



EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Company law, corporate governance and financial crime

Brussels, 12 December 2005
MARKT/F2/MFS D(2005)

SYNTHESIS OF THE COMMENTS RECEIVED FROM INTERESTED PARTIES ON THE

WORKING DOCUMENT OF INTERNAL MARKET AND SERVICES DIRECTORATE GENERAL
OF 12 SEPTEMBER 2005 IN RELATION TO

DIRECTIVE 2005/60/EC 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

Introduction

On 12 September 2005, the Internal Market and Services Directorate General published a working document in relation to the 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 (the so-called Third Directive)¹.

This working document called for comments on the general orientation with regard to the adoption, by the Commission, of possible implementing measures to the Third Directive. The publication of the working document was part of the open and transparent regulatory process that the Commission follows for drawing up technical implementing measures in the financial area (see recital 47 of the Directive).

The Internal Market and Services Directorate General would like to thank the interested parties who responded to this working document for their contributions. 32 responses from interested parties were received. They are available on the website of the Internal Market and Services Directorate General, except for those for which confidential treatment was expressly requested.

Contributions were received from interested parties located in 9 Member States and 3 territories outside the EU. A number of contributions were also submitted by European and international associations.

This report seeks to provide a synthesis of the main comments received. It does not provide detailed statistical data, but rather seeks to present a qualitative assessment of the contributions received. This synthesis is based on the replies of 29 interested parties². In particular, it does not integrate the comments received from public authorities, whether from Member States or from territories outside the EU. It follows the structure of the working document, and therefore starts at section 3.

¹ Directive 2005/60/EC of 26 October 2005, published in the OJ L 309 of 25.11.2005. At the moment of launching the consultation, the Directive had not been yet officially adopted, although the European Parliament and the Council had reached an agreement on the text of the Directive at that time.

² 7 replies from European or national associations of regulated professionals (e.g. accountants/auditors, lawyers etc.); 10 replies from European or National banking associations; 3 replies from individual banks; 4 replies from national associations of financial institutions other than banking; 3 replies from individual financial institutions other than banks; 1 reply from an academic, 1 reply from an information service provider.

3. SIMPLIFIED CUSTOMER DUE DILIGENCE (CDD)

3.1. General considerations on CDD: simplified vs. normal CDD; the risk based approach.

Question 1: Would the application of the risk based approach in connection with normal CDD procedures be in your view enough for institutions and persons covered by the directive to deal normally with the low risk situations?

If a case-by-case approach implying the need to adopt implementing measures is followed, would the practical application of the directive rules be more difficult for the institutions and persons covered by the directive?

What would be, in your view, the costs and benefits of both approaches?

(1) Many respondents consider that a too casuistic approach may run counter to the very objective of the Directive, which consists in allowing a risk based analysis. A casuistic approach would allow for only a very small percentage of customers to fall in the low risk category and would result in financial institutions deciding not to engage in risk categorisation, as there will be little cost/benefit to be gained as such a small percentage of accounts will end up as low risk. On the contrary, the application of the risk based approach would imply that greater care in evaluating the status of clients/customers would be taken to make sure that a low risk approach was indeed justified: institutions/persons must always be able to identify risks as soon as they appear and to implement appropriate measures. It is recalled in this context that the vast majority of the transactions are legitimate: the risk based approach is aimed at weeding out the proceeds of crime and preventing money laundering. **A risk based approach in connection with normal CDD procedures would be the best way to enable the institutions/persons to deal with the risks and to tackle these situations appropriately** (without prejudice to adopting criteria on simplified CDD in the implementing measures – see below).

It is also underlined that **national legislators, when implementing Article 8 of the Directive, should give sufficient discretionary leeway**: as much freedom to act as possible in relation to the national implementation of the risk based approach is necessary in order to prevent the rules from getting too rigid. If, on the contrary, national legislation is restrictive, the cases in which "simplified CDD" is to be applied assume greater importance. Therefore, the approach adopted by national legislation will be crucial. In this connection, it is highlighted that in all cases, different implementing measures in different countries will complicate matters and disturb the level playing field.

Indeed, some of these respondents voice a strong concern that any detailed approach to be taken by the Commission may have a deterring effect on Member States and their authorities to proceed to the normal risk-based approach under Article 8(2) of the Directive for low risk transactions, products and customers. They underline that Member States and their authorities should be given the discretion to assess the risk profile of a specific transaction or customer without feeling limited by a prescriptive set of situations. If the exercise of Member States' discretion ultimately leads to substantial disparities, the Commission could consider adopting implementing measures on the basis of Article 40

(1)(b) of the Directive. The Commission should not act in a premature way. Indeed, some respondents would prefer the Commission not to act at all.

