

NEWSLETTER
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40 FATF Recommendations Against Money Laundering : Implementation in Switzerland and in the EU

In June 2004 the European Commission issued a proposal for its Third Money Laundering Directive, which will be the basis for upcoming negotiations between the EU Council and Parliament. In December 2004 the Finance Ministers of the 25 EU Member States already agreed on a text based on this proposal. Final adoption of this proposed Third Money Laundering Directive ("Proposed Directive") is planned before the end of 2005. On 12 January 2005, Switzerland opened a consultation procedure aimed at amending its anti-money laundering legislation. Hence, a timely opportunity to review, and compare, both developments.

The Proposed Directive as presented by the European Commission is intended to improve the existing EU anti-money laundering legislation by consolidating the First and Second Money Laundering Directives and by incorporating the revised Forty Recommendations of the Financial Action Task Force on Money Laundering ("**FATF Recommendations**"). The Proposed Directive shall repeal the First and Second Money Laundering Directives and propose a new autonomous text. Once adopted, each Member State will still have to implement the Proposed Directive in its own legislation which should occur rapidly as this task is among the EU's top priorities.

Current Swiss legislation is, to a large extent, already compatible with the revised FATF Recommendations. However, for those instances where Swiss law diverges, the Swiss Federal Council opened on 12 January 2005 the consultation procedure on the proposed legal amendments through which the revised FATF Recommendations will be fully implemented into Swiss law ("**Draft Federal Act**"). The

consultation procedure, which is expected to continue up to mid-April, contains amendments not only to the Federal Act on the Prevention of Money Laundering in the Financial Sector (the "**Anti-Money-Laundering Act**" or "**AMLA**"), but also to the Criminal Code, the Code of Obligations, the Copyright Act, the Act on Administrative Criminal Law and the Act on Mutual Assistance in Criminal Matters. Insofar as informal hearings with the relevant Swiss business sectors on these amendments already took place in 2004, it seems likely that the Draft Federal Act will be adopted with few changes.

This Newsletter reviews the implementation of the FATF Recommendations in the European Commission's Proposed Directive as well as in current Swiss legislation, respectively in the Draft Federal Act.

1 The FATF Recommendations

The original FATF Recommendations were enacted in 1990 and amended in 1996. In June 2003 the recommendations were extensively revised to cover now also terrorist financing (to be found at www.oecd.org/dataoecd/12/26/2789371.pdf).

The FATF Recommendations set the **international anti-money laundering standard** and have been endorsed by more than 130 countries. The FATF enforces adherence to the Recommendations through regular compliance assessment and failure to adhere can result in countries being placed on an international blacklist and suffering commercial sanctions. Financial institutions that fail to adopt the FATF Recommendations also face a risk of being prevented from undertaking financial transactions by international financial institutions that have adopted the FATF Recommendations.



2 New Sectors Regulated

In accordance with the revised FATF Recommendations, the Proposed Directive extends control to a number of **new sectors outside the traditional financial sector**, including the following:

- I Life/investment insurance intermediaries;
- I Persons trading in goods or providing services and accepting cash payments exceeding € 15,000, whether the transaction is carried out in a single operation or in several operations which appear to be linked; and
- I Trust and company service providers.

The definition of **trust and company service providers**, which mirrors the FATF definition, covers any natural or legal person, which by way of business provides specific services to third parties. The list of these services includes not only forming companies or other legal persons, and acting as or arranging for another person to act in functions such as director or secretary of a company, partner of a partnership, trustee of an express trust or similar legal arrangement or nominee shareholder for another person, but also providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement.

Moreover, the Proposed Directive provides that trust and company service providers as well as currency exchange officers will have to be licensed or registered, at the election of each Member State. Each Member State's choice, between a full licensing system or a registration procedure, will naturally have an effect on compliance costs. These requirements are expected to have an important impact on common law countries in the EU, especially by tightening applicable anti-money laundering regulations relevant to their trust business sector.

In comparison, the **AMLA already regulates a number of business sectors outside the traditional financial sector**, including life/investment insurance intermediaries, trust service providers, currency exchange officers, estate agents and persons providing services and goods for cash payments, insofar as they accept, deposit or assist in investing/transferring third-party funds on a professional basis (see Schellenberg Wittmer Newsletter of October 2004). It does, however, not regulate companies that only provide registered offices, business addresses or accommodation services. In contrast, the **Draft Federal Act intends to further regulate professional art dealers** as well as dealers in precious metals, gemstones and real estate. Additionally, apart from the longstanding Swiss licence system existing for banks, persons and institutions subject to the AMLA must already register with a supervisory authority. Thus no new licensing requirements are being proposed in the Draft Federal Act.

