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RECENT DEVELOPMENTS IN THE ITALIAN ANTI-MONEY LAUNDERING LEGISLATION

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On January 1, 2014 two regulations, issued by the Bank of Italy in April 2013, entered into force, which deal with the customer due diligence in the field of anti-money laundering and the keeping of the Single Financial Transactions Database ("*Archivio Unico Informatico*"; hereinafter, the "SFTD"), respectively. Such regulations were long awaited, since a draft thereof was submitted to a public consultation, which ended on March 15, 2012 (i.e. more than a year before the adoption of the afore-said regulations) and saw the participation of many market operators.

In the course of 2012, a new provision was added to Legislative Decree of November 21, 2007, no. 231 (the Italian anti money laundering law; hereinafter, the "Decree"), pursuant to which banks, financial intermediaries and the other persons to which the Decree applies (hereinafter, jointly referred to as the "Addressees") have a duty to return money and other financial means received from the clients, in the event that the customer due diligence on the latter could not be completed. Such novelty was strongly criticized by the industry due to easily foreseeable difficulties in its practical application.

As a result, both the Ministry of Economy and Finance and the Financial Intelligence Unit ("*Unità di informazione finanziaria*", the Italian anti-money laundering unit established within the Bank of Italy) issued, in the second half of 2013, some implementing measures aimed at clarifying scope and application of the above mentioned new provision of the Decree.

More recently, two new pieces of secondary legislation were adopted: namely, the Financial Intelligence Unit communication of December 2, 2013, providing for anomaly indicators (both subjective and objective) related to transactions involving trusts, and CONSOB (the Italian securities regulator)'s resolution of December 18, 2013 no. 18731, setting out implementing measures in relation to customer due diligence obligations to be complied with by financial promoters.

1. The Bank of Italy regulations on customer due diligence and the keeping of the SFTD

On April 3, 2013, the Bank of Italy, having heard CONSOB and the Italian insurance market regulator (*Istituto per la Vigilanza sulle Assicurazioni*, "IVASS"), adopted:

(i) a regulation on customer due diligence, pursuant to Section 7, sub-section 2, of the Decree (the "DD Regulation"); and

(ii) a regulation on the keeping of the SFTD, and simplified recording procedures, pursuant to Section 37, sub-sections 7 and 8, of the Decree (the "SFTD Regulation").

The above regulations were published in the Official Gazette of May 7, 2013, no. 105 and came into force on January 1, 2014.

1.1 The DD Regulation

It applies to all the continuous relationships existing as of January 1, 2014, including those established before the entry into force of the Decree (i.e. prior to December 29, 2007). Its main provisions can be summarized as follows:

Risk-based approach

As envisaged under Section 20 of the Decree, the extension and intensity of the customer due diligence obligations are proportional to the risk of money laundering and terrorism financing, which must take into account i) the type of customer, ii) the continuous relationship established with the latter, iii) the professional services provided to the latter, and/or iv) the type of single transaction at issue. In this respect, the Addressees must responsibly carry out an independent evaluation considering all the factors that may imply an exposure to money laundering and terrorism financing. In particular, clear evaluation systems and decision-making processes must be adopted, with a view to ensure i) coherent conducts within the company's structure, and ii) the traceability of the controls and evaluations to be carried out.

The DD Regulation provides for general evaluation criteria with regard to the client, the continuous relationship and/or the occasional transaction at issue, which must be considered in order to determine the level of risk involved in the specific case. Further risk assessment elements can, of course, be taken into account by the Addressees on a case-by-case basis.

According to the information received and the analysis performed thereon, the Addressees must identify the risk profile of each client, and assign to the latter one of the risk classes previously established, which are associated to a certain level of anti-money laundering obligations (such as the depth of customer due diligence and evaluation of suspicious transactions). In case of continuous relationships, the Addressees must also determine the frequency with which the client's risk profile must be updated, as well as the situations where the adequacy of the risk class assigned to the client must be verified (e.g., in case of relevant changes concerning the client's activities).

Pursuant to the DD Regulation (see Section III, Part I), the above mentioned exercise can be carried out also by means of algorithms and IT systems, which automatically assign to each client a certain risk class.

In the context of a group of companies, where the definition of the client's risk profile is not centralized, each company must adopt the highest risk profile among those assigned by all the companies of the group for one and the same client.

Customer due diligence obligations

Section II, Part II, of the Regulation provides that the Addressees must proceed to the customer due diligence only in connection with those transactions which fall within the scope of their institutional activities. Therefore, in relation to persons and/or transactions relating to their organization, functioning and administration, the Addressees do not have to carry out any customer due diligence. It remains to be clarified whether the "connected and instrumental activities" (i.e. other than investment and ancillary services carried out by financial intermediaries) must be deemed as excluded from the customer due diligence obligation set out by the Regulation.

