

# The New FATF 40 Recommendations: A Framework for the Future

The Financial Action Task Force ("FATF") has revised its International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation ("the Recommendations"). FATF is the inter-governmental organisation with responsibility for drawing up measures to combat money laundering, terrorism financing and the proliferation of weapons of mass destruction. Over 180 countries participate in the formulation and implementation of the Recommendations.

The amendments respond to shifts in regulatory priorities since the Recommendations were last updated in 2003 and follow a public consultation which was initiated in 2009. The changes include an increased focus on a risk-based approach to anti-money laundering ("AML") and counter terrorist financing ("CFT") measures, designed to allow countries, within the framework of the FATF requirements, to adopt a more flexible set of measures commensurate to the nature of risks identified. This includes the strengthening of requirements in areas now identified as high risk, such as the identification of politically exposed persons ("PEPs"), and the expansion of the Recommendations to deal with new threats, such as the financing of the proliferation of weapons of mass destruction.

In addition to extending the scope of the Recommendations, FATF has also sought to encourage the efficient and effective use of resources by embedding a risk based approach and clarifying obligations in some specific areas where countries have experienced practical difficulties with implementation.

## Key changes to the Recommendations

We set out in the table below a brief overview of some of the more significant changes to the Recommendations, which are now consolidated (together with the 9 former "special recommendations") into a new single set of 40 Recommendations. The key changes to the Recommendations can be summarised as: -

- The inclusion of tax crimes as predicate offences for money laundering;
- The extension of obligations on financial institutions to conduct enhanced due diligence on a risk basis to domestic PEPs;
- The introduction of more rigorous requirements in relation to the information which must accompany wire transfers;
- The requirement for countries to establish mechanisms to record basic company information and to enable financial institutions, competent authorities and others to determine beneficial ownership and conduct appropriate Customer Due Diligence ("CDD");
- The introduction of a new step-by-step process for the identification of beneficial ownership and control of companies as part of CDD measures.

Many of the measures in the Recommendations are directed at national governments (for example, those requiring increased international co-operation and information sharing), whereas others are directed at those in the private sector required to comply with AML and CFT obligations (financial institutions and other non-financial businesses and professions).

## Timetable for implementation

Before the revised Recommendations have legal effect, they will need to be implemented into national law. In the EU, the process of incorporating the changes to the Recommendations into European law is already underway. The European Commission ("**the Commission**") is currently reviewing the operation of the Third Money Laundering Directive ("**the 3MLD**"), which implements the Recommendations in Europe. The Commission proposes that, subject to the outcome of ongoing consultations, a legislative proposal to amend the 3MLD in line with the changes to the Recommendations will be adopted by the end of 2012.

The 3MLD is transposed into UK law by the Money Laundering Regulations 2007 ("**MLR 2007**"). The extent of the subsequent amendments to the MLR 2007 (and/or other UK AML and CFT legislation) will only become clearer as the European legislative process continues. Many of the changes made to the Recommendations already form part of the EU and UK AML and CFT regime (for example, tax offences are already regarded as predicate offences), however certain amendments may follow, particularly in relation to new requirements regarding PEPs, and Wire Transfers (described below).

In 2013, FATF will commence its evaluation process to assess how effectively countries have implemented the Recommendations (including the latest changes).

## Impact of the changes for UK firms

Where the changes to the Recommendations that affect financial institutions and other non-financial businesses and professions are not already covered by UK legislation, in many cases they may nevertheless already be incorporated into the practice currently employed by financial institutions. For example, many institutions currently, when conducting due diligence, do not typically differentiate between domestic and foreign PEPs.

As such, whilst the changes to the Recommendations introduce some new obligations and place additional emphasis on some areas, their immediate impact on UK firms is not likely to be substantial. However, AML and CFT legislation and practice vary significantly across jurisdictions, and the changes are likely to require more significant legislative and structural changes in many other jurisdictions where UK firms operate.

UK firms will also wish to take note of the changes to the Recommendations as they are reflective of a number of areas which have featured prominently in the FSA's enforcement strategy in recent years. It has taken a number of instances of high profile action for breaches both of MLR 2007 and of Handbook provisions (specifically Principle 3 (management and control) of its Principles for Business and rule 3.2.6R of its Senior Management Arrangements, Systems and Controls sourcebook ("**SYSC**") in respect of firms' AML and anti-bribery systems and controls.

Most UK firms will already be compliant with many of the Recommendations as amended. However, the clearer guidance now issued by FATF, coupled with the appetite of the FSA to take robust action, underlines the importance for firms of maintaining awareness of and compliance with their AML obligations. Firms whose policies do not already comply with the new requirements are therefore advised to consider implementing relevant changes to be in line with the new requirements in advance of the legislative changes coming into effect.

