REGULATORY ALERT

Money laundering and terrorism financing (AML-CFT)

Main changes brought by the French government's implementing decree for Europe's 4th Money Laundering Directive.

*On April 20, 2018, the French government released an implementing decree for its ordinance 2016/1645 of December 1, 2016 (the « **Decree** »), in order to ensure compliance with European Directive 2015/849 (the « **4th Directive** »).*

In anticipation of further implementing rulings (arrêtés)[1] and guideline updates for operational implementation of the AML-CFT regulatory framework[2], this Decree aligns the regulatory to the legislative sections of the Monetary and Financial Code (MFC).

Given that significant sanctions may be personally incurred by managers and compliance officers[3], institutions subject to this new regulatory framework ought to swiftly ensure compliance and to take advantage of technical changes in the rules to digitalize the identification processes of their clients and beneficial owners.

The Decree delays compliance with the core of the new requirements until October 1, 2018. It also follows an earlier decree, released a few weeks ago, a regulatory framework for assets frozen by the authorities, whose implementation is, again, postponed until October 1, 2018 at the latest.

It introduces some interesting developments detailed below.

[1] Including that amending the General Regulation of the AMF for management companies.
[2] Guidelines of the various regulators (ACPR, AMF, DGCCRF, TRACFIN, SCCJ).
[3] In addition to the institutions themselves.

Alexandre Marion
Avocat Associé

alexandre.marion@latourinternational.com
+33 1 42 25 91 69 / +33 6 45 61 63 44

Summary

The Decree reflects both sectorial changes and the interesting evolution brought by the 4th Directive, allowing institutions subject to AML-CFT to identify their clients through innovative electronic means (those mentioned by European eIDAS Regulation).

This part of the regulation becomes an incentive for institutions to digitalize their marketing approach, along the lines of a regulatory trend initiated by the French legislature, including recently by ordinance n°2017-1433 dated October 4, 2017, relating to digitalization of contractual relationships for the financial sector, fully applicable since April 1, 2018.

In addition, the Decree impacts the distribution agreements of management companies, which will have to be reviewed for compliance with the Decree by October 1, 2018.

Furthermore, in accordance with the changes brought by 4th Directive, the Decree confirms that certain vigilance waivers are no longer available, while allowing institutions to lower their identification measures, depending on their risk assessment of money laundering/financing of terrorism.

Finally, the Decree is an invitation to institutions subject to AML-CFT, particularly those of the non-financial sector, to review their governance process and internal organization.

1. Details on the identification of beneficial owners – already applicable

One of the core moves of the 4th Directive is the creation of beneficial owners' national registrars (for registered companies, other similar registered entities, and collective investment schemes registered as companies or trusts). Consistently, institutions established in France had to register their beneficial owners before April 1, 2018.

As such, the French registrars anticipated a provision of the Decree pursuant to which institutions subject to AML-CFT can designate substitutes to beneficial owners (e.g. a manager) in the absence of money laundering threats, if no private individual can be identified.

2. Vigilance measures – applicable on October 1, 2018

2.1 Requirement to verify the identity of the client and its beneficial owner(s)

While the requirement to identify and verify the identity of the client already existed, the Decree provided details with respect to the verification measures of the beneficial owner, on the basis of a regulatory framework already applicable to the banking sector.

The new developments relate to the requirement for institutions subject to AML-CFT to collect the same amount of information on the beneficial owner as those relating to the client, when initiating business relationships and subsequent business/financial activities. The Decree specifies that the frequency of any subsequent updates to this information shall depend on the underlying money laundering risks.

Moreover, the Decree modifies the verification measures of the client identification (or its beneficial owner) by introducing innovative electronic identification measures deriving from European eIDAS Regulation (e.g. an electronic signature or a visual recognition) in lieu of the more standard presentation or communication of identification documents or companies' identification documents or trust agreements.

In compliance with the principles deriving from the 4th Directive on the classification of risks, the choice of the tools and measures for the above verification is subject to the underlying money laundering risks associated with the business relationship and must be justified with the supervisory authorities.

