5th Anti Money Laundering Directive: What Lies Ahead?

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THE 5TH AMLD DIRECTIVE (EU) 2018/843 will come into force in January 2020. So, where do these legislative ideas come from and how can the various jurisdictions and professional anticipate and possible push back against these forces? Let's begin with a bit of history, and a discussion about the 5th ALMD, that will help us to see the future of other changes that will be coming.

A sad fact is the EU AML Directives are required legislative initiatives. These required legislative initiatives are a treaty-bound requirement to enact laws as outlined by the OECD. The OECD grew out of the Marshall Plan to rebuild Europe after World War II and became a permanent world fixture with the signing of the "Convention on the Organization for Economic Co-operation and Development" on 14 December 1960 in Paris. Article 5 of the OECD Convention states, "In order to achieve its aims, the Organisation may: (a) take decisions which, except as otherwise provided, shall be binding on all the Members".

The Financial Action Task Force (FATF), from which all Anti-Money Laundering legislative initiatives have commenced in the last 30 years, is an organ of the OECD. In 1989 the G7 (Group of 7 OECD convention signatories with the largest economies in the world) passed an initiative to form an organisation whose specific function was to look at tax evasion, arbitrage, and money laundering in 1989. This initiative became the FATF, whose founding as an official organ of the OECD was formalised and commenced operations in 1990. The FATF's subsequent call to action was the 1998 initiative "Harmful Tax Competition". It was over 11 years later, and only after the attacks in the United States on 11 September 2001, that at the FATF's Extraordinary Plenary meeting on 29-30 October 2001 they chose to consider developing special guidance for financial institutions to help them detect the techniques and mechanisms used in the financing of terrorism.

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The point of this introduction is that the EU had no choice but to extend to all of the EU members, even those not a signatory to the OECD, to abide by the OECD initiatives.

The EU 5th directive is the natural outgrowth of the OECD-hosted Global Forum on Transparency and Exchange of Information for Tax Purposes. The FATF Recommendations are the most widely established international standards for ensuring the availability of beneficial ownership information, and the FATF definition has been adopted in both the Exchange of Information On Request (EOIR) and Automatic Exchange of Information (AEOI) Standards.

"From a tax perspective, knowing the identity of the natural persons behind a jurisdiction's legal entities and arrangements not only helps that jurisdiction preserve the integrity of its own tax system, but also gives treaty partners a means of better achieving their own tax goals. Transparency of ownership of legal entities and arrangements is also important in fighting other financial

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crimes, such as corruption, money laundering, and terrorist financing, so that the real owners cannot disguise their activities and hide their assets and the financial trail from law enforcement authorities using layers of legal structures spanning multiple jurisdictions."[1]

The 5th AMLD addresses several areas.

1. The directive extends the scope of the AMLDs to virtual currency platforms, wallet providers, traders of art, and tax-related services.

The regulators appear to now understand that there are many things that can contain value that can be exchanged. The crypto currency market as of 5 November 2019 has a market capitalization of USD 252 billion spread unevenly over 3,053 crypto currencies with 240 exchanges. [2] While this seems to be a great deal, in terms of the world supply and turnover of funds it is not much. There is also the truth that most crypto currencies have failed with a high percentage of Initial Coin Offerings (ICOs) as frauds. It is my expectation that shortly, all crypto currencies will and should be regulated just like any other currency. An objet d'art can store a great deal of value, but the art market is opaque, private, and works on purposefully asymmetric and incorrect information. The regulators misunderstand the art market in its entirety. As for tax-related services, let's get back to the FATF objectives – the AMLDs are about buttoning up a country's economy so the country's residents can be taxed.

2. It will require member nations to grant access to the public beneficial ownership information of EU- based companies created under the 4th AMLD; while this is not required by the FATF, the EU has deemed it desirable. It also makes it an obligation to check these registries as part of the Know Your Customer (KYC) process.

This requirement poses a host of risks. It will allow criminals to sift and sort and look for the wealth of individuals they have kidnapped and/or create a menu of kidnap targets. This has already occurred, albeit by accident, when a news source revealed the wealth of the owner of a hijacked ship. As a result of the disclosure, just as they were concluding negotiations with the pirates, the pirates learned of the true wealth of the owner and raised the ransom demand 30- fold. The ransom demand inflation was so severe, what once was an almost settled ransom over a three month time period then dragged on for over a year. The pirates knew they had a wealthy owner, not one in financial trouble. The K&R insurance underwriters are looking at the impact of the Ultimate Beneficial Owner (UBO) registries, the easy access to information once kept private, and the impact on the inflation of ransoms and thus the cost of insurance.

The 5th AMLD is problematic for innovation. Competitors will be able to uncover what their competition might be contemplating under affiliated companies. Innovation and property acquisitions, once private, will become public and will be a tremendous resource to the Competitive Intelligence Professionals.

