*The European Union's Fourth Anti-Money Laundering Directive 2015/849 (**4AMLD**), was adopted by the European Parliament and Council on 20 May 2015. The so-called 'Fifth' Anti-Money Laundering Directive is in fact a set of proposed amendments to 4AMLD looking to strengthen its core provisions in light of intervening terrorist events in Europe.*

Fourth and 'Fifth' Anti-Money Laundering Directives: implementing AML updates and UBO registers in Cyprus

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The European Union's Fourth Anti-Money Laundering Directive 2015/849 (***4AMLD***), was adopted by the European Parliament and Council on 20 May 2015. It needs to be transposed into the domestic legislation of all EU member states by 26 June 2017. 4AMLD repeals and replaces the EU's (and world) current benchmark regime in this area, the Third Anti-Money Laundering Directive 2005/60/EC (***3AMLD***). The so-called 'Fifth' Anti-Money Laundering Directive (***5AMLD***) is in fact a set of proposed amendments to 4AMLD, looking to strengthen its core provisions in light of intervening terrorist events in Europe. The EU institutions currently aim to finalise 5AMLD by June 2017.

Cyprus is one of the 28 member states of the EU and currently implements EU anti-money laundering directives through the Prevention and Suppression of Money Laundering Laws 2007-2013 (***AML Law***). The Advisory Authority for Combating Money Laundering (***AML Advisory Authority***), a public-private industry representative body established under the AML Law, is working to coordinate with local industry participants in relation to the transposition of 4AMLD, and in due course 5AMLD, through legislative amendments to the AML Law. We outline an update of implementing measures in the "Implementation in Cyprus" section below.

Background and context of EU anti-money laundering legislation

In economic terms the EU is the world's largest economy, its largest trading bloc and the largest trader of manufactured goods and services[1]. Legislatively, the EU is the global standard bearer in implementing the requirements of the Financial Action Task Force's (***FATF***) International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation Recommendations 2012 (***FATF Recommendations***). So it is fair to say that when the EU updates its AML regime the world takes note and tends to follow suit over time. The transition from 3AMLD to 4AMLD has been a long time coming but developments in the financial services industry since 2005

[1] http://ec.europa.eu/trade/policy/eu-position-in-world-trade/

mean that is it somewhat overdue. We examine the differences between 3AMLD and 4AMLD in the "4AMLD: What has changed?" section below.

Pan-EU treatment of AML rules

The current pan-EU regime acknowledges that the threats of money laundering, terrorist financing and organised crime remain significant problems which need to be dealt with at a Union level, especially bearing in mind the freedom of capital movements and freedom to supply financial services within the Union's integrated financial area. To recap:

- money laundering is a process by which the origins and ownership of money, generated as a result of criminal activity, can be concealed. In effect, money is "laundered" through legitimate means and, as a result, the proceeds lose their initial criminal identity and appear to have originated from a legitimate source

- terrorist financing, on the other hand, refers to the use of the financial system to channel either lawful or illicit money for terrorist purposes

History of EU and Cypriot anti-money laundering laws

Council Directive 91/308/EEC provided for the First EU anti-money laundering framework (***1AMLD***) and was aimed predominantly at drugs-related offences. 1AMLD introduced obligations on credit and financial institutions to verify the identity of their customers and report concerns of money laundering. Furthermore, it established key preventative measures that we today treat as standard such as obtaining customer identification and due diligence prior to entering into a business relationship, record-keeping and central methods of reporting suspicious transactions.

Cyprus[2] was not a member state of the EU in 1991, so did not directly transpose 1AMLD. Nevertheless, as a ratifying party to both the 1988 UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (***Vienna Convention***) and the 1990 Council of Europe Convention on laundering, search seizure and confiscation of the proceeds of crime (***Council of Europe Convention***), Cyprus remained at the cutting-edge of AML law at the time through the passing of the Confiscation of Proceeds of Trafficking of Narcotic Drugs and Psychotropic Substances Law 1992. The 1992 law was repealed and replaced by the comprehensive Prevention and Suppression of Money Laundering Activities Law 1996 (***AML Law 1996***). The First Mutual Evaluation Report of the Council of Europe (1998) described the Cypriot regime at the time as being "significantly in advance of any other country in its geographic sub-region."

