Date 21.01.16

European Banking Federation's (EBF) response to ESAs consultation on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions

The European Banking Federation (EBF) would like to take this opportunity to thank the ESMA, the EBA, the EIOPA and the Joint Committee of the European Supervision Authorities (ESAs) for consulting the stakeholders on the joint Guidelines project under articles 17 and 18(4) of directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors that credit and financial institutions should consider when assessing the money laundering and terrorist financing risks associated with individual business relationships and occasional transactions.

General comments:

The EBF recognises the value that can be brought through the EU Guidelines in terms of providing a consistent approach to financial crime compliance across the EU. This is essential if we are to successfully combat the laundering of the proceeds of crime by organised crime groups that are increasingly operating across European borders. The EBF believes the proposed guidelines will undoubtedly assist firms adopting risk-based Anti-Money Laundering & combating the Financing of Terrorism (AML/CFT) policies and procedures.

However, notwithstanding the above, the EBF also would like to underline the importance of the need to clearly distinguish between risk factors regarding money laundering risks (ML-risks) on the one hand and risk factors relating to terrorist financing (TF-risks) on the other hand: TF-risks are very different from AML-risks. Thus, the risk factors/indicators are also very different. Likewise, the manner in which a risk based approach is to be applied differs considerable. We therefore strongly believe that these two issues have to be clearly separated throughout the guidance paper.

Generally speaking the EBF members finds that the EU Guidelines provide helpful clarity at a high level on what is expected in terms of the approach to implementation of the new 4th EU Money Laundering Directive by banks. However, the lack of detail does also mean that there are questions of application that are not sufficiently addressed. Specific comments are made in

the document below, but we would emphasise particular concern around the lack of clarity around the expectations of enhanced due diligence (and the extent to which a Risk Based Approach (RBA) can be applied to application of the enhanced due diligence) in regard to:

- Domestic Politically Exposed Persons (PEPs), their family members and close associates.
- Correspondent banking (and in particular for activities that full under the definition of correspondent banking but in reality are lower risk).

Therefore the EBF stresses the need for more detail on the practical implementation of the requirements in regard to correspondent banking and PEPs.

The EU Guidelines put great emphasis on consideration of geographic risk. However, the European authorities have actually provided no additional information to support banks in this respect. This means that banks are left to find information themselves and there are particular challenges. There are also questions around the suggestions around using public sources and adverse media. The EBF members would very much appreciate if the ESAs could elaborate specific guidance on how geographic risks can be assessed and what sources should be used.

Also, the EBF feels that the EU Guidelines should take into consideration the challenges posed by a need of coherence between the 4th EU Money Laundering Directive and other EU policies/ laws including:

- The Payment Accounts Directive
- The EU Data Protection Regulation (still to be finally adopted)
- Emerging EU policies around refugees and migrants

Finally, there is recognition from many national authorities and international bodies that there needs to be much closer collaboration between the banking industry, regulators and supervisors and policy makers on AML/CTF matters. However, the final 4th EU Money Laundering Directive did not take on board many points made by the banking industry. Better engagement by the ESAs with the banking industry will be needed to ensure effective implementation of the new AML/CTF requirements. For this purpose the EBF would propose to the ESAs regular meetings with representatives of the European banking industry on the practical application of the new 4th EU money laundering requirements.

Please find below first the EBF answers to the questions and secondly additional specific comments to the text:

1. Answers to the three questions asked by the ESAs in the public consultation:

Do you consider that these guidelines are conducive to firms adopting risk-based, proportionate and effective AML/CFT policies and procedures in line with the requirements set out in Directive (EU) 2015/849?

It seems that the proposed risk factors are very broad (especially regarding beneficial owners). They also could be understood to imply that they have to be applied in all situations and in their entirety. As regards the requirements in respect of beneficial owners and PEPs thy also may

give the wrong impression that the relevant information on the beneficial owners and PEPs can be obtained and verified easily, which is clearly not the case. To avoid the misconception that the guidelines set out definitive requirements which are to be observed in all cases and thus unduly burdensome or even clearly unreasonable requirements it should therefore be clarified that not all factors are applicable in all cases and that the regulatory authorities and the institutions have considerable discretion regarding how this criteria are to be implemented in the context of the applicable national law.

In this connection it should also be pointed out and expressly clarified that there will be differences in the manner in which a customer and its beneficial owner will be identified: Customer identification procedures will necessarily be materially different from the procedures to be applied in order to establish the identity of beneficial owners. In some jurisdictions this is reflected in the fact that the term identification is only used to cover the former in order to take into account that the formal identification on the basis of qualified identification documents is only possible in the case of a customer and not in the case of a beneficial owner. Thus, a clear distinction needs to be drawn between customer identification and establishment of the identity of the beneficial owner. The same applies correspondingly to the establishment of the identity of a PEP.

