Capital Markets and Financial Institutions — 28 June 2013

Focus
- Money Laundering and Terrorist Financing

In this newsletter, we will focus on money laundering and terrorist financing. In this connection, we will take a look at which changes the European Commission's bill for a new Anti-Money Laundering Directive will entail if it is adopted in its current form. Based on a recent judgment by the High Court of Eastern Denmark, we will take a look at how sentences for violation of the Danish Act on Measures to prevent Money Laundering are fixed in practice. Finally, we will look into which new elements the Danish Financial Supervisory Authority's updated guidelines for the Danish Act on Measures to prevent Money Laundering contain.

The European Commission's Bill for a new Anti-Money Laundering Directive

The current directive

The current Anti-Money Laundering Directive (click link) from 2005 is the third of a number of directives on anti-money laundering. The directive replaced the Anti-Money Laundering Directive from the early nineties and expanded the original scope of the directive to also cover matters other than money laundering in connection with drug crime. The directive is based on the forty so-called FATF-standards from 2003, which have since then been continuously updated.

Among other things, the current Money Laundering Directive added rules prescribing that terrorist financing was to be governed by the anti-money laundering rules, that financial institutions may not provide anonymous bank accounts, that customers must be identified and that all suspicious transactions must be reported to a register. In Danish law, the Anti-Money Laundering Directive is incorporated in the Danish Act on Measures to prevent Money Laundering (click link - in Danish).

Why is it necessary to propose a new Anti-Money Laundering Directive?

The constant technological development and dismantling of barriers in the Single European Market not only benefits the establishment and development of companies in the EU, but also increases the opportunities for criminal activities.

Therefore, it is necessary to continuously adapt the legislation, in order that there always are effective rules to avert and prevent money laundering and terrorist financing. As mentioned, the EU legislation is based on the FATF-standards, and in connection with an extensive revision of these standards in 2012, the EU Commission ordered an examination of the scope of the EU law. The conclusion of the report prepared by the Deloitte is that it would be advantageous to carry out a revision of the Anti-Money Laundering Directive and to make the rules clearer and more transparent with regards to a number of matters regulated by the directive. Therefore, 5 February 2013, a new Anti-Money Laundering Directive was proposed. This directive will be the fourth in the line of anti-money laundering directives.

What is money laundering and terrorist financing?

"Money laundering" is a process where the origin of funds obtained unlawfully is obscured, thus making it impossible to determine that the funds derive from criminal activities. "Terrorist financing" is a designation for funds obtained both improperly and properly which are used to finance terrorism.

It has not been proposed to change these definitions in the bill put forward, but in the catalogue of criminal activities covered by the definition of money laundering, it is added that breaches of tax rules are also to be governed by the directive.

What is new?

The FATF-standards include recommendations in relation to electronic cross-border money transfers. This is not a part of the Anti-Money Laundering Directive, but has instead been implemented in the EU

through an EU-Regulation. In connection with the submission of the bill for a new Anti-Money Laundering Directive, a new Regulation regarding the aforementioned subject was also proposed. Figure 1 provides an overview of the new elements in the bill.

Figure 1. Overview of the bill's new elements

	In the Bill for a new Anti-Money Laundering Directive, it is proposed to...
➡	expand the scope of the directive and reduce the threshold for the cash payments covered to EUR 7,500
➡	expand the provisions regarding politically exposed persons
➡	change the rules regarding customer identification, in order that a risk-based approach is always applied
➡	lay down new rules regarding identification and storage of information on a company's beneficial owners
➡	strengthen the cooperation between the different national financial intelligence entities
➡	assign further sanctioning powers to the competent authorities

How is the scope of the directive changed?

The Anti-Money Laundering Directive covers a wide range of natural and legal persons, e.g. credit institutions, financial institutions, auditors, real estate agents and other persons trading with goods, cases where a cash amount of EUR 15,000 or more is paid or received as well as casinos. As the Anti-Money Laundering Directive lays down a number of minimum requirements, each individual member state may choose whether the rules of the directive should apply to a larger group of people.

If the bill is adopted in its current form, the scope will be expanded. Thus, it will not only apply to the aforementioned persons, but also to letting agents. The threshold of how large a cash amount is paid or received is reduced to EUR 7,500, and in the future, not only casinos, but also providers of gaming services in general will be covered by the directive. The latter should be viewed as a consequence of the fact that the market for online gaming services has grown explosively since the Anti-Money Laundering Directive was adopted in 2005.

