



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, 10 October 2011

EBIC RESPONSE TO COMMISSION'S LETTER ON THE REVIEW OF THE THIRD AML DIRECTIVE (2005/60/EC)

Advance comments

The European Banking Industry Committee brings together European banking associations with a mandate to provide advice, assure a comprehensive consultation of market participants and ensure a representative view of the European financial industry. EBIC has been established by the main banking industry federations: the European Banking Federation (EBF), the European Savings Banks Group (ESBG), the European Association of Cooperative Banks (EACB), the European Mortgage Federation (EMF), the European Federation of Building Societies (EFBS), the European Federation of Finance House Associations (Eurofinas)/ the European Federation of Leasing Company Associations (Leaseurope), and the European Association of Public Banks (EAPB).

Executive Summary

Risk based approach

- EBIC encourages the EU to publish in an Annex to the future 4th Directive a harmonised list of EU-wide recognised identity documents (or categories thereof) issued by Member States which would greatly facilitate the risk-based identification of customers by financial institutions also in a cross-border context.
- A specification of core risk assessment factors in the provision of Article 8 would greatly help in implementing the risk-based approach (RBA) in a harmonized manner, thus avoiding competitive distortions which may otherwise result if the provision remains as vague or non-descript as it is currently.
- The 3rd Directive and related regimes evidently fail to provide guidance where it is really required and rather tend to concentrate their efforts on business areas and products (e. g. development banking, infrastructural or environmental policy loans) which may be less prone for money laundering or terrorist financing activities, thus affecting the clarity of the provisions. The Commission should take this into consideration in any review of the 3rd Directive.

Beneficial ownership (BO)

- Of the new CDD-requirements imposed by the 3rd Directive the obligations concerning the identification of a potential beneficial owner is the single most challenging element from an implementation perspective.
- Particularly the case of direct or indirect ownership or control over a corporate entity raises a number of questions as to the interpretation of the legal requirements as well as their effective and pragmatic application.
- Cases of complex multi-layered corporate structures in which natural persons as ultimate BOs do not directly hold any shares in the customer are the cases in which the obligation to identify the BO proves to be very difficult to comply with.
- As a result of the forthcoming review a new (“fourth”) Directive should provide a fairly clear cut definition of the concept of “control”, which in the opinion of EBIC is regarded as an essential prerequisite for an efficient, pragmatic and harmonized implementation of the BO identification obligation. “Control” within complex multi-layered corporate structures should be assumed to exist for beneficial ownership purposes if the natural person has a majority shareholding (i. e. over 50 %) in the customer.
- EBIC regards the inclusion of harmonized, reliable, transparent, detailed, updated and relevant shareholding as well as BO information concerning non-listed companies in public registries as imperative if credit and financial institutions are expected to discharge their obligations concerning BO identification pursuant to the 3. Directive in a manner that ensures high standards of integrity of the CDD process of credit and financial institutions, provides them with the required legal certainty and is truly consistent with the risk-based approach.
- EBIC furthermore suggests that the Commission should also explore options to introduce corresponding changes to the company law regime of the EU which would include formal cooperation and reporting obligations for non-listed companies to furnish/submit the relevant information mentioned above to the public registries and to keep them updated as a result of changes that may occur within the company from time to time.

- Moreover, the cooperation and reporting obligations should be valid for all companies and enforced irrespective of specific legal forms provided by the company law regimes of the Member States.

Third country equivalence

- EBIC recommends that the CPMLTF list should have binding effect for all Member States and changes thereto should be introduced in a regular and orderly consultation process.
- Moreover, EBIC suggests to expand the scope and dynamics of the consultation process so as to swiftly include expert and practitioner assessments of the European banking industry concerning the equivalency of existing and other/new third country jurisdictions to be considered for privileged treatment while regularly updating the CPMLTF list.

Simplified Due Diligence (SDD)

- EBIC is of the opinion that in a 4th AML Directive, the regulatory framework on customer due diligence should take into account the different levels of risk of certain customers and products. The rules currently laid out in Article 11 of the 3rd Directive and Article 3 of the of the Implementing Measures Directive (IMD), however, should avoid overly bureaucratic and rule-based criteria concerning SDD, and rather focus on principles for a differentiated regulatory approach that would ensure that the regime in place is proportionate.
- In this context certain provisions in Article 11, especially paragraph 5, of the 3rd Directive and Article 3 IMD should be evaluated in the light of the experience of the European banking sector.

Politically Exposed Persons (PEP)

- EBIC would welcome a statement of the European Commission that would endorse the view according to which enhanced CDD should be applicable only in case of PEPs residing in a third country jurisdiction and that Intra EU PEPs would be treated as domestic PEPs since the EU is considered to be a single jurisdiction.
- While redrafting the PEP provision of the 3rd Directive and the IMD with regard to family members, close associates etc. the Commission should consider the size of the assets or turnover, the pattern of transactions, the economic background, the reputation of the country and the social, political and economic differences between countries as well as the plausibility of the customer's explanations as the main arguments for financial institutions to follow up suspicions and conducting enquiries on potential PEPs
- EBIC would like to renew its proposal for the publication of updated PEP lists (at least for intra-EU PEPs) so that credit and financial institutions may use it as a substantive tool to discharge their CDD obligations independently of any commercial lists which may not always conform to the qualitative standards of European and Member State laws and which, therefore, might harbour potential legal uncertainties and compliance risks for the credit and financial institutions as users. This is important, especially in light of the FATF proposal to require financial institutions to take reasonable measures to determine whether a customer is a domestic PEP; and to require enhanced CDD measures for domestic PEPs if there is a higher risk.
- If in absence of a high quality public list, credit and financial institutions decide on their own to use the services of commercial providers, an adequate measure/procedure for PEP determination in general would be ensured from a supervisory perspective and their CDD obligation

concerning PEP determination could be regarded as fulfilled. Therefore a review of the PEP provision of the 3rd Directive should recognise and possibly incorporate such a procedure/mechanism as one of several options for fulfilling the CDD obligation of PEP determination.