The main advantage of this approach is its flexibility: detailed rules, while increasing the procedural burdens, may not adapt quickly enough to the evolution of business practices and technology. Furthermore, it is stated that the low risk categories identified in the working document are extremely limited (many firms would have a much larger category of low risk products and clients) and it is questionable whether they provide any real assistance to practitioners and regulated entities. It is further stated that unless a certain degree of flexibility is foreseen, the burden and cost of compliance could undermine the smooth functioning of the system put in place by the Third Directive. Indeed, with regard to the **costs involved**, it should be borne in mind that, as is known, the declared aim of these criteria should be to identify situations in which financial institutions can apply less CDD, thus avoiding unnecessary expenditure and concentrating available resources more strongly on higher-risk situations. This aim would be undermined if the work required to determine whether the criteria define a situation in which less CDD is justified were to outweigh the savings resulting from application of less CDD. It is also underlined with regard to costs that the risk-based approach represents, in the long-term, a significant cost benefit to the institution/person and is less likely to result in an expensive compliance burden (although one respondent states that a risk-based approach is unlikely to be cheaper to operate than the current situation and will involve start-up costs: e.g. on revised internal guidance and staff training). The **main disadvantage** of this solution is the individual approach to the risk and the non uniform application of the Directive.

However, **some of these respondents are not opposed to define clear criteria** as a complementary approach, to the extent that they are broad enough to allow their adaptation to the national situation. One of them³ expresses the need to have criteria for situations in the simplified CDD category for very low risk situations. Therefore, some recommend to define at this stage only a limited number of low risk cases and to test their practicability. While others agree that there will be a need to regularly review the criteria.

Others recommend that non-binding guidelines/criteria be adopted either by the Commission or preferably at national level, based on consultation with stakeholders. Should the Commission adopt guidelines, it could do so within a certain period from the transposition of the Third Directive, to orientate the action of the institutions and persons to which the Directive applies, in the light of the concrete experience and information collected on money laundering activities. The aim should be to provide sufficient guidance while safeguarding the possibility of graduating CDD measures in relation to the concrete risk.

³ This respondent makes clear that there is a difference between Article 8(2) and Article 11. Article 11 would allow for not applying CDD at all. Gathering information to establish if a customer qualifies for an exemption (that can only be done by some form of identification of the customer and clarification of the customer's activities) could not amount to carrying out CDD, indeed this action would not be part of simplified CDD. Article 7(c) would not apply in the simplified CDD cases, because there is no suspicion. Continuous monitoring would be contrary to the derogation in the directive. Of course, if a firm by alertness and observation suspects that there is wrongdoing it must report it, but that would be a key part of good business practice, not part of CDD as it is defined in the Directive.

(2) A respondent is of the opinion that the application of the risk based approach in connection with normal CDD procedure (cf. Article 8 (2)) is not enough for institutions and persons covered by the directive to deal with the low risk situations. Hence, while recognising the value of the risk-based approach, it welcomes the derogation to the general rules on CDD, the so-called “simplified CDD”, and regards the possible extension of the list of customers, products and transactions justifying the application of simplified CDD procedures as an important and appropriate solution.

The main advantage of this approach is the uniform/consistent application of the Directive obligations as well as giving some structure/framework within which institutions can operate and manage effective CDD. In addition, it ensures legal certainty. The main disadvantage, relying on a limited set of criteria could be too rigid.

(3) Other respondent make their position conditional on certain interpretation of the Directive requirements or seem unable to take a clear position between the two options.

It has been indicated as well that the Commission should rather define the situations that deserve enhanced CDD.

3.2. Customers

Question 2: Do you agree with these sets of technical criteria [*in relation to customers*]? Can you identify other relevant technical criteria? Can you identify any entity which could possibly meet the first set of technical criteria further to the entities already covered by the directive?

Do you prefer having broader (non cumulative) technical criteria? If so, please specify those broader criteria. Please specify as well which checks and balances would justify the application of simplified CDD in those circumstances.

What would be, in your view, the costs and benefits of such criteria?

(1) Some respondents broadly agree with the criteria. It is underlined that the application of a simplified procedure to pre-determined situations can optimise the cost-benefit relationship for intermediaries. It is suggested that these criteria should be adopted for the purposes of "future proofing": while the technical criteria would be difficult to meet, the restrictions would be appropriate to preserve the integrity of the regime the Directive aims to impose.

