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Risk Report

MONEY LAUNDERING AND TERRORIST FINANCING IN EUROPE: EU LAW AND BREXIT

FINANCIAL

COMPLIANCE

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RISK REPORT

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Summary

Money laundering and terrorist financing have gained increased attention by the media and legislators in Europe in recent years. The EU is making an effort to prevent and combat money laundering and associated risks through the revision of EU law. Meanwhile, Brexit has become a risk to the policing of money laundering in Europe and the UK. Post-Brexit, the UK must ensure that legal frameworks policing money laundering are firm and law enforcement is guaranteed. This Risk Report places focus on recent developments in EU laws on money laundering and terrorist financing and examines how Brexit will influence money laundering risks in the UK.

List of Abbreviations:

<i>EPRS</i>	European Parliamentary Research Service
<i>EU</i>	European Union
<i>FATF</i>	Financial Action Task Force
<i>FIU</i>	Financial Intelligence Unit
<i>NECC</i>	National Economic Crime Centre
<i>NCA</i>	National Crime Agency
<i>PM</i>	Prime Minister
<i>UK</i>	United Kingdom

BOLTS: FINANCIAL, COMPLIANCE.

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Introduction

Money laundering in Europe gained widespread public attention when a 200 billion euro money laundering scandal at the Estonian branch of Danske Bank, one of Denmark's largest banks, came to light in 2018.¹ Between 2007 and 2015, money from Estonia, Russia, Latvia, Cyprus, and Britain was funneled through shell companies into Estonia, Latvia, China, Switzerland, Turkey, Britain, and many more countries, generating enormous fees. Deutsche Bank was reportedly implicated in the scandal, which led to an investigation by prosecutors in Frankfurt into the bank's involvement in laundering money from Russia.² A year earlier, in 2017, journalist Daphne Caruana Galizia was investigating money laundering in Malta when she was killed by a car bomb.³ Events like these explain why the European Union (EU) has revised and reinforced anti-money laundering and anti-terrorist financing laws in recent years.

Although no exact data on the scale of money laundering in Europe is available, estimations suggest that multiple billions are moved through Europe every year.⁴ The Danske Bank scandal confirms this estimation. However, the nature of money laundering makes it difficult to assess how much money is moved illegally and where it originated. Money is moved through multiple opaque channels in order to conceal the purpose of the transaction and the identity of the owner.

In concrete terms, there are three steps to money laundering: *placement*, *layering*, and *integration*. In the first step, *placement*, illegal money is deposited at a legitimate financial institution, such as a

¹ Jensen, T. (2018): **Explainer: Danske Bank's 200 billion euro money laundering scandal**, *Reuters*. Available at: <https://www.reuters.com/article/us-danske-bank-moneylaundering-explainer/explainer-danske-banks-200-billion-euro-money-laundering-scandal-idUSKCN1NO10D> (Accessed: October 26, 2019).

² Storbeck, O. (2019): **Deutsche Bank co-operating with criminal money-laundering probe**, *Financial Times*. Available at: <https://www.ft.com/content/1408bd00-df97-11e9-9743-db5a370481bc> (Accessed: November 1, 2019).

³ Reuters (2019): **Malta appoints public inquiry into murder of prominent journalist**, *Reuters*. Available at: <https://www.reuters.com/article/malta-daphne/malta-appoints-public-inquiry-into-murder-of-prominent-journalist-idUSL5N26B55E> (Accessed: October 26, 2019).

⁴ Rahman, A. (2019): **Will Brexit make money laundering easier?**, *Lawyer Monthly*. Available at: <https://www.lawyer-monthly.com/2019/04/will-brexit-make-money-laundering-easier/> (Accessed: October 2019).

bank. The purpose of *layering* is to hide the source of the funds through several transactions and other accounting techniques. The final step is *integration* and permits the withdrawal of “clean” money from a legitimate account. Money laundering is strongly connected to organized criminal activity and the acquisition of luxury real estate. Governments could also potentially utilize it in order to interfere in international affairs.⁵ Concealing a person’s identity by laundering money can help facilitate disruptive activity across borders.

