The implications of Brexit for UK anti-money laundering regulations

Will the fourth AML directive be implemented or be binned?

Norman Mugarura

Department of Research,
Global Action Research and Development Initiative Limited, Barking, UK

Abstract

Purpose – The purpose of this paper is to explore the law relating to European Union (EU) Anti-Money Laundering (AML) Directives and the effect of Brexit on money laundering regulation in the UK and the EU. The first part of the paper involves a review of AML Directives and how they are transposed into the UK. The question whether the fourth AML directive or other directives due to become law in the UK will be implemented or culled will largely depend on the relationship between the UK and the EU going forward. The UK will have the full autonomy in terms of making decisions as to which laws to implement or which laws to scrap or to cull, as it sees fit. The UK having relinquished its membership of the EU notwithstanding could still be bound by EU anti-money directives particularly if it chooses to remain in the EU single market. The UK could also forge alliances with EU member states and in which case it will be expected to apply the same EU market rules as its other EU counterparts. The fourth AML directive that was due to become law in all EU member countries in June 2017. This directive was introduced to streamline the third AML directive (2005/60/EC) largely with regard to beneficial ownership of nominee accounts and politically exposed persons (PEPs).

The paper scoped current EU AML directives, and how they have been used in the fight against money laundering both in the UK and beyond. Brexit is likely to have far-reaching implications on many regulatory areas, including in prevention of money laundering and its predicate offences in the UK and the EU. The fourth AML directive was due to become law in the UK on 26 June 2017, and whether the UK Government will go ahead and implement it or bin remains to be seen.

Design/methodology/approach – The paper has evaluated the potential effect of BREXIT on EU AML Directives in the UK, drawing examples in non-EU countries. It articulates the raft of EU AML Directives to assess whether the fourth AML directive (which was due to become law in June 2017) will become law in the UK or be culled. It draws on experiences of non-EU countries like Switzerland and Norway, which despite not being members of the EU, have full access to the EU single market. The first part of the paper provides a review of AML Directives in Europe and how they are internalised into member countries. Data were evaluated often alluding to existing mechanisms for harnessing EU AML Directives in member countries. The last part of the paper proposes the measures that are ought to be done to minimise or forestall the threat of money laundering and its predicate offences in the post-Brexit regulatory environment.

Findings – The BREXIT has already unravelled markets both in the UK and in the EU with far-reaching implications on money laundering regulation in multiple ways. The paper has articulated the mechanisms for internalisation of EU AML directives in all Member countries and countries that want to exit the EU. It is now clear that, as the UK voted to relinquish its membership of the EU, it will not be under any obligations to apply EU AML regimes or any other EU laws for that matter. The findings of the paper were not conclusive, as the UK government has not yet triggered Article 50 of Treaty of Lisbon on the functioning of the EU. The fourth AML directive, which was due to become law in the UK on 26 June 2016, could still be adopted or culled depending on the model the UK decides to adopt in its relationship with the EU going forward. There is a possibility for the UK to remain a member of the EU single market and to retain some of the regulatory rules it has operated in relation to money laundering regulation and its predicate offences. It could adopt the Norway, Switzerland or the Canadian model, each of which will have different implications for the UK and the EU in terms of their varied AML obligations. It will be in the commercial interests of the UK Government to not cull the fourth AML directive (which was due to become law in June 2017) but to transpose it into law.
Research limitations/implications – There were not so many papers written on the issue of Brexit in the context of this topic. It was therefore not possible to carry out a comparative review of Brexit and its effect on money laundering regulation in the UK, drawing on experiences of other countries that have exited.

Practical implications – Brexit is likely to have far-reaching implications on many regulatory areas, including prevention of money laundering and its predicate offences in the UK and the EU.

Social implications – The Brexit has elicited debates and policy discussions on many regulatory issues and not the least money laundering counter-measures in the post-Brexit environment. Brexit will have far-reaching implications for markets, people and national governments both in the EU and beyond. It has already unravelled social and economic life both in the UK and in the EU. The significance of paper is that it could enhance future research studies on money laundering regulation within countries delinking from regional market initiatives to address attendant changes.

Originality/value – This paper proffers insights into the Brexit and its implication on AML regulation in the UK and the EU during and post-Brexit era. To curtail the social-economic effect of Brexit on financial markets regulation, the UK should remain a member of the European single market not only to minimise the potential of losing more ground and leverage as a financial capital of the world but also to protect financial markets tumbling downhill!

Keywords Regulatory changes, Brexit, AML Directives, Non-EU member countries, vlmImplications of Brexit, EU Directives, Fourth AML Directive Regulatory Changes

Paper type Research paper

1. Introduction
The question of whether the European Union’s (EU’s) fourth anti-money laundering (AML) Directive, or other directives due to become law in the UK, will be implemented or culled will largely depend on the relationship between the UK and the EU going forward. The UK will have full autonomy to make decisions as to which laws it implements or which laws it scraps or culls as it sees fit once it has withdrawn from the EU. The UK, notwithstanding having relinquished its membership of the EU, could still be bound by EU AML Directives, particularly if it chooses to remain in the EU’s single market. The UK could also forge alliances with EU members states, in which case it will be expected to apply the same EU market rules as its other EU counterparts. The fourth AML directive was due to become law in all EU member countries in June 2017. This Directive was introduced to streamline the third AML directive (2005/60/EC) largely with regard to the beneficial ownership of nominee accounts and politically exposed persons (PEPs). This paper scopes current EU AML Directives and how they have been used in the fight against money laundering both in the UK and beyond.