Directive 2001/97/EC (***2AMLD***) replaced 1AMLD in December 2001. 2AMLD widened the scope of predicate offences and businesses covered to ensure compliance with FATF developments. Of particular importance was the expansion of the regime beyond credit and financial institutions to cover professions such as lawyers and accountants. At around the same time, rules were developed to target terrorist financing, following the

[2] This analysis relates to the part of the Republic of Cyprus under the effective control of the Government. Laws of the Republic and the *EU 'acquis'* (body of laws and rules) have been suspended and do not presently apply to the northern part of the island under Turkish occupation. Rather than being merely an oddity, it is in fact widely acknowledged internationally that there are "serious deficiencies in the anti-money laundering regime of the Turkish Cypriot administered area of Cyprus": US Department of the Treasury Financial Crimes Enforcement Network (FinCEN), Guidance to Financial Institutions on the Money Laundering Threat Involving the Turkish Cypriot Administered Area of Cyprus (20 March 2008).

September 11 attacks in the United States. In Cyprus, no amendments were made to the AML Law 1996 to reflect developments in the EU under 2AMLD. However, the Council of Europe in its Second Mutual Evaluation Report (2001) noted "Cyprus has made since the first round further progress towards building an effective and robust anti-money laundering regime. With the exception of the legal professions, there is a strong commitment from all institutions in the system, including the private sector, to join the anti-money laundering effort."

3AMLD replaced 2AMLD in October 2005 to introduce the concept of a risk-based evaluation of anti-money laundering and terrorist financing with, for the first time, distinctions being made between standard due diligence and enhanced due diligence measures depending on the risk profile of the customer. 3AMLD importantly entrenched the regime against terrorist financing as a central tenet of pan-EU AML policy. Cyprus joined the EU on 1 May 2004 as part of the Union's eastward expansion. As a new member state, Cyprus fully implemented 3AMLD within the standard two-year window, following its adoption at EU level through transposition under the current AML Law in 2007.

4AMLD: What has changed?

In order of importance, the developments now are as follows.

Beneficial ownership registers

Article 30 of 4AMLD mandates that member states must use a central register to hold information on beneficial ownership for corporate and other legal entities incorporated or based in their jurisdiction. We examine this further in the section "Central register of beneficial ownership information" below.

Increase in focus on risk-based assessments

Importantly, persons and institutions covered by the 4AMLD (***obliged entities***) may no longer avoid conducting risk assessments against regulated credit and financial institutions based in the EU or in 'equivalent jurisdictions'. Instead, obliged persons are required to have regard to the risk variables set out in Annex I of 4AMLD and undertake simplified or enhanced due diligence as appropriate. Annex II of 4AMLD provides a non-exhaustive list of potentially lower risk factors for the due diligence assessment. Annex III includes a list of higher risk factors.

As relevant, obliged entities should consider the following when determining risk:

- the purpose of the account or relationship
- the level of assets to be deposited and size of transactions
- the regularity or duration of the relationship
- assessment of due diligence on beneficiaries of insurance or investment policies at the appropriate time

Abandonment of 'white list' of equivalent jurisdictions

As a consequence of the move to focus on risk-based analysis, the approach of 3AMLD to determine certain third countries as being 'equivalent' to the EU looks to have been abandoned[3]. Despite the superficial appearance of extra bureaucracy, this approach is to be welcomed, bearing in mind the often arbitrary results of the previous regime.

For example, the US AML regime was treated as being equivalent to the 3AMLD, even though it featured shortcomings in certain areas, such as in the context of fund administration and as relevant to lawyers and accountants in certain circumstances. Equally, the UK Crown Dependencies (Isle of Man, Jersey, Guernsey) were treated as equivalent to the EU whereas the UK Overseas Territories (Bermuda, Cayman Islands, British Virgin Islands) were not even though all of these UK territories earned favourable and materially similar reviews from their peer groups reviews.

Instead, under 4AMLD it will be for the obliged entities to make the determinations as to risks bearing in mind the specific fact pattern of their customer and the circumstances.

*"*De minimis*" threshold lowered for certain obliged entities*

The requirement to comply with due diligence requirements and other obligations under the 3AMLD applied to businesses trading in goods and making payments in cash in an amount of EUR15,000 or more, whether as a series or one-off transaction. Under 4AMLD, this threshold has been lowered to EUR10,000 and also applies to businesses receiving, as well as making, payments in cash.