What is changed with regards to politically exposed persons?

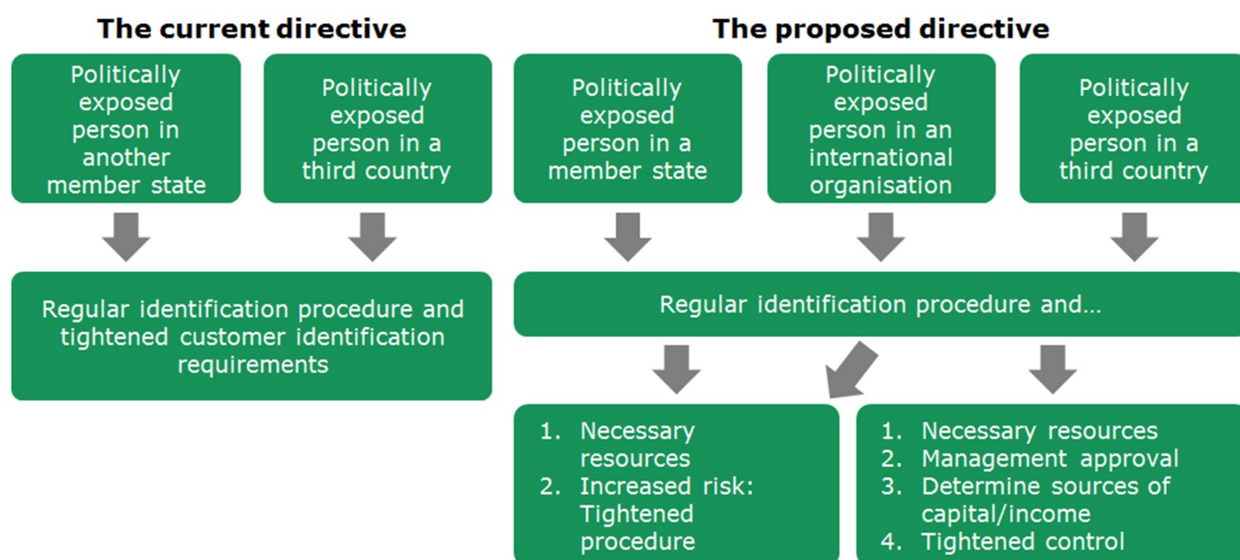
The basis for the Anti-Money Laundering Directive is that, in general, certain types of customers constitute a higher risk than other customers. One of the customer groups, which generally constitute a higher risk than other customers, is the so-called politically exposed persons. Politically exposed persons are persons who have or have had a higher public function, e.g. heads of government, ministers, members of parliament, Supreme Court judges and ambassadors.

In the current directive, a tightened customer identification requirement applies if such a politically ex-

posed person is domiciled in another member state or in a third country. Henceforward, a distinction must be made between politically exposed persons domiciled within the EU and politically exposed persons domiciled outside of the EU.

Furthermore, there is a third category of persons with a higher function in international organisations. Therefore, the directive will also equate politically exposed persons from the person in question's own member state, which were previously not covered, with politically exposed persons from other member states. In connection with the customer identification procedure, different procedures must be carried out, dependent upon on the type of politically exposed person. The rules regarding politically exposed persons also cover family members and close associates of the person with a higher public function. Figure 2 illustrates the consequences of the bill for politically exposed persons.

Figure 2. Politically exposed persons



The detailed provisions on how to define politically exposed persons are moved from a Commission directive to the Anti-Money Laundering Directive itself.

What is changed in the customer identification procedures?

The current Anti-Money Laundering Directive distinguishes between three different customer identification procedures: the regular customer identification procedure, an eased customer identification procedure and a tightened customer identification procedure. The tightened customer identification procedure applies "on top" of the regular customer identification procedure. When establishing a business relationship with persons who themselves are covered by the directive, an exemption applies under the current directive. Thus, there is no requirement to carry out customer identification.

This exemption has been removed in the bill, and instead no easing of the customer identification requirements will apply as a result of the person in question belonging to a certain category. The ap-

proach is to be risk-based. A requirement for a tightened customer identification procedure for certain types of customers, e.g. politically exposed persons, will still apply.