The paper has evaluated the potential effect of Brexit on EU AML Directives in the UK, drawing examples from the UK and the EU. It also details the raft of EU AML Directives as a backdrop for assessing whether the fourth AML directive (which was due to become law in June 2017) will become UK law or be culled. It also alludes to the experiences of non-EU countries like Switzerland and Norway, which, despite them not being members of the EU, have full access to the EU’s single market. The first part of the paper provides a review of AML Directives in Europe and how they have been internalised by the EU’s member countries. Data were evaluated that often alluded to the existing mechanisms for the harnessing of EU AML Directives by member countries. The last part of the paper proposes measures that ought to be taken to minimize or forestall the threat of money laundering and its predicate offences in the post-Brexit UK regulatory environment.

Brexit has had far-reaching implications for markets both in the UK and in the EU in multiple ways. It is now clear that as the UK has voted to relinquish its membership of
the EU, it will not be under any obligation to apply EU AML regimes or any other EU laws for that matter in future. The findings of the paper were not conclusive, as the UK government had not triggered Article 50 of the Treaty of Lisbon at the time of writing. The fourth AML directive, which was due to become law in the UK on 26 June 2016, could still be adopted or culled depending on the model the UK decides to adopt for its relationship with the EU going forward. There is a possibility that the UK may remain a member of the EU’s single market and therefore retain some of the regulatory rules that it has operated until now in relation to money laundering and its predicate offences. It could adopt one of the Norwegian, Swiss or Canadian models, each of which would have different implications for the UK and the EU in terms of their varied AML obligations. It would ultimately be in the commercial interests of the UK government not to cull the fourth AML directive (which was due to become law in June 2017) but to transpose it into UK law.

Brexit has elicited wide-ranging debates and discussions about policies. It will have far-reaching implications for markets, people and national governments both in the EU and beyond it. Brexit has already unravelled some of the social and economic life of the UK and this process is likely to be far from over. This paper proffers insights into Brexit and its implications for AML regulation in the UK and the EU. To reverse the socioeconomic implications of Brexit on money laundering and financial regulation, the UK should remain a member of the European single market not only to minimize the potential of losing more ground and leverage as a world financial capital but also to protect its financial markets from sliding in their global significance.

2. Background analysis

“Brexit”, which was the term coined to describe Britain’s exit from the EU in the referendum held on 23 June 2016, has the potential to unravel financial markets in the UK, the EU and elsewhere in the world in a multiplicity of ways. Brexit will not only change the UK financial markets’ regulatory landscape, as it is obvious that the UK will no longer be bound by EU laws but also elicit wide debates on the UK’s future relationship with its European counterparts (Mugarura, 2016a, 2016b).

Article 50 of the Treaty on European Union (TEU, also known as the Treaty of Lisbon 2009) lays down modalities for the potential exit of a member state, which provides that EU treaties would automatically cease to apply to a departing member after a period of two years from the date of its notification of its intention to leave the EU[1]. Bearing in mind that international law operates on the basis of consensus between states in the forms of interstate agreements, both the UK and the EU will have to enter into negotiations until they have reached a satisfactory new arrangement that caters for their varied interests going forward. The UK acceded to the European Communities (ECs) by its adoption of the European Communities Act (ECA) in 1972, an enabling Act that formed the basis for the UK’s relationship with the then EC. For instance, Section 3 of the ECA stipulated that in the event of conflict between UK and European law, the latter would take precedence. The 1972 ECA will have to be repealed because EU law will no longer have primacy over UK laws in the post-Brexit legal dispensation. Repealing the ECA will bring an end to the constitutional relationship between EU and UK law and, thus, the vast amounts of secondary legislation that has been passed to give effect to EU law will have to be considered by the UK Government. The government may decide to retain that body of law or to scrap it because EU law will no longer have a binding effect in the UK or any other member that may decide to leave the EU in future, for that matter.
Similarly, following the UK’s invocation of Article 50 of the Lisbon Treaty (2009), it will no longer be bound by EU laws, including its AML laws whether they have already been passed or are in the process of being passed into UK law[2]. It will also have full discretion to decide which EU laws to retain and which laws to scrap and to determine any variants that will replace them. There is also a possibility that the UK could still implement EU AML Directives, if it chooses to remain a member of the EU single market or to forge post-Brexit alliances with EU countries. While the UK can impose its own variant laws [as it did, when it passed the Sales of Goods Act (1979) or the Proceeds of Crime Act (POCA) 2002], it could also retain some EU AML regulations.

The EU is governed by an elaborate system of rules, including directives and regulations, which are augmented by decisions of the European Court of Justice (ECJ), which settles disputes involving the EU and member states. The EU legislates in many regulatory areas and asks member states to adopt its laws to form a uniform framework across the Union in an agreed timescale, or immediately in the cases of regulations and ECJ decisions. The EU’s elaborate framework of rules is applicable by all member states. For example, when regulations have been issued to a member state, by either the European Council or the European Commission, they are directly applicable to member states. Regulations are binding legislative acts to be applied in their entirety by all EU countries.

EU laws take precedence in member countries in a number of forms – i.e. regulations and decisions of the ECJ. The decisions of the ECJ must be implemented by member states pacta sunt servanda[3]. The third form of EU laws is Directives, which, unlike regulations, must be transposed by member states normally within two years. Once the decisions of the ECJ have been issued, they are final and must be implemented by member countries without further negotiation (Europa, 2015).