Under the President of the EU Commission, Jean-Claude Juncker, the EU drafted and implemented rigorous anti-money laundering regulations. Additionally, the role of the European Banking Authority was also strengthened in order to combat financial crime. Despite the fortification of the legal framework for European member states, questions regarding money laundering and terrorist financing risks in the United Kingdom (UK) emerge as the UK proceeds with Brexit. Following Brexit, the UK will become more vulnerable to the risk of financial crime. Not only will EU laws no longer apply to the UK, but the UK will also lose access to EU intelligence networks. This situation demands an in-depth look at existing EU laws and the impact of Brexit on money laundering and terrorist financing risks in the UK.

EU Law on Money Laundering and Terrorist Financing

EU authorities have amended laws on the prevention of money laundering and terrorist financing twice in recent years, seeking to close gaps in the legislation. Until 2018, EU Directive 2015/849, also known as Fourth Anti-Money Laundering Directive, was in force.⁶ Directive 2015/849 was amended

⁵ Kirschenbaum, J. & Veron, N. (2019): **The European Union must change its supervisory architecture to fight money laundering**, *Bruegel*. Available at: <https://bruegel.org/2019/02/the-european-union-must-change-its-supervisory-architecture-to-fight-money-laundering/> (Accessed: October 24, 2019).

⁶ Directive (EU) 2015/849 of the European Parliament and of the Council of May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849> (Accessed: October 26, 2019).

and expanded by the Fifth Anti-Money Laundering Directive, EU Directive 2018/843, in May 2018.⁷ Following the enforcement of this law, the EU supplemented it again on October 23, 2018, with the sixth version of the regulation, EU Directive 2018/1673.⁸ EU member states must integrate the Fifth Directive into national law by January 10, 2020, and the Sixth Directive by December 3, 2020. Firms and institutions within member states must comply with these rules thereafter. At present, the Fourth, Fifth, and Sixth Anti-Money Laundering Directives are in force.

The Fifth Anti-Money Laundering Directive in Depth

With the adoption of the Fifth Anti-Money Laundering Directive, legislators aimed to “improve the power of Financial Intelligence Units, increase transparency around beneficial ownership information, regulate virtual currencies and prepaid cards to prevent terrorist financing.”⁹

The EU revised its Fourth Anti-Money Laundering Directive due to several factors at the European, the state government, and the business level. Some European banks had not adequately complied with EU regulations on money laundering, either because of the lack of internal implementation mechanisms or because risky business models prevented them from doing so.¹⁰ At the state level, government authorities were also not adequately enforcing laws related to financial crime due to flawed prioritization and a lack of resources, expertise, and available tools. This led to “ineffective cooperation between anti-money laundering authorities, prudential authorities, Financial Intelligence Units (FIU), and law enforcement authorities.”¹¹

⁷ Directive (EU) 2018/843 of the European Parliament and of the Council of May 2018 on combating money laundering by criminal law. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843> (Accessed: October 26, 2019).

⁸ Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law. Available at: <https://eur-lex.europa.eu/eli/dir/2018/1673/oj> (Accessed: October 26, 2019).

⁹ European Commission (2019): *Fight against money laundering and terrorist financing: Commission assesses risks and calls for better implementation of the rules*. Available at: https://europa.eu/rapid/press-release_IP-19-4452_en.htm (Accessed: October 24, 2019).

¹⁰ Ibid.

¹¹ Ibid.

Anti-Money Laundering Bodies

A network of controlling bodies is tasked with the surveillance of suspicious financial activities in the EU. Every EU member state is required by EU regulations to have a Financial Intelligence Unit. FIUs are responsible for gathering, receiving, assessing and distributing intelligence to law enforcement authorities or a foreign FIU to combat money laundering, terrorist financing, organized crime, fraud, and corruption.¹²

At the international level, the Financial Action Task Force (FATF) is responsible for establishing global anti-money laundering standards and mitigating risks for the banking system and financial institutions. This intergovernmental organization was set up by the G-7 Summit in 1989.¹³ At present, the FATF counts 39 members, including the European Commission and several EU member states like France, Germany, Greece, Denmark, Italy, and the UK.¹⁴ The FATF provides 40 recommendations on anti-money laundering and the financing of terrorism, which were last updated in 2012.¹⁵