### Key changes to the Recommendations

<p><b>Emphasis on risk-based approach to AML and CTF measures and supervision</b></p>	<ul style="list-style-type: none"> <li>■ The revised Recommendations call on financial institutions to apply a risk-based approach to identify, assess, monitor, manage and mitigate AML and CTF risks. A risk-based approach is also required to be taken by competent authorities in setting the rules and supervising financial and other institutions.</li> <li>■ Where higher risks are identified, enhanced measures are required to manage and mitigate those risks. Simplified CDD measures may be allowed where lower risks are identified</li> <li>■ The FATF has provided additional guidance in the form of illustrative examples of higher and lower risk factors, and the appropriate measures that might be adopted in certain situations. The FATF has also indicated that it will initiate further work to update existing guidance documents to reflect the changes in the risk-based approach, and to consider developing additional compliance risk indicators and best practices</li> </ul>
<p><b>Inclusion of Tax Crimes as a Predicate Offence for Money Laundering</b></p>	<ul style="list-style-type: none"> <li>■ The list of predicate AML offences has been expanded to include tax evasion and other serious tax offences.</li> </ul>
<p><b>Revised CDD Measures in relation to Beneficial Ownership</b></p>	<ul style="list-style-type: none"> <li>■ The Recommendations include a new step-by-step process for firms to follow when identifying beneficial ownership and control of companies as part of their CDD measures. Pursuant to that process, financial institutions should first try to identify the natural persons who ultimately have a controlling ownership interest; but if there is doubt over whether such persons hold the beneficial ownership, or when no such natural persons can be identified, any other natural persons that may exercise control over the customer through means other than shareholding should be identified. If these measures fail to identify a natural person exercising such controls, the financial institution should then take reasonable steps to identify the natural person holding a senior management position.</li> <li>■ The revised Recommendations do not include a numerical threshold for determining controlling ownership of a legal person, but FATF has indicated that such an approach may be reasonable in some cases, and it will be the responsibility of individual countries to determine if appropriate. In the 3MLD, this is currently set at 25%.</li> <li>■ The revised Recommendations also clarify that for life insurance policies, CDD measures in identifying beneficiaries need only occur at the time of the payout rather than at the beginning of the business relationship.</li> </ul>
<p><b>Strengthening of transparency requirements in relation to Beneficial Ownership</b></p>	<ul style="list-style-type: none"> <li>■ Connected to the new Recommendations referred to above, in order to enable financial institutions and others to conduct appropriate CDD on companies and their beneficial owners, the revised Recommendations require national governments to ensure that all companies maintain basic information relating to the company, its directors and shareholders. The Recommendations note that countries have a range of options to determine how additional information relating to beneficial ownership is maintained (e.g. official databases) and that measures should be adopted to ensure these are "<i>adequate, accurate and current</i>".</li> <li>■ The Recommendations also include new requirements for nominee directors and shareholders to disclose their status to the company registry, or be licensed.</li> <li>■ In relation to Trusts, the revised Recommendations allow countries to determine if a trust registry should be required, and focuses on the obligations of a trustee. As such, trustees now have to obtain and maintain adequate and accurate beneficial ownership information, including information on the identity of the settler, the trustee(s), and the protector (if any), as well as disclose their status as trustees when entering into a relationship with a financial institution.</li> </ul>

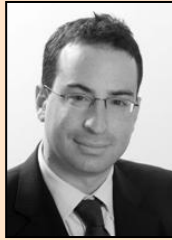
<b>PEPs</b>	<ul style="list-style-type: none"> <li>■ The new Recommendations extend obligations on financial institutions to conduct enhanced due diligence to cover domestic PEPs, PEPs from international organisations and the family and close associates of PEPs. These measures are imposed in relation to increased international concerns on corruption, and unlike the requirements in relation to foreign PEPs (which are always deemed high risk and should be subject to enhanced CDD), are to be implemented on a risk-based approach.</li> <li>■ In order to facilitate the private sector efforts in implementing the PEP requirements, the FATF has indicated that it intends to develop further guidance that would include guidance on how to identify a PEP, his/her family members and close associates.</li> </ul>
<b>Wire Transfers</b>	<ul style="list-style-type: none"> <li>■ The revised Recommendations include more rigorous requirements on the information which must accompany wire transfers, including information on both the beneficiary and originator (previously the requirements applied only in relation to originator information).</li> <li>■ The information to be included comprises (i) the name of the originator (ii) account number of the originator (iii) any of either of the originator's address, or national identity number, or customer identification number, or date and place of birth; (iv) the name of the beneficiary; and (v) the account number of the beneficiary.</li> </ul>
<b>Third Party Reliance and Group-Wide Compliance Programmes</b>	<ul style="list-style-type: none"> <li>■ The revised Recommendations provide greater clarity in relation to the circumstances in which financial institutions may rely on third parties to undertake due diligence and on the application of AML and CFT measures in foreign branches and subsidiaries.</li> <li>■ In particular, amendments have been made to clarify the distinction between an outsourcing and agency relationship, to allow for more flexible intra-group reliance, and for the level of country risk to be mitigated (i.e. no longer limiting eligible third parties to those based in countries that adequately comply with FATF standards), if the third party is part of the same financial group which applies group-wide AML/CFT measures.</li> <li>■ The new Recommendations also require the implementation of group-wide compliance programme to a financial institution's foreign branches and subsidiaries.</li> <li>■ The revised Recommendations also recognise the difficulties that the private sector face in relation to data protection and privacy laws in relation to intra-group cooperation and reliance, and FATF have indicated that it is considering a coordinated process to further examine the issue. In the meantime, the revised Recommendations seek to promote cooperation between relevant authorities to facilitate intra-group cooperation and exchange of information.</li> </ul>
<b>Requirements for Countries</b>	<p>The revised Recommendations also include various requirements for Countries and national governments to follow:</p> <ul style="list-style-type: none"> <li>■ To the extent they have not already done so, countries should become party to and implement certain key international instruments, and are encouraged to ratify and implement other relevant international conventions</li> <li>■ Countries should provide "<i>the widest possible range</i>" of mutual legal assistance, including in relation to asset freezing and confiscation and extradition</li> <li>■ Countries to co-operate in relation to the provision of basic and beneficial ownership information under appropriate conditions and an assurance of confidentiality</li> <li>■ To the extent they have not already done so, countries should establish Financial Intelligence Units to receive, analyse and disseminate disclosures from reporting entities</li> <li>■ Countries should also designate responsibility for AML/CFT investigations to proactive competent authorities with adequate resources and powers to obtain all relevant documents</li> </ul>

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