European Banking Industry Committee

European Banking Federation (EBF) • European Savings Banks Group (ESBG) • European Association of Cooperative Banks (EACB) European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS)
European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)
European Association of Public Banks (EAPB)

Brussels, 11 January 2005

EBIC Position
regarding the Council general approach on the proposal for a new EU Directive on Money Laundering (DOC 14981/2004)

EXECUTIVE SUMMARY

EBIC considers that the Directive must be improved on several points. For EBIC, the two most important issues concern the definition of the beneficial owner and of politically exposed persons.

- **BENEFICIAL OWNER**

EBIC would recommend that the definition of "beneficial owner" should foresee a principle instead of too concrete rules. Should the EU nevertheless decide to opt for a detailed and concrete definition, credit institutions will not be able to meet those requirements as they do not have access to public registers to obtain the identity and to verify the identity of shareholders in non-listed companies and other legal arrangements. Therefore, the identification and verification requirements of the beneficial owner should be subject to access to publicly available sources of information (e.g. register or gazette).

- **POLITICALLY EXPOSED PERSONS (PEPS)**

EBIC considers that the definition of PEP runs in contradiction with the risk-based approach. The definition of PEP should only cover persons:

- from third countries
- having prominent public functions at state level (i.e. high ranking PEPs)
- having substantial or complex financial or business transactions which may represent enhanced money laundering and reputational risk
- and persons identified as close family members and associates

The EU should be considered as a single jurisdiction and EU PEPs - whatever Member States they are residing - should be excluded from this definition, especially since credit institutions already apply appropriate due diligence procedures. Undue bureaucracy would jeopardise the objective of ensuring special measures with regard to a high-risk customer group. In this context, the Council definition is introducing a discrimination between European PEPs which is prohibited by EU law and constitutes a clear barrier to the internal market.

Other topics of main concern are:

- CUSTOMER DUE DILIGENCE WITH REGARD TO PEP

Institutions and persons covered by this Directive should apply appropriate procedures or policies to determine whether the customer is a politically exposed person. Based on this procedures and policies, those institutions and persons would have to install appropriate IT-management where necessary. In all cases, one cannot impose dubious "risk management system" on all professions and sectors covered by the Directive.

- CORRESPONDENT BANKING RELATIONSHIP / SHELL BANKS:

EBIC cannot agree with Article 11 (2) which prohibits credit institutions from entering into or continuing a correspondent banking relationship with a respondent bank which permits its accounts to be used by shell banks. Such a provision raises the issue of indirect relationships with shell banks. It would not be applicable in practice as banks would have no means of verifying whether their respondents have relations with shell banks. An obligation to know "the customer´s customer" is generally not workable, regardless of whether the customer is another credit institution, a legal entity or a natural person.

- FEEDBACK FROM FIU

In order to apply anti-money laundering measures efficiently, credit institutions must be able to rely on timely and specific (case-by-case) feedback provided by competent authorities. This is essential for credit institutions to make an assessment/improvement of the IT-tools and procedures. Besides that credit institutions virtually depend on information concerning every single case just to decide whether the respective business relationship has to be finished or could be continued. The current wording concerning FIU feedback is too non-committal and should be strengthened.

- PERFORMANCE BY THIRD PARTIES:

Article 16 is very problematic and would have adverse consequences on leasing and sales financing activities as well as on electronic business. The word "outsourcing" is inappropriate as in some countries, outsourcing measures in the banking industry require the conclusion of specific outsourcing contracts. Furthermore, the demanded "synonymous" status of third parties should be clearly limited to compliance with the requirements concerning customer identification and verification.

- STRICTER MEASURES BY MEMBER STATES

In the context of the EU internal market, uniform rules on AML are the only adequate solution to fight against money laundering, to avoid distortions of competition and to prevent legal shopping between jurisdictions. Member States should therefore not be permitted to take stricter measures in the AML field.

EBIC position on the Council general approach on the proposal for a new EU Directive on Money Laundering (DOC 14891/2004)

EBIC welcomes the general approach reached by the Council on the third money laundering directive. Indeed, anti-money laundering legislation is essential for public security and a swift and uniform implementation of this Directive is greatly supported. However, the Council did not solve all the technical concerns which were identified. Several major issues still need to be improved in this respect, especially the provision on the definition of the beneficial owner and the definition of PEP. EBIC urges to take the appropriate time to solve these issues rather than to adopt in haste the directive in first reading.