2.2 Contractual framework of third party identification and correspondent banking

The Decree requires deeper scrutiny of correspondent banking as well as distribution agreements with non-EU countries whose regulations are not deemed as EU equivalent by requiring that their provisions specify the "*audit measures undertaken to ensure compliance with the agreement*".

In addition, the Decree requires that third party identification shall only occur through a written agreement. The latter shall also specify the audit vigilance measures carried by the third party. This will therefore impact agreements currently in place.

2.3 Simplified due diligence measures

The Decree confirms that the then existing vigilance waivers are no longer available (other than on listed companies). Consequently, even if simplified customer due diligence can be applied to clients which are (i) institutions subject to AML/CFT, (ii) public authorities or (iii) beneficiaries of money deposited in regulated escrow accounts, institutions shall always undertake to identify such clients and their beneficial owner(s).

In addition, all simplified due diligence measures (e.g. differ the verification of the client or that of the beneficial owner) or any other simplification of the vigilance measures (e.g. alleviated quantity of information collected or the quality of the source of data used) shall be justified by:

- collection of information evidencing lesser risk of money laundering involving the client or the product; and

- implementation of a general system enabling surveillance and analysis of transactions suitable for the core characteristics of clients and products, enabling institutions subject to AML/CFT to identify any unusual or suspicious transactions.

2.4 Additional/enhanced vigilance measures

While the Decree can only confirm that the notion of politically exposed persons (PEP) also includes those persons residing in France (on top of persons not residing in France), some changes can be noted, including that relating to the spouse or equivalent of an ascent (e.g. a spouse who is not himself or herself strictly family) who is no longer deemed to be PEP or else

those persons known to be close associates of PEP, who now expressly include private individuals who are beneficiaries of collective investment schemes or trusts.

In addition, when dealing with the required additional vigilance measures when the client or its representative is not physically present when entering the business relationship (for which regulations require a minimum of two identification measures among the full list of measures), the Decree listed two additional possible measures (the same above mentioned electronic identification measures applicable to the KYC process), but nevertheless required that the selected two measures "*combined together, allow the verification of all components of the client identification*".

3. Procedures and internal control – applicable on October 1, 2018

The Decree also changes the rules relating to the organization of the AML/CFT system and internal control. Yet its new provisions essentially derive from principles already contained in applicable ruling (*arrêté*) dated November 3, 2014 pertaining to the internal control of institutions of the banking/payment/investment services sector. The changes are therefore more tangible for institutions subject to AML/CFT than for other sectors (non-financial or insurance).

In addition, the Decree specifies – to the extent necessary – that institutions subject to AML/CFT shall ensure that transactions carried out by a client are coherent with their knowledge of the "*up to date business relationship*". For example, one may expect from an institution subject to AML/CFT that it has put in place IT tools triggering an alert in case wire transfers are not coherent with the profile of the business relationship.

Finally, the Decree brought in some institutional changes, such as the indirect confirmation that institutions subject to AML/CFT shall also take into account the French specific (i) risks of money laundering and terrorism financing and (ii) mitigating measures of these risks, as outlined by the French guidance board in charge of the fight against money laundering and terrorism financing.

4. Purely sectorial changes – essentially applicable as of October 1, 2018

With respect to sectorial changes, one may note that:

- the Decree authorizes insurance institutions and currency exchange offices to outsource their AML/CFT vigilance obligations, excluding however the filing of suspicious transaction reports;

- to the extent management companies became institutions subject to AML/CFT, including when limiting to market units of CIS, they shall take advantage of the period until October 1, 2018 to revise placement agreements concluded with institutions which invest on behalf of their clients, for example by transforming such agreements into third party identification agreements;

- in the sector of payment services, the requirement to designate a central contact point was reaffirmed and the Decree abrogates the previously available waiver of e-banking payment transactions;

- in the insurance sector, the legal waiver granted to the « ancillary financial activity » is strictly limited to insurance distributors to the extent the activity at stake is limited to agreements whose annual premium are less then €1,000; in addition, the Decree alleviates the identification process for insurance contracts whose annual premium does not exceed certain thresholds;

- in the gambling sector and in the context of the new identification requirement of clients whose bets exceed certain thresholds, if in principle the verification of the client identification only applies when the business relationship is initiated, the timing of this verification requirement has been amended.