- The requirement to obtain prior approval from senior management for establishing business relationships with PEPs should be redrafted in a pragmatic manner within the context of the forthcoming review.
- EBIC urges the Commission, while redrafting the PEP provision of the 3rd Directive and the IMD within the context of the forthcoming review, to abstain from introducing provisions that link the PEP issue with that of the BO.
- From a RBA perspective it should be up to individual financial institutions to implement appropriate procedures to ensure an “enhanced on-going monitoring” by taking account of and incorporating the individual risk status of the customer. EBIC proposes that this aspect be recognised and explicitly endorsed by the European Commission while redrafting the PEP provision of the 3rd Directive and the IMD within the context of the forthcoming review.
- EBIC proposes that the principle of proportionality set out in Article 9 Paragraph 5 of the 3rd Directive in respect of non-compliance with general CDD requirements should also apply correspondingly with regard to enhanced CDD requirements in case of business relationships with PEPs and credit and financial institutions are provided with the means of choosing the appropriate measures (i. e. execute transactions or continue with the business relationship) to respond adequately in such difficult situations.

Cross-border wire transfers

- EBIC wishes to emphasise that the EU for the purposes of FATF’s Special Recommendation (SR) VII and of the Fund Transfers Regulation ((EC) 1781/2006) must be clearly considered and recognised as a single jurisdiction.
- For EBIC an imperative that further amendments to SR VII and its Interpretative Note as well as subsequent changes to EU’s fund transfers regime should be preceded by a straightforward and thorough analysis of the costs and benefits of introducing such changes.
- Requiring additional beneficiary information, as suggested by the FATF, appears quite difficult from a practical point of view. Moreover, the proportionality and usefulness – with regard to the purpose envisaged by some members of the FATF – of requiring further information on the beneficiary is to be questioned.
- EBIC is of the opinion that any changes to the SR VII regime suggested by the FATF should not be indiscriminately adopted by the EU. If changes to the funds transfer regime prove to be necessary, they should be introduced in a manner so as to avoid an overly detailed approach and should be rather focused on general principles.

Employee protection

- EBIC considers the way the provision related to the protection of employee (recital 32 and article 27) has been transposed in some countries has led to serious deficiencies. From the experience of European financial institutions it cannot be stated that liabilities exemption and confidentiality requirements are good enough to protect employees, as financial institutions experience dramatic increase of threat and hostile action against employees.

- EBIC strongly supports the idea of reviewing this point of the 3rd Directive by imposing on Member States an obligation to ensure that separate procedures are established in order to ascertain the good faith of the filing institutions' employees when their liability is challenged in the course of a money laundering proceeding at the court.

Feedback obligation pursuant to Article 35, Paragraph 3 of the 3rd Directive

- On grounds of effectiveness, it would be helpful to concentrate all provisions dealing with the same subject matter, i. e. FIU, STRs and timely feedback on STRs in one single provision (preferably in Article 21).
- Furthermore, the wording of the feedback obligation pursuant to the present Article 31, Paragraph 3 is too noncommittal and should in the opinion of EBIC be amended to reflect a more binding obligation focusing on the aspect of a *“timely and specific feedback on the effectiveness of and follow-up to reports of suspected money laundering and terrorist financing transactions”*.

Convergence of EU and FATF Standards

- EBIC would like to encourage the Commission to promote a better international understanding of the structural features of Europe's AML/CFT regime.
- Such a step would help to bridge any regulatory gaps perceived by the FATF and thereby facilitate the process of convergence between the standards of the two regimes.

1. General Remarks

The adoption of the 3rd Directive and the “Implementing Measures Directive” 2006/70/EC of 1 August 2006 (henceforth: “IMD”) have replaced the pre-existing European legal framework concerning AML/CFT with a completely restructured and comparatively complex set of new rules. The implementation of this new set of rules has, in most Member States, necessitated a comprehensive revision as well as modernisation of the existing national AML/CFT framework. As the national laws of the Member States implementing the Directives and the underlying concepts vary to some degree, it is, therefore, not practically feasible to describe the implementation process and the various approaches taken by all Member States in any detail.¹ Nevertheless, EBIC, in addition to the issues addressed in the aforementioned Commission letter, would also like to focus on those areas where, from a practical perspective, the changes brought about by the 3rd Directive are especially challenging for those who have to translate the new legal rules and concepts into practical and effective procedures to be applied in day-to-day business transactions.

Yet, on a more critical note and based on the experience so far derived from the implementation of the 3rd Directive in the banking industry in the Member States, EBIC would like to emphasise that the current regime, although recognising the principle that;

- not every business relation or transaction is subject (to the same extent) to the risk of an abuse for AML/CFT purposes,
- a multi-tiered, risk based differentiation of the combat strategy is essentially required for facilitating a manageable handling of varying degree of AML/CFT related business risks resulting from different types of customers, products and transactions and
- the AML/CFT strategy has to be implemented in a meaningful as well as reasonable manner into the internal control systems and procedures and aligned with the risk management function established in financial institutions, so as to not disrupt day-to-day business,

fails to incorporate the logical consequences of the principles stated above and, as a result, fails to deliver a consistent and undiluted risk based approach which is very much required. The language and thrust of various individual provisions that will be discussed in greater detail below illustrates that the 3rd Directive continues to assume the same risks for each and any customer and transaction in an undifferentiated manner, a fact which for the banking industry remains a matter of serious concern. This problem has also been identified in the recent Deloitte study carried out on behalf of the European Commission.²

Hence, with a view to the process of reviewing the 3rd Directive meaningful safeguards are required in order to ensure that the 4th Directive will be consistently and homogeneously geared towards a risk based and effective combat strategy and that the structural deficits of the 3rd Directive are not perpetuated. The fight against international terrorism and money laundering can only be successful if

¹ However, mention should be made in this context of a very detailed and, therefore commendable, study undertaken by the international consultancy firm of Deloitte on behalf of the Commission in 2010, which examined the application of the 3. Directive and IMD in the Member States and included to some extent an impact assessment of the practical aspects of EU's AML/CFT legislation. See Deloitte, European Commission Final Study on the Application of the Anti-Money Laundering Directive (abbreviated as: Deloitte 2010), Brussels 2010.