1. Article 3 (8): Definition of the beneficial owner

European banks in principle fully support measures concerning the identification of beneficial ownership. However, they generally prefer workable rules which can be put into practice. The definition of a legal entity's or legal person's beneficial owner provided by the Council in Article 3 (8) (a) of the proposed Directive is not workable as credit institutions do not have access to public register to verify this information. The proposed definition is therefore not compatible with some Member States' company laws, since in those jurisdictions legal entities or legal persons are under no statutory obligation to disclose natural persons or to register their names into publicly accessible registers.

Therefore, applying customer due diligence procedures in order to systematically verify the shareholder's identity and percentage on the basis of publicly accessible registers, publications or any other reliable documents will be impossible for credit institutions willing to enter into a business relationship with such legal persons or entities - especially in the case of indirect ownership/shareholding. They would thus have to rely exclusively on the information given to them by the person opening the bank account for and on behalf of such legal entity or legal person. Such a policy would offer no guarantee of transparency concerning the respective legal entity's or legal person's shareholding, since the credit institution would have no means of verifying such information. The only solution would be for Member States to grant access to public registers which must provide reliable and updated shareholding information on non-listed companies. However, such a solution would inevitably require substantial and costly changes in Member States' company law regimes which is by no means deemed to be adequate compared with the effect of the proposed anti-money laundering rules. Indirectly, the new Money Laundering Directive would cause substantial changes to the existing company law regimes of several Member States to an extent reaching far beyond the changes outlined by the Commission in its Action Plan on Company Law. Even if Member States provides this type of information, the problem will remain with third countries which won't introduce such register.

To sum up: the Council compromise, consisting of an increase of the threshold to 25 % (compared with the Commission's initial proposal of 10 %), is an improvement but does not solve the real problem (i.e. obtaining reliable information).

Amendment : broad and general definition according to the FATF text

Against this background and with due regard to the need for flexibility concerning different national company law regimes as well as different due diligence procedures with respect to beneficial owners already being implemented by the banking industry, we would recommend that the new rules adopted by the EU should be restricted to a broad and general definition based on the FATF text. Such a broad and general definition would leave sufficient flexibility to Member States and be in line with the FATF recommendations. A general definition is more suited than too concrete rules which would be incompatible with the law and practice in several Member States and therefore unworkable.

Against this background, EBIC recommends the following amendments for Article 3(8):

"Beneficial owner" means ***the natural person who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction is being conducted. This also incorporates those persons who exercise ultimate effective control over a legal person or legal arrangement.***

In addition, it should be made clear in Art. 7 b) that a formal verification of the identity of the natural persons who are the ultimate beneficial owners is only necessary where there is a significantly higher risk of the legal entity, foundation, trust or similar legal arrangements being misused for money laundering purposes. The respective paragraph b) of Art. 7 should be amended as follows:

"identifying, where applicable, the beneficial owner and taking ***risk-based and*** *reasonable measures to verify the identity of the beneficial owner such that the institution or person is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts and similar legal arrangements, taking* ***risk-based and*** *reasonable measures to understand the ownership and control structure of the customer"*

Fall-back: detailed definition - CDD subject to publicly accessible information

However, should the EU decide to stick to a very concrete and descriptive definition as agreed by the Council, verifying the identity of the beneficial owner should only be mandatory if the identity of the respective natural person (and its shareholdings) have been published in a publicly accessible register or official gazette. In this case a reference (in Art. 7 b) to a public register where the information on major shareholdings are required and/or to an obligation of the customer to officially publish the relevant information would be necessary. Therefore, we would suggest the following wording in Article 7 (1) (b):

"1. Customer due diligence procedures shall comprise the following activities:

(a) (…);

(b) identifying, where applicable, ***on the basis of publicly accessible and reliable independent source documents, data or information*** *the beneficial owner and taking* ***risk-based and*** *reasonable measures to verify the identity of the beneficial owner such that the institution or person is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts and similar legal arrangements, taking reasonable measures to understand the ownership and control structure of the customer;(…)"*

2. Article 3 Par. (10): Politically exposed persons

EBIC considers that the definition of Politically exposed persons (PEPs) runs in contradiction with the risk-based approach of the proposed directive. Based on the risk-based approach, the **PEP definition should only cover persons:**

- **from third countries**
- **having prominent public functions at state level (i.e. high ranking PEPs)**
- **having substantial or complex financial or business transactions which may represent enhanced money laundering and reputational risk**
- **and persons identified as close family members and associates**

In this context, we noticed that "national PEPs" are excluded from the PEP definition in the Council text but it is hardly to understand that EU PEPs from other Member States are still covered by the definition. This discrimination is neither politically justified (i.e. internal market, single payment area, European area of freedom and justice) nor practically appropriate (focus on PEPs from third countries which represent the real risk). It clearly introduce a discrimination which is prohibited by EU law and constitutes a barrier to the internal market.