One respondent broadly agree with these sets of criteria to the extent that the decisive criteria are the proper supervision by public authorities and the registration/disclosure obligations concerning customers' identity. However, this respondent considers that these sets of cumulative criteria are far too detailed.

(2) Other respondents do not agree with the criteria proposed. Some of them are in favour of broader criteria or not cumulative criteria. Another respondent is against any set of technical criteria, which in their view may not be relevant to all and which could be dangerous in encouraging a 'box ticking' mentality. This respondent would be opposed to EU wide mandatory lists, but would be happy for broad helpful guidelines to be agreed at local level after consultation.

Specifically, respondents representing interests of regulated professionals consider that professionals should benefit from simplified CDD when acting as customers/clients. Professionals are regulated and have onerous responsibilities under the Directives that are almost identical to credit and financial institutions. It would send the wrong signals if firms and/or professionals cannot be considered as part of a simplified CDD regime.

(3) Respondents (whether in agreement with the criteria or not) make some suggestions in relation to the first set of technical criteria:

- On critterion 1 (the customer is an entity subject to the directive), a respondent indicates that if a parent company meets the criteria, simplified CDD should be applied to its whole group of companies. Another respondent considers this criterion overly restrictive as there are customers that are publicly accountable, but not subject to the Directive and that one would want to treat under simplified CDD rules, such as high education requirements. Another respondent considers that paragraph (1) of the first set of criteria must be extended to the nominee entities of regulated custodians.
- On critterion 2 (customer's identity is publicly available etc.), where there is evidence that the customer has a transparent, publicly available and well-recognised reputation this should be sufficient to ensure that the customer is considered to be low risk.
- On critterion 3 (licensed customer), a respondent suggests that all regulated entities should be assessed as low risk. Another respondent suggests to extend this category to cover utilities, which may be private companies not listed in stock exchanges.
- On critteria 1 and 4 (supervision by competent authorities), it is stated that the term "national" should be interpreted in order to make possible for provincial and municipal institutions to be subject to simplified CDD.
- On critterion 4, it is suggested to make reference to equivalent legislation from third countries, similarly to the drafting in Article 11(1).
- Many respondents strongly argue against the addition of the critterion 6 (“the only material source of income is known, stable and of impeccable repute”). It would not be reasonable to expect institutions to assess all the material sources of income of their customers at the outset of a business relationship. However, for one respondent, meeting this critterion on its own would be reasonable to consider that risks of money laundering are low.

(4) Respondents (whether in agreement with the criteria or not) make some suggestions in relation to the second set of technical criteria:

Respondents consider that this cumulative set of criteria will be almost impossible ascertain in practice without extensive and disproportionate levels of effort given the likely level of risk in most instances. One respondent considers that the European Commission does not deserve the exemption. For some respondents, consideration could be given to removing critterion 4 (the source of income of the customer is known, stable and of impeccable repute).

(5) In addition, some other situations that could benefit from simplified CDD have been identified:

- Privately held companies will be both transparent enough and be known publicly such that they fit within the second set of cumulative technical criteria. For example certain family owned entities in Germany.
- It is suggested to apply simplified CDD procedures when the "customer is [a not for profit] entity established for the purpose of promoting social, educational and/or representative activities". Examples of these entities could be: Educational establishments; Organizations established for scientific research; Representative bodies, (i.e. Bars and Law Societies); Amateur sporting associations and clubs; Religious bodies; Bodies established for charitable purposes; and similar entities. It appears that these clients and customers are themselves unlikely to represent a risk, either because their objectives have no financial implications or are in fact of a social nature rather than economic, and can also be identified either specifically or in general terms. Therefore, they could be included in the low risk category.
- A respondent finds that besides the IMF, World Bank and comparable international financial institutions, there are other recognised international organisations that can be assumed to be low-risk - such as UN organisations, its agencies and development banks.
- Development banks which extend loans to customers indirectly through a "house bank" under the "house bank principle" and thus do not have a direct customer relationship with the borrower;
- Transaction banks which, e.g. as payment services providers, merely convert paper-based items such as cheques or credit transfers into electronic data records for further processing and thus operate as agents of banks and do not have any contact of their own with customers (see also recital 34 of the Directive);
- Public/state-owned enterprises at federal/national, state/regional and municipal level that are subject to sovereign legal and technical supervision as well as additional due diligence and reporting requirements;
- Lenders who advance the full premium amount of a credit/lease to an insurance broker.
- Others (e.g. pupils in respect of saving activities organised at school).