² See Deloitte 2010, at p. 46 et seq.

its measures are consistently geared towards real risks. Any attempts to cover each and any purely theoretical risk by way of countermeasures will inevitably lead to a meaningless proliferation of measures, a fragmented implementation of EU's AML/CFT regime in Member State jurisdictions and a serious misallocation of scarce human and material resources available to credit and financial institutions. In effect, this would have an adverse impact on the structural integrity of the AML/CFT regime as a whole and render any serious efforts of the Member States to combat money laundering and financing of terrorism ineffective.

2. Comments on specific issues concerning the 3rd Directive

For reasons of better readability and for your convenience we have inserted our comments below the questions/issues addressed in your letter which are highlighted in italics.

2.1 Risk based approach

To what extent do you consider it appropriate to introduce more risk-based rules into the Directive and how do you believe this should be done? Can you provide any evidence which might support a case for a more focussed approach to the application of AML/CFT rules, or outline the ways this might be achieved in individual institutions - in particular which might support any claim of greater effectiveness?

The 3rd Directive recognizes that the risk of money laundering and terrorist financing is not the same in every transaction. EBIC, therefore, welcomes that the 3rd Directive has introduced the principle of risk orientation into EU's AML/CFT regime, as this is in accordance with the 40+9 Recommendations of the Financial Action Task Force (FATF) and the CDD document of the Basel Committee on Banking Supervision (BCBS) of 2001.³ The risk-based approach (RBA) intends to break with the very formal and inflexible methods propagated by the rule-based approach which did not leave any room for a risk sensitive differentiation in the application of measures.

However, as noted earlier, national implementation of the RBA on the basis of the 3rd Directive has been somewhat inconsistent and, therefore, to a considerable degree unsuccessful in the Member States. This is largely due to the combined effect of an unprecedented expansion of "customer due diligence" (CDD) obligations and simultaneous introduction of the RBA pursuant to the 3rd Directive which has resulted in a substantially more complex framework of CDD requirements. The translation of this complex new system into effective, robust and consistent internal CDD compliance procedures have been particularly demanding since the new EU framework entered into force.

The obligations required by the CDD process may help to illustrate the problems encountered by the banking industry while implementing the RBA. The single most significant provision of the RBA in the context of CDD obligations is Article 8 Paragraph 2 of the 3rd Directive. Pursuant to this provision, financial institutions (and all other addressees of the statutory obligations) are required to determine the extent of the CDD measures to be implemented on a risk sensitive basis, taking into account the customer, business relationship, product and/or transaction type. As a consequence of

³ BCBS, Customer due diligence for banks, Basel October 2001 (abbreviated as: BCBS 2001)

this provision, the RBA effectively permeates all aspects of the CDD process as it directly affects all obligations which contain an element of discretion on the part of the addressee. One practical example is the obligation regarding the verification of information on the customer's identity. The relevant provision in the Directive does not specify how to verify other than on the basis of reliable documents or information from reliable sources unless the applicable laws and regulations contain other specific instructions. Consequently, in principle at least, the addressees of the obligation are granted some degree of discretion regarding the selection of the documents and sources of information relied upon for verification purposes. However, this discretion has to be exercised in a responsible and risk sensitive manner. Moreover, the discretion only exists to the extent that the applicable national law does not contain specific and "hard" provisions prescribing the steps to be taken and/or the type of documents to be used in this process. **Against this backdrop EBIC encourages the EU to publish in an Annex to the future 4th Directive a harmonised list of EU-wide recognised identity documents (or categories thereof) issued by Member States which would greatly facilitate the identification of customers by financial institutions also in a cross-border context.**

Furthermore, the requirement to apply the RBA in the context of CDD obligations calls on credit and financial institutions to vary their CDD-procedures with regard to different groups of customers/transactions, depending on the potential risk involved. It also, at least implicitly, requires financial institutions to conduct a comprehensive general assessment/analysis of the specific risk situation of their institutions and to classify their customers, products and transactions in accordance with the results of this assessment. Such a general risk assessment requires revision and updating on a regular basis. However, Article 8 Paragraph 2 does not set out any further details as to the intervals (annual or semi-annual) in which such comprehensive risk assessments need to be conducted or regarding the scope of the risk assessment as well as the methodology to be applied. **Therefore, a specification of core risk assessment factors in the provision of Article 8 would greatly help in implementing the RBA in a harmonized manner, thus avoiding competitive distortions which may otherwise result if the provision remains as vague or non-descript as it is currently.**

Moreover, in the context of RBA implementation it should be mentioned that the provisions of Article 11 of the 3rd Directive and Article 3 IMD concerning simplified CDD prescribe very narrow and detailed customer- and product-based thresholds as well as identification procedures, which can be too bureaucratic and impractical to implement. On the other hand the Directive remains in a surprisingly and almost contradictory manner silent or – at best - vague concerning high risk situations which require not only the application of enhanced CDD measures, but also the provision of official and detailed guidance to implement enhanced CDD procedures on a meaningfully risk-sensitive basis. This is especially true in the case of politically exposed persons (PEPs) pursuant to Article 13 of the 3rd Directive as well as Article 2 of the IMD. Mention may be made of the fact that both Directives fail to give – even on the level of an EU Member State – detailed guidance which could facilitate the banking industry to generally determine/identify which position of a "sub-national" PEP is to be regarded as being of national importance and which criteria should be used to determine whether a person is closely associated with a PEP. **These examples illustrate that the 3rd Directive and related regimes evidently fail to provide guidance where it is really required and rather tend to concentrate their efforts on business areas and products (e. g. development banking, infrastructural or environmental policy loans) which may be less prone for money laundering or terrorist financing activities. We, therefore, sincerely request that any review of the 3rd Directive focused on improving the implementation of the RBA should take the above into consideration while drafting the 4th Directive.**

2.2 Beneficial ownership (BO)

As banks have argued that the identification of beneficial owners is challenging - especially in the case of complex structures - how would you suggest the Directive could be adapted to incorporate practical solutions for obliged entities? FATF discussions tend towards placing more onus on the companies providing such information themselves, while the Deloitte consultants' study suggested a possible role for public authorities in making such information available in registries. It would be helpful if you could provide your views on such ideas as well as providing any background information relating to compliance with the existing beneficial ownership arrangements.

