accounts held by notaries and other independent legal professionals referred to in Article 3(5).*
- (e) *life insurance policies where the annual premium is no more than €1000 or the single premium is no more than €2500;*
- (f) *insurance policies for pension schemes if there is no surrender clause and the policy cannot be used as collateral;*
- (g) *a pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme rules do not permit the assignment of a member's interest under the scheme.*

51. The UK's current risk-based approach allows not only for reduced or simplified due diligence but follows the previous (Second) EC Money Laundering Directive in permitting no due diligence at all in very specific low-risk situations.
52. It is not clear whether Article 8 permits there to be no due diligence (beyond checking whether or not an individual case, product or category is low risk). If this is permitted, given that the list is not exhaustive the impact of this provision in the UK is not likely to be great.

#### **Questions:**

- 1. Is reduced due diligence appropriate for these examples, or are there any risks associated with them?**
- 2. Are the life insurance thresholds in paragraph (e) appropriate (NB they have been the same since 1991)?**
- 3. Are any other categories suitable for inclusion?**

#### **(iv) Enhanced due diligence**

53. The Directive also proposes that the regulated sector apply a higher level of due diligence in certain, higher-risk, situations. Article 9 requires extra due diligence procedures in all the following situations, but does not specify what those extra procedures might be (NB the Commission's list is non-exhaustive):
- (a) *when the customer has not been physically present for identification purposes (non-face to face operations);*
  - (b) *cross-frontier correspondent banking relationships;*
  - (c) *relations with politically exposed persons;*
  - (d) *complex or unusual large transactions and all unusual patterns of transactions which have no apparent economic or lawful purpose.*

54. The 2003 Money Laundering Regulations already require the regulated sector to “take into account the greater potential for money laundering which arises when [the applicant for business] is not physically present when being identified”. It is therefore not clear whether provision (a) would add anything to the current arrangements in the UK (although the reference in the draft directive to taking “specific and adequate measures necessary in [high-risk] situations” may mean going beyond a risk-based approach, and requiring enhanced due diligence for all non-face-to-face transactions).
55. Cross-border correspondent banking and relations with politically exposed persons are already covered in UK guidance, although not in Regulations. It is not clear, therefore, whether this provision would do anything more than put into legislation what is already industry good practice. The Commission’s proposals on politically exposed persons are discussed further below.

**Questions:**

1. **Do non-face-to-face transactions require a greater level of due diligence in all cases? If not, please give examples and explain why enhanced due diligence is not justified in such cases.**
2. **In your opinion, does Article 9 add any further anti-money laundering controls to those already in existence in your sector?**
3. **What procedures would you consider appropriate and useful for “enhanced due diligence”?**

(v) Politically Exposed Persons (PEPs)

56. As set out above, politically exposed persons are identified by the draft directive (and FATF) as high risk and therefore subject to enhanced due diligence. This obligation should be seen in the context of the definition of politically exposed persons. This is set out in Article 1(J) and mirrors the FATF definition, which includes both those in prominent positions and their close family and associates:

1. *Natural persons who may involve a reputational risk and who are or have been entrusted with prominent public functions, such as Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials and*
2. *Close family members or close associates of persons referred to under 1”*

57. The draft definition in the directive includes all politically exposed persons, no matter where they come from. However, three options are under discussion in the EU: (i) that enhanced due diligence should apply to politically exposed persons from all countries, including own nationals; (ii) from all countries except own nationals; (iii) from all except EU Member States.
58. Currently, UK legislation, focusing as it does on high-level objectives, does not require specific procedures for dealing with politically exposed persons. However, the JMLSG’s Guidance Notes include advice on dealing with politically exposed persons.

**Questions:**

- 1. Does your sector/firm already identify and have special arrangements for dealing with politically exposed persons, as a matter of good practice?**
- 2. What are the costs and benefits of identifying PEPs and their close families/associates?**
- 3. Can you identify any practical difficulties and, if possible, any solutions to such difficulties?**
- 4. Is it appropriate to exclude domestic and/or EU PEPs?**

(vi) Anonymous accounts

59. The Directive includes a provision prohibiting credit and financial institutions from keeping “*anonymous accounts, anonymous passbooks or accounts in fictitious names*”. The purpose of this provision, as with the underlying FATF standard, is to reduce money laundering risks that exist with numbered anonymous accounts.
60. In the UK it is not possible to hold an anonymous account, because financial and credit institutions are required to identify their customers. Where the customer appears to be acting for another person, “*reasonable measures must be taken for the purpose of establishing the identity of that person.*” - Regulation 4(3)(d) of the 2003 Regulations. However, the notion of “fictitious accounts” is potentially more problematic: although it depends how “fictitious” is defined, this could include legitimate categories such as people on witness protection schemes. FATF Recommendation 5 refers instead to “obviously fictitious names”.

**Questions:**

- 1. What are the practical implications of this proposal, including its costs and benefits?**
- 2. What would the impact of this provision be if it were extended to the entire regulated sector, not just credit and financial institutions?**

(vii) Casinos

61. The casino industry is covered by a particular provision (Article 7), which has not changed much since the previous directive. The industry is also made subject to the same customer due diligence requirements as the rest of the regulated sector, but the identification obligation is triggered when a customer purchases or exchanges gambling chips worth at least €1,000, rather than the €15,000 threshold which applies to other industries. Casinos can choose to identify all customers “*immediately on entry*”.
62. The proposed provision hardly differs from the position in the Second Directive, which has already been implemented in UK law by the 2003 Regulations. The sole difference with the draft Third Directive is that the identification obligation is triggered when a customer purchases or exchanges gambling chips worth at least €1,000, rather than only when the customer purchases or sells chips, as previously. The FATF Recommendations are phrased in more general terms,

referring to situations in which “customers engage in financial transactions equal to or above the applicable designated threshold.”