The UBO disclosure information requirements are expensive to create and maintain. The 5th AMLD will cost the honest financial institution and commercial enterprise a good deal of money to implement, in reality, a criminal can structure the UBO using a nominee or use a revenue-sharing agreement where a vast majority of the revenue is apportioned to a criminal third party. The companies run by criminals have zero ownership value as they are disposable entities. The value is the control of the cash streams. Once again, it looks like a compliance requirement without benefit or impact.

3. This directive requires member states to create a list of national public offices and functions that qualify as politically exposed and, therefore, anyone holding those offices will be designated a politically exposed person (PEP).

This is of great help to all in determining who is and who is not a politically exposed person and will be helpful in the KYC process for all. It will fix the difference of opinions between regulators and regulated on exactly who is and who is not a PEP.

4. This directive creates central access mechanisms to bank accounts and safe deposit boxes holder information throughout the EU and ends the anonymity of bank and savings accounts and safe deposit boxes.

To be sure this is Orwellian, but for the most part, the EU member nations have long eliminated anonymity for all of these services. This appears to be a shot at those nations who still permit limited privacy. The push back will come from the EU when the EU will require some sort of "parity" with those nations as part of any Mutual Legal Assistance Treaty (MLAT) or trade negotiations. The central registry is aimed at taxation – period. However, the registry can also serve to aid heirs looking for funds as well as in the location and freezing of the assets of frauds, corruption, and other crimes. All national registries will be interconnected through the European Central Platform.

5. There are proscribed enhanced due diligence measures for financial flows from high-risk third countries.

This proscription addresses the ham-fisted attempts of many financial institutions to conduct due diligence. The abject failures of so many financial institutions, both large and small, are plain for all to see. My experience tells me it is worse than we have seen in the media. In a review of many banks' AML, KYC, and Due Diligence procedures in dealing with correspondent banks, not one of my bank clients had a copy of the client bank's AML, KYC, or Due Diligence compliance manuals. It also specifically includes the capability for entities to use eiDAS-compliant technology for the completion of their Customer Due Diligence requirements, introducing a path for a transition to the widespread use of electronic means for KYC/AML/CTF purposes. This too is bound to fail. Proscribed due diligence is just a longer checklist with the due diligence clerks following yet another mindless checklist.

6. All real estate holders' names and addresses will be compiled in a centrally available database accessible to the public authorities.

The use of companies to hold real estate to avoid punitive transfer taxes is at the heart of this initiative. Like the UBO requirements, the ability to structure and keep the UBO private and to continue the use of entities to hold property will continue. The registry is about taxation not the prevention of criminals owning and controlling and transferring assets.

7. Enhances the powers of the Financial Intelligence Units (FIUs) and facilitates cooperation and information exchange among authorities.

This eliminates conflicts in the interpretation of several laws on the

books in different EU countries to address what is private and what can be exchanged. The permission for the exchange of information and the enhanced ability for the FIUs to request and share the information is at the core of this recommendation.

8. Lowers thresholds for identifying purchasers of prepaid cards and for the use of e-money.

The current regulations of most developed economies make the adaption of stored value cards and electronic money difficult. The advent of mobile money and use throughout the world has not caught on in most "over-regulated" jurisdictions. The impact that mobile money has made in places like East Africa has been transformative. M-Pesa started in Kenya but has since expanded to Tanzania, Lesotho, Mozambique, Democratic Republic of the Congo, Ghana, and Egypt and conducted over 11 billion transactions in 2018.[3] This lower threshold will help the unbanked and the under served communities. It might even permit some innovation.

The 5th AMLD is another bid to pass laws required by treaty obligations to recognise value in assets and to monitor transactions. It is about the identification of assets and income streams to tax.

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Implementation will take time. The 5th AMLD has already required a great deal of retooling and expenditures for the financial industry and government. The costs of retooling the financial industry, yet again, and the costs of the creation and maintenance of the massive private and public databases on UBO, property, bank accounts, and safety deposit boxes, as well as KYC/Due Diligence remediation and training for employees, is costly. I do not expect that the regulations will generate the tax revenue in amounts anywhere near the cost of new government infrastructure and commercial compliance obligations. The current threshold will stay, and the 10 per cent desired threshold was pushed back, as it was not deemed necessary at this time. It is wise to expect the 10 per cent threshold to be pushed when the 25 per cent does achieve desired results.

There will also come a point in time where the economic friction (indirect costs related to a transaction) become so great that some participants will leave the EU markets and other similarly regulated countries. The OECD understands this and will continue to enforce regulatory hegemony/homogenisation amongst member nations and their trading partners in all other jurisdictions. Do not kid yourself, it is comply or die. Expect more blacklists.[4]

Footnotes

1. Beneficial Ownership Implementation Tool Kit – published by the IDB and the OECD 19 March 2019
2. According to CoinMarketCap.com as of 05 November at 6:30 PM UTC
3. From www.vodafone.com/what-we-do/services/m-mesa on 05 November 2019
4. 90 nations have been blacklisted at one time or another to force the hegemony