3 Extension of the List of Criminal Activities

A substantial amendment of the Proposed Directive relates to the definition of criminal activity, which now refers to any kind of criminal involvement in the commission of a **"serious crime"**. The definition of "serious crime" continues to depend on the relevant national criminal code of each Member State. Nevertheless, "serious crimes" which are predicate offences for money laundering under the Proposed Directive must at least encompass terrorism, drug trafficking, activities of criminal organisations, serious fraud and corruption.

In Switzerland, the Draft Federal Act also extends the list of predicate offences for money laundering. Under the amendments to the Swiss Criminal Code, persons and institutions handling monies resulting from **insider trading, share price manipulation, counterfeiting of goods and product piracy** can also be prosecuted for money laundering.

4 Beneficial Owner

The Proposed Directive's definition of "Beneficial Owner" now specifically covers beneficiaries of trusts and foundations as well as of companies and other legal persons. It encompasses:

- I The natural person who ultimately, directly or indirectly, owns or controls 10% or more of the shares or of the voting rights of a legal person or who otherwise exercises a comparable influence over the management of a legal person, other than a company listed on an official stock exchange;
- I The natural person who is the ultimate beneficiary, directly or indirectly, of 10% or more of the property of a foundation, a trust or similar legal arrangement or who exercises influence over a comparable quantity of the property of a foundation, a trust or a similar legal arrangement, other than a company listed on an official stock exchange; or
- I The natural persons on whose behalf a transaction or activity is being conducted.

Furthermore, under the new definition, the beneficiary of a trust must be identified at the time of the trust's creation rather than at the time a benefit is actually conferred. Thus, all persons who merely and remotely "may" benefit under a trust, in addition to those who actually will receive a benefit under, for example, a discretionary irrevocable trust, will have to be identified.

In comparison, Switzerland's definition of "Beneficial Owner" is not as detailed as in the Proposed Directive. **In contrast Switzerland has adopted a more pragmatic approach.** Thus, as for discretionary trusts, the Swiss Banking Association's Code of Conduct of 2003 requires banks to identify the actual settlors, the determinable beneficiaries or circle of likely beneficiaries, the protectors as well as the persons holding powers of instruction. Currently no changes are planned in this respect.

Nevertheless, the Draft Federal Act intends to **increase transparency within companies, by imposing a duty to declare holdings in bearer shares**. Under the proposed amendment, any holder of bearer shares, who wishes to participate in a general meeting either in person or by proxy and who controls directly or indirectly 10% of all voting rights, will have to inform the company in writing of his name, his address and the total of his voting rights.

5 Customer Due Diligence (“CDD”)

The Proposed Directive’s provisions on CDD significantly mirror the FATF Recommendations. Regulated persons and institutions will be required to conduct CDD procedures in the following cases:

- I When establishing a business relationship;
- I When carrying out occasional transactions amounting to € 15,000 or more (whether a single operation or seemingly linked operations);
- I When there is a suspicion of money laundering financing; and
- I When there are doubts about the veracity or adequacy of previously obtained customer identification data.

Moreover, the proposed Directive will prohibit engaging in business with shell banks, granting authorisations to such banks and maintaining anonymous accounts.

The **AMLA already complies** with the above standards, with the exception of the second point (no pre-defined standard amount). Nevertheless, consultation on this very issue is already pending, but with a slightly different approach. Indeed, the Draft Federal Act intends to subject all transactions to CDD requirements, but to exclude “obviously legal transactions concerning assets of nominal value”, thus leaving each regulatory body define the minimum monetary value that will trigger the CDD requirements for each business sector.

6 Risk-Based Approach

As to the CDD duties, persons and institutions subject to the Proposed Directive will have to:

- I Identify their customer and verify his/her identity;
- I Identify the beneficial owner and take reasonable measures, on the basis of a risk-based approach, to be satisfied that they know who the beneficial owner is. For legal persons and arrangements, this should include taking reasonable measures to understand the customer’s ownership and control structure;
- I Obtain information on the purpose and intended nature of the business relationship; and

- I Conduct, on the basis of a risk-based approach, ongoing due diligence of the business relationship and of the transactions undertaken, to ensure that these are consistent with their knowledge of the customer, of the business and of the risk profile, including where necessary, the source of funds.