Member state discretion to exclude low risk businesses

In certain limited circumstances (expressly excluding the money transmission industry) member states may issue bespoke safe-harbours to the application 4AMLD to businesses otherwise covered as obliged entities. To qualify, the 'financial activity' must be: firstly limited in absolute terms; secondly limited on a transaction basis; thirdly not the main activity of such persons; fourthly ancillary and directly related to the main activity of such persons; fifthly the main activity of such persons must not be an activity referred to in Article 2(1)(3)(a) to (d) or 2(1)(3)(f) of 4AMLD (covering accountants, lawyers, trust companies, estate agents, gambling service providers); and lastly the financial activity must be provided only to the customers of the main activity of such persons and not generally offered to the public. In practice, this safe-harbour is likely to apply to certain categories of businesses now potentially caught by the 4AMLD as a result of the lowering of the *de minimis* threshold (see above).

Extension to the entire gambling sector

Under 3AMLD only casinos were mandatorily caught as obliged entities. This has now been expanded under 4AMLD to cover gambling business in general. Online gaming businesses will now therefore be caught as a matter of EU law.

[3] The EU white list was previously contained in the document "Common understanding between Member States on third country equivalence under the Anti-Money Laundering Directive (Directive 2005/60/EC) of June 2012.

Inclusion of tax crimes as a form of money laundering offence

Under the list-based system of determining which underlying criminal offences may lead to 'predicate' money laundering offences being triggered, 4AMLD clarifies that tax evasion and other similar tax crimes will now be included as classes of underlying offence. Such development is consistent with developments in international rules under FATF principles since 2012.

Politically exposed persons (PEP)

The definition of Politically Exposed Persons (***PEP***) has been expanded to include domestic as well as foreign PEPs. In addition, extra certainty has been provided on the meaning of a PEP which includes the following:

- heads of states and governments and ministers and their deputies and assistants
- members of parliament or similar and members of governing bodies of political parties
- members of high level courts whose decisions are not subject to appeal
- members of courts of auditors or boards of central banks
- ambassadors and similar and high ranking forces officials
- members of the administrative, management or supervisory bodies of state-owned enterprises
- directors, deputy directors and board members or equivalent of international organisations

Helpfully, mid-ranking or junior officials are specifically excluded. Finally, as with 3AMLD, the definition continues to catch close associates and family members of PEPs.

Extra focus on transparency

4AMLD contains a number of outright prohibitions on anonymous accounts or passbooks and restrictions on bearer shares. Further importance is placed on identifying the customer and verifying their identity, on the basis of documents, data and information from a reliable and independent source. In addition, obliged entities must assess and obtain information where appropriate on the purpose and intended nature of the relationship (source of funds).

Central register of beneficial ownership information

Perhaps the most important development under 4AMLD is the requirement for each member state of the EU (and by extension the European Economic Area, ie the 28 EU member states plus Iceland, Norway and Liechtenstein) of a central register of ultimate beneficial owners (***UBO***) of corporate and other legal persons.

Article 30 and 31 of 4AMLD set out the applicable rules on the collection, storing and access to information on UBOs. Under 3AMLD obliged entities were, of course, required to hold such information as part of their internal books and records. Under 4AMLD such information will move to be held on a centralised registry. Member states have discretion to hold the information in a commercial register, companies register or a public register. At this stage there is no requirement that member states open the centralised register to be accessible to the public.

UBO definition

A beneficial owner is defined as any natural person who ultimately owns or controls a corporate or legal entity (including trusts) or on whose behalf the entity is conducting its activity or transaction.

In the case of corporate entities, 4AMLD specifically states that it relates to a natural person who ultimately holds a shareholding or controlling interest or ownership interest of 25 per cent plus one share or ownership interest. Similar to the position under the Common Reporting Standard, where no UBO can be identified the relevant natural person will be the natural person holding the position of a senior managing official over the entity in question.

In the case of trusts, the UBO would comprise all of the settlor, the trustee, the protector, the beneficiaries and any other person exercising ultimate control over the trust. As regards beneficiaries, where relevant individuals have not yet been determined the UBO would include the class of persons in whose main interest the legal arrangement or entity is set up and operates. As regards foundations, UBO information on natural persons holding equivalent or materially similar positions to those for a trust must be included.

Access to the centralised register

Member states must ensure that the information on beneficial ownership is held in a central register in each member state and that it must be accessible to competent authorities and financial intelligence units (***FIU***) without the knowledge of the entities or persons listed in the register.

In addition, 'obliged entities' carrying out customer due diligence measures and those persons who can demonstrate a 'legitimate interest' may be granted access to the register. Access to the information must, however, comply with data protection laws and may be subject to online registration and the payment of a fee (though such fees may not exceed the costs of administering the system).