Harmonisation of the definition of a company's beneficial owner

To ensure that money laundering or terrorist financing is not conducted through different company law constructions, the Anti-Money Laundering Directive requires that a company's beneficial owner must be identified. The beneficial owner is the natural person(s), who ultimately own(s) 25% of the company. The rules also apply to other legal entities such as trusts.

The rules on the calculation of the 25% threshold have been interpreted differently in the individual member states. Therefore, it is proposed to change the wording in order to achieve greater harmonisation.

As a new measure, it has been proposed to adopt rules stating that companies etc. must obtain and store correct and current information on the entities' beneficial ownership.

Strengthening of the cooperation between the national financial intelligence entities

The cooperation between the national financial intelligence entities has only been mentioned very briefly in the current Anti-Money Laundering Directive. Here, it is only stated that the Commission must provide the assistance necessary to facilitate cooperation between the entities. The national financial intelligence entities have established a cross-border network for the sharing of information, the FIU platform, which the Danish Money Laundering Secretariat is a part of.

If the bill is adopted in its current form, it will lead to more provisions on the sharing of information being provided in the directive. At the same time, more guidelines on data exchange and cooperation with Europol will be provided.

Sanctions

Under the Money Laundering Directive currently in force, the member states must ensure that persons obligated under the directive are held accountable for violations. The only requirements imposed by the directive with regards to the sanctions are that the sanctions must be effective, proportional and have a deterrent effect. This has led to very different sanctions for violations of the money laundering rules being imposed in the individual member states. In Denmark, the Danish Act on Measures to prevent Money Laundering states that a fine is the principal sanction, but in certain particularly severe or prolonged violations of certain provisions, the sanction may be prison for up to six months.

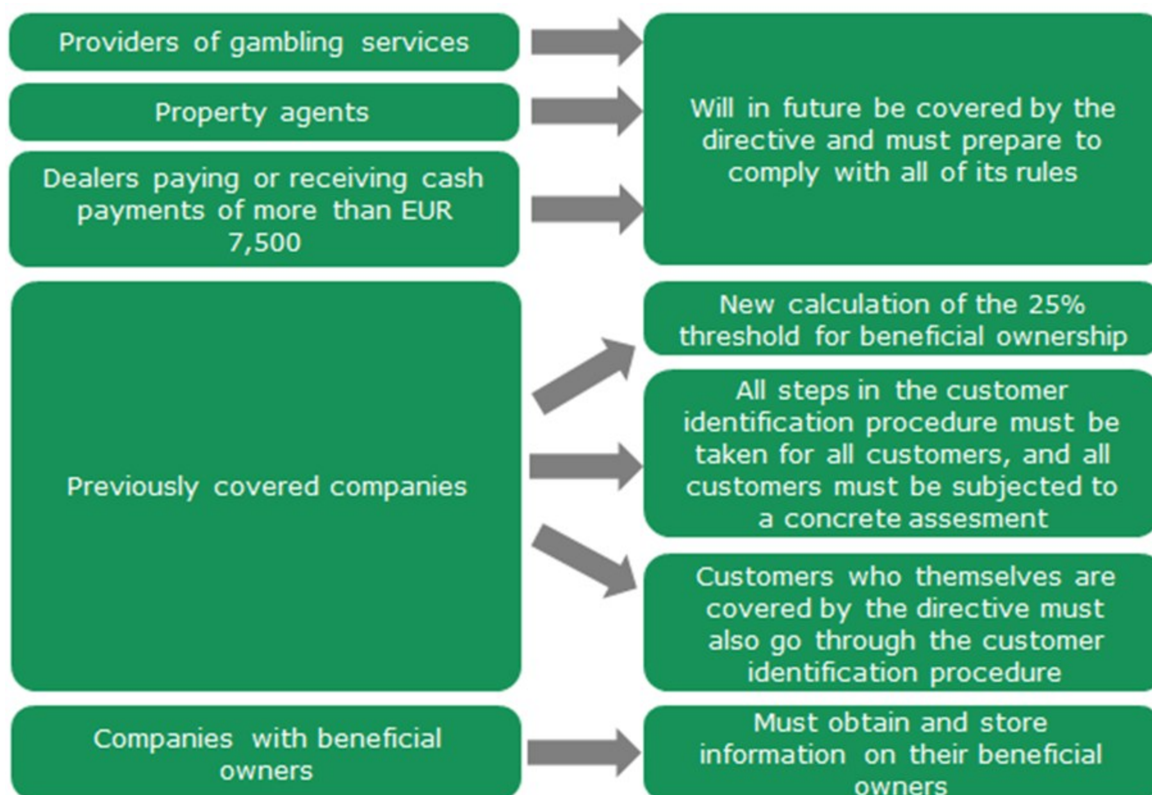
In continuation of the fact that certain minimum sanctions have been prescribed in other sets of rules for certain financial areas, it has been proposed that this should also be the case in the new money laundering directive. Thus, it has been put forward that in cases of systematic violations of e.g. the provisions relating to customer identification, the identity of the offender and the nature of the offence are to be published, that any permits are to be revoked, that administrative fines of up to 10% of the yearly turnover are to be imposed on legal persons and that fines of up to EUR 5.000.000 are to be imposed on natural persons. The new scope for sanctions is illustrated in figure 3.