Following a risk-based approach, the extent of CDD measures required will depend on the characteristics of the specific client and the product/service in question. Thus for companies and other legal persons (but not for individuals) this means taking “reasonable measures to understand the ownership and control structure”. The advantages of a risk-based approach are generally perceived to **be proportionality, cost-efficiency and efficient allocation of available resources**. Such an approach allows businesses to focus their due diligence and resources on those situations where the risk of money laundering is perceived to be at its highest and avoids an inflexible minimum standard which would not be appropriate to all businesses and activities. The disadvantage, on the other hand, is that there will not be uniform CDD procedures for all customers.

As for **Switzerland**, the banking sector has had a risk-based approach since July 2003 and this approach will be further extended to other sectors, such as lawyers, in the near future.

7 Enhanced Due Diligence

Following the current Swiss requirements, the Proposed Directive sets out a non-exhaustive list of certain high-risk situations requiring enhanced CDD measures:

- I When the customer has not been physically present for identification purposes (non-face to face operations);
- I Cross-frontier correspondent banking relationships; and
- I Relations with politically exposed persons (“PEPs”).

The definition of PEPs includes all politically exposed persons irrespective of where they come from. This definition mirrors the FATF definition and was notably inspired by current Swiss legislation.

The Proposed Directive also requires regulated persons and institutions to closely examine activities which could be regarded as particularly likely by their nature to be related to money laundering and, in particular, those that involve complex or unusual large transactions or unusual patterns of transactions which have no apparent economic or lawful purpose.

In this respect, **Switzerland** already has similar provisions (non-face to face relations, PEP, etc.), especially in the banking sector. Moreover, the AMLA imposes enhanced due diligence when the transaction or business relation appears unusual or when there is reason to suspect that assets are the proceeds of a crime



8 Performance by Third Parties

Institutions and persons covered by the Proposed Directive are allowed to **rely on third parties to identify the customer, the beneficial owner, the control structure and the business.** These third parties must be persons or institutions “equivalent” to those regulated by the Proposed Directive and must thus satisfy the following requirements:

- | They are subject to mandatory professional registration (e.g. banks, lawyers);
- | They apply CDD and record keeping measures equivalent to those of the Proposed Directive; and
- | Competent authorities supervise their compliance with the provisions of the Proposed Directive.

Furthermore, the delegating person or institution will retain ultimate responsibility for CDD irrespective of reliance on a third party.

Overall, the AMLA already allows reliance on third parties. However, it is much more complex, insofar as the particular requirements vary according to the specific regulating body of each business sector and in some instances, is more burdensome (e.g. required written agreements, sub-delegation prohibitions). Similarly, however, the delegating person or institution also retains ultimate responsibility for his CDD duties.

9 Reporting Obligations

The Proposed Directive requires institutions and persons subject to the Proposed Directive to file a report with their country’s official financial intelligence unit, when they know, suspect or have reasonable grounds to suspect that money laundering is being committed or attempted.

In this respect, **Switzerland** already has identical reporting obligations, based upon reasonable grounds of suspicion, as well as a procedure to block suspicious assets. The Draft Federal Act, therefore, does not contain any substantial development.

10 Equivalent Measures in Third Countries

The Proposed Directive allows for **extra-territorial reach of the Proposed Directive**, insofar as it requires EU institutions to ensure that their non-EU branches and majority owned subsidiaries in third countries apply measures “at least equivalent” to those set out in the Proposed Directive as respects CDD and record keeping.

The **AMLA** already has equivalent legislation on this issue in the banking sector, which takes a global risk approach to its CDD duties.

11 Conclusion

While Switzerland can be satisfied that most of the new rules applicable to financial institutions in the EU already apply in large part to Swiss institutions, the Draft Federal Act will still introduce some changes in the sector. Nevertheless, Switzerland will undoubtedly welcome the finalisation of the Proposed Directive, since it can only help to level the playing field among the EU member states, thereby enhancing harmonization of laws and improving the overall effectiveness of the international combat against money laundering.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. If you seek advice with regard to your specific circumstances, please get in touch with your Schellenberg Wittmer contact person or any of the following persons:

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