Importantly, member states may restrict access to the register in exceptional circumstances where such access would expose the UBO to the risk of fraud, kidnapping, blackmail, violence or intimidation or where the UBO is a minor or otherwise incapable.

UBO information contained on the register

As a minimum, member states must provide that the following information be kept on the register:

- name
- month and year of birth
- the nationality and the country of residence of the UBO
- the nature and extent of the beneficial interest held

Commission and Council proposals for 5AMLD and data protection issues

More recently, in July 2016 the European Commission proposed amendments to 4AMLD (colloquially known as ***5AMLD***) to take into account developments that occurred since 2015, in particular the desire to more tightly

regulate virtual currency exchanges following the 2015 Paris terrorist attacks and also to provide for greater access to beneficial ownership registries as a result of the fallout from the Panama Papers[4].

Under the proposed amendments, the key suggestions are as follows:

- virtual currency exchanges platforms as well as custodian wallet providers are requested to be included within the definition of 'obliged entities'. In addition EU law for the first time defines the term "virtual currency"
- harmonisation of the EU approach to high risk countries is recommended so that the method for undertaking enhanced due diligence across the Union is more uniformly applied
- it called for greater public access to the central register in respect of a limited category of UBO information
- it is suggested that the 25 per cent ownership threshold be reduced to 10 per cent in the case of entities that present a real risk of being used for money laundering and tax evasion
- the Commission at the same time called for faster implementation of 4AMLD across the Union

In December 2016 in response to the Commission's proposal the EU Council issued a compromise text to 5AMLD which acknowledged the Commission calls for greater oversight and regulation of virtual currency exchanges and a number of other proposals.

However, as regards access to beneficial ownership information by persons with a 'legitimate interest', the Council scaled back the Commission's proposal, essentially leaving such matters to the discretion of member states in line with the current text of 4AMLD. Additionally, the Council reaffirmed that the implementation date for 4AMLD would not be fast-tracked, as requested by the Commission, and would instead remain 26 June 2017. The compromise text for 5AMLD continues to pass through the machinery of EU government and is expected to be finalised prior to the deadline for transposition for 4AMLD in June 2017.

2017 Opinion of the European Data Protection Supervisor

As a further twist to the ongoing tussle between EU institutions on UBO registers, the European Data Protection Supervisor (***EDPS***) issued its opinion on 2 February 2017 regarding the compatibility of the proposals for access to UBO registers with Union-origin data protection laws[5]. The findings are very interesting and lend to the idea that the Commission's proposals for more open or public access under 5AMLD may in fact be incompatible with EU data protection laws:

- the EDPS noted that the policy aim of 4AMLD, consistent with EU anti-money laundering legislation historically, is the detection and prevention of money laundering and terrorist financing. As such the processing of personal data to strengthen such policies would be compatible with data protection laws

[4] http://www.consilium.europa.eu/en/press/press-releases/2016/12/20-money-laundering-and-terrorist-financing/

[5] Opinion 1/2017, EDPS Opinion on a Commission Proposal amending Directive (EU) 2015/849 and Directive 2009/101/EC: https://secure.edps.europa.eu/EDPSWEB/webdav/site/mySite/shared/Documents/Consultation/Opinions/2017/17-02-02_Opinion_AML_EN.pdf

- by contrast the Commission's proposals under 5AMLD indicate that the policy purposes behind the amendments include "[enhancing] transparency and the fight against tax evasion and avoidance"

- according to the EDPS, processing personal data collected for one purpose (AML) but used for another (fighting tax evasion and avoidance) "infringes the data protection principle of purpose limitation and threatens the implementation of the principle of proportionality"

- the opinion also notes that the broadening of access to beneficial ownership information beyond competent authorities to the public would be a policy tool to facilitate and optimise enforcement of tax obligations. The EDPS notes that the way such solution is implemented leads to a lack of proportionality with significant and unnecessary risks for individual rights to privacy and data protection

Implementation in Cyprus

The AML Advisory Authority in Cyprus is tasked with preparing amendments to the domestic AML Law (the Prevention and Suppression of Money Laundering Laws 2007-2013) to implement 4AMLD within the jurisdiction.

Status of legislative processes

Since the publication of 4AMLD in 2015, the AML Advisory Authority has been coordinating amendments to the legislation with relevant sectoral supervisory authorities, principally including the Central Bank of Cyprus (***CBC***) and the domestic financial intelligence unit 'MOKAS' (Unit for Combatting Money Laundering from the Greek, *Μονάδα Καταπολέμησης Αδικημάτων Συγκάλυψης*). The outcome will be to produce a first draft of a bill to amend the AML Law (***Bill***) in order to comply with 4AMLD as finally amended by 5AMLD.