FIUs cooperate internationally and share intelligence through the Egmont Group, which is comprised of 164 FIUs. All EU member states and the two European Economic Area member states Iceland and Norway are part of the Europe I regional group. Highlighting the EU's effort to mitigate the risks associated with money laundering and terrorist financing, Egmont Group states that, "the recent and new 4th and 5th AML [anti-money laundering] directives clearly reflect this ambitious path as many instruments, especially concerning TF [terrorist financing], go beyond what is

¹² Böszörményi, J. & Schweighofer, E. (2015): A review of tools to comply with the Fourth EU anti-money laundering directive, *International Review of Law, Computers & Technology*, 29(1), 63-77.

¹³ Financial Action Task Force [FATF] (n.d.): *History of the FATF*. Available at: <https://www.fatf-gafi.org/about/historyofthefatf/#d.en.3157> (Accessed: October 26, 2019).

¹⁴ Financial Action Task Force [FATF] (n.d.): *FATF members and observers*. Available at: <https://www.fatf-gafi.org/about/membersandobservers/> (Accessed: October 26, 2019).

¹⁵ Financial Action Task Force [FATF] (2012): *The FATF Recommendations*. Available at: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> (Accessed: October 26, 2019).

demanded by FATF as a minimum standard.”¹⁶ Therefore, anti-money laundering efforts in the EU can be evaluated as overall relatively strong, recent money laundering scandals notwithstanding.

Stages of Implementation and Enforcement

Anti-money laundering laws are implemented in the following six steps:

1. The FATF creates **international anti-money laundering and terrorist financing standards**.
2. The EU reviews, complements, and adopts FATF standards, formally known as **EU Directives**.
3. **EU member states** then integrate these EU Directives into **national law**.
4. **Obligated entities** within a state must then **detect suspicious activities and prevent money laundering**. Obligated entities include, among others, credit and financial institutions, real estate agents, auditors, notaries, auction houses, gambling companies, and legal entities.
5. Obligated entities must then **report** their findings **to the national FIU**.
6. Finally, the **FIU disseminates the report**. **EU member states must assist FIUs** in obtaining access to relevant information, which permits the identification of potential suspects through electronic data and registers, if available.

Furthermore, detecting money laundering and terrorist financing can be achieved with two main procedures:¹⁷

1. **Identification**: Financial institutions must gather data on their customers and identify beneficial owners and politically exposed persons. Beneficial owners are those people on whose behalf an illicit money transaction or activity is conducted, according to Article 3(5) of the Fourth Anti-Money Laundering Directive. A politically exposed person is someone who serves in a prominent public position, such as government officials, politicians, judicial or military officials, and executives of state-owned companies or international organizations.

¹⁶ Egmont Group (n.d.): *Europe I Region*. Available at: <https://egmontgroup.org/en/content/europe-i-region> (Accessed: October 27, 2019).

¹⁷ Böszörmenyi, J. & Schweighofer, E. (2015): A review of tools to comply with the Fourth EU anti-money laundering directive, *International Review of Law, Computers & Technology*, 29(1), 63-77.

Collected data on customers can be entered into software that generates a risk rating. This risk rating indicates which customers should be further examined and monitored.

2. **Customer Due Diligence** : Financial institutions must profile their customers and business partners by monitoring their transactions and activities. The risk-based approach of the Fifth Anti-Money Laundering Directive suggests that customers and business partners may be categorized based on their individual risk levels and managed differently according to these risk levels.

Amendments and Improvements in EU Law

The Fifth Anti-Money Laundering Directive places greater emphasis on international cooperation between European countries, banks, and FIUs. Criminal organizations tend to launder money in countries and banks with weaker enforcement mechanisms.¹⁸ For this reason, the EU seeks to fill security gaps by improving anti-money laundering policing in all EU member states. Better cooperation and communication between anti-money laundering institutions can help reduce the risk of financial crime.