The upsurge of EU regulations applicable to UK businesses was exploited by the “Brexiteers” who argued that the EU had not only outlived its purpose but also encumbered UK businesses and prevented them from operating freely (The Guardian Newspaper, 2016). EU Directives require implementation by member countries before they can have any binding legal effect. As the UK has voted to exit the EU, it will have unfettered discretion to decide which EU laws to adopt, when they have already been passed by the UK Parliament, or to replace or repeal those of which it does not approve (The Guardian Newspaper, 2016). Unlike Directives, which require implementation before becoming law, EU Regulations have had direct applicability and have been directly implemented into UK law without recourse to further legislative measures in Parliament. By contrast, Regulations are more powerful legislative instruments than Directives because of their immediacy in application. However, because of the upsurge of regulations, there could be a quicker erosion of their effects in the post-Brexit era when compared to Directives, as there will be no implementation of national legislation during the period of transition as the UK decouples itself from the EU.

The originality of this paper derives from the fact that there have not been many papers that have been written about Brexit in this context. It has a relevant message for those who have a vested interest in addressing money laundering and its predicate offences and the role that EU AML Directives will have during the Brexit negotiation process and in the post-Brexit AML regulatory environment.

3. European Union anti-money laundering directives and financial institutions
The EU has long been at the forefront of fighting money laundering, and this has been manifested since early initiatives that were taken by the Council of Europe (1990)
(Tsingou, 2005). The Council of Europe Convention of 1990 was the first to apply a framework for the harmonisation of practices and policies regarding money laundering and the tracing, seizure and confiscation of the proceeds of crimes within European member states (Tsingou, 2005). The EU subsequently issued three AML directives (in 1991, 2001 and 2005) to bring about a certain degree of harmonisation among money laundering laws within its member countries. There are several discernible trends in the EU’s AML drive:

- the linkage with the Financial Action Task Force (FATF) standards and discussions is both strong and in many ways, binding;
- G7 members, such as the UK and France, have been at the forefront of proposals and more eager to push for comprehensive regional standards; and
- countries with long-established offshore status, most notably Luxembourg, are experiencing intense pressure to address the potential weaknesses in their AML/Combatting the Financing of Terrorism (CFT) regulatory frameworks (Tsingou, 2005).

The European AML Directives are designed to bring EU law in line with international standards and the EU has been robust in the implementation of its international AML obligations. This robustness is reflected in the fact that every time the FATF has adopted new sets of recommendations, the EU has responded by adopting Directives (measures) to introduce those obligations in EU member states. For example, after the FATF issued its first 40 recommendations, the European Council adopted its first AML directive in June 1991. When the FATF revised its recommendations in 1996 to extend their scope to “designated non-financial businesses and professions”, the European Council issued the second AML directive in December 2001.

The second European AML directive (91/308/EEC) was adopted in the form of amendments to the first directive, inserting a new provision which required member states to ensure that obligations laid down in the first directive were imposed on, amongst other bodies, notaries and other independent legal professionals assisting in the planning or execution of any activities which effectively constituted money laundering (FATF Recommendation, 2012). The Directive was adopted to address fears among EU member states that an integrated financial system could promote drug trafficking and money laundering, thereby undermining the integrity of the financial system and disrupting the market (EC Directive: 77/780/EEC). They were also troubled by the prospect of ad hoc efforts to curb money laundering by individual nations, which they perceived would have a negative effect on the achievement of a unified system. Thus, the Directive prescribed a series of measures for all member states to adopt in their efforts to tackle money laundering. It prohibited the “knowing acceptance” and disposition by financial institutions and nonbank finance companies of the proceeds of non-drug-related crimes and the proceeds of narcotic trafficking[4]. It thus required member states to criminalize the laundering of the proceeds of drug offences as set out in the United Nations Convention and “any other criminal activity designated as such for the purpose of this Directive by each member state.” (Alexander, 2000). The Directive primarily called for the adoption of prevention and detection mechanisms against money laundering and terrorism by financial institutions (Alexander, 2000). It applied to all financial institutions because of their potential vulnerability to money laundering schemes. Financial institutions were defined in the directive as “undertakings whose business is to receive deposits or other repayable funds from the public and to grant credit for their own account” (EC Directive: 77/780/EEC).
The Directive defined financial institutions as “an undertaking other than credit institutions whose main activity is to carry out one or more of the functions listed in the Second Banking Directive.” (Article 1, EC Directive: 77/780/EEC). These functions included lending (consumer and mortgage credit), financial leasing, money transmission services, guarantees and commitments, trading for their own accounts or for customer accounts, money broking, portfolio management and advice (EC Directive: 89/646/ECC). Financial institutions also included insurance companies authorised in accordance with the Insurance Directive (79/267/EEC) as amended (Alexander, 2000). Credit and financial institutions included branches located in European states whose home offices were based outside Europe (Alexander, 2000). Article 12 of the Directive provided that member states must extend either all or part of the Directive’s professional categories, other credit and financial institutions referred to in Article 1, which engaged in activities likely to involve handling money and hence have the potential for being exploited for money laundering purposes. This would include casinos and the proliferating money changing or lending businesses that had emerged as a response to the contemporary dynamics of the global market (EC Directive: 91/308/EEC).

