German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comment

on the general orientation of the Council and the European Parliament legislative resolution on the proposal for a Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

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After the adoption of the legislative resolution of the European Parliament on 11 March 2014 and the general orientation of COREPER on 18 June 2014 on the proposal for a Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, and in view of the upcoming trialogue negotiations, the German Banking Industry Committee (*Die Deutsche Kreditwirtschaft* – DK) would like to make the following comments. In addition, we refer to the position paper of the European Banking Industry Committee (EBIC) from 22 April 2013 and to the comments of the DK from 10 June 2013.

1. Business Register / Commercial Registry - Beneficial Owner Information (Art. 29)

DK Request: The obligation to provide registers and/or data retrieval systems with information on beneficial owners must lie with companies, trusts and foundations. The registers and/or data retrieval systems must be accessible for obliged entities of the Directive.

In its legislative resolution dated 11 March 2014, the European Parliament determined that the obligation to provide data to a central register, commercial registry or business register lies with companies, trusts and other legal entities. We welcome this decision taken by the European Parliament.

In its proposal dated 18 June 2014, the Council provides for Art. 29 that so-called "data retrieval systems" may be set up (instead of public registries) containing information on beneficial owners, which "may be" accessible for obliged entities.

We would like to remind all parties involved that the quality of data on beneficial owners can hardly been improved with these "data retrieval systems" if the obliged entities provide themselves the required information – as can be observed with the automated account screening in Germany. While the obliged entities are only able to rely on the statements of clients/companies and their individual access to information based on the business relationship with a company, the only way to increase data quality significantly would be to require companies to provide information on beneficial owners to a registry, together with relevant attachments.

Against this background, we find it hard to believe that the European Commission and the Council are not aiming at an actual improvement of standards regulating transparency and data on beneficial owners of legal entities in the Fourth Anti-Money Laundering Directive, as proposed in FATF recommendation 24/40 and the explanations provided. The EU should insist on a reliable implementation of these standards for the following reasons: While companies can be obliged to provide information on beneficial owners to the registry under company law, and face sanctions by competent authorities if they do not fulfil this obligation correctly, credit institutions – as obliged entities – have only very restricted possibilities to enforce a company's obligation to cooperate and to verify the data provided. The Council proposal provides a rather vague obligation on the side of member states to ensure that corporate or legal entities are required to provide information concerning beneficial owners to obliged entities (Art. 29 (1), sentence 2); however, we believe this obligation is not sufficiently, and confronts credit institutions with

considerable problems under civil law, particularly in the case of already existing business relationships.
In addition, corporate clients, which are themselves embedded in larger group-like structures, often have no knowledge about their existing ownership structure and hence do not know the beneficial owners. This is also due to their limited right to information regarding their own shareholding entities. However, the establishment of a public registry – with competences backed by company law – would clearly enhance data quality on beneficial owners, and eliminate the existing problems in terms of data collection.

Hence, a registry or retrieval system with data provided by companies is required, accessible to the relevant authorities as well as obliged entities. One advantage for the companies would be the possibility to provide information on their beneficial owners to only **one registry** (which also applies to updates of the existing data), instead of providing this information to all contracting parties according to the draft Directive. Another advantage would be that companies and obliged entities would have (online) access to the information stored on beneficial owners in the registry in the case of occasional / "on and off transactions" according to Art. 10 (b) of the draft Directive. This is the only way that would allow – in the majority of such business transactions – for the deal to be carried out in accordance with the Directive, since the persons acting on behalf of a company usually cannot provide the entire documentation instantly.

Therefore, our clear recommendation is that **companies be obliged to provide information on beneficial owners (shareholders) to a registry or retrieval system, which is accessible to the relevant authorities and obliged entities**; this will enhance the quality of data provided and lead to a streamlined manageability of customer due diligence.

2. Definition of Beneficial Ownership (Art. 3 (5) (a) (i))

DK Request: in the case of indirect ownership of an entity, the focus should be on control according to company law.