Another central aim of the Fifth Directive is to establish a public register of companies and their beneficial owners. Such registers may help reduce the number of shell companies, as information about a business will become more accessible to the public. Shell companies are common vehicles for money laundering. They are officially registered companies, but their sole purpose is to convert illicitly obtained money into legitimate assets. Mechanisms to verify company information can further mitigate risks of fraud and money laundering, according to the Fifth Directive.

Digital currencies and prepaid cards are new additions in the Fifth Directive. These two payment methods have been associated with criminal and terrorist activity as they allow users to retain anonymity when purchasing goods. Previously, the owners of prepaid cards loaded with over 250 euro had to be identified and categorized, based on the principle of customer due diligence. The

¹⁸ **Marria, V. (2018): The EU's 5th Anti-Money Laundering Directive: What does it mean?, *Forbes*. Available at: <https://www.forbes.com/sites/vishalmarria/2018/09/13/eu-5th-anti-money-laundering-directive-what-does-it-mean/#5a8efdf5d3> (Accessed: October 25, 2019).**

Fifth Directive lowers this amount to 150 euro to further decrease risk. Additionally, cryptocurrencies will be managed the same way as other financing methods in order to increase security.

Finally, FIUs are granted enhanced authority over a company's financial transactions registers and digital data. Previously, a Suspicious Activity Report had to be filed before the FIU could react. The Fifth Directive, however, grants FIUs permission to intervene directly. Granting FIUs unimpeded access to relevant information to investigate offenses is a priority for the EU. Similarly, the EU encourages that FIUs cooperate with law enforcement authorities to accelerate investigations.

Future Challenges

Despite positive developments in combating money laundering, critics argue that international communication and collaboration is still lacking. Some criticize that state authorities cannot efficiently communicate with each other or with the European Central Bank, which regulates the eurozone.¹⁹ Furthermore, small member states do not always have sufficient capacity and resources to prevent organized crime.²⁰ This, in turn, renders these countries more vulnerable to financial crime.²¹ Malta is one example of this. Malta may be a small island state, but the EU member had enthusiastically invited foreign investment to boost its economy. This exposed Malta to money laundering risks. The Maltese government was subsequently warned by EU authorities regarding its failure to police domestic money laundering.

Weak compliance on the part of member states has led some experts to argue in favor of an EU-wide organization to combat money laundering and the financing of terrorism.²² Such an

¹⁹ Kirschenbaum, J. & Veron, N. (2019): **The European Union must change its supervisory architecture to fight money laundering**, *Bruegel*. Available at: <https://bruegel.org/2019/02/the-european-union-must-change-its-supervisory-architecture-to-fight-money-laundering/> (Accessed: October 24, 2019).

²⁰ *Ibid.*

²¹ *Ibid.*

²² Rahman, A. (2019): **Will Brexit make money laundering easier?**, *Lawyer Monthly*. Available at: <https://www.lawyer-monthly.com/2019/04/will-brexit-make-money-laundering-easier/> (Accessed: October 2019).

organization could improve on the current legal framework by enhancing international coordination and developing expertise in the field, thus detecting and deterring financial crime more effectively.²³ It would also be politically independent. Moving forward, the EU's finance ministers intend to formally mandate the European Commission to draft recommendations for such a centralized, independent institution.²⁴ This would encourage the compliance of financial institutions with EU law and shield the EU's banking system from exploitation.

While an overarching surveillance organization could potentially make combating money laundering more efficient, recent amendments in EU laws have demonstrated the EU's effort to mitigate money laundering risks. If EU member states are able to adequately implement current regulatory standards, security levels in the EU could rise. In order to achieve this goal, the EU must ensure that state governments attracting foreign investment strictly enforce anti-money laundering laws. While foreign investment can be beneficial for the growth of a state's economy, it can also increase the risks of financial crime and foreign interference if legal enforcement is weak. This poses the question of how the UK will manage risks associated with money laundering following its departure from the EU.