The third AML directive was adopted with a broad mandate, which extended its remit to lawyers and other professionals, such as accountants. The European Council Directive (EC Directive: 60/2005/EEC) on money laundering articulated the basic principles for the prevention of different money laundering typologies specified under EC Directive: 91/308/1991 in Europe. The third AML directive introduced a risk-based approach for carrying out “customers due diligence” (CDD). It also created a two-way reporting regime for low-risk clients (Article 9); and “enhanced due diligence” in situations regarded as being at a high risk of money laundering (EC Directive: 60/2005/EEC). The latter included situations where money was received without using face-to-face interactions with clients such as in online, telephone and other transactions. The second category related to cross-border banking relationships; a new category of politically exposed persons residing abroad was defined (Article 10) (EC Directive: 60/2005/EEC). The broad mandate introduced by the AML Directives was transposed by EU member states via national AML measures.

4. Sanctions mechanisms under the directive
Two types of sanctions mechanisms operate in the EU. First, there are specific sanctions (such as economic sanctions and the use of force) designed to implement the United Nations’ Resolutions pursuant to Chapter 7 of the Charter of the United Nations 1945 (Articles 40 and 41). Second, there are autonomous EU sanctions regimes, which include arms embargoes, trade sanctions, flight bans and restrictions on admission to the EU for countries aspiring to join the EU (European Union, Article 215 TFEU). EU Directive: 91/308/EEC prescribed a range of duties to credit and financial institutions who have been expected to take appropriate measures to ensure the full application of its provisions, and it described, in particular, the penalties to be imposed for the infringement of the measures adopted (Article 14, n 15). The European Commission brought its first action to enforce its money laundering directive in May 2000, when it instituted proceedings against Austria for failing to enact necessary laws to implement the foregoing directive. Pursuant to Article 226 of the Treaty establishing the European Economic Community (1957), the Commission alleged that Austrian legislation did not reflect the concerns raised by the European AML Directive (above). The FATF alleged that Article 40 of the Austrian Banking Act (1959) wrongly provided an exemption to the identification of customers who were opening passbook accounts. This had the effect of allowing persons
to open as many passbook accounts as they desired without declaring their identity (EC Directive: 91/308/EEC). Such a provision was clearly inconsistent with the Directive, which required member states to enact laws prohibiting financial institutions from keeping anonymous accounts and requiring them to take appropriate measures to identify customers (Alexander et al., 2006). Austria responded to this action and to pressure from other international bodies (e.g. the FATF) by amending Article 40 to prohibit the issuance of anonymous passbook accounts after 1 November 2000, as well as imposing an obligation to identify all depositors after this date (with the exception of holders of transfer securities deposits) (FATF, press release 2010).

The raft of foregoing measures is testamentary to the reality that the EU has adopted one of the strictest AML regimes of any jurisdictions. It perpetuates the know-your-customer or “KYC” concept, first introduced by the Basel Committee on supervisory banking standards, and later broadened in the FATF Recommendations. It added teeth to the suspicious transaction reporting standards advanced by the FATF by making such reporting mandatory (FATF, press release 2010).

The second AML directive extended the scope of money laundering to include a wide range of criminal activities. This was largely a reflection of the policy agenda derived from the “war on drugs”, which had served as a justification for the initial money laundering counter-measures introduced to combat the multifaceted threat of organised crime (Alexander et al., 2006). It also reflected the views of experts who advised that the limitation of money laundering just to drug trafficking would render the Directive ineffective. This was provided for in the United Nations report as follows: “The time may have come to end the artificial division of criminal money into categories depending on the nature of the crime”[5].

As far as the EU AML framework is concerned, the issue of money laundering and predicate offences has been partly addressed in the specific context of third-pillar measures on fraud and confiscation[6]. According to Recommendation 26 (b) of the action plan on organised crime, the criminalisation of laundering of the proceeds of crime should be created as broadly as possible to ensure a range of powers of investigation into these offences (Mugarura, 2016b). In its report on the first Commission Implementation, the European Parliament adopted a motion, whose resolution Point 5 called on all member states, insofar as they had already not done so, to extend their legislation on combating money laundering, not only to money derived from drug trafficking but also to professional practices and organised crime (Mugarura, 2016b).

The link between drug trafficking and money laundering was recognised in the adopted text of the Directive which stated that, “member states shall ensure that obligations laid down in this directive are imposed on the following institutions: credit institutions (as defined previously); financial institutions (also as defined previously); and on the following legal or natural persons acting in exercise of their professional activities: auditors, external accountants and tax advisors, real estate agents, notaries and other independent legal professionals, when they participate, whether: by assisting in the planning or execution of transactions for their clients concerning:

- buying and selling of real property or business entities;
- managing of clients’ money, securities or other assets;
- opening of management of bank, savings or securities accountants;
- organisation of contribution necessary for the creation, operation or management of companies;
creation, operation or management of trusts, companies or similar structures; or
by acting on behalf of and for their client in any financial or real estate transaction,
dealers in high value goods, such as precious stones or metals, or works of art,
auctioneers, whenever payment is made in cash and in amount of EUR 15,000 or
more” (Mitsilegas, 2003).