In case the client is a natural person, co-beneficiaries and executors of the latter must be identified following the same procedures used for the client itself (i.e. through the acquisition of ID data provided by the

interested party or other valid document among those listed in the technical annex to the Decree). With regard to the executors, it will be also necessary to verify the existence of a valid power of attorney, as well.

Conversely, should the client be a legal entity, the identification must be carried out in relation to i) the client itself (for instance, by acquiring relevant information concerning, *inter alia*, legal form, activities carried out, corporate purpose, and enrolment number in public registers, if any), and ii) the executor (by verifying the existence of a valid power of attorney) granted to the latter.

The identification must be carried out in the physical presence of the client (in case he/she is a natural person) or of the executor (in case the client is a legal entity).

On the contrary, the identification of the beneficial owner does not require its physical presence and must be carried out contextually with the client's identification, on the basis of the information provided by the client pursuant to Section 21 of the Decree or through different methods, for instance by recurring to public registers, lists, acts or publicly available documents.

The Addressees must then verify the acquired data relating to client, executor, and beneficial owner by comparing such information with those obtained through a reliable and independent source (such as public acts and authenticated private deeds, corporate certificates, and public registers). The acquired information must be kept by the Addressees either in paper or electronic form.

In any case, the identity of client, executor, and beneficial owner must always be verified before the continuous relationship is established or the transaction executed, except for the following cases:

(i) the verification of the beneficial owner's data can be carried out after that the continuous relationship is established, provided that no transaction is executed before the verification;

(ii) the verification of the above mentioning data can be carried out after that the relationship is established if this is necessary to avoid the interruption of the ordinary course of business and there is a low risk of money laundering and terrorism financing. However, the verification procedure must be completed as soon as possible after the first contact with the client and, in any case, within thirty days from the date on which the relationship is established.

The Addressees must acquire information regarding nature and purpose of the continuous relationship they are entering into, concerning i) the establishment of such relationship, ii) the role of the executor(s) of the transaction in question, iii) the economic goal pursued, and iv) the business relationships among the interested parties. Further information (such as the origin of the funds used for executing the transaction(s) and the relationship between client and beneficial owner) must be acquired only when the risk-based approach chosen by each Addressee so requires.

An ongoing monitoring of the continuous relationships must also be carried out in order to keep the client's profile updated and hence detect any inconsistency with the existing information, which may intervene in the course of the time (leading to a suspicious transactions reporting, if any).

<u>Simplified customer due diligence procedure</u>

A simplified customer due diligence procedure may be applied in the cases outlined under Section 25 of the Decree, where there is a low risk of money laundering or terrorism financing.

In such cases, the due diligence can be limited to ascertain the client's identity by acknowledging name, legal nature, registered office and fiscal code thereof, if any.

Moreover, the Addressees must periodically verify if, based on the afore-said risk-based approach, the conditions for the application of the simplified customer due diligence still persist. Furthermore, they must abstain from the simplified procedure where:

(i) there are doubts on the suitability and/or veracity of the information acquired for the purpose of classifying a specific client as worthy of a simplified procedure;

(ii) the conditions necessary to ascertain that there is a low risk of money laundering or terrorism financing are no longer met;

(iii) a suspicion of money laundering or terrorism financing arises in the course of time; or

(iv) upon adoption by the European Commission of a decision pursuant to Section 40, paragraph 4, of Directive no. 2005/60/EC with regard to a non-EU country. In such a case, the Addressees cannot resort to the simplified procedure in relation to banks, financial institutions or listed companies of the third country in question.

Enhanced customer due diligence procedure

An enhanced procedure (consisting, *inter alia*, in requesting further information to the client) must be carried out where there is a high risk of money laundering or terrorism financing at stake, resulting from specific law provisions or an independent assessment based on criteria laid down by the DD Regulation. In particular, such procedure must be applied:

(a) when the client is not physically present at the time of identification (e.g. Internet banking, phone banking);

(b) with regard to politically exposed persons (i.e. natural persons who are entrusted with prominent public functions and are hence more exposed to corruption);

(c) in the presence of bank accounts opened by non–EU entities;

(d) in case of deposits of cash or securities coming from third countries (whether EU and non-EU) for a total amount equal to or higher than 10 thousand Euro;

(e) if a suspicious transaction report is sent to the Financial Intelligence Unit (in such a case, the enhanced due diligence procedure must be followed up until the risk of money laundering is excluded); and

(f) in relation to products and technologies which may increase the risk of money laundering and terrorism financing (for instance, by facilitating the anonymity of the parties involved).

