afme/ Finance for Europe

Association for Financial Markets in Europe

Response to the European Supervisory Authorities (ESAs) Joint Consultation paper on AML Risk Factor Guidelines

20th January 2016

Introduction

1. The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on European Supervisory Authorities Joint Consultation Paper on AML Risk Factor Guidelines. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

2. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

3. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

4. AFME welcomes the publication of the draft Guidelines as they attempt to establish a common understanding across all Member States of what the risked based approach (RBA) entails and how obliged entities should consider simplified due diligence (SDD) and enhanced due diligence (EDD) in terms of its customers. It is important however, that the ESAs ensure, as far as possible, that supervisors adopt a consistent approach across the EEA when interpreting the Guidelines. Furthermore, obliged entities should have the right to appeal to an independent body, possibly to the appropriate ESA, should they have a legitimate disagreement over the interpretation of the Guidelines with their supervisor.

Risk Based Approach

5. AFME welcomes the statement made by ESA officials at the Public Hearing held last month on the Guidelines that an obliged entity's view of risk is paramount in most cases compared to the view of the regulator. AFME encourages the ESAs to include a statement to that effect in the final Guidelines. AFME acknowledges that an obliged entity may have a legitimate difference of opinion on its own view of a particular aspect of risk compared to that of its regulator. In such cases the obliged entity should be prepared to justify why it adopts a particular view of the risk in question. It is AFME's experience that some regulators and supervisors opine that an obliged entity, for example, cannot treat, in any circumstance, a jurisdiction which is usually deemed as higher risk, as a standard or lower risk jurisdiction notwithstanding the obliged entity has conducted extensive, documented research on the jurisdiction in question.

6. AFME also welcomes the statement made by ESA officials at the Public Hearing that the customer relationship is predominant when also considering such other factors as geography, industry, product and distribution channel as part of the firm-wide risk assessment. Again AFME encourages the ESAs to include a statement to that effect in the final Guidelines.

7. Paragraph 90 of the draft Guidelines discusses the measures to be applied by obliged entities who offer correspondent banking relationships with respondents based in EEA countries. The Guidelines state that correspondents must identify and verify the respondent and its beneficial owners, obtain information about the respondent's reputation and business, obtain information about the management of the respondent, consider any links that the respondent's management and owners might have to PEPs or other high risk individuals. Given that under CRDIV, regulators have a duty to approve all of a respondent bank's directors, approve all ultimate beneficial owners holding at least 10% of the respondent bank's voting equity and to consider other matters mentioned in the first bullet of paragraph 90, AFME believes that it is disproportionate to require correspondents to undertake such measures. The practical effect on correspondents is that they are being instructed, in effect, to "second guess" the decisions of the respondent's regulator in regard to these matters. It will always be the case that the regulator has far greater ability than a correspondent to acquire such information and seek formal interviews with the directors, management and beneficial owners of a respondent. An ESA official in the Public Hearing did state that correspondents could rely on an EEA regulator. Accordingly, AFME suggests that the Guidelines state that where a respondent is based in an EEA country and is supervised by that country's national regulator, the measures discussed in the first bullet of paragraph 90 need not be applied.

8. The Guidelines should make clear where they include lists of measures which obliged entities may take, that regulators should not expect an obliged entity to undertake all the possible listed measures in appropriate circumstances. Otherwise there is a risk that both obliged entities and regulators may adopt a "tick box" approach which is the antithesis of the RBA. Additionally, it may be helpful to clarify the meanings of "may", "should" and "must".

9. It would be helpful if the Guidelines clearly reinforced the statement of an ESA official at the Public Hearing that the amount of due diligence in any particular case is a decision for the obliged entity, but the entity must be prepared to justify its decision to a regulator.

10. With the laudable desire of the ESAs to provide a common understanding of the risk based approach, AFME suggests that they recognise that the Guidelines may have the effect, unintended or not, that the Guidelines become a vehicle for maximum harmonisation across the EEA, in contrast to the Fourth Money Laundering Directive which is a minimum harmonisation piece of legislation. It is notable that throughout the Guidelines there are many suggestions which go beyond measures currently suggested in materials published by regulators, supervisors and other official bodies.

11. In the United Kingdom, obliged entities in the financial services industry often use the Guidance issued by the Joint Money Laundering Steering Group (JMLSG) to assist them in discharging their AML and CTF obligations. The JMLSG Guidance, produced by the financial services industry itself, is endorsed by a Minister of Her Majesty's Treasury and a UK court or regulator must take into account compliance with the JMLSG Guidance when assessing whether a relevant obliged entity has breached its legal or regulatory obligations. Without an equivalent endorsement, it is possible that UK financial services obliged entities may use the JMLSG Guidance rather than the ESAs Guidelines as their primary reference material. Similar issues may arise in other EEA jurisdictions.

12. In paragraph 19, the fifth bullet suggests that "where a customer or their beneficial owner is a PEP, firms must always apply enhanced due diligence measures" as per the 2015 Directive. The next bullet then suggests that there may be a risk where "the customer or beneficial owner holds another public position that might enable them to abuse public office for private gain". It

would be helpful if the Guidelines could provide greater clarity as to the difference between the risks suggested in the respective bullets.

13. The eighth bullet in paragraph 19 discusses whether quality of supervision and the effectiveness of the AML/CTF regime for credit or financial institutions. AFME suggests that another risk factor may be whether or not such institutions have been sanctioned by a regulator or a court of law for breaches of financial services regulation or law or for breaches of AML/CTF law or regulation.

14. In assessing the effectiveness of a particular jurisdiction's AML/CTF regime, it would be helpful for the ESAs Guidelines to address situations where an EEA or FATF member's jurisdiction has been assessed as not being effective either by that jurisdiction's own National Risk Assessment or by a FATF (or equivalent) mutual evaluation.

15. Paragraph 59 advises that "firms should not enter a business relationship….where they are not satisfied that they can effectively manage the risk…." The following paragraph discusses "de-risking" of entire categories of customer. The effect of these two paragraphs may be that the risk of each business relationship in a category of higher risk customer may be required to be assessed and for those deemed to have an unmanageable risk the relationship is either not commenced or is terminated. The consequence of such an analysis will mean that the cost of managing the remaining customers within that high risk category will result in a higher cost per customer of managing those risks. The members of the management body of the obliged entity will always be mindful of their individual fiduciary obligation to operate the entity for the benefit of the shareholders (or equivalent) as a whole. Accordingly, they may face a legal challenge from the shareholders (or equivalent) where they elect to maintain a high risk business relationship that does not generate an adequate return after incurring the cost of managing the risk as well as other costs.

16. Paragraph 100 suggests that a customer who is non-resident compared to the obliged entity providing the service may be a higher risk. It is precisely for this reason that many financial institutions decline to offer services to non-residents, particularly where local institutions offer comparable financial services. However, on 10 December 2015, the European Commission published its Green Paper on retail financial services with a view to developing the Single Market in retail financial services. Additionally, it may be argued that the objectives of the Single European Payments Area may be compromised if non-resident customers for the Member State in question are deemed to be higher risk. AFME suggests that the ESAs reconsider the Guidelines to ensure they adequately address the Commission's objectives in these respects.

17. AFME is disappointed that the ESAs have elected not to undertake a full, quantitative cost benefit analysis (CBA) of their proposals. A robust CBA serves as a mechanism to ensure, as far as possible, that policy proposals result in effective outcomes both in terms of efficiency and implementing and operating costs. AFME respectfully requests that the ESAs reconsider their decision in this respect.

<u>Conclusion</u>

18. Should you require any further information on this paper, please do not hesitate to contact us.