The Council reiterated the need to adopt a uniform framework based on the Tampere
European Council Conclusions expanding the scope of money laundering’s predicate
offences. This proposition was also reflected by the EU after the United Nations Convention
on Transnational Organised Crimes (Mitsilegas, 2003)[7]. Article 1(5) stated that, “in the
money-laundering field, the convention should extend a broad range of offences, and in
particular should be consistent with the 40 Recommendations of the FATF (Gilmore, 1995).”
This particular provision was incorporated as an acknowledgement of the international
trends of money laundering, such as the revision of the FATF Recommendations, justified
by the need to facilitate suspicious transaction reporting and international co-operation in
this area (Mugarura, 2013). Rather than following the all-crime prohibition, the Commission
opted for an extension to cover, along with the drug offences of the 1991 text, the following
conduct: participation in activities linked to organised crime, and fraud, corruption or any
other illegal activity damaging or likely to damage the ECs financial interests (Mugarura,
2013). The adoption of the EU Directive (91/308/EEC) was influenced by the increasing use
of financial and non-financial institutions for money laundering purposes (Mugarura, 2013).
This was considered to have resulted from money laundering counter-measures and the
increased level of compliance by credit and financial institutions – prompting launderers to
shift to non-regulated professions for their activities (Mugarura, 2013). This trend was also
associated with the sophistication in money laundering activities, which involved a wide
range of intermediary professions of varied expertise.

The growing role of professionals, such as accountants, solicitors and company
formation agents, was emphasised as they were frequently mentioned in money
laundering cases (Mugarura, 2013). In devising sophisticated schemes to conceal money
laundering, it was often the professionals who provided advice and extra layers of
respectability to money laundering operations (Mugarura, 2014a, 2014b). The FATF
addressed the foregoing concerns by revising the 40 plus recommendations in 1996.
Recommendation 8 (formerly 9) was revised to ensure that member states equally applied
AML standards to non-financial institutions which were not subject to formal prudential
supervisory regimes in all countries such as bureaux de change (Mugarura, 2013).
Recommendation 9 (formerly 10) on the other hand required national authorities to
consider an extension of the recommendations’ duties to “the conduct of financial
activities as a commercial undertaking by businesses or the professions, which are not
financial institutions, where such conduct is not allowed or not prohibited”. In the same
context, the European Parliament proposed the extension of the ratione personae scope of
the Directive to cover a wide range of professions at risk of being involved in money
laundering or abused by money launderers (Mugarura, 2013). The indicative list included
both the financial and non-financial professions, such as estate agents, art dealers,
auctioneers, casinos, bureaux de change, transporters of funds, notaries, accountants,
advocates, tax advisors and auditors (Mugarura, 2012).

The EU AML counter-measures were strengthened by the third AML directive, which
consolidated the first and second directives (Mugarura, 2012). The third AML directive
reflected the changed regulatory market environment and typologies of money laundering
as per the revised FATF 40 recommendations. The revision aimed, in particular, to extend
the scope of predicate offences, providing guidance on customer identification requirements, which now took place on a risk-based basis, taking into account categories of individuals such as PEPs and the misuse of corporate vehicles (Gilmore, 1995). As a strategy to undercut terrorist funding, which was largely fuelled by money laundering, the third AML directive signalled a concerted effort by the EU to link money laundering and the threat of terrorism (Gilmore, 1995). In relation to enhanced reporting requirements, member states were asked to establish financial intelligence units (FIUs) with the specific mandate to access the national databases of countries. This would help to overcome the issue of data protection provisions under national laws, which impeded organisations from accessing individuals’ files (Gilmore, 1995).

The EU Directives have been designed with mechanisms to ensure that credit and financial institutions have taken appropriate measures to ensure the full application of their provisions and, in particular, the penalties to be imposed for the infringement of those measures adopted (Gilmore, 1995). The European Commission brought its first action to enforce its AML Directive in May 2000, when it instituted proceedings against Austria for not enacting the necessary laws to implement its AML obligations. For example, pursuant to this provision, in 2000, the Commission brought Australia before the ECJ, alleging that it had failed to pass legislation that complied with the European AML Directives. Specifically, the FATF alleged that Article 40 of the Austrian Banking Act (1959) wrongly provided an exemption to identifying customers who had opened passbook accounts. This had the effect of allowing persons to open as many passbook accounts as they desired without declaring their identity (Mugarura, 2014a, 2014b) Such a provision was clearly inconsistent with the Directive, which required member states to enact laws prohibiting financial institutions from keeping anonymous accounts and requiring them to take appropriate measures to identify customers (Mugarura, 2014a, 2014b). Austria responded to this action and to pressure from other international bodies (e.g. the FATF) by amending Article 40 of its Banking Act to prohibit the issuance of anonymous passbook accounts after 1 November 2000, as well as imposing an obligation to identify all depositors after that date (with the exception of transfer securities deposits) (Mugarura, 2014a, 2014b). The Directive demonstrated that the EU had adopted some of the strictest AML standards of any jurisdictions. It has perpetuated “KYC”, the concept first introduced by the Basel Committee on supervisory banking standards, which was later broadened by the FATF Recommendations. It has added teeth to the suspicious transaction reporting standards advanced by the FATF by making such reporting mandatory (Mugarura, 2014a, 2014b). Even if the UK is about to relinquish its membership of the EU, it is unlikely that its operative AML regulatory regimes will change that much, given that most of the EU Directives are based on the FATF standards or on the United Nations framework in which the UK has been a dominant player. The UK, as a member of the FATF, is obliged to domesticate the FATF 49 recommendations on the varied issues to which they relate. What is likely to change is that it will no longer have to do so within the framework designated by the EU but in an autonomous manner, that reflects the UK’s economic interests (Mugarura, 2014a, 2014b).