The proposed guidelines may be understood to imply that non -face-to-face business generally constitutes a higher risk. Such a generalisation would of course directly conflict with the digital agenda of the European Commission. To avoid such a misconception, all references to high risks in connection with non-face to face transaction should be reviewed. Alternatively it should be expressly clarified non-face-to face-transactions need not be classified as high risk as such or only under certain circumstances, at least where accepted and secure methods for customer identification have been used. .

Do you consider that these guidelines are conducive to competent authorities effectively monitoring firms' compliance with applicable AML/CFT requirements in relation to individual risk assessments and the application of both simplified and enhanced customer due diligence measures?

The EBF fears that in particular the guidelines set out in Title II may be misunderstood and give rise to the false expectation, that all of the criteria and questions set out in ESAs guidelines have been addressed and answered in all cases. As already mentioned above, this is not possible and would result in undue and unreasonable burdens.

The guidelines in Title III of this consultation paper are organized by types of business. Respondents to this consultation paper are invited to express their views on whether such an approach gives sufficient clarity on the scope of application of the AMLD to the various entities subject to its requirements or whether it would be preferable to follow a legally-driven classification of the various sectors; for example, for the asset management sector, this would mean referring to entities covered by Directive 2009/65/EC and Directive 2011/61/EU and for the individual portfolio management or investment advice activities, or entities providing other investment services or activities, to entities covered by Directive 2014/65/EU.

Generally speaking the EBF members are in favour of the proposed structure as this allows for a more detailed guidance on risk factors and measure to be applied in specific sectors. However, certain activities such as Trade Finance activities fall into more than one sector and thus will be affected by more than one type of guidelines. This should perhaps be recognised and also underlines the need to review and the general part of the guidelines in order to provide for a consistent set of guidelines for such activities.

2. Specific Comments on the text:

On a general approach the EBF considers that the meaning of the terms '*should*' and '*must*' may not be sufficiently clear. In particular, it is not entirely clear whether these are used interchangeably or whether they are indeed used to describe differing degrees of authority (that is "should" implying a degree of discretion and "must" describing a largely rigid obligation)

We believe as well that there is a lack of clarity throughout the document on the distinction between a firm wide risk assessment and a customer risk assessment. The text seems to stray from one to the other, sometimes referring to both in the same paragraph. In Title II the distinction is particularly unclear, whereas in Title III there is a lot more clarity.

Many of the identified risk factors – especially those relating to customer behaviour - relate to matters that can only be determined once the business relationship is under way (and in some case after considerable time or sufficiently large volume of transactions), and so cannot be acted upon at the point in time when the customer relationship is first established. This should recognised throughout the text, in particular in Title III.

Consequently, all issues connected to transaction monitoring (being a separate subset of the Customer Due Diligence (CDD) obligations) should be clearly separated from all issues concerning the establishment of a business relationship. Throughout the text.

In the discussion of PEPs, reference is made to different degrees of (high) risk. This is a new approach not foreseen in the Directive and should therefore be reconsidered.
The guidance regarding trade finance raises concerns since there appear to exist misunderstandings regarding the risks involved (which are not higher than in other areas) or the insight banks have into the background (banks never have insight into the underlying trade transaction/the goods in question).

Page 11:

§8

- Third bullet: The definition of occasional transaction in not in line with the concept of occasional transaction provided in the Directive. In this regards, then, EBA should take into account the relevant threshold (more than 15.000 €)

Page 12:

§10:

- First bullet – the closing reference to institutions which may not need an overly complex assessments is addressed in the context of the business-wide assessment. This issue could also be addressed in the third bullet – holistic view of customer?

- Second bullet – we suggest to replace 'decide' with 'form part of the decision'

Page 13:

§10:

- Fourth bullet – This is the only part which uses the term 'must', thereby implying a stronger/ more rigid type of requirement. It is not clear whether this is the intention or not, see also our comment above regarding the use of the terms "should"/"must" throughout the text.)

Page 14 & 15:

§ 17 – We very much welcome this clarification but would suggest to address this also in the introduction to avoid misconceptions, see also our comments above.