The obligations concerning the identification of a potential beneficial owner (BO) is the most challenging element from an implementation perspective of the CDD-requirements imposed by the 3rd Directive. The evidence compiled thus far by Deloitte⁴ shows that this is even true for some jurisdictions which already had, before the implementation of the 3rd Directive, at least some experience with somewhat similar obligations addressing the particular issue of a third party having an interest in a business relationship with a customer. However, at a closer look, the obligations of the 3rd Directive concerning BO- although similar in terminology and purpose of previous Directives- are very different as regards their depth and complexity. For one, the understanding of what constitutes a BO under the 3rd Directive is far wider than under the pre-existing obligations: The Directive defines the beneficial owner(s) as the “*natural person(s) who ultimately own(s) or control(s) the customer and/or the natural person on whose behalf a transaction or activity is being conducted*”. Compared with the previous Directives, the definition clarifies the scope of the term “BO” to some extent by setting out two separate instances of irrefutable presumptions of control and/or beneficial ownership; one regarding customers which are corporate entities and another regarding trusts and similar legal arrangements:

- In the case of corporate entities (legal persons) that are not listed on regulated markets (with EU-equivalent disclosure requirements) control is to be presumed where a natural person “owns or controls” directly or indirectly more than 25% of the shares in the relevant corporate entity.
- In the case of trusts and similar legal arrangements, beneficial ownership is to be assumed where a natural person is the beneficiary of 25% or more of the “property” of a trust or similar arrangement. In the event the beneficiaries have not yet been determined, the class of natural persons in whose main interest the trust or legal arrangement has been set up is to be considered as beneficial owners.

However, the obligation to identify the BO remains very complex and demanding owing largely to the fact that the definition of the 3rd Directive (Article 8 Paragraph 1 lit. b in conjunction with Article 3 Nr. 6) distinguishes the following three very different types of beneficial ownership concepts that have to be considered within the framework of customer adoption procedures:

- The first case (i. e. “acting on behalf of”) appears to cover situations where a customer executes a transaction or enters into a business relationship following instructions from another natural person. These are cases where the customer is either acting openly in a fiduciary capacity for

⁴ See Deloitte 2010, at p. 50 et seq.

another person or only nominally poses as the customer, but in fact acts as a “front man” for another person.

- The second case (i. e. position of beneficiary with regard to 25% or more of the assets) covers trusts, fiduciary structures and similar legal arrangements. It bears certain typological similarities with the first case.
- The third case (i. e. direct or indirect ownership or control over a corporate entity) is of particular practical relevance as it potentially arises in connection with a large portion of the corporate customer base. It also needs to be recalled that in relation to corporate entities the obligations entail a second element, namely measures to understand the ownership and control structures.

It is in particular the third case that raises a number of questions as to the interpretation of the legal requirements as well as their effective and pragmatic application. In the context of corporate customers difficulties arise from the fact that the definition may not be as clear-cut as it perhaps appears at first glance. This is because the assumption regarding shareholdings with its 25% threshold is designed to apply to – and only works in - cases where the shares or a relevant percentage hereof, is owned by a natural person. It is not directly applicable to the case of customers that are corporate entities and the shares of which are held by other corporate entities (intermediate entities) in complex multi-layered structures.⁵ In these cases, it cannot be said that the shares in the customer (or a relevant percentage of the shares in the customer) are straightforwardly owned by a natural person. The definition, however, also refers to cases of indirect control or ownership without defining the concept of control in this context. It also follows from the definition that control is the overriding term in the context of the obligations in relation to the BO and that ownership, specifically the ownership of shares, is just one instance of control. Therefore, more appropriate question to ask in such a situation is, therefore, that of actual – indirect – control over the customer, or a relevant percentage of the shareholding (more than 25%) in the customer, through the intermediate entities. The person controlling the intermediate entity which in turn holds all of the shares in the customer or at least a shareholding exceeding 25%, will then have to be considered to be the BO. In practice, it may, therefore, helpful to distinguish between two very different situations, namely:

- the fairly straightforward cases of direct ownership, i. e. natural persons directly owning the relevant percentage of shares and
- cases in which natural persons are not directly holding any shares in the customer.

The latter cases in which natural persons as ultimate BOs do not directly hold any shares in the customer (because one or more levels of intermediate companies exist between them and the customer) are the cases in which the obligation to identify the BO prove to be far more difficult to comply with. In such instances the key question that naturally arises is then as to how such control could be determined. As already pointed out, the BO definition of the 3rd Directive does not address the issue of “control”.⁶ However, the challenge of identifying BOs with controlling interests in a customer, nevertheless, remains and credit and financial institutions are tasked with

⁵ See Deloitte 2010, at p. 65.

⁶ See also Deloitte 2010, at p. 65 et seq.

problem of selecting a meaningful approach that accomplishes the original objective of the obligation pursuant to the 3rd Directive, namely identifying the ultimate and controlling BO by avoiding a formalistic and meaningless coverage of all BOs along the shareholding chain who may own more than 25 % of a customer, but may not wield any significant control over the customer.

Therefore, as a result of the forthcoming review a new (“fourth”) Directive should provide a fairly clear cut definition of the concept of “control”, which in the opinion of EBIC is regarded as an essential prerequisite for an efficient, pragmatic and harmonized implementation of the BO identification obligation. Since the issue has been over time subject to considerable debate and research within the framework of international company law and accounting standards⁷ EBIC, therefore, suggests to pragmatically borrow useful criteria from these regimes and define the term “control” along those lines as “...*the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.*”⁸ Absent any indications for other forms of control or influence, such “control” is assumed to exist for beneficial ownership purposes where the natural person owns a majority shareholding (i. e. over 50 %⁹) in the intermediate company that in turn holds all or at least more than 25% of the shares in the customer. EBIC would like to emphasize that the approach to BO identification within complex multi-layered corporate structures suggested above is consistent with the basic thrust of the obligation pursuant to the 3rd Directive. It would require credit and financial institutions to identify the natural person as the ultimate BO who

- through his/her majority shareholding (of over 50 %) exercises effective control over the intermediate company that in turn holds all or more than 25% of the shares in the customer and thereby
- has a degree of influence corresponding to that of a direct shareholder holding more than 25% of the shares in the customer.