The fourth AML directive prescribes a number of measures, which competent authorities may use to punish entities, which fail to implement EU AML/CFT obligations. These include not least:

- Publishing statements in the media in relation to instances of a designated person’s breaches of AML requirements.
- Making orders requiring a designated person to cease and desist specified conduct.
5. The proposed changes under the fourth European Union directive

The fourth AML directive provides a framework for sharing information on the beneficial ownership of companies and trusts that is to be made available to the public, allowing stakeholders to know the provenance of funds and to minimize the use of secretive legal structures [EU Directive (2015/849)]. The fourth EU AML directive came into force on 26 June 2015. The practice has been that once a Directive has been issued it must be transposed by a member state into its national legislation within two years [EU Directive (2015/849)]. This Directive was due to become law in the UK by 26 June 2017, and one wonders, what may happen now that the UK has voted to leave the EU? The primary objective of the fourth AML directive was to tighten loose ends in beneficial ownership rules and to simplify the CDD requirements. On beneficial ownership, most criminal networks use obscure company constructions to avoid detection by the authorities [EU Directive (2015/849)]. Moreover, these networks operate on an increasingly international level, further complicating the transparency of ownership. To link criminal activity to the proper persons and allow for prosecution, it is essential to uncover who owns an offending company. The fourth AML directive therefore stipulates that anyone who owns 25 per cent or more of a company should be registered as a so-called beneficial owner [EU Directive (2015/849)]. Technically speaking, as the UK has voted to exit the EU, it is no longer bound by EU law; thus, it will have its own native variant of the fourth AML directive. As all laws that were to be transposed into UK law, including the fourth AML directive, may be dispensed with, they cannot be imposed directly in the UK when it ceases being an EU member state [EU Directive (2015/849)].

The overriding purpose of the fourth AML directive is to modify and extend CDD requirements and to reinforce the “risk-based” approach to money laundering. The fourth AML directive has CDD requirements that include:

- CDD on cash transactions over €10,000 (a reduction in the limit from the current level of €15,000).
- CDD by providers of gambling services where customers wish to place a stake or collect winnings of at least €2,000 [EU Directive (2015/849)].

The Directive also calls for a broad definition of PEPs. The definition of PEPs is no longer limited to persons outside the UK but also includes people with high-level domestic appointments in the UK, foreign PEPs, and senior officials of international organisations, of whom enhanced due diligence checks are required [EU Directive (2015/849)].

6. Simplified customer due diligence

CDD information comprises the facts about a customer that should enable an organisation to assess the extent to which they are exposed to a range of risks. These risks include money laundering and terrorist financing (a survey of 10,000 companies on
how to run CDD[8]. Simplified CDD will have to be made in accordance with a risk assessment on individual customers and transactions. Regulated firms will be allowed to use simplified CDD where:

- the firm has identified an area of low money laundering risk; and
- the transaction within that area is considered to be low-risk.

In assessing the risk level posed by individuals or a transaction, the fourth directive provides a non-exhaustive list of factors that must be taken into account to provide evidence of lower-risk situations [EU Directive (2015/849)]. If a firm is able to identify certain factors as relevant to its transaction, it may be able to use a simplified CDD procedure. Customer risk factors, for example, include dealing with a public company listed on a stock exchange that is subject to disclosure requirements; or delivery channel risk factors, e.g. insurance policies and pension schemes; and geographical risk factors, e.g. non-EU countries with different standard AML systems.

7. Register of beneficial ownership

Member states will be required to ensure that information about the beneficial owners of businesses is stored on a central register [EU Directive (2015/849)]. This register will contain the names, dates of birth, nationalities, countries of residence and the nature and extent of the beneficial owners’ interests in transactions. While the UK already has a mechanism in place for certain companies to keep limited information on registers, the requirement for an accessible register of beneficial ownership is a potentially significant extension of that regime. The registers will be accessible to “authorities”, “obliged entities” (e.g. banks carrying out CDD on customers) and “others” [EU Directive (2015/849)]. These “others” will include anyone who can demonstrate a “legitimate interest” in gaining access to the information. This will likely provide a useful source of information for businesses carrying out CDD on their customers.

8. Overseas branches

Where firms have a branch or a majority-owned subsidiary outside the EU and the AML laws are less strict in that country than in the EU, the firm will still be required to apply the higher standard of EU AML rules in that third country. A good example as I have noted in one of my papers is Barclays Bank, which requires its overseas branches to adopt robust EU AML policies. The AML operative regimes in many African countries are in their nascent stages and when that is coupled with the absence of robust infrastructures and legal systems and a lack of adequate resources, that puts the fight against money laundering on a back foot (Mugarura, 2014a, 2014b).

9. The UK sector review on money laundering

The Department for Business, Innovation and Skills launched a review calling for evidence from companies on the impact of the current AML regulation (The Guardian Newspaper, 2016). The call for evidence closed on 23 October 2015, and was part of a larger programme of “cutting red-tape”. The review encouraged businesses to provide evidence of where the existing money laundering regulations are ineffective or overcomplicated (The Guardian Newspaper, 2016). The consultation on the burdens of AML rules appears to go against the grain of the fourth directive, highlighting the tension between protecting against money laundering and terrorist financing and its downside effects on businesses. If the UK
government chooses to remain a member of the European single market, there is a possibility that it could implement the fourth AML directive as specified in its implementation deadline (The Guardian Newspaper, 2016).