§18 to 21: customer risk factors': the guidelines make no difference between the customer and the customer's beneficial owners' risk factors'. However, Annex II and Annex III of the Directive 2015/849 state that risks are linked to the customer and where appropriate specified the situation of the beneficial ownership. Article 15, 16, 17 and 18 of the Directive do also do not require the collection of the same information on clients and beneficial owner. Rather, in line with the risk based approach to be applied, the type and amount of information obtained on the latter is dependent on the risks involved.
This recognises the fact that it may often not be possible to obtain extensive information on the (ultimate) beneficial owner. It should therefore be clearly stated that those risk factors are examples only, and that these do not necessarily have to be applied in their entirety and in all cases Otherwise, the guidelines can be misunderstood to set out rigid requirements and result in clearly unreasonable burdens or obligations which are impossible to fulfil. See also our comments above on this issue and, in particular on the need to clearly distinguish between identification of a customer and the establishment of the identity of the beneficial owner.

§19 –

- First bullet: This bullet classifies certain sectors as high risks. The selection may be too inflexible and arbitrary. We therefore suggest deletion. At the very least it should be clarified that the sectors mentioned are only non-binding/ general examples.

§19 -

- Third bullet (corruption) and item 23 bullet 3 (terrorist activities), 5 (tax and secrecy haven) and 7 (judicial system): The EBF feels that this type of information should be made available by the national authorities. Efficiency in AML/CFT matter relies on efficient information.

§ 19 -

- Fourth bullet – '*purpose of their establishment'* is an unclear concept in this context.

Page 16 & 17:

§ 20 – all bullets: the factors mentioned comingle soft (inconclusive/subjective) indications (adverse media reports) and hard (objective) evidence (asset freezes) which should be clearly separated

- The fourth bullet is a bit vague, and very wide. How can firms collect/use this sort of material with any confidence?

§21 – some bullets appear to apply exclusively to individuals and some to corporate entities. These should be addressed separately.

§21 - seventh bullet: Firms will only be able to determine whether a customer is requesting (the tense used suggests continuous) complex etc. transactions after establishment of the business relationship (see also our general comments on this aspect above).

§21 - third last bullet – Once again, this can only be determined after establishment of the business relationship.

Page 18:

§ 24 - Considering the relevance of this factor it might be considered to move it up or include this aspect in the preamble to the EDD

Page 19:

§27 – A distinction needs to be made between products/transactions which by their very nature are comparatively complex (trade finance) and those which are unnecessarily so or structured in a unnecessarily complex manner by the customer

Page 20:

§ 30-

- First bullet –As to our general concern over classifying non-face to face CDD as a high risk, see above.

- Second bullet – accessing internal audit reports for a group will be extremely difficult if not impossible. We strongly suggest deletion in order to avoid unrealistic expectations.

- Third bullet – It difficult to see how firms are supposed to assess 'the quality of the third party's CDD measures' and what criteria they are supposed to use to decide whether they can rely on them.

- Sixth bullet – the above applies correspondingly regarding the assessment of whether the supervision of an intermediary's AML processes is 'effective'.

§34 – the introductory remarks about the weight given to different factors varying from case to case is more a general point that merits to be addressed in a more prominent manner and perhaps already in the introduction or in a separate section.

Page 22:

§39 – refers to applying 'each' CDD measure which implies that there is a specific list of measures. We suggest deletion of the words "*each of*".

§41 – We suggest to insert the words" "*identified*" between "*is*" and '*low*' to better reflect that this is necessarily the result of an assessment and not and objective fact.

§42- The guidelines describe average customer due diligence as simplified one, however some of these are actually normal/standard diligence, in particular:

"*Adjusting the quantity of information obtained for identification, verification or monitoring purposes, such as: verifying identity on the basis of one document only*

"*Accepting information obtained from the customer rather than an independent source when verifying the beneficial owner's identity*"

Page 25:

§ 49 – Introduces the idea that PEPs can fall into different risk categories. This is a new approach, not required under the Directive and should be reconsidered.

- Third bullet – Again, this is something requiring monitoring and thus can only be determined after establishment of the business relationship.

The terminology regarding risk levels should be harmonised to avoid confusion (currently the following terms are used to denote a higher risk – '*degree of high risk*', '*level of increased risk'*, *level of high risk'*

§ 50 – this is not a particularly helpful or insightful sentence as it only repeats the Directive.

§ 51 – the reference to 'all of these measures' is a bit vague, and it is not clear to what this refers to.

Page 26:

§ 53 – this sentence appears to apply across the board, and not just to EDD. However, the directive does requires EDD in these circumstances.

§ 54, second bullet –firms will often monitor individual transactions as part of a monitoring system anyway.

Page 27:

§ 57, second bullet – the term '*establishing*' implies a degree of certainty which is not possible to attain as this is a matter of, of assessment. We therefore to suggest to replace this term by "*being satisfied*". The end of this sentence includes both factors that are very vague/subjective (independent media source and hard/objective (tax returns etc.)

Page 29:

§ 62 – it is not clear what the phrase '*the underlying factors*' refers to.