We welcome the approaches taken by the European Parliament and the Council for the identification of direct ownership: Thresholds proposed are "25% plus one share" (European Parliament) or "25% or more" (Council). **In order to maintain consistency, the current thresholds of "25% plus one share" or "more than 25%" should be adhered to in the identification of direct ownership.**

However, we would like to recommend that the European Commission reconsiders the absolute insistence on the proposed threshold values for the identification of beneficial owners in the case of indirect ownership.

The threshold proposed by the European Commission as an indicator for indirect ownership ("25% plus one share" at each level of a corporate group / concern) would lead to a higher number of newly identified beneficial owners, although these persons do not actually exercise ultimate control over the respective entity. Considering enforceability, it should be borne in mind that it can be very difficult to identify the beneficial owners in larger corporate groups.

The German authorities therefore focus on the concept of control according to company law (majority shareholding or other means of effective control) in the case of group-like structures, which involves the obligation to identify the beneficial owners. We assume that according to the FATF and the majority of current member states' money laundering regulations, the threshold of 25% is applicable only in the case of direct ownership. However, for higher levels of ownership and control along the "ownership chain", FATF does not provide any threshold values. This implies that for all indirect ownership levels, the definition of the "control" concept is derived from company law.

Since the Commission's approach **does not seem to be appropriate** for an identification of a company's controlling person(s) **from a company law and regulatory perspective**, and since this approach **is not in line with FATF standards**, the German Banking Industry Committee (*Die Deutsche Kreditwirtschaft* – DK) proposes that **the threshold value of "more than 25%" should not be applied on indirect ownership, and Art. 3 (5) (a) (i) should be amended accordingly.**

The European Commission, European Council and the European Parliament currently propose that all natural persons of a **company's senior management shall be considered as / instead of beneficial owners, if no shareholder were identified** as beneficial owner. However, as senior employees of companies do not, in fact, form part of beneficial owners, but are considered corporate bodies, they **should be identified separately from beneficial owners in order to avoid confusion** regarding the different obligations of a company's representatives and shareholders in the context of money laundering – e.g. in terms of differing due diligence duties, such as determining whether a beneficial owner might be a politically exposed person. **Thus, the identification of the company's representatives should be clearly separated from the actual beneficial owners and <u>should explicitly be regarded as a fall-back solution</u>.**

3. Simplified Due Diligence (Art. 15)

DK Request: We believe that a list of clear examples or at least the member states' "Best Practices" on simplified due diligence is required. The preparation of guidelines – in particular for simplified due diligence – by the European supervisory authorities EBA, ESMA and EIOPA has to be realised before the transposition of the Directive into national law by member states.

We welcome the extension of the list of factors and types of evidence of potentially lower risk (Annex II (1)-(3)) by the European Parliament (see amendments 137-145). However we are still concerned, given the fact that these factors are only included in the Annex and are considered evidence of "potentially" lower risk. This means that the actual factors in use for the application of a simplified due diligence either have to be explained by the bank, or have to be negotiated with supervisory authorities. Despite the high degree of details provided, the provisions of the third Anti-Money Laundering Directive on simplified due diligence for an identification of lower risk situations during risk analysis (Art. 11 of the Third Anti-Money Laundering Directive) have proven useful, e.g. with a view on dealing with national authorities of member states or listed companies as customers of credit institutions. **Therefore, we clearly recommend that the**

provisions of the Third Anti-Money Laundering Directive on simplified due diligence remain applicable.

In the trialogue negotiations, the European Parliament and the Council should at least provide that a provision is added to Article 15, clarifying that current "Best Practices" of EU member states have to be considered by the European supervisory authorities EBA, ESMA and EIOPA in the draft process for guidelines on simplified due diligence.