It is worth pointing out that, in case 500 and 200 Euro notes are used in relation to deposit, withdrawal or payment transactions exceeding 2,5 thousand Euro, the Addressees must perform a more in-depth analysis in order to verify the purpose of the use of such notes and exclude that it is anyhow related to money laundering. If such purpose cannot be ascertained or does not appear to be justifiable, the Addressees must refrain from carrying on the continuous relationship or execute the transaction, and consider to file a notice of suspicious transaction with the competent authorities.

Execution by third parties of customer due diligence obligations

All phases (except the ongoing monitoring) of the customer due diligence may be carried out also through third parties (see Section 30 of the Decree). In such a case, the Addressees remain responsible for the correct compliance with the above obligations and can be deemed to be satisfied only when a suitable attestation

is delivered by the third party who performed the customer due diligence (in relation to an ongoing relationship) in the presence of the client. It is the Addressees' responsibility to assess that the elements acquired and the checks carried out by the third parties in question are adequate and fulfill the relevant obligations set forth by the Decree. According to the DD Regulation, the Addressees must:

(i) define the phases of the due diligence delegated to third parties, identify the data which need to be transmitted from such third parties, as well as modalities and timeframe of such transmission;

(ii) arrange electronic or paper instruments for the promptly exchange of the information flows;

(iii) verify, within the limits of professional diligence, the veracity of the documents received and the correctness and reliability of the information contained in such documents;

(iv) acquire, where necessary, further information from third parties, the client itself or other sources.

Relationships and transactions between intermediaries

According to the DD Regulation, the Addressees must apply enhanced measures in relation to credit and financial institutions established in non-EU countries and whose anti-money laundering regime is not deemed equivalent to the Italian one, when such legal entities intend to establish a continuous relationship by means of correspondent and payable-through accounts. Such enhanced measures must at least provide for the acquisition of certain information (concerning, for example, ownership structure and nature of the activities carried out) on such non-EU financial institutions. Moreover, the opening of such payable-through account must be authorized by a general manager or a person holding equivalent powers. Finally, the agreements with such non-EU entities must be executed in writing.

Moreover, the DD Regulation specifies the procedure to be followed in case one of the Addressees requests, on behalf of its client(s), another person to whom the Decree applies to execute an *ad hoc* transaction or enter into a continuous relationship. In this respect, market operators pointed out the difficulties they will meet in order to access the information regarding the Addressee's client(s), and consequently decide whether to apply the ordinary, simplified or enhanced customer due diligence procedure.

Implementing provisions for the customer due diligence to be carried out by financial promoters

On December 18, 2013, CONSOB issued a regulation pursuant to Section 7, sub-section 2, of the Decree (published in the Official Gazette of December 30, 2013 no. 304, and entered into force on January 1, 2014), which laid down implementing provisions on the customer due diligence to be carried out by financial promoters. The regulation was adopted on the basis of a public consultation ended on September 15, 2013.

As a general rule, the agents must carry out the customer due diligence by observing the same measures, methods and internal procedures envisaged for its staff by the intermediary for which the agents provide their services.

This being consistent with the provisions of the DD Regulation (see Part V, Section II, footnote 14 thereof), where it is pointed out that financial promoters must be trained with regard to the customer due diligence in the same way as the employees of the intermediary for which they work for.

In this respect, financial promoters must be thus considered as an integral part of the organization of the intermediary for which they operate.

1.2 The SFTD Regulation

The SFTD Regulation is composed of two parts: the first contains rules relating to the keeping of the SFTD, while the second establishes simplified recording procedures for some Addressees such as *Cassa depositi e prestiti S.p.A.*, *Poste Italiane S.p.A.*, legal entities subject to Sections 111 (microcredit institutions) and 112 (credit guarantee consortia) of Legislative Decree of September 1, 1993, no. 385 (the "Italian Banking Law") and money changers.

The legal base being Section 37 of the Decree, according to which the Addressees must set up a SFTD in order to record the identification data and other information collected, which concern the continuous relationship(s) established and/or the occasional transaction(s) carried out.

Moreover, in an effort to prevent money laundering transactions, the Addressees must adopt internal control procedures in relation to the keeping of the SFTD, and provide their employees with an adequate training.

The data recorded in the database can be used for any investigation into the existence of money laundering transactions carried out by the Financial Intelligence Unit or other competent authorities.

In this regard, the Financial Intelligence Unit published, on December 23, 2013, a regulation concerning production and transmission of aggregate anti-money laundering reports to be sent monthly thereto pursuant to Section 40 of the Decree.

