Jersey Financial
Services Commission

Joint Committee of the European Supervisory Authorities
Sent by upload

Your Ref.:

Our Ref.:

21 January 2016

Dear Sirs

Joint consultation paper: risk factors guidelines

Thank you for allowing the Jersey Financial Services Commission (the "**JFSC**") an opportunity to comment on joint guidelines on risk factors published in draft on 21 October 2015 (the "**guidelines**"). Under separate cover, the Government of Jersey has also taken the opportunity to comment on the guidelines.

The guidelines set out factors that firms should consider when assessing the money laundering and terrorist financing ("**ML/TF**") risk associated with a business relationship or occasional transaction. They also set out how firms should adjust the extent of their customer due diligence ("**CDD**") measures in a way that is commensurate to the ML/TF risk that they have identified.

The JFSC supports the general approach that is taken in the guidelines, but does not consider that they are conducive to the effective implementation of Directive (EU) 2015/849 (the "**4MLD**") in three particular areas:

1. *Assessment of country and geographic risk;*
2. *Assessment of third country equivalence; and*
3. *Application of simplified CDD measures to intermediaries.*

The rest of this response explains why these areas are not conducive to effective implementation of the 4MLD.

1. Assessment of country and geographic risk

Amongst other factors, paragraph 23 of Title II of the guidelines says that firms should consider whether a jurisdiction is a "known tax haven, secrecy haven or offshore jurisdiction" when identifying the level of ML/TF risk associated with a jurisdiction. None of the terms "tax haven", "secrecy haven" and "offshore jurisdiction" are defined in the guidelines; nor are there any internationally agreed definitions of these terms.

If these terms were to remain in the final guidelines adopted by the European Supervisory Authorities following the consultation, the JFSC is concerned that:

- This would give considerable scope for subjective interpretation about which jurisdictions can be regarded as covered by such terms and lead to a divergence in approach across the European Union (**"EU"**); and

› PO Box 267, 14-18 Castle Street, St Helier, Jersey, JE4 8TP, Channel Islands
Telephone: +44 (0)1534 822000 Email: info@jerseyfsc.org Online: www.jerseyfsc.org
› Confidential Whistleblowing Line: +44 (0)1534 887557

INVESTORS IN PEOPLE

Personal data provided to the Commission – a data controller as defined in the Data Protection (Jersey) 2005 – will be used by the Commission to discharge its statutory, administrative and operational functions. Further information may be found in the Commission's Data Protection policy, copies of which are available on request from the Commission and which may also be found on www.jerseyfsc.org.

- Notwithstanding that firms are encouraged to take an "holistic" view of risk under paragraph 17 of Title II of the guidelines, firms would give disproportionate attention to such terms at the expense of other factors, such as the quality of a jurisdiction's AML/CFT controls.

Instead, we consider that the guidelines might draw attention to terms and standards that are agreed at international and/or EU level.

As an alternative to referring to "tax havens", firms should instead take into account a jurisdiction's **tax governance arrangements,** including: (i) OECD/Global Forum reports that rate jurisdictions for tax transparency and information sharing; (ii) commitment to automatic exchange of information based on the Common Reporting Standard; and (iii) compliance with the EU's Code of Conduct on Business Taxation at European level.

As an alternative to referring to "secrecy havens", firms should instead take into account a jurisdiction's **level of transparency**, including: (i) FATF reports that rate financial institution secrecy laws (Recommendation 9), transparency and beneficial ownership of legal persons (Recommendation 24), and transparency and beneficial ownership of legal arrangements (Recommendation 25); (ii) OECD/Global Forum reports that rate jurisdictions for tax transparency and information sharing; and (iii) commitment to automatic exchange of information based on the Common Reporting Standard.

An alternative to referring to "offshore jurisdictions", firms should instead consider the **general nature of financial services undertaken** in a jurisdiction which would take into account: (i) the relative size and importance of the financial services sector; (ii) the size and characteristics of its customer base, e.g. predominantly domestic or cross-border; and (iii) the complexity of products and services offered. Reference might be made to: (i) reports published by the FATF and FATF-Style Regional Bodies; and (ii) to national risk assessments undertaken and published in line with FATF Recommendation 1.

These alternatives would be consistent with the objective approach that will be followed under Article 9(4) of the 4MLD to identify high-risk countries, which points to the use of "relevant evaluations, assessments or reports drawn up by international organisations and standard setters …".

There are also references to "offshore jurisdictions" in sectoral guidance for investment managers, where it appears (at paragraph 196 of Title III of the guidelines) that offshore jurisdictions are to be considered as presenting a high risk, with no further explanation[1].