Figure 3. New sanctioning powers

What must companies covered by the directive change?

The Directive entails that new companies are covered by the directive and that the companies already bound by the old directive are subjected to further obligations. The most material changes are illustrated in Figure 4.

Figure 4. What must companies bound by the directive change?



Henceforward, providers of gaming services and real estate agents must adapt themselves to comply with the conditions laid down in the Anti-Money Laundering Directive. As these two groups have not

previously been covered by the rules, it is important that these groups adapt their procedures etc. to the new requirements. The same applies to retailers who in the course of their business receive or pay cash amounts exceeding EUR 7.500. For the groups who were also previously covered by the directive it is particularly important to note that the rules relating to customer identification and beneficial ownership will change. Concretely, this implies that, henceforward, each individual step in the customer identification procedure must be applied to all customers - however, the extent may be modified following a concrete risk assessment. Henceforward, the customer identification procedure must, as a starting point, be carried out for customers who themselves are bound by the directive, unless the individual member state has decided that an eased customer identification procedure is sufficient. These companies are not, as was previously the case, completely exempt from carrying out the customer identification procedure. Depending on how Denmark chooses to implement the directive, there will be changes as to when a tightened customer identification procedure must be carried out.

The proposed changes to the rules regarding real ownership will influence two groups. Henceforward, companies etc. must collect and store appropriate, accurate and current information regarding their real ownership, in order that the covered entities will have easier access to the information. The covered companies must, if necessary, change their procedures for calculating the 25% threshold and adapt the procedure to the situations where the rules apply.

Furthermore, all covered units must change their procedures regarding politically exposed persons, thus taking into account the three new categories for such persons.

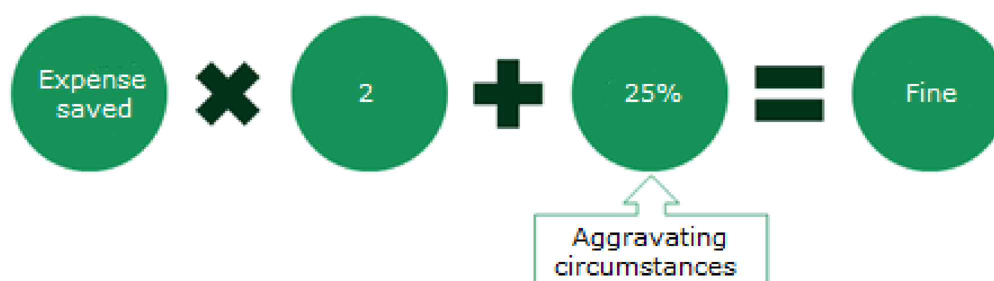
Sentencing in Practise

5 May 2013, the High Court of Eastern Denmark made a decision in an appeal case regarding violation of the Anti-Money Laundering Act. The City Court of Copenhagen had made a decision 14 September 2012 where the company was fined.

The High Court of Eastern Denmark fixed the fine taking the Anti-Money Laundering Directive into account, as neither the Danish Act on Measures to prevent Money Laundering nor its interpretative notes contains any provisions regarding fine levels. On the other hand, the Anti-Money Laundering Directive prescribes that the sanction must be effective, proportional to the severity of the offence and have a deterrent effect.