The Financial Intelligence Unit makes use of such data for identifying possible cases of money laundering and terrorist financing in specific geographical areas, while performing statistical controls on aggregate reports, in order to ascertain anomalies that are then brought to the attention of the intermediary at issue.

According to the SFTD Regulation, the above data must be recorded by the intermediary upon opening, modifying or closing any continuous relationship(s) with its clients.

The relationships which need to be recorded are those constituted by accounts, deposits or other types of continuous relationships (e.g. loans or financial leasing, as well as those established following the award of an engagement or a mandate).

In addition, all the transactions executed upon clients' order and involving the transfer of means of payment amounting, in total, to 15 thousand Euro or more must be registered in the SFTD. Likewise, must be registered therein transactions amounting to less than 15 thousand Euro, in relation to which financial agents pursuant to Section 128-*quarter*, sub-sections 2, 6 and 7, of the Italian Banking Law must comply with customer due diligence obligations.

Technical provisions are also laid down by the SFTD Regulation in respect of recording criteria and procedures, as well as of information and data to be acquired and recorded by the Addressees.

2. Implementing measures on the intermediaries' duty to return money to the clients pursuant to Section 23, sub-section 1-*bis*, of the Decree

Section 18 of Legislative Decree September 19, 2012, no. 169 (modifying Legislative Decree of August 13, 2010, no. 141 on consumer credit), which came into force on October 17, 2012, introduced, under Section 23 of the Decree, a new sub-section 1-*bis* according to which, in the event the Addressees are unable to comply with the customer due diligence concerning an ongoing continuous relationship or an *ad hoc* transaction in the course of execution, they must return money, financial instruments and any other financial means received from the client through a bank transfer on an account indicated by the client itself. Such transfer must be

accompanied by a message informing the banking counterparty that the transfer itself was due to the impossibility to complete the customer due diligence with regard to the bank account holder.

The effectiveness of the above provision was suspended up until the issue of the related implementing measures, which were published by the Ministry of Economy and Finance and the Financial Intelligence Unit on July 30, 2013 and August 6, 2013, respectively.

In particular, the Ministerial Circular set forth the procedure to be followed by the Addressees in case of impossibility to comply with the customer due diligence requirements. According to the Circular, before returning money and other financial means to the client pursuant to Section 23, sub-section 1-*bis*, of the Decree, intermediaries must contact the client in question in order to verify whether it is still possible to complete the due diligence (for instance, by means of an integration to the existing documentation) within a reasonable time. Upon acknowledging that the due diligence cannot be completed, intermediaries must provide the client with a written communication aimed at (i) informing on the duty to return money and other financial means received, as well as at (ii) requesting the bank account data where the wire transfer can be made. Such information must be provided by the client within sixty days from the receipt of the afore-said intermediary's communication.

In addition, the Financial Intelligence Unit's communication specified the contents of the information to supply to and obtain from the client, which must be kept on record by intermediaries in relation to each return transaction executed.

Notwithstanding the publication of the above implementing measures, it is still not clear, however, (i) what will happen in the event the client does not have a bank account on which the financial means can be transferred to, as well as (ii) scope and content of the message to be sent to the bank where the client's account is opened (in particular, whether the reason underlying the bank transfer must be contained in the transfer itself or in an *ad hoc* communication). Another criticism to the newly established procedure is whether the freezing up of the client's money and the liquidation of the latter's financial instruments, which derive from the impossibility to complete the customer due diligence, could represent a breach of the client's right to dispose, at any time, of the sums deposited on his/her bank account (by means of a withdrawal, a cashier's cheque, or a wire transfer on to another account). According to some market operators, this may lead to possible actions for damages to be brought by the interested clients in the near future.

3. Conclusions

With a six-time increase of the reporting of suspect transactions to the Financial Intelligence Unit from 2008 to date (ranging in the area of 70 thousand in the year 2013 only), it may be said that, in the absence of a clear regulatory framework relating to customer due diligence obligations, banks and financial intermediaries (not to mention the other Addressees) may be tempted to resort to such reports as an extreme tentative to avoid fines and other administrative sanctions, which may be imposed to them for breach of the relevant legislation.

This situation may be even worsened as a result of the recent entry into force of the implementation provisions commented upon herein. Indeed, in the presence of some difficulties in relation to the carrying out and completion of the customer due diligence, banks and intermediaries may opt for accelerating the procedure of returning money and the equivalent in cash of the liquidation of the financial instruments held by the client without spending too much time to ascertain the specific situation of the latter and the actual risk of money laundering and/or terrorism financing relating to him/her.