Money Laundering in the UK after Brexit

The UK's National Crime Agency (NCA) estimates that approximately 24 billion pounds of laundered money flow through the UK annually.²⁵ The NCA also reports that there are 2 million Suspicious

²³ Kirschenbaum, J. & Veron, N. (2019): *The European Union must change its supervisory architecture to fight money laundering*, *Bruegel*. Available at: <https://bruegel.org/2019/02/the-european-union-must-change-its-supervisory-architecture-to-fight-money-laundering/> (Accessed: October 24, 2019).

²⁴ Brunsden, J. & Fleming, S. (2019): *EU proposes new anti-money laundering body in wake of scandals*, *Financial Times*. Available at: <https://www.ft.com/content/d810c676-fb34-11e9-98fd-4d6c20050229> (Accessed: November 1, 2019).

²⁵ National Crime Agency [NCA] (n.d.): *Money laundering and illicit finance*. Available at: <https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/money-laundering-and-terrorist-financing> (Accessed: October 27, 2019).

Activity Reports in its database. Moreover, approximately 380,000 Suspicious Activity Reports are submitted per year and 46 million pounds of assets are denied to suspicious customers.²⁶

These numbers indicate that the UK will be vulnerable to increased money laundering if the British government does not provide for a strong anti-money laundering protection post-Brexit. Once the UK has exited the EU, the EU Directives on Anti-Money Laundering and Terrorist Financing will no longer apply to the UK. As long as the UK is still within the EU, it will be required to integrate EU Directives into national law. However, even if the UK adopts recent EU law amendments, such as the Fifth and Sixth Directive on money laundering, the UK must manage legislation on money laundering and terrorist financing on its own moving forward.

The NCA warns that Brexit is likely to make the UK more vulnerable to financial crime after it leaves the EU.²⁷ It is expected that money laundering will be particularly problematic. Money laundering is not only associated with terrorist financing but also with the drug trade and human trafficking. As money laundering risks reach far beyond the financial realm, it is imperative that the British government implement comprehensive anti-money laundering laws, surveillance, and enforcement mechanisms proactively and well in advance of Brexit.

Corporate Financial Crime in the UK Post-Brexit

Since UK laws overlap with most of the amendments of the EU's Sixth Anti-Money Laundering Directive, risks of corporate-related money laundering appear to be relatively low.²⁸ The UK's laws on corporate liability provide that companies can be held liable for money laundered for their

²⁶ National Crime Agency [NCA] (n.d.): *Money laundering and illicit finance*. Available at: <https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/money-laundering-and-terrorist-financing> (Accessed: October 27, 2019).

²⁷ Marria, V. (2018): *The EU's 5th Anti-Money Laundering Directive: What does it mean?*, *Forbes*. Available at: <https://www.forbes.com/sites/vishalmarria/2018/09/13/eu-5th-anti-money-laundering-directive-what-does-it-mean/#5a8efdf5d3> (Accessed: October 25, 2019).

²⁸ Binns, J. (2019): *The UK's anti-money laundering laws post-Brexit*, *Open Access Government*. Available at: <https://www.openaccessgovernment.org/anti-money-laundering-laws-post-brexit/72376/> (Accessed: October 25, 2019).

benefit by someone in a senior position in a company. They can also be held liable if managers fail to track and prevent potential acts of money laundering.²⁹ The UK could further strengthen its legal framework by enforcing a law that penalizes corporate failure to prevent money laundering.³⁰ The time leading up to Brexit will likely prove critical as the UK seeks to fill gaps in its legal framework in order to strengthen its anti-money laundering enforcement.

Intelligence Sharing in Europe

Following Brexit, the UK will lose access to Europol's intelligence network. The Europol Information System facilitates intelligence sharing between EU member states. Countries within the EU can thus track suspicious movement of money across borders, improving crime prevention. Post-Brexit, the UK will likely seek to negotiate intelligence-sharing agreements with European countries in order to retain the ability to investigate financial crime and maintain international anti-money laundering standards. The UK is also likely to remain in the FATF and the Egmont Group, as these are international bodies that surpass the borders of the EU.