63. It is important that the Third Money Laundering Directive should reflect the evolving nature of the casino industry; for example, there may no longer be a physical casino or chips; equally, different forms of gambling are emerging, such as high-value slot machines.

**Questions:**

1. **Are the provisions on casinos appropriate to the evolving nature of the industry? If not, please explain what difficulties arise.**
2. **Do you see any significant difference in identifying customers when they purchase or exchange gambling chips, rather than when purchasing or selling chips?**
3. **What will be the impact of applying all the new provisions of the Third Directive, for example including those on customer due diligence, to the casino industry?**

(viii) ‘Introducers’ and mutual recognition of CDD procedure

64. Article 10 amends the provisions allowing the regulated sector to rely on intermediaries or other third parties to carry out customer identification (“introducers”). Introducers must make information on CDD immediately available to the person or institution to which the customer is referred, although supporting evidence need only be provided immediately if it is requested - Articles 10 (1) (c) and (d).
65. Article 10(2) of the Directive requires Member States to permit the regulated sector to rely on customer due diligence carried out by institutions in other Member States. However, the article also makes clear that institutions in the regulated sector will still retain ultimate responsibility for CDD in such situations. There appears to be some conflict within the text of the Directive: recital 18 of the preamble states that mutual recognition within the EU “*should be obligatory*”, but Article 10 itself only says that this is permitted.
66. Article 10(3) specifies that agency and outsourcing relationships are excluded from the provisions of the article. We understand this to mean that agency and outsourcing relationships do not count as introduced business but rather form part of the regulated institution itself.
67. In the UK, Regulation 5(3) of the Money Laundering Regulations 2003 permits reliance on other institutions’ customer due diligence procedures for one-off transactions. The Guidance Notes of the JMLSG build on this to allow a more general reliance on introducers (including from other EU Member States), as long as an introduction certificate is provided (plus either certified copies of the identification evidence or sufficient detail to permit such evidence to be obtained at a later stage).
68. Although a mandatory mutual recognition clause would represent a significant change for the UK, the draft wording appears to be relatively close to the current

UK position (except for the need for introducers to make identification information immediately available).

**Question:**

1. Do you see any difficulties with the proposed changes to the provisions on introduced business?
2. What would be the advantages and disadvantages of a mandatory EU-wide mutual recognition clause?
3. If there is a mandatory mutual recognition clause across Member States, should the same apply within Member States?
4. Should a mutual recognition clause apply more widely beyond the EU?
5. Does the fact that ultimate responsibility for CDD remains with the financial institution mean that mandatory mutual recognition would be ineffective?
6. Would the proposals on the information/documents to be provided by introducers and the timing thereof (Article 10 (1) (c) and (d)) cause any difficulties?
7. Should the proposals on introducers be extended beyond the sectors in Article 3 (1 to 6) – and, if so, on what basis?
8. Article 10 specifies that agency and outsourcing relationships are excluded. Should the directive define these more explicitly; if so, how?

**(D) Miscellaneous**

**(a) Restrictions on criminals**

69. Within the provisions on supervision (Article 23) is a ban on “*criminals or their associates ... holding or being the beneficial owner of a controlling interest, holding a management function in, or being an operator of*” bureaux de change, casinos or trust and company service providers. This would appear to exclude anyone with a criminal record, which is not currently the case in the UK. For example, under the FSA’s ‘fit and proper’ test, a conviction for a criminal offence does not automatically mean that an application will be rejected: each application is treated on a case-by-case basis.

**Question: What are the likely costs and benefits of this restriction?**

**(b) Register of bank accounts**

70. A few Member States (not including the UK) have a register of all bank accounts, which they argue facilitates law enforcement. They are pushing for a similar register in other Member States, although this is not currently in the Commission’s draft.

**Question: What would be the costs and benefits of such a register of bank accounts?**

**(c) Restrictions on large cash payments**

71. A number of Member States also require that **all cash transactions over €15,000** be channelled through a bank. They too are pushing for a similar provision in other Member States, although the Commission has not included it in its latest draft.

**Question: What would be the advantages and disadvantages of such a restriction?**

(d) Personal liability of money laundering reporting officers

72. Each institution and person subject to the money laundering regime has to designate a money laundering reporting officer (MLRO) to transmit information on suspicious transactions to law enforcement authorities. In the UK, a personal liability attaches to MLROs.

**Question: Should other Member States include personal liability of MLROs and, if so, what are the arguments in favour?**

#### **IV. General questions**

- 1. Are there other issues that we have not documented which are also matters of concern?**
- 2. Are you aware of any analysis of the wider economic impacts that we would find useful?**
- 3. Are there any other measures in the revised FATF 40 Recommendations that you think are insufficiently covered by the proposed Third Money Laundering Directive?**

**HM Treasury would like to know and understand all potential issues and concerns that all interested parties have on the draft directive before negotiations start. We would therefore be interested in hearing from interested parties who have views on either the issues this document has highlighted, or on any other issues that are not documented.**

**If you would like to respond to this consultation, please do so by 18 June 2004, to:**

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*HM Treasury, 27 May 2004*

## **Glossary**

CDD	customer due diligence
EU	European Union
FATF	Financial Action Task Force on Money Laundering
FSA	Financial Services Authority
JMLSG	Joint Money Laundering Steering Group
MLD3	Third EC Money Laundering Directive
MLRO	money laundering reporting officer
QMV	qualified majority voting (an EU voting system: each Member State has a number of votes based on its size and population and a certain weighting of votes is required to pass a proposal; this means that unanimity is not required and a minority can be overruled)
PEP	politically exposed person(s)
regulated sector	see para. 18 (p.5 above)
RIA	regulatory impact assessment