With the decision, the High Court laid down guidelines for the determination of fine levels. According to the City Court and the High Court, the amount saved by the company as a result of not complying with the regulations must be taken into consideration when fixing the level of the fine. As the aggregate savings in this case were estimated to be approximately DKK 1.000.000, the fine should therefore be twice this amount. However, in the case at hand, several aggravating circumstances were present, which meant that this principle was derogated from, resulting in the fine being fixed at DKK 2,500,000. The principle behind the High Court's fixing of fine levels is illustrated in Figure 5. Furthermore, the High Court emphasised that the company had deliberately been in violation of the Danish Act on Measures to prevent Money Laundering and the orders from the Danish Financial Supervisory Authority and that the violation had been taking place for several years.

Figure 5. The Principle for the Determination of Fine Levels.



The concrete case concerned a credit card company owned by approximately 130 stores, whose business was to offer unsecured consumer loans from DKK 5.000 to DKK 40.000. The company also issued credit cards useable for payment at the participating stores.

2 September 2009, the Danish Financial Supervisory Authority informed the company that an inspection would be carried out 1 October 2009. Prior to the inspection, a board member in the company wrote a letter to the Danish Financial Supervisory Authority, from which it appeared that the employees were aware of the fact that the company was covered by the Money Laundering Act, but that it was probably not likely that the company was being used for money laundering or for the financing of terror. For this reason, no educational programmes or compliance function had been established. Furthermore, the board member stated that the duty of inspection in Section 6 of the Money Laundering Act had not been observed, as the company did not have any complex or unusually large transactions or transactions with connections to countries where the risk of money laundering or financing of terror was prolific according to the FATF.

The Danish Financial Supervisory Authority's inspection took place 9 November 2009, where it was noted that the company did not comply with the legislation regarding money laundering.

Two days after the inspection, a board meeting was held in the company. The minutes show that on the following board meeting, a topic concerning the risk of money laundering was to be included on the agenda. At the board meeting in December 2009, the board agreed on a number of situations where either a director or an attorney was to be notified. 5 February 2010, the company was ordered by the Danish Supervisory Authority to prepare a risk control policy, to appoint a compliance officer, to prepare written internal rules, to initiate educational and instructional programmes, to ensure an on-going monitoring of customer matters, to ensure an investigation of the purpose behind the customer transactions, to ensure that the duty of inspection was observed and to ensure the compliance with EU regulations regarding financial transactions. The order had to be complied with before 15 March 2010. The enforcement order was discussed on the board meeting 2 March 2010, and the minutes show that the board was of the opinion that the Danish Financial Supervisory Authority's report lacked common sense and that the company should neither spend time nor money on incorporating the report's conclusions in its procedures. Conversely, the company would appeal the case in order to gain time.

Therefore, the board of directors brought the case before the Danish Company Appeals Board which in December 2010 upheld the Danish Financial Supervisory Authority's decision.

As mentioned above, the City Court of Copenhagen decided that the Money Laundering Act had been violated and consequently fined the company. The High Court agreed to the City Court's decision regarding the question of guilt and fixed the fine as described above.

New Guidelines from the Danish FSA

21 April 2013, the Danish FSA published new guidelines for the Danish Act on Measures to prevent Money Laundering (click link - in Danish). In addition to some consequential amendments and editorial changes, the new guidelines inter alia contain an update of the guidelines' section regarding the scope of the Danish Act on Measures to prevent Money Laundering. One of the most significant changes is that professional physical transport of cash is indicated as being covered by the law. In addition, reference is made to an expected amendment to an act (based on the abovementioned bill on a new anti-money laundering directive) regarding a reduction of the threshold for cash payments from DKK 100.000 to DKK 50.000.

The guidelines' section regarding the "know your customer" principle has been added, including a section regarding the use of NemID, a log-in solution for Danish Internet banks, government websites and some other private companies, in connection with the identification procedure. According to the guidelines, NemID may be applied in the identification procedure as a supplementary identification measure, but that NemID may not be the only measure used to identify the customer. Furthermore, NemID may be used in low risk customer relationships if the covered company correlates the data with the CPR register. Moreover, an entire new section regarding correspondent banking relationships has been added. According to the guidelines, such relationships are considered to be established when SWIFT keys have been exchanged with the foreign credit institute or at the establishment of an account or custody connection.

Finally, it is stated in the guidelines that the obligated companies may refrain from obtaining identification and information proving identity if the information is provided by an attorney or an auditor.

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