Regardless of the approach and methods chosen for BO identification, another key issue credit and financial institutions are confronted with in this context is that concerning procurement of the information required to make the necessary determinations. Mention should be made in particular of information on the distribution of shares among shareholders of intermediate companies that are not easily available or, in some instances, not available at all, even if the customer fully cooperates. Moreover, requiring credit and financial institutions to serve as formal access points to collect and manage information on beneficial ownership as proposed by the FATF’s second consultation paper on the review of the standards and preparation for the fourth round of mutual evaluations would be utterly disproportionate.¹⁰ This task should be exclusively assigned to the official register of companies.

Therefore, EBIC recommends establishing harmonized mechanisms in the Member States to access BO information.

⁷ International Accounting Standards (IAS) Board, IAS 27: Consolidated and separate financial statements, 1 July 2010.

⁸ See IAS 27.4.

⁹ Existing literature on the analysis of control and ownership specifically refers to the 50 % threshold mark as an indication for control or influence; see also Schmit, Mathias et al, Public Financial Institutions in Europe, Brussels 2011, at p. 43.

¹⁰ FATF, The Review of the Standards – Preparation for the 4th Round of Mutual Evaluation, Second public consultation, Paris 2011 (abbreviated as: FATF-CP 2011), Nos. 1.2. (a) or (b)

As highlighted by Deloitte¹¹ credit and financial institutions are encountering considerable difficulties while discharging their obligations to identify the BO of a non-listed company as such tasks require sophisticated and specialized research. In some jurisdictions legal persons are under no statutory obligation to disclose the natural persons acting on behalf of them (or to register their names into publicly accessible registers). Financial institutions thus have to rely exclusively on the information given to them by the person opening the bank account on behalf of such legal persons. The most helpful, practical and efficient solution would be to grant financial institutions access to public registries of the Member States that would provide harmonized, reliable, transparent, detailed, updated and relevant shareholding as well as BO information concerning non-listed companies. EBIC, therefore, welcomes earlier indications of the Commission to explore channels regarding the issue of access to public registries in Member States and to promote harmonization to the extent that such publicly accessible registries provide the necessary company information for purposes of BO identification and, where applicable, verification. **EBIC regards the inclusion of the requisite information mentioned above in public registries as imperative if credit and financial institutions are expected to discharge their obligations concerning BO identification pursuant to the 3rd Directive in a manner that ensures high standards of integrity of the CDD process of credit and financial institutions, provides them with the required legal certainty and is truly consistent with the risk-based approach.**

In order to meet this objective, **EBIC furthermore suggests that the Commission should also explore options to introduce corresponding changes to the company law regime of the EU which would include formal cooperation and reporting obligations for non-listed companies to furnish/submit the relevant information mentioned above to the public registries and to keep them updated as a result of changes that may occur within the company from time to time. This could be done in the form of the binding obligation to publish the names of all stakeholders holding more than 25 % shares in the companies' annual reports. Moreover, the cooperation and reporting obligations should be valid for all companies and enforced irrespective of specific legal forms provided by the company law regimes of the Member States.**

2.3 Third Country Equivalence

The Directive tasks Member States with exchanging information about equivalence of standards of third countries in a number of areas (simplified due diligence, third party reliance, prohibition of disclosure, CDD and record keeping). EU Member States have in the past compiled a list of equivalent third countries and this list is in the process of being updated. It would be useful to understand how banks use this list, whether the existence of a single list at EU level presents advantages for banks, as well as any other suggestions on how recognition of third country equivalence might be facilitated in the future.

EBIC regards the list of equivalent third countries issued by the Committee on the Prevention of Money Laundering and Terrorist Financing (CPMLTF) on behalf of the Member States as an extremely important and useful tool. The list considerably facilitates the task of the European banking industry to prepare a substantive and uniform, i. e. EU-wide, assessment of the money laundering and terrorist financing risks prevailing in third country jurisdictions for the purposes of

¹¹ See Deloitte 2010, at p. 7 and 70.

SSD, third party reliance, exceptions to the prohibition of disclosure, conducting CDD, record keeping and correspondent banking relationships. The list provides a general and solid benchmark for the privileged treatment of business relationships with customers/contractual partners from the listed countries. These business relationships are generally subject to normal CDD procedures established by the credit and financial institutions, except for such cases where existence of higher customer related risks based on solid evidence may suggest otherwise and warrant enhanced CDD. Moreover, EBIC commends the work of the CPMLTF on updating the list as has been recently done in June 2011.

However, there are concerns based on past experience that competent authorities of Member States might within the context of national regulation take the liberty to modify the CPMLTF list and push out some of the third country jurisdictions and even EU Member States which are per se considered to be equivalent. Such an unilateral regulatory action would render a substantive and uniform assessment by European financial institutions of the money laundering and terrorist financing risks prevailing in third country jurisdictions impossible and give rise to arbitrage between Member State jurisdictions and competitive distortions which might possibly impair the functioning of the internal market. **In view of the aforementioned EBIC recommends that the CPMLTF list should have binding effect for all Member States and changes thereto should be introduced in a regular and orderly consultation process. Moreover, EBIC suggests to expand the scope and dynamics of the consultation process so as to swiftly include expert and practitioner assessments of the European banking industry concerning the equivalency of existing and other/new third country jurisdictions to be considered for privileged treatment while regularly updating the CPMLTF list.**

2.4 Simplified Due Diligence (SDD)

Article 11 of the Directive, in conjunction with Article 3 of the implementing Directive (2006/70/EC), describes types of customers, transactions and products that present a lower risk of money laundering and terrorist financing. For such customers, a simplified customer due diligence regime applies. The EU regime has come under some criticism from the FATF because in some Member States' legislation, SDD appears to amount to a total exemption from CDD measures. We would like to understand from the banking sector, what types of measures banks take when applying the SDD regime, and especially how they assess whether customers fulfil the necessary criteria to be considered as representing a "low risk of money laundering or terrorist financing".