Referring to the timing of the outstanding guidelines, we welcome the European Parliament's proposal according to which the European supervisory authorities EBA, ESMA and EIOPA have to publish the guideline **within a period of one year** after first-time application of the Directive. The time schedule proposed by the Commission and supported by the Council suggests the publication of the guidelines within a period of two years after first-time application of the Directive, which corresponds to the deadline for the transposition of the Directive into national law on the side of member states. **Hence, with the timescale of two years for the publication of the European guideline, they could not be considered by national authorities in national legislative procedures.**

4. Definition of Politically Exposed Persons – PEPs – (Art. 18, 19)

DK Request: The distinction between domestic and foreign politically exposed persons, in the sense of a risk-based approach, has to be maintained.

We regret that the Council has dropped the idea of a risk-based approach for politically exposed persons (PEPs) from within the EU, and abolished the distinction between domestic (EU-internal) and foreign PEPs. According to the Council, the higher due diligence standards shall apply to all PEPs.

We reject this approach and recommend that the original Commission's proposal is adopted, according to which higher due diligence standards automatically apply to foreign PEPs, while EU-internal PEPs are treated as domestic PEPs. **The distinction between domestic and foreign PEPs would allow credit institutions to emphasise other risk factors, which would enable them to concentrate their resources on PEPs bearing higher risks, as proposed in the FATF's International Anti-Money Laundering Standards, recommendation 6.** In addition, this would enable obliged entities to partially compensate the additional administrative expenses caused by the inclusion of domestic PEPs in the fourth anti-money laundering Directive. Alternatively, we support the European Parliament's proposal to exclude the respective national PEPs from higher due diligence standards at least, except when higher risk levels can actually be assigned to individual cases.

5. Register of Politically Exposed Persons

DK Request: It is necessary to establish an accessible register of PEPs for obliged entities and/or a list of all functions/categories of PEPs.

We welcome the European Parliament's proposal (Art. 19a), according to which the Commission is required to establish a list – together with the member states and international organisations – featuring relationships with domestic PEPs or persons who are (or have been) entrusted with a prominent function in a member state.

Such a list would facilitate the identification of a PEP, his/her family members, and – in particular – of close associates in every member state. If the EU authorities are not able to provide such a PEP list with the names of the office-holders, an Annex should be added to the Directive including the relevant functions/categories of politically exposed persons in the EU.

6. Third Country Policy (Art. 8a new)

DK Request: We expressly welcome the establishment of a "black list" of third countries with deficiencies in their national anti-money laundering regimes by the European Commission – as proposed by the European Parliament and the Council. This negative list should be complemented by a third-country equivalence list.

We welcome the proposals of the European Parliament and the Council which would obligate the Commission to identify "high-risk third countries" using delegated acts (Art. 8a (1), Council compromise) or to create a list of third-country jurisdictions "which have strategic deficiencies in their national AML/CFT regimes (...)" (Art. 8a, European Parliament legislative resolution). **Such a support for the obliged entities would lead to the same competitive conditions for all obliged entities, also in view of a uniform approach to global transactions. Ignoring these proposals would increase the risk of differing third-country assessments by national supervisory authorities, which would contradict a uniform legal framework in the EU and would hardly be feasible for the obliged entities.**
Moreover, we support the European Parliament's proposal to establish a **third-country equivalence list (white list) in addition to the negative list** (Art. 25 (2a), European Parliament legislative resolution). In the draft Directive, the equivalence of third countries is still considered a geographic factor for the risk exposure. **Hence, it would be helpful to work with an additional list of countries which are considered equivalent from the side of the EU.** A list - with high-quality data and regular updates on the basis of the research and analysis conducted by the member states and the European Commission on the legal environment for combating money laundering and terrorist financing in third countries - delivers objective criteria which can be included by institutions in the respective internal hedging mechanisms for the prevention of money laundering and terrorist financing. This kind of additional information on country risks actually supports, instead of undermining, a successful risk-based approach by financial institutions.

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