We still regret that the Council definition in Article 3 Par. (10) and Article 11 goes far beyond the scope laid down in the revised FATF 40 Recommendations. According to the FATF definition, national (non-foreign) PEPs should be excluded from the definition. In this context, the EU should be considered as a single jurisdiction for the purpose of the PEP definition. PEPs residing in a EU Member State should therefore be deemed domestic PEPs and be excluded from the definition. A limitation to PEPs from third countries would also be in line with the reference in Recital 17 of the proposed directive to high risk persons "*coming from countries where corruption is widespread(…)*". It would also be in line with the implementation in EU law of Special Recommendation VII - Wire transfers. A limitation of the PEP definition to persons from third countries will therefore be consistent with other EU legislation in this field.

Imposing the enhanced due diligence requirements to EU PEPs residing in another EU Member State would be redundant with current legislation and practice and counter-productive. For PEPs residing in the EU, credit institutions have already in place risk-based in-house due diligence policies and controls that have been implemented pursuant to Article 11 of the first EU Money Laundering. Therefore, credit institutions can already identify unusual transactions within the normal operation of an account pursuant to the current due diligence requirements. Accordingly, credit institutions currently apply to those EU PEPs other due diligence procedures than the very specific ones used for foreign PEPs. These procedures applied for EU PEPs proved to be fully appropriate and efficient; additional enhanced due diligence requirements could only lead to counter-productive effects.

This runs also in contradiction with the risk-based approach as the definition would cover a very large circle of persons without any consideration to the real risk represented by those persons. This is a real problem for the daily business as banks often implement sophisticated IT-tools based on dedicated database to check transactions from PEPs. At present, there are some IT-companies which provide access to a database containing almost 600,000 PEPs. This database still does not contain all members of Parliament from the 25 Member States. If this database would contain all potential EU PEP and close family members and associate, the amount of data would inevitably explode and largely soar the half-a-Million level. If the major credit institutions could try to cope with this, smaller credit institutions won't be able to process such information flow.
In addition, the PEP definition is not intended to cover middle ranking or more junior individuals, as mentioned in the FATF 40 recommendations' glossary. Such a mention in

combination with the criterion of *"prominent public functions"* should exclude from the definition at least all politicians at sub-national level. Therefore, it should be clarified that PEPs only include persons having prominent public functions at national level. Without such a limitation, this target group would cover an excessive and inappropriate number of individuals, thus hindering an efficient implementation of the risk-based approach by credit institutions.

Finally, as far as close family members or close associates of PEPs are concerned, the tasks of a bank would be even more difficult. Therefore, they should only be included in the PEP definition provided that banks are able to identify them as PEPs-related persons.

A modification of the PEP definition is therefore essential for the banking and financial industry. Otherwise, particularly when it comes to the identification and the establishment of a business relationship, the requirement under Article 11, Par. (1), i.e. *"identification of PEPs via appropriate risk management systems"* would prove unworkable in practice. A risk management system can only detect risks inherent to customer relations when there is advanced knowledge of risk enhancing factors, e.g. membership of a politically exposed group of persons. Only on the basis of such data which must be verified under banks' in-house "know your customer policies" (KYC), the risks can subsequently be assessed during the ongoing monitoring process. That means that a broad definition of the term PEP would necessarily have to lead to an amendment of credit institutions' customer identification measures and procedures. Should the present proposal of including EU PEPs from another Member States be maintained, then banks would have to check for each customer any political involvement (e.g. in the capacity of a mayor or in the capacity of a party chairman in a small municipality); this would require frequent updates. In effect, as a result of the present definition, undue bureaucracy would jeopardise the actual objective, i.e. ensuring special measures with regard to a high-risk customer group.

In view of the above, EBIC urges the EU legislator to revise the PEP definition with a view to bring it into line with the definition provided in the Glossary of the revised FATF Forty Recommendations.

Against this background, EBIC recommends the following amended wording:

COUNCIL Article 3 (...)

(10) "Politically Exposed Persons" means natural persons

(a) *who are or have been entrusted with prominent public functions at* ***state level and whose substantial or complex financial or business transactions may represent enhanced money laundering and reputational risks and***
(b) ***identified as*** *close family members or close associates of such persons;*

(...)