This directive is designed with mechanisms to address loopholes in the financial regulatory system based on a risk-based approach, to make sure companies become more vigilant about fighting money laundering and its predicate crimes [Directive (EU) 2015/849]. Companies are expected to institute enhanced CDD and to report any suspicious activity to a relevant authority. These measures include a strong focus on identifying and maintaining records of beneficial owners of any entity wishing to make any cross-border fund transfers of at least €1,000 ($1,350) [Directive (EU) 2015/849]. A beneficial owner is any individual or entity that enjoys the benefits of owning an asset, regardless of in whose name the title of the business, property or security is. Hiding, disguising and misrepresenting companies' beneficial ownership structures is a standard practice of companies that engage in illegal business activities, including bribery, tax evasion, embezzlement and money laundering [Directive (EU) 2015/849]. Increasingly governments around the world – including in the USA, the UK and Denmark – require companies to disclose beneficial owners at the time of their incorporation and they restrict the use of anonymous companies. The information required of all beneficial owners should include their legal name of entity, their common name if different, their company website, their type of entity, city, the country of their headquarters, ownership information including percentages owned and the date that ownership information was last updated. Companies are required to provide 100 per cent of the information available on beneficial ownership [Directive (EU) 2015/849]. Beneficial ownership must be determined through due diligence, to make sure that the real owner of the money involved in a business is not someone who has a lot of cash and needs to hide it, like a drug dealer, thief or corrupt politician. Compliance officers and other executives of financial services firms know all about beneficial ownership due diligence – but sometimes business pressures can weigh against diligence. The financial services institutions and their compliance departments must appreciate that any lack of adequate, accurate and timely beneficial ownership information facilitates money laundering and sanctions evasion by disguising:

- the identity of known or suspected criminals,
- the true purpose of an account or property held by a corporate vehicle, and/or natural persons, and the source or use of funds or property associated with a corporate entity. The concept of beneficial ownership extends beyond legal ownership (as that could just be a red herring) and even day-to-day control; it encompasses the actual persons who own and take advantage of the capital and assets involved [Directive (EU) 2015/849].

The fourth AML directive calls for enhanced due diligence measures for “politically exposed persons (PEPs)” who are viewed as presenting a potentially higher risk of corruption, tax evasion and money laundering. These measures will apply to not only transactions involving foreign nationals but also domestic PEPs, their families and their close associates [Directive (EU) 2015/849]. The Directive also proposes specific provisions to address tax crimes and has a comprehensive coverage of the entire gambling industry (EC Directive 91/308/EEC). Failure to follow the proposed enhanced due diligence measures will expose companies and their executives to temporary bans on individuals overseeing the company, fines of up to 10 per cent of a company’s annual turnover, or €5m ($6,775,000) for individuals. Further sanctions of up to twice the profit gained or loss avoided from a particular transaction may also be imposed, often depending on the magnitude of non-
compliance and a number of other factors (EC Directive 91/308/EEC). It has to be noted that because of the extraterritorial reach of EU AML regimes, the UK as a non-member state could still be bound by EU AML laws. EU AML laws are not exclusive to member countries or offshore jurisdictions, but continuously seek to incorporate agreements to bind non-member states (EC Directive 91/308/EEC). According to the Commission, the standard clause refers to efforts and co-operation to avoid money laundering and the establishment of suitable standards against money laundering equivalent to those adopted in the EU and by other international bodies such as the FATF (EC Directive 91/308/EEC). Membership of the European Economic Area (EEA) has provided the UK with full access to the single market but this cannot be guaranteed any more in view of the UK’s vote to leave the EU. Thus, while many options are on the table, the fact is that to gain membership of the EEA, the UK will have to accept certain core EU principles such as free movement of workers, which was largely a reason why the majority of the UK citizens voted to leave the EU. This is likely to put it on a collision course with the UK electorate who voted “leave” largely because of the influx of immigrants into the UK using free movement of workers to gain unfettered access to the UK.

A key concern in the regulatory realm will be the potential loss for UK-based financial institutions of the ability to sell products and services to other EEA member states, and to establish branches in EU countries without the need to seek local authorisation (Mugarura, 2016a, 2016b). There is a plethora of single market directives which give “passporting” rights to, amongst other businesses, banks and building societies, insurers and reinsurers, insurance and mortgage intermediaries, alternative investment fund and Undertakings for the Collective Investment of Transferable Securities (UCITS) managers, wholesale and retail investment firms (including market operators, brokers/dealers, wealth and portfolio managers and advisers) and payment services providers. Many of the largest European financial institutions are headquartered in London, as are the major subsidiaries of US and other third-country institutions, and all of these make significant use of passporting rights. There are several possibilities for compromise, such as entering into bilateral agreements with the EU for reciprocal arrangements on many aspects of common interest based on Switzerland’s model (Mugarura, 2016a, 2016b). There is a possibility that the UK could become “another Norway” and be part of the EEA, enabling it to benefit from passporting, without it being a part of the full EU. The UK could adopt the Canadian model, which has been based on negotiating trade agreements with individual member countries. According to The Economist magazine, Canada has 15 free trade deals in place and Britain could adopt many agreements on both trade in goods and services (Mugarura, 2016a, 2016b). The largest and most important deal for Canada is the North American Free Trade Agreement (NAFTA) between it, Mexico and the USA (Mugarura, 2016a, 2016b). Canada has also negotiated, but not signed, a pact with the EU that went further than NAFTA in some areas, such as government procurement that will allow firms from both sides to bid for many more contracts, and called for the accelerated removal of tariffs. The Canada-EU Trade Agreement (CETA) grants Canada limited access to Europe’s single market. The CETA trade agreements share common elements with NAFTA whereby in both instances, member states retain separate external tariffs and rely on rules of origin to determine whether an item is eligible for preferential treatment. Both the foregoing arrangements call for all tariffs to be eliminated, allowing the free flow of goods and services, but crucially not of people and capital. NAFTA has a skeletal secretariat to resolve disputes. The NAFTA member states have attempted without much success to harmonize regulations that are in the exclusive domain of individual states, such as taxation. Should Britain decide to adopt the Canadian model in its trading relationship with the EU it would gain independence in its policy-
making and border controls, which are issues that prompted Brexiteers to vote to leave the EU. The Canadian model also implies that there would no longer be unfettered freedom of movement of people, which is currently a troubling issue for the UK electorate. The downside is that as a non-EU member state, the UK’s influence in Europe will be significantly reduced. It will have no say about the rules of the single market. However, these options can only begin to be investigated or exercised now that Article 50 of the TEU (Lisbon Treaty 2009) has been triggered[9].