As mentioned in your letter the SDD regime pursuant to Article 11 of the 3rd Directive, in conjunction with Article 3 of the IMD has come under some criticism from the FATF. However, contrary to FATF's view that in some Member States' legislation, SDD appears to amount to a total exemption from CDD measures, the European banking industry is of the opinion that national implementation of the SDD regime has often resulted in the prescription of very narrow and detailed customer- and product-based thresholds as well as identification procedures, which can be too bureaucratic, impractical to implement and represent a clear departure from the RBA.¹² Moreover, the rules laid down in the two Directives fail to adequately capture the national characteristics and

¹² See Ganguli, Indranil, Achteik, Olaf et al., The Third AML-Directive: Europe's Response to the Threat of Money Laundering and Terrorist Financing – Part III, in: The Banking Law Journal, Vol. 126 No. 9 October 2009 (abbreviated as: Ganguli/Achteik et al. III), at p. 841.

variety of products and their usage by customers in different Member State jurisdictions. In view of the aforementioned and in order to avoid compliance risks as well as additional costs resulting from the layers of complexity added by the rule based and bureaucratic SSD regime many financial institutions have, therefore, opted to use general/normal CDD procedures instead of SDD also in those cases, in which very low risks of money laundering or terrorist financing prevail.¹³

EBIC is of the opinion that in a 4th AML Directive, the regulatory framework on customer due diligence should take into account the different levels of risk of certain customers and products. The rules currently laid out in Article 11 of the 3rd Directive and Article 3 of the IMD, however, should avoid overly bureaucratic and rule-based criteria concerning SDD, and rather focus on principles for a differentiated regulatory approach that would ensure that the regime in place is proportionate. In this context the provisions in Article 11, especially paragraph 5 of the 3rd Directive and Article 3 IMD should be closely evaluated in the light of the aforementioned experience of the European banking sector.

2.5 Politically Exposed Persons (PEP)

The regime in the Directive requires that enhanced customer due diligence measures are applied in the case of politically exposed persons (PEPs) residing in another Member State or in a third country. There has been some debate within the EU as to how to define the scope of a "PEP", and in particular how far to go in respect of "immediate family members, or persons known to be close associates, of such persons". We would be interested in your views on this issue, as well as any suggestions you might have which might facilitate identification of PEPs. One suggestion, on which we would also like to invite your comments, has been to consider all PEPs residing in the EU as "domestic".

The current EU rules, namely that enhanced CDD measures should be applied only to such PEPs residing in another Member State or in a third country jurisdiction, mirrors the FATF assessment according to which the application of enhanced CDD measures is not required in case of domestic PEPs. **If the EU is to be considered a single jurisdiction there are, however, good reasons to consider Intra EU PEPs as domestic. EBIC would therefore highly welcome a statement of the European Commission that would endorse the view according to which enhanced CDD should systematically be applicable only in case of PEPs residing in a third country jurisdiction.**

Regarding the scope of PEPs, as we have already mentioned under Section 2.1 the Directive remains surprisingly silent or – at best - vague concerning high risk situations which require not only the application of enhanced CDD measures, but also the provision of official and detailed guidance to implement enhanced CDD procedures on a meaningfully risk-sensitive basis. Therefore, it is not surprising that the issue of PEP determination on the basis of enhanced CDD is one of the fundamental issues of the 3rd Directive and the IMD that is most intensely discussed in the context of the risk-based approach. EBIC would once more like to highlight that Article 13 of the 3rd Directive as well as Article 2 of the IMD fail to give – even on the level of an EU Member State – detailed guidance that could facilitate the banking industry to generally determine/identify a PEP, his position within the political and administrative structure and the requisite criteria to be used to determine whether a person is closely associated with a PEP.

¹³ See Deloitte 2010, at p. 49, 84.

Although the 3rd Directive specifies in line with the requirements of the FATF and the BCBS that institutions and other covered persons under the Directive in relation to PEPs must have appropriate risk-based procedures to determine whether the customer is a PEP¹⁴, this identification requirement already causes a series of problems as it compels financial institutions to determine the attribute of a PEP with regard to new and existing customers with a high degree of certainty. The provisions adopted by the European Commission in the IMD or statements and circulars of national supervisory authorities also remain surprisingly vague and, unfortunately, fail to provide the required guidance. Moreover, while the Directives require covered institutions to apply reasonable and adequate measures for PEP determination¹⁵, even the BCBS concedes that it is unrealistic to expect financial institutions to know or investigate every distant family, political or business connection of a (foreign) customer. **The need for thoroughly following-up suspicions and conducting enquiries will depend rather on (a) the size of the assets or turnover, (b) the pattern of transactions, (c) the economic background, (d) the reputation of the country and (e) the social, political and economic differences between countries as well as (f) the plausibility of the customer's explanations.**¹⁶ Therefore, from a RBA perspective the arguments (a) to (f) should be considered while redrafting the PEP provision of the 3rd Directive and the IMD within the context of the forthcoming review. In consideration of the difficult application of the PEP determination of family members and close associates and for the sake of consistency the definition of closely associated persons should be also aligned with the definition in the Market Abuse Directive (MAD) (and its review).

Furthermore, it should be mentioned, that in conjunction with the discussions held during the legislative process of the 3rd Directive the European banking industry had proposed that the European Commission should provide and maintain a PEP-list/database like the existing one regarding persons, groups and entities subject to EU financial sanctions. The proposal was rejected at that time by the European Commission on the grounds that such an official lists would, inter alia, not reflect the specifics of each country. **EBIC would therefore like to renew its proposal for the publication of updated lists at least for intra-EU PEPs so that credit and financial institutions may use it as a substantive tool to discharge their CDD obligations independently of any commercial lists which may not always conform to the qualitative standards of European and Member State laws and which, therefore, might harbour potential legal uncertainties and compliance risks for the credit and financial institutions as users.** This is important, especially in light of the FATF proposal to require financial institutions to take reasonable measures to determine whether a customer is a domestic PEP; and to require enhanced CDD measures for domestic PEPs if there is a higher risk.