COUNCIL Article 11

In respect of transactions or business relationships with politically exposed persons residing ~~**in another Member States or**~~ *in a third country, Member States shall require institutions and persons covered by this Directive to: (...)*

3. Article 3 Par. (11): Definition of "business relationship"

The term “business relationship” defined in Article 3 Par. (11) is not precise and should - in our opinion - only cover such business relationships which in case of banking are specifically related to or carried out in close conjunction with the mainstream activities of the financial institution (for example securities trading and safe custody).

Against this background, EBIC supports the following wording:

„(11) ‘‘Business relationship‘‘ means a business, professional or commercial relationship which is ***maintained in close conjunction with corresponding activities of the institutions and persons subject to this Directive and which is*** *expected, at the time when the contact is established, to have an element of duration.“*

4. Customer due diligence with regard to business relations to PEP

Article 11 provides that institutions and persons covered by the Directive should have "risk management systems" into place for identifying PEPs. This expression is too vague and does not represent a workable tool to apply enhanced CDD on PEPs. Institutions and persons covered by this Directive should in fact apply appropriate procedures or policies to determine whether the customer is a politically exposed person. Based on this procedures and policies, those institutions and persons would have to install appropriate IT-management where necessary. In all cases, one cannot impose dubious "risk management system" on all professions and sectors covered by the Directive.

In order to find an adequate solution to the above mentioned issue, we propose the following wording in Article 11 (1):

Article 11 (1)

(...) In respect of relations with politically exposed persons, Member States shall require those institutions and persons to:

(a) have appropriate ***risk-based procedures in place*** *to determine whether the customer is a politically exposed person; (...)*

5. Article 11: Cross-border business relations with correspondent institutions

EBIC cannot agree with Article 11 (2) which prohibits credit institutions from entering into or continuing a correspondent banking relationship with a respondent bank which permits its accounts to be used by shell banks. Such a provision raises the issue of indirect relationships with shell banks. It cannot be applicable in practice as banks would have no means of verifying whether their respondents have relations with shell banks. An obligation to know "the customer´s customer" is generally not workable, regardless of whether the customer be another credit institution, legal entity or natural person. This inapplicable provision would only lead to bureaucracy and red-tape, i.e. sending and filing of questionnaires without any possibility of verification. This provision would induce a serious step backwards for the establishment of world-wide efficient correspondent banking relationships.

<u>Against this background, EBIC would recommend the following amended wording:</u>

Article 11

2. Member States shall prohibit credit institutions from entering into or continuing a correspondent banking relationship with a shell bank ~~***or a respondent bank which permits its accounts to be used by shell banks***~~.

6. Article 14: transmission of identification/verification data

The second paragraph of article 14 states that third parties, being financial institutions, are obliged to supply 'relevant copies of identification and verification data' to the institution to which the customer is referred. In the light of the digitalisation of society financial institutions increasingly no longer hold physical dossiers of their retail clients. They only have electronic dossiers. The wording 'relevant copies of identification and verification data' could inhibit this. Article 7 of the Third AML however does not oblige the bank executing the CDD to keep a physical copy of the ID document. The third AML should therefore not in an indirect way oblige financial institutions to do this anyway to make third party CDD possible. Third party CDD is an important aspect for financial institutions especially with respect to internet banking. Essential is that verification data is transmitted to the receiving financial institution. This could be the number of the identification document or a copy of the identification document.

<u>Against this background, EBIC would recommend the following amended wording:</u>

Article 14

(...)
Relevant copies of identification ~~***and***~~ ***<u>or</u>*** *verification data and other relevant documentation on the identity of the customer or the beneficial owner shall immediately be forwarded by the third party to the institution or person to which the customer is being referred on request.*

7. Article 16: performance by third parties

EBIC considers that Article 16 is very problematic and would have adverse consequences on leasing and sales financing activities as well as on electronic business.

The original wording "this Section shall not apply (...)" could lead to the conclusion that Article 12, which opens up the opportunity of customer due diligence procedures to be performed by third parties, shall not apply to a contractual take-over of the identification. As a result an identification by third parties within the context of agency relationships would not be possible. The excluded provisions should therefore be specified to prevent misinterpretation.

Moreover, compared to several banking regulations in Member States, the term "outsourcing" could be interpreted in a very strict way by national authorities. In some countries, outsourcing measures in the banking industry are intensively regulated and require the conclusion of specific outsourcing contracts. For instance, sales financing banks operating for more than one manufacturer ("Non-Captives") cooperate with up to 40,000 partners by contractual arrangement. The conclusion of specific outsourcing agreements with all of them would become inevitable and extremely cumbersome.