Page 32:

§ 72 stands out in comparison with the first para in other chapters – it is not clear why this introductory sentence is needed here.

§ 76: By making only a very specific reference to "*SWIFT RMA plus capability*", the application of simplified due diligence may be unduly limited as other similarly limited relationships will also be of a similar low risk. We suggest deletion.

Page 33:

§ 77 – Third bullet: This implies or presupposes that an institution will always be aware of or is always informed on supervisory/ regulatory inadequate applications or breaches of AML/CFT obligations of the respondent and its group members. This is of course not the case. It should therefore be clarified that the institution can only take into account measures it is aware of. In addition, it should be clarified that only material/serious actions taken by regulators are relevant indicators since not every minor actions taken merits a risk re-assessment. .

§ 77 – Last bullet point: It is unrealistic to expect that the correspondent bank always has insight into the amount of the transactions.

Page 34:

§ 80 – The reference to the effectiveness of the implementation is unhelpful as institutions are not able to assess this.

§84 – CDD questionnaires are usually used by banks and can be helpful in the KYC process. As the questionnaires are not issued by authorities, banks have to rely on international organisations. The EBF would welcome that authorities issue the CDD questionnaire which will ensure efficiency and compliance on what the authorities expect as CDD's information.

Page 35:

§ 88 – general: This item is heavily qualified by § 90, so it would be helpful to indicate that this is subject to the qualifications made under § 90.

Third bullet: Onsite visits will be the exception and not the norm. To expect onsite visits as a standard procedure would effectively exclude many banks from establishing correspondent banking relations, especially smaller and medium sized banks and would have significant adverse impact on international trade. We strongly suggest to reconsider this approach or at last also mention alternatives.

Page 40:

§ 102: Institutions are not able to assess the level of predicate offences. We therefore suggest to either refer to specific sources of information or country risk assessments.

§ 102 - How do we evaluate "*jurisdictions with higher levels of predicated offences*"? Shall we refer to the list to be published by the Commission as provided by article 9-2 of the Directive 2015/849?

§ 104 –

- First bullet. EBA should specify that the additional safeguards that where in place, reduce the level of risk of no face to face transaction.
- Second bullet. EBA should delete the reference to higher risk when reliance on a third party's CDD measures in situations where the bank does not have a long-standing relationship with the referring third party. According to the Directive also this situation should be risky based, taking also into consideration that the third party is an obliged and supervised entity.

Page 42:

For clarity, in the second bullet it should be made clear that the '*business relationship*' referred to is that with the customer (and not the business relationship between customer and clients).

Page 43:

§ 109 – It should be clarified that the '*conditions*' referred to are the ones set out in the Guidelines

§ 110 – As to the use of the term 'shall', see our comments on the use of the terms should and must and the need for clarity and consistency.

Page 46:

§ 116 – all the factors here can only be seen once the business relationship is under way – see our comments on the need to clearly distinguish between factors concerning the establishment of a business relationship and factors concerning monitoring of an existing relationship.

Page 55:

§ 143 – See our comments on the need to clearly distinguish between factors concerning the establishment of a business relationship and factors concerning monitoring of an existing relationship

Page 57:

§ 146: The reference to "*privacy havens*" or "*culture of banking secrecy*" is unhelpful as these are subjective/vague concepts. They should be replaced by a reference to clear and generally used terms and official /objective sources.

Page 59:

§ 149 – We do not believe that it is appropriate to generally exclude the possibility to apply SDD to wealth management in all cases.

Page 60:

§ 151 –

- It should be considered to include bank guarantees as a further standard /typical trade finance instrument.

- The reference to Part 1 should be reviewed.

§ 152 – We see no reason to exclude these products. Project finance is generally not considered to fall under trade finance.

§ 153 – The possibility of abuse is not unique to trade finance. In fact, there is no evidence that such abuse is particularly prevalent or occurs disproportionately. This should be clarified, at least by adding a statement to the effect that trade finance products, like other instruments, can be subject to abuse.

Page 61:

§ 156 -It should expressly recognised that such limited access to information on the background of transactions is a consequence of the nature of the products which concern only the financial transaction and not the underlying trade transaction itself. As such the situation is in fact not

much different from any payment transaction where the bank has also no insight into the background of the underlying transaction the payment relates to.

§ 159 – fourth bullet: A bank will as a rule – that is, except in very exceptional circumstances – not have any information on the actual goods shipped. It will thus almost never be able to detect discrepancies. Again, the situation is not much different from a normal payment order where the bank also has no means to determine what the payment refers to. This bullet should therefore be deleted.

§ 171 – It could be considered to make a reference to bills of lading instead of 'transport documents'?

Should you any questions on the statements above, please do not hesitate to contact us.

Yours sincerely

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