Business Risks in the UK

Big cities with large property markets can be targets of money laundering. The NCA reports that London as a financial center is particularly exposed to such criminal activity. Commonly, illicit funds are generated abroad and then laundered in London and the UK. If large sums of money are continuously laundered in the UK, the UK's financial sector could be negatively affected. Financial institutions that do not adequately track or report money laundering can be penalized by UK, EU,

²⁹ Binns, J. (2019): The UK's anti-money laundering laws post-Brexit, *Open Access Government*. Available at: <https://www.openaccessgovernment.org/anti-money-laundering-laws-post-brexit/72376/> (Accessed: October 25, 2019).

³⁰ Ibid.

or US authorities. Consequently, these financial institutions could decide to leave the UK and move to another location, weakening the UK's financial sector.³¹

Another risk related to Brexit is the relocation of firms. If a large number of companies leave the UK as Brexit approaches, national anti-money laundering authorities could have difficulty surveilling all transactions and relocations. This could also strip compliance officers of the resources required to track the establishment of new businesses in the UK, which would impact anti-money laundering security.³² Business relocation and business establishment therefore increase the risk of financial crime as Brexit negotiations proceed.

The British Anti-Money Laundering Safety Net

While there are uncertainties surrounding money laundering in relation to Brexit, security in the UK is still provided by three anti-money laundering authorities: the NCA, the National Economic Crime Centre (NECC), and the UK's FIU.

The NCA combats financial crime by denying assets to politically exposed persons or foreign investors. The agency also possesses the authority to freeze accounts and recover criminal assets.³³ The NECC supports the goal of the NCA and aims to reduce serious organized economic crime. Through the NECC, "law enforcement and justice agencies, government departments, regulatory bodies and the private sector"³⁴ are able to combat economic crime. Finally, the UK's FIU is also responsible for managing and sharing Suspicious Activity Reports with UK law enforcement.

³¹ National Crime Agency [NCA] (n.d.): *Money laundering and illicit finance*. Available at: <https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/money-laundering-and-terrorist-financing> (Accessed: October 27, 2019).

³² Weber, A. (2019): Brexit throws a wrench into EU's fight against money laundering, *Bloomberg*. Available at: <https://www.bloomberg.com/news/articles/2019-10-04/brexit-throws-a-wrench-into-eu-s-fight-against-money-laundering> (Accessed: October 25, 2019).

³³ National Crime Agency [NCA] (n.d.): *Money laundering and illicit finance*. Available at: <https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/money-laundering-and-terrorist-financing> (Accessed: October 27, 2019).

³⁴ Ibid.

Approximately 460,000 Suspicious Activity Reports are sent to the British FIU every year.³⁵ Therefore, it is a vital element to managing financial crime.

Another anti-money laundering safety net is the Unexplained Wealth Order. Purchasers of real estate or goods worth more than 50,000 pounds can be requested to provide an accounting of how they attained the funds to afford the property. Unexplained Wealth Orders can be issued against politically exposed persons and people who have been involved in serious criminal activity.³⁶ The order allows British authorities to investigate suspicious activity and seize illegally financed property.

The Impact of PM Boris Johnson's Potential Tax Policies

Incumbent Prime Minister (PM) Boris Johnson stated that he supports the establishment of about six tax-free zones in ports in the UK after Brexit.³⁷ PM Johnson considered the transformation of Belfast, Northern Ireland's capital, into a tax-free zone.³⁸ Supporters of this plan even argued in favor of turning all of Northern Ireland into a free port, which would lift custom duties on imports that are processed in the area.³⁹ The idea of tax-free zones in the UK is based on the Singaporean tax model. PM Johnson appears to hope that this model could help boost the British economy after Brexit.

³⁵ National Crime Agency [NCA] (n.d.): *Money laundering and illicit finance*. Available at: <https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/money-laundering-and-terrorist-financing> (Accessed: October 27, 2019).

³⁶ Magra, L. (2019): Britain is targeting 'dirty money' with Unexplained Wealth Order, *The New York Times*. Available at: <https://www.nytimes.com/2019/05/30/world/europe/harrods-unexplained-wealth-order.html> (Accessed: October 27, 2019).