Moreover, as far as PEP determination is concerned competent Member State authorities cannot indiscriminately expect credit and financial institutions to use international PEP-databases which include up to 500.000 persons and are offered by several commercial providers, as this is not a legal requirement of the 3rd Directive, the IMD or national laws. **If, however, credit and financial institutions decide on their own to use the services of such commercial providers, an adequate measure/procedure for PEP determination in general would be ensured from a supervisory perspective and their CDD obligation concerning PEP determination could be regarded as fulfilled. Therefore a review of the PEP provision of the 3rd Directive should recognise and**

¹⁴ Article 13 Paragraph 4 of the 3-AMLD.

¹⁵ Recital (2) of the IMD.

¹⁶ BCBS, CDD 2001, Paragraph 54.

possibly incorporate such a procedure/mechanism as one of several options for fulfilling the CDD obligation of PEP determination.

Moreover, pursuant to Recital (26) of the 3rd Directive obtaining prior approval from senior management for establishing business relationships should not imply obtaining approval from the board of directors but from the immediate higher level of the hierarchy of the person seeking such approval. Irrespective of the clarification in Recital (26) of the 3rd Directive financial institutions can – on a voluntary basis – escalate the approval mechanism to the board of directors or comparable committees under company laws on the basis of an individual PEP risk-rating which determines the individual risk of a PEP as a (new) client. By doing so, separate risk factors such as the country, the transaction and the profession could be compiled and processed into a final assessment which could then be used for determining the competent level for approval to establish business relationships with PEPs. **This is also a point EBIC proposes to the European Commission to consider while redrafting the PEP provision of the 3rd Directive and the IMD within the context of the forthcoming review.**

Another very intensely debated issue is that of the PEP as a beneficial owner. Starting point of investigations will often be a KYC-Questionnaire in which (corporate) customers of a credit or financial institution are required to disclose this information. However, verification of such information that might indicate with a high degree of certainty that a PEP is a BO with more than 25 % of the controlling interest in a corporate customer is, as experience shows, very difficult to obtain. It is almost impossible in the case of corporate customers that are part of multi-layered corporate structures with a range of interposed companies and beneficial owners at different levels of the structure and with varying degree of shareholdings. The problem is further aggravated by the fact that the identification of a PEP as BO holding more than 25 % (but less than 51 %) at any given shareholding level within such a complex corporate structure may eventually lead – from a regulatory point of view – to a “PEP-contamination” of such a customer. The credit institution would be forced to qualify the customer as high risk and to conduct a subsequent, compulsory and thorough identification of all natural as well as legal persons along the entire shareholding chain. Such an outcome would be from a RBA perspective highly undesirable as it would tie up scarce and valuable resources in an overly protracted CDD process that could be potentially disruptive for the proper conduct of business. **Therefore, EBIC urges the Commission, while redrafting the PEP provision of the 3rd Directive and the IMD within the context of the forthcoming review, to abstain from introducing provisions that link the PEP issue with that of the BO.**

The difficulties as to how an “enhanced on-going monitoring” could be realized is also a regular object of debate among practitioners across the entire range of the European and global banking industry. Already the general CDD requirements for all categories of customers require an on-going monitoring of the business relationship. This includes scrutiny of transactions undertaken throughout the course of the relationship in order to ensure that (a) the transactions being conducted are consistent with the financial institution's knowledge of the customer, the business and risk profile, including, where necessary, the source of funds and (b) the relevant documents, data or information are kept up-to-date. This kind of on-going monitoring is generally conducted in institutions – as far as possible – by using electronic data processing (EDP) tools and information technology (IT)-based systems which are able to identify suspicious transactions and cases via a scoring procedure based on “scenarios,” or individual rules, parameters or typologies, customer groups and adaptive customer profiles. However, from a RBA perspective it is up to individual financial institutions to implement appropriate procedures by taking account of and incorporating the individual risk status of the

customer. **EBIC proposes that this aspect be recognised and explicitly endorsed by the European Commission while redrafting the PEP provision of the 3rd Directive and the IMD within the context of the forthcoming review.**

Finally, the attention should be turned to those situations in which credit and financial institutions are unable to comply with the enhanced CDD requirements concerning PEPs. Pursuant to national legislation in certain Member States credit and financial institutions are in such cases required (a) not to carry out transactions through a bank account, (b) not to establish business relationships with PEPs, or (c) to terminate existing business relationships. Although the 3rd Directive does not provide for such a requirement, **EBIC proposes that the principle of proportionality set out in Article 9 Paragraph 5 of the 3rd Directive in respect of non-compliance with general CDD requirements should also apply correspondingly with regard to enhanced CDD requirements and credit and financial institutions are provided with the means of choosing the appropriate measures to respond adequately in such difficult situations.** Indeed there is a qualitative difference if a (new) customer persistently and/or repeatedly refuses to comply with the CDD procedures or the reasons for non-compliance are beyond control of the customer or the financial institution. Therefore, a careful balancing of legally protected interests is required, by which – in either case – the risks resulting from continuing the business relationship with PEPs and the pending loss for customers as well as financial institutions are taken into due consideration.

2.6 Cross-border wire transfers

Finally, although it does not fall under the scope of the Third Anti-Money Laundering Directive, but rather under the Fund Transfers Regulation ((EC) 1781/2006), there have been discussions within the FATF about the inclusion of additional information contained in wire transfers (including full originator and full beneficiary information), monitoring by financial institutions with respect to the completeness of the information as well as the screening of transactions against international sanctions lists, also by intermediary financial institutions. We would be interested to have your views on the possible implications for the EU payments system.