10. Conclusion
The paper has evaluated the effect of Brexit on EU AML Directives and their implementation in the UK – those already passed into law and those that are yet to be transposed. The post-Brexit framework for regulation of money laundering and its predicate offences is likely to remain broadly the same both in the UK and in other EU countries. This is because most AML Directives have been introduced to internalize AML changes recommended by either the FATF or the United Nations’ AML treaties. While it is a fact that the UK will exit the EU and not be bound by its laws, it will continue to play a significant role as a member of the FATF, the UN and other oversight agencies. In this same regard, it is in the interest of the UK Government not to cull the fourth AML directive (which was due to become law on 26 June 2017) but to implement it. The UK should also consider remaining a member of the European single market to minimize the potential for losing its established position as a world financial capital and for the sake of the stability of financial markets globally. The post-Brexit environment has already presaged that the financial industries in the UK could face severe challenges unless they quickly come up with measures to minimize further damage. If the UK remains a member of the single market, it will still have access to the EU’s “passport” rules, which enable banks, asset managers and other financial firms in one member state to tap market opportunities in the other 27 EU countries without necessarily having a local presence in those countries. It is because of these passport rules that the UK subsidiaries of non-EU banks such as American, Japanese and Swiss institutions are able to do business throughout Europe from London, and it has been a major reason why London has become the EU’s financial capital[10].

In her acceptance speech, the UK Prime Minister (Theresa May) has said that “Brexit means Brexit”. However, it may take more effort than it was ever imagined for the UK to disentangle itself from the EU of which it has been an influential member for the past 43 years. Brexit will mean Brexit to give effect to the wishes of the UK electorate which voted (albeit by a small margin) to leave the EU. Before kickstarting the process, the UK Government will have to evaluate the consequences of Brexit carefully, not least by putting measures in place to fill the void in AML laws, as well as in other regulatory areas. There is a need to institute well-thought-through measures and to establish a reasonable trade-off between the competing paradigms that are the positions of the EU and the practicalities of Brexit. The UK could adopt a variant, for instance, in relation to asset sales perhaps inspired by the model of Switzerland. Currently, there is an EU framework to facilitate cross-border mergers between UK companies and companies from other EEA states, which will not be guaranteed in post-Brexit UK unless it remains a member of the EU single market. This is one area that is anticipated to become a potential subject for Brexit negotiations that will have a significant impact on the current AML regulatory regimes.
Notes

1. This article states that “Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements. 2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218 (3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament. 3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period. 4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3) (b) of the Treaty on the Functioning of the European Union. 5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.”

2. The text of this Article states that “If the Commission considers that a Member State has failed to fulfill its obligations under the Treaty, it shall deliver a reasoned opinion on the matter after giving the State concerned to submit its observations. If the State concerned does not comply with the opinion within the stipulated period by the Commission, the latter may bring the matter before the court of justice.”

3. States are bound to fulfill the commitments agreed under a bilateral or multilateral treaty once it has been ratified and entered into force. Pacta sunt servanda is a Latin maxim which translates as “treaties shall be complied with,” and this describes a significant general principle of international law — one that underpins the entire system of treaty-based relations between sovereign states.

4. The EU’s leaders voiced their fears that “when credit and financial institutions are used to launder proceeds from criminal activities, the soundness and stability of the institutions concerned and confidence in the financial system would be jeopardized.”

5. The joint action on money laundering, the identification, tracing, freezing and confiscation of the instrumentalities and the proceeds from crime (OJ L 333, 9.12.1998, p. 1) calls on member states to ensure that no reservations are made to Article 6 of the Council of Europe’s money laundering Directive in so far as serious offences are concerned. See in particular [Article 1(b) of the above instrument].

6. The second Protocol of the Convention on the Protection of the European Communities Financial Interests (OJL 221 19.7. 1997, p. 11) criminalizes the laundering of proceeds of fraud, at least in serious cases, and active and passive corruption [Article 1 (e) and 2].


9. This article states that “Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements. 2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with
that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218 (3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament. 3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period. 4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3) (b) of the Treaty on the Functioning of the European Union. 5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure laid down in Article 49."

10. The City UK, (a trade body that vehemently opposed Brexit) campaigned vigorously to protect the longstanding position of London as a world financial capital. This can be attested to by the fact that 70 per cent of the market for euro-denominated interest-rate derivatives, and 90 per cent of European prime brokerage (assisting hedge funds with trading) and more are traded in the City of London. See The Economist magazine, 2 July 2016.

References
Further reading
EC Directive 60/2005/EEC.

Corresponding author
Norman Mugarura can be contacted at: n2000mugarura@yahoo.co.uk

For instructions on how to order reprints of this article, please visit our website: www.emeraldgrouppublishing.com/licensing/reprints.htm
Or contact us for further details: permissions@emeraldinsight.com