³⁷ Rankin, J. (2019): Free ports favoured by Boris Johnson are money-laundering threat - EU, *The Guardian*. Available at: <https://www.theguardian.com/world/2019/jul/24/eu-identifies-free-ports-as-money-laundering-threat> (Accessed: October 24, 2019).

³⁸ O'Carroll, L. & Davies, R. (2019): Belfast could be Singapore-style tax free zone, says Johnson, *The Guardian*. Available at: <https://www.theguardian.com/politics/2019/jul/02/boris-johnson-jeremy-hunt-accused-of-trying-to-turn-uk-into-tax-haven-freeports> (Accessed: October 28, 2019).

³⁹ Ibid.

EU authorities in Brussels, however, are skeptical about the introduction of free ports in the UK, fearing they could foster money laundering.⁴⁰ Free ports are warehouses in which high-value assets like art, gems, gold, or wine collections can be stored and are attractive offshore financial centers because they eliminate import duties, user tax, and indirect taxes like VAT. Moreover, customers benefit from a high degree of secrecy when they use free ports.⁴¹

In 2018, the European Parliamentary Research Service (EPRS) released a study on money laundering and tax evasion risks in free ports, highlighting that free ports like Geneva, Luxembourg, Singapore, Beijing, Monaco, and Delaware are more vulnerable to illicit financial activity.⁴² High-value goods stored in free ports and traded between offshore companies worldwide can be paid for in cash or in kind. This can reduce the transparency of transactions and conceal the identity of the ultimate beneficial owner of goods. The EPRS reports that this creates the ideal atmosphere for illegal activities such as money laundering and tax evasion.⁴³ It is important that UK policymakers remain aware of these risks if they plan to establish tax-free zones in the UK post-Brexit to attract foreign investment.

Risks of the Golden Visa Scheme

In some European countries like Malta or Cyprus, foreign nationals can obtain a so-called “golden visa” residency permit by investing in property, government bonds, or corporate entities. The UK also offers a golden visa scheme, formally known as Tier 1 Investor Visa, to foreign nationals who invest at least 2 million pounds in the UK. The number of foreign investors applying for a Tier 1 visa

⁴⁰ Rankin, J. (2019): Free ports favoured by Boris Johnson are money-laundering threat - EU, *The Guardian*. Available at: <https://www.theguardian.com/world/2019/jul/24/eu-identifies-free-ports-as-money-laundering-threat> (Accessed: October 24, 2019).

⁴¹ European Parliamentary Research Service [EPRS] (2018): Money laundering and tax evasion risks in free ports. Available at: https://www.europarl.europa.eu/cmsdata/155721/EPRS_STUD_627114_Money%20laundering-FINAL.pdf (Accessed: October 28, 2019).

⁴² Ibid.

⁴³ Ibid.

reached a five-year record high of 255 recipients in the first half of 2019.⁴⁴ The golden visa scheme, however, is not without controversy. Former Minister of State for Immigration, Caroline Nokes, discontinued the golden visa scheme in December 2018 because of money laundering and organized crime risks. The scheme, however, was resumed later with more rigorous regulation to minimize money laundering and associated risks.⁴⁵

The EU views investment-based citizenship and residency permits with concern. A 2019 European Commission Report on the impact of money laundering and terrorist financing risks on the internal market and cross-border activities highlights that golden visa schemes create “inherent risks as regard security, money laundering, tax evasion and corruption.”⁴⁶ In order to reduce these risks, the EU improved regulations on customer due diligence in the Fifth Anti-Money Laundering Directive. Third-country citizens applying for investment-based residence or citizenship in an EU member state are subjected to greater scrutiny, as required by the amendment of Annex II point (1) of the Directive.⁴⁷ Once the UK departs the EU, however, the British government and Home Office must ensure that the profile of golden visa-applicants is sufficiently reviewed to avoid money laundering risks.

⁴⁴ Neate, R. (2019): Rise in number of world’s rich buying UK ‘golden visas’, *The Guardian*. Available at: <https://www.theguardian.com/uk-news/2019/sep/27/number-of-foreigners-buying-uk-golden-visa-rises> (Accessed: October 28, 2019).