From a European banking and payments perspective **EBIC wishes to emphasise that the EU for the purposes of FATF's Special Recommendation (SR) VII and of the Fund Transfers Regulation ((EC) 1781/2006) must be clearly considered and recognised as a single jurisdiction** as stated in the Para. 11 of Basel Committee's guidance dated May 2009.¹⁷ This fact is of fundamental importance and it is one of the defining features of the EU. EBIC repeatedly conveyed this position to the FATF on several occasions, and has done so most recently in its response to FATF's second consultation paper on the review of the standards and preparation for the fourth round of mutual evaluations. In its position paper, EBIC, furthermore, recommended that the FATF should take note of the fact that the European financial sector has taken substantial steps to establish a "Single Euro Payments Area" (SEPA) which will be fully operational by 2014 and will then account for the bulk of EU payments (based on an EU-Regulation on SEPA). In fact it may be argued that SEPA will solve some of the most pressing issues addressed in the proposed FATF amendment as far as the EU as a single payments area and jurisdiction is concerned. **To that end it is for EBIC an imperative that further amendments to SR VII and its Interpretative Note**

¹⁷ BCBS, Due diligence and transparency regarding cover payment messages related to cross-border wire transfers, Basel May 2009 (abbreviated as: BCBS 2009)

(INSR) as well as subsequent changes to EU's fund transfers regime should be preceded by a straightforward and thorough analysis of the costs and benefits of introducing such changes.

Current payment industry standards generally require the ordering bank to include the beneficiary account number (but not the beneficiary name) in domestic or SEPA payments (single jurisdiction). However, for international transfers standards require at a minimum the beneficiary name, the bank identifier (BIC) or other identifiers and only where available, the account number, to execute a transfer. Those differences according to the domestic or international character of a transfer have to be taken into account in order to avoid jeopardising the efficiency of a system which has been developed over several decades. **However, requiring additional beneficiary information, as suggested by the FATF during the aforementioned consultations, appears quite difficult from a practical point of view. Moreover, the proportionality and usefulness – with regard to the purpose envisaged by some members of the FATF – of requiring further information on the beneficiary is to be questioned.**

Finally, we believe that requiring additional beneficiary information is not an efficient contribution to the prevention/detection of money laundering and terrorist financing. It will only lead to additional costs, without any real benefits. In the same context, we would like to stress that it is important that banks and here especially intermediate financial institutions (FIs) are not required to verify the content of the information accompanying the fund transfers while processing the fund transfers as it would just be impossible for them to apply such a requirement along the entire correspondent banking chain. In light of the aforementioned, **EBIC is of the opinion that any changes to the SR VII regime suggested by the FATF should not be indiscriminately adopted by the EU. If changes to the funds transfer regime – after conducting the recommended cost benefit analyses – prove to be necessary, they should be introduced in a manner so as to avoid an overly detailed approach and should be rather focused on general principles.**

Finally, EBIC welcomes the statement of the FATF that one should not require FIs to verify the identity of parties to a transaction who are not their customer. In particular, intermediary FIs are not able to verify the identity of either the originator or beneficiary.

3. Other issues

3.1 Employee protection

The protection of employees is for EBIC an issue of importance and critical concern and should be, therefore addressed by the Commission.

EBIC believes that even if the wording of the 3rd Directive seems to be rather clear (Recital 32 and Article 27), the way this provision has been transposed in some countries is definitely not sufficient. Moreover, the general view that liabilities exemption and confidentiality requirements are good enough to protect employees do not provide ample relief, as a dramatic increase of threat and hostile action against employees in some Member States can be observed. Civil, administrative and criminal immunities for the employee who has filed a report in good faith are actually only efficient if the confidentiality is fully respected. Even when the breach of confidentiality of the transaction report is punishable as a crime, it appears that, in some jurisdictions transaction reports are disclosed in the legal proceeding against the money launderers in order to ascertain the good faith of the filing financial institutions' employees. As a consequence the money launderers have a legal access to the transaction report, which becomes part of the court file. In other words, there are situations where legal conflicts might exist between the filing employees' right to immunity and the defendants' right

to see the evidence **Therefore, EBIC strongly supports the idea of reviewing this point of the 3rd Directive by imposing on Member States an obligation to ensure that separate procedures are established in order to ascertain the good faith of the filing institutions' employees when their liability is challenged in the course of a money laundering proceeding at the court.**

3.2 Feedback obligation pursuant to Article 35, Paragraph 3 of the 3rd Directive

Article 21 of the 3rd Directive provides for the creation of a Financial Intelligence Unit (FIU) and specifies the activities as well as the responsibilities of such a "central national unit". Furthermore, Article 35, Paragraph 3 requires Member States to ensure, wherever practicable, that as a follow-up measure timely feedback on the effectiveness of suspicious transaction reports (STRs) concerning money laundering and terrorist financing is provided – amongst others – to credit and financial institutions as covered persons. **On grounds of effectiveness, it would be helpful to concentrate all provisions dealing with the same subject matter, i. e. FIU, STRs and timely feedback on STRs in one single provision (preferably in Article 21). Furthermore, the wording of the feedback obligation pursuant to the present Article 31, Paragraph 3 is too noncommittal and should therefore be amended to reflect a more binding obligation. In the opinion of EBIC the language should, therefore, focus on the aspect of a “timely and specific feedback on the effectiveness of and follow-up to reports of suspected money laundering and terrorist financing transactions”.**

3.3 Convergence of EU and FATF Standards

Substantiated by past experience of FATF's country specific evaluations of the AML/CFT regimes of the Member States EBIC would like to bring to the attention of the Commission an issue which gives rise to grave concerns within the European banking industry. At the heart of this issue is the notion occasionally presented by the FATF that the provisions of the 3rd Directive – on which the national AML/CFT regimes of the Member States are based – lack some degree of conformity with the FATF 40+9 standards. EBIC, therefore, is under the impression that the FATF while evaluating the Member State regimes actually questions some fundamental aspects as well as the rationale of the 3rd Directive. Therefore, EBIC would like to request the Commission to continue its dialogue with the FATF with a view to promote

- recognition of the EU as a single jurisdiction and payments area as well as
- understanding for the specificities of EU's AML/CFT legislation and its national implementation.

Moreover, EBIC refers to the recently initiated review of the 3rd Directive and would like to encourage the Commission to communicate and explain to the FATF the results of the review process. EBIC is of the opinion that such steps would promote a better international understanding of the structural features of Europe's AML/CFT regime and would help to bridge any regulatory gaps perceived by the FATF and thereby facilitate the process of convergence between the standards of the two regimes.