The Bill is due to be released to the public as part of a consultation by the Ministry of Finance and the AML Advisory Authority towards the end of the first quarter of 2017. Interested parties will have an opportunity to review and suggest changes to the Bill. It is anticipated that the Bill will be enacted prior to the end of the transposition period in June.

Extent of changes anticipated: General

As part of its ongoing peer review by MONEYVAL (the regional sub-grouping of FATF, of which Cyprus is a member), the AML Law has already been subject to recent and significant scrutiny since the developments made to the FATF Recommendations in 2012, in particular due to MONEYVAL's 4th Round of Evaluation and Biennial Update on Cyprus which occurred in November 2013. As such, many of the changes required by 4AMLD from 3AMLD have already been implemented in Cyprus, such as the inclusion of domestic PEPs and the threshold for UBO holdings being at 10 per cent rather than 25 per cent (this was not strictly required by 4AMLD but was a provisional requirement of the Commission's jettisoned version of 5AMLD).

However, many changes are required, in particular:

- the creation and development of UBO registers in Cyprus to comply with 4AMLD's central register requirements

- the expansion of the definition of obliged entities to include gambling services beyond casinos, and the imposition of the Cyprus National Betting Authority as a new supervisory authority

Extent of changes anticipated: UBO registers

A key new element of 4AMLD is the move for member states to produce centralised registries of UBO information, along the lines outlined above under "Central register of beneficial ownership information". Cyprus has of course maintained for many years information on shareholders of domestic companies as part of the data filed with the Registrar of Corporate Affairs. Directors of companies and company secretaries (usually service providers for the case of foreign interest companies) had a legal obligation to hold and update UBO information on the companies or trusts they were involved with, under the current AML/CFT law provisions and the applicable regulatory regime. However, the requirement for UBO registers will require the jurisdiction to go further:

- companies will need to declare UBO information in central registers in addition to shareholder information, as at present
- it is likely that trusts administered in Cyprus, whether subject to Cyprus or foreign proper laws, will be subject to a requirement to declare UBO information in registers regarding the settlors, beneficiaries, etc

It is understood that, since the precise rules governing the establishment of the registers are still to be finalised at EU-level (ie between the initial requirements set out in 4AMLD and those proposals set out in 5AMLD), the Cyprus government is likely to take steps to establish the necessary systems and infrastructure once these rules are finally agreed on. However, at present:

- it is expected that the register will be stored as part of a commercial register or existing companies register, in line with the suggestions made by 4AMLD (Article 30(3)). However, it is highly unlikely that Cyprus will 'gold-plate' 4AMLD or 5AMLD so as to provide that the register of UBO information will be made available to the public. The recent opinion of the EDPS may in fact cast doubt on the legality of such a policy
- the latest text for the proposal on 5AMLD, agreed at Council level, provides for the setting up of these registers in 36 months after the publication of the Directive[6]. It is likely that Cyprus will aim to complete arrangements within this time period

Concluding remarks

Much of 4AMLD is largely consistent with the pre-existing drivers for greater focus on risk based due diligence and know your client techniques encouraged under the FATF Recommendations of 2012 and other OECD / IMF programmes that stress the importance of transparency in the financial sector for the prevention of money laundering, terrorist financing and associated criminal conduct. Cyprus is well on course to full implementation in this regard.

However, the requirement to establish centralised UBO registers is new. Tension does exist within the EU between the Commission and the Council on the extent and scope of the obligation. In light of the recent comments by the EDPS in its 2017 opinion, we are of the view that the Council's position against the imposition of mandatory rules on public access across the EU is likely to prevail in due course.

[6] Article 67 of the Council Proposals: http://data.consilium.europa.eu/doc/document/ST-15605-2016-INIT/en/pdf

Additionally, bearing in mind that Union AML law is implemented through directives rather than regulations, it would not be unimaginable to expect similar divergences to evolve between member states, in particular on whether such registers are made public or not. While we expect Cyprus to implement the requirements on time and in compliance with EU requirements, we do not concurrently expect the jurisdiction to rush to full implementation of a central register before the mandatory requirement arises, nor do we expect the authorities to require such register to be made available to the public at large.

For more information and key contacts please visit www.harneys.com/cyprus.