⁴⁵ *Ibid.*

⁴⁶ European Commission (2019): *Report from the Commission to the European Parliament and the Council on the assessment of the risk of money laundering and terrorist financing affecting the internal market and relating to cross-border activities*. Available at: https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union.pdf (Accessed: October 28, 2019).

⁴⁷ Directive (EU) 2018/843 of the European Parliament and of the Council of May 2018 on combating money laundering by criminal law. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843> (Accessed: October 26, 2019).

Strategic Summary

Opportunities

- Money laundering cases in Malta and Estonia received heightened media attention in Europe. To combat such cases, the EU is focusing on strengthening legal frameworks with the implementation of the Fourth, Fifth, and Sixth Directives on anti-money laundering and terrorist financing in the EU.
- Strong laws and enforcement mechanisms can help prevent and reduce money laundering, tax evasion, and serious organized crime in European countries.
- Despite Brexit, the UK should seek to communicate and cooperate with European and international organizations to fight money laundering and organized crime.

Risks

- Once the UK terminates its EU membership, EU law on anti-money laundering and terrorist financing will no longer apply to the UK. This could potentially leave the UK vulnerable to money laundering risks immediately following Brexit. The UK must therefore work quickly to strengthen its laws and enforcement mechanisms in advance.
- If tax-free zones are established in the UK to boost the economy post-Brexit, the British government must be particularly vigilant about money laundering and tax evasion.
- After Brexit, the UK will also lose access to Europol's intelligence-sharing network, which will weaken British law enforcement. The UK must negotiate new intelligence-sharing deals with European countries.

Tactical Breakdown

Financial

- While the nature of money laundering makes detecting the scope of the problem difficult, estimations suggest that laundered money flowing through the UK amounts to multiple billions of pounds annually. This indicates that financial and organized crimes should be a central concern for the UK government.

- The British National Crime Agency warns that anti-money laundering policing will be weakened by Brexit. This will likely attract individuals, businesses, and organizations targeting vulnerable countries for money laundering. Therefore, the UK could potentially face an increase of financial assets being laundered in the UK post-Brexit.
- While the UK's economy could benefit from free ports and golden visa schemes, government leaders should ensure that financial crime prevention remains strong.

Compliance

- While the UK will not be subject to EU law after Brexit, the UK still has laws and agencies controlling and combatting money laundering. These are the NCA, the NECC, and the national FIU. Furthermore, national laws on corporate financial crime provide another safety net against money laundering security risks.
- Security is also provided by the Unexplained Wealth Order, which helps British authorities track suspicious acquisition on high-value property.
- Post-Brexit, the UK could potentially benefit from copying EU laws on money laundering in order to fill gaps in the domestic legal framework.
- Creating public registers of companies and their beneficial owners, as established by the Fifth Anti-Money Laundering Directive, can increase transparency on financial transactions and expose shell companies.
- As the Fifth Anti-Money Laundering Directive provides, including cryptocurrencies and prepaid cards in money laundering and terrorist financing regulations creates a more comprehensive and safe legal framework to fight criminal activity.

Conclusion

Money laundering can facilitate serious organized crime and the financing of terrorism, which is why these security risks should be adequately understood, prevented, and combated. EU law provides for public registers that record beneficial owners of a company. This facilitates financial transparency. Critics, however, could argue that it also infringes on the data privacy of individuals. This situation leaves a gap between public security and individual privacy. In order to trace potential

money laundering activity better, authorities may choose to collect more private data. This, however, means that anti-money laundering regimes could interfere with privacy rights.

While the EU is focusing on enhancing laws on money laundering and international cooperation, Brexit is a setback for the EU's effort. Brexit not only leaves the UK more vulnerable to money laundering, but it can also impact European security if money laundering and organized crime rates increase in the UK. While such concerns are legitimate, UK security agencies like NCA, the NECC, and the FIU, will continue mitigating risks of money laundering. UK authorities like the NCA are also aware of risks associated with Brexit, which is why they appear to push for enhanced security and surveillance in the UK. Furthermore, the UK will continue to be part of international anti-money laundering organizations such as the FAFT and the Egmont Group, which can provide a safety net for the UK post-Brexit.



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