2. Assessment of third country equivalence

Whereas paragraph 23 of Title II of the guidelines states that firms should note that the 4MLD does not recognise "equivalence" of third countries (and that Member States' lists of equivalent jurisdictions will no longer be maintained), the draft guidelines nevertheless include a number of references to the consistency or equivalence of third country AML/CFT regimes. For example:

- Paragraph 30 refers to intermediaries which are subject to AML obligations that are consistent with the 4MLD – in the context of an assessment of delivery channel risk factors.
- Paragraph 78 refers to a respondent's AML/CFT controls being in line with those required by the 4MLD – in the context of assessing the risk of a respondent bank.
- Paragraph 99 refers to transactions carried out through an account in a customer's name at a credit or financial institution that is subject to AML/CFT requirements equivalent to the 4MLD – in the context of assessing product, service and transaction risk factors for retail banks.

- Paragraph 180 refers to a credit or financial institution that is subject to requirements to combat ML and TF and supervised for compliance with these requirements in a manner that is consistent with the 4MLD – in the context of assessing customer and beneficiary risk factors for life insurance.
- Paragraph 210 refers to payment made through an account in the name of the customer with a bank subject to equivalent AML/CFT standards – in the context of enhanced CDD measures that should be applied by providers of investment funds in high-risk situations.

In the absence of any guidance, it is not clear how firms will determine whether a customer or other person is in a third country that is subject to consistent or equivalent AML/CFT legislation, and there is a risk that this will become a costly and time-consuming assessment. Instead, guidelines should refer to customers and others subject to AML/CFT requirements in jurisdictions that have been assessed as complying or largely complying with relevant Financial Action Task Force ("**FATF**") Recommendations (by the FATF or a FATF-Style Regional Body, e.g. MONEYVAL) (and equivalent under the new round of evaluations).

3. Application of simplified CDD measures to intermediaries

In line with Article 15 of the 4MLD, where certain conditions are met, retail banks (paragraph 108 of Title III of the guidelines) and providers of investment funds (paragraph 212 of Title III of the guidelines) will be able to continue to operate relationships with intermediaries (depositors and investors respectively) on a "non-disclosed" basis – i.e., without applying upfront identification measures to third parties on whose behalf a customer (depositor or investor respectively) acts. In both cases, the bank and fund operator need only establish that their customer will provide - upon request - information on its underlying clients. In order to apply such simplified measures, the intermediary must be subject to AML/CFT obligations in an EEA state.

The JFSC welcomes this pragmatic approach and considers that it is in line with guidance published by the Basel Committee on Banking Supervision[2], International Organisation of Securities Commissions[3], and International Securities Services Association[4]. It is also consistent with guidance published by the Wolfsberg Group[5]. However, the application of simplified CDD measures to intermediaries does not: (i) adequately reflect risk; or (ii) appear to have been considered in all sectors where intermediaries are commonly found.

In particular:

- The JFSC does not agree that the application of simplified CDD measures by retail banks and providers of investment funds to intermediaries should be limited to those intermediaries based in an EEA state, and, in line with a risk-based approach, considers that the application of simplified CDD measures should be limited instead to intermediaries subject to AML/CFT requirements in jurisdictions that comply or largely comply with relevant FATF Recommendations (and equivalent under the new round of evaluations).

---

1 There is also a reference to "offshore and certain onshore trusts" in paragraph 26 of Title II of the guidelines, whereas reference should be made instead to "certain trusts". A number of international financial centres, including Jersey, apply long-established and tested prudential, conduct and AML/CFT supervisory regimes to trust and company service providers that mitigate the risk that trusts will be used for illicit purposes.

2 Consultative document published in July 2015 on general guide to account opening which is in line with existing guidance.

3 Anti-Money Laundering Guidance for Collective Investment Schemes (October 2005).

4 Financial Crime Compliance Principles (August 2015).

5 Anti-Money Laundering Guidance for Mutual Funds and other Pooled Investment Vehicles (2006).

Jersey Financial Services Commission

- Whilst it may be common for simplified CDD measures to be applied to intermediaries by retail banks and providers of investment funds, intermediary relationships are commonly found in other sectors, e.g. dealing in investments, undertaking discretionary investment management, and giving investment advice and it is not clear to what extent the application of simplified measures has been considered in these sectors.
- Paragraph 198 of Title III of the guidelines states that, where the risk associated with a business relationship is increased, a firm that is an investment manager should identify and, where necessary, verify the identity of underlying investors where the customer is an unregulated third party investment vehicle. This suggests that there is no need to find out the identity or verify the identity of underlying investors in a case where risk is assessed as being lower. This should be clarified.

In the event that full CDD measures must be applied to intermediaries in third countries, the effect of this would be to require such an intermediary to provide information and evidence of identity for each of its customers. This may make it too difficult or costly for firms to service intermediary customers outside the EEA.

Please do not hesitate to contact us if any part of this response needs clarifying or if further information is required.

Yours faithfully

Andrew Le Brun

Director, Financial Crime Policy

Tel: +44 (0) 1534 822065

Email: a.lebrun@jerseyfsc.org