In addition we wonder if the term "to be regarded as synonymous with the institution (...) covered by the Directive" is intended to prescribe the third parties to comply with any obligation of the Directive the institution is obliged to fulfil. If that is the case, it would require that each trader as well as his sales staff, which naturally is subject to a certain turnover, is trained individually on the spot with regard to existing methods of money laundering. This amount of work is in no proportion to the risk potential of loan accounts. In EBIC's view, the demanded "synonymous" status of third parties should be clearly limited to compliance with the regulations concerning customer identification and verification. We therefore suggest that Art. 16 clearly determines that third parties are only to be regarded as synonymous with the institution concerning customer due diligence procedures only.

To conclude, a large proportion of leasing and sales financing houses would be unable to shoulder the large amount of work connected with specific outsourcing agreements and meet the "synonymous" status required in Article 16. Such burden are clearly disproportionate compared to the money laundering risks represented by leasing and sales financing activities. In order not to endanger electronic business and the credit granting at the point of sales, it is therefore proposed that Art. 16 no longer refers to the term "outsourcing" and clarifies the requirements on CDD.

Against this background, EBIC would recommend the following amended wording:

Article 16

Articles 13 to 15 of this Directive shall not apply if an agency relationship exists between institutions or persons covered by this Directive and third parties regarding the fulfilment of the obligations resulting from Article 7 paragraph 1 (a) to (c) where on the basis of a contractual arrangement the agent is to be regarded as synonymous with the institution or person covered by this Directive with regard to customer due diligence procedures.

8. Article 18 and Article 31 Par. 3: Financial Intelligence Unit

Article 18 and 31, paragraph 3 of the proposal for a Directive contains information on the creation and activities and also on the duty of a "central intelligence unit" to give specific feedback to credit institutions. EBIC strongly welcomes and emphasises the importance of these provisions for credit institutions. In order to apply anti-money laundering measures efficiently, credit institutions must be able to rely on timely and specific (case-by-case) feedback provided by Financial Intelligence Units (FIUs). Such general need of feedback from FIU was acknowledged by the FATF in its revised Forty Recommendations[1]. On grounds of transparency, it would be helpful to subsume all provisions dealing with the feed-back from FIU in a single article (i.e. in Article 18). It also remains of paramount importance that these FIU receive adequate resources from Member States and are properly staffed.

<u>Against this background, EBIC would recommend the following amended wording:</u>

Article 18:

(...)
3. The adequate resources of Member States shall ensure that the financial intelligence unit provides to the institutions and persons covered by this Directive timely and specific feedback on the effectiveness of and follow-up to reports of suspected money laundering transactions.

Article 31:
(…)
3. Member States shall ensure that ***~~, wherever applicable,~~*** *timely feedback on the effectiveness of and follow-up reports of suspected money laundering or terrorist financing is provided.*

[1] Recommendation 25: The competent authorities should establish guidelines, and provide feedback which will assist financial institutions and designated non-financial businesses and professions in applying national measures to combat money laundering and terrorist financing, and in particular, in detecting and reporting suspicious transactions.

9. Article 4: Implementation by way of stricter provisions

Article 4 of the proposed Directive provides that "Member States may adopt or retain in force stricter provisions in the field covered by this Directive to prevent money laundering". The provision is identical with a provision previously contained under Art. 15 of Directive 91/308/EEC. Nevertheless, the provisions of the proposed new Directive would go far beyond those of the previous Money Laundering Directives, thus questioning the need for stricter provisions adopted by Member States. Moreover, this regulation is incompatible with the needed principle of uniform European-wide money laundering standards. In the context of the EU internal market, uniform and common rules on AML are the only adequate solution to effectively fight against money laundering. It is also the only solution to avoid competition distortion between economic operators due to potential differences in AML-legislation in Member States. Therefore, based on the overall approach of the current proposal for a Directive, the remaining provision under Article 4 appears obsolete.

Against this background, EBIC would recommend the following:

(Deletion of Article 4)
~~The Member States may adopt or retain in force stricter provisions in the field covered by this Directive to prevent money laundering.~~

10. Article 37 and 38: Implementing measures and amendment measures

The Commission expressed its willingness to organise a proper consultation with interested parties when preparing the adoption of EU implementing measures. EBIC insist on the need for proper consultation with the industry within a reasonable timeframe. This also supposes a timely access to draft Commission proposals at an early stage. The banking industry is committed to be a partner in the prevention against money laundering and to work with the EU institutions for the adoption of implementing measures. In this respect, EBIC recalls the need to avoid any over-regulation in this field especially concerning the implementation of the risk-based approach.

Therefore, EBIC would like a clear reference at least in a recital - ideally in a provision set in the Directive - to a proper consultation of interested parties for the adoption of implementing measures.