Another respondent considers that on the basis of the first set of criteria, pooled accounts of all regulated firms would appear to qualify for exemption from a CDD obligation. This would be supported as otherwise there appears to be an obligation on financial and credit institutions to identify the beneficial owners of pooled accounts held by e.g. estate agents and accountants that are regulated.

Question 3: Do you agree with the approach in relation to transparency of legal entities, to beneficial owners of pooled accounts and to the implementation of the domestic public authority exception in respect of simplified customer due diligence?

Some respondents broadly agree with the approach of the working document in this issue. It has been however underlined the contradiction in the Directive of treating the head of a public body as a PEP, whilst the institution fully controlled by him/her represent a low risk (on the basis of the Article 11 of the Directive).

Concerning the exception for listed companies, a respondent calls for its extension to large private companies that are widely known, stable and without suspicion, This could be done by adapting one of the criteria on customers.

Concerning the exception for beneficial owners of pooled accounts, it has been stated that the wording of the directive is too limited. It is suggested to extend the exception to similar additional cases, such as pooled accounts held by regulated businesses or trust accounts that have a similar purpose as pooled accounts.

Concerning **domestic public authorities**, some views call for a wider definition based on public tasks so as to encompass public entities closely related to public administration or organized under public law, publicly regulated, but privately owned, utility company, or even recognised churches and religious communities. This matter should not be left to Member States but clarified in implementing measures. Some other views criticise the fact that the exemption is limited to domestic public authorities: the exemption should be extended to public authorities located in the EU/EEA area. Otherwise the current limitation may lead to problems for international banks that have domestic public authorities as clients in multiple jurisdictions, which would run contrary to the Basel Consolidated KYC recommendations.

3.3. Products and transactions

Question 4: Do you agree with these criteria [*in relation to products and transactions*]? Can you identify other relevant technical criteria?

Do you prefer having broader (non cumulative) technical criteria? If so, please specify those broader criteria. Please specify as well which checks and balances would justify the application of simplified CDD in those circumstances.

What would be, in your view, the costs and benefits of such criteria?

(1) Some respondents broadly agree with the criteria. They do not support other broader criteria that could create uncertainty in the handling of transactions, increasing rather than reducing the level of risk for the financial institutions, and therefore the costs (including administrative costs). Instead, creating a set of specific criteria offers an element of certainty to financial institutions, preserve the integrity of the regime of the Directive, and help reducing operating costs and related risks.

(2) Others do not agree with the proposed criteria. Some consider the criteria regarding products and transactions too detailed (in particular, the second set of cumulative criteria would not be necessary at all), or they consider that these criteria should be broader and not be cumulative. **For some of them, the practical benefit of such criteria for low-risk types of transaction appears limited.** It is underlined that, as a rule, banks would refrain from establishing separate CDD policies and procedures for such types of transaction, as the potential savings would be outweighed by the additional workload imposed by the introduction of such procedures. After all, customers will usually not confine themselves to conducting the types of transaction classified as low-risk. Therefore, application of less CDD in this area would offer little savings potential.

Indeed, it is underlined that trying to classify transactions according to risk cannot be done in isolation from other variables: what is unusual for one type of client is quite normal for another. It would be almost impossible to describe at EU level, and covering all areas of business, transactions that are either suspicious in all situations or

permanently low risk. As every product is capable of being used for money laundering, an exercise to formalise products and transactions that will be exempt from scrutiny will be of no value and only serve to encourage the criminals to exploit such products for their own ends. This respondent concludes that individual institutions should be free to develop their own definition of risk (or at an industry level) in conjunction with their regulator.

Finally, it has been highlighted that while the risk of money laundering may be low in some cases, the risk of terrorist financing in the same cases may be higher.

(3) Some respondents make suggestions in relation to the sets of technical criteria:

Concerning the first set of cumulative technical criteria, criterion 3 (transactions conducted at the counter of a credit/financial institutions fails to take into account that there is a lower risk also where such transactions are conducted through "mobile advisers" in a customer's home or via the Internet. Some respondents suggested that when the beneficiary is a public authority, no additional cumulative criteria seem necessary; alternatively, if the financial transaction is imposed by legislation, risks of money laundering would be virtually excluded, as the purpose of the transaction is to fulfil a legal obligation, and the persons or entities involved have no choice as to whether carrying out the transaction or not. In addition, the criteria should make reference to the fact that the payee's account needs to be an ordinary account normally used for these types of payments (to avoid that illegitimate funds are used for paying taxes).

Concerning the second set of cumulative criteria, comments have been made regarding the language used and the need to have some clarification on some terms. Concerning criterion 3 (no realisation of the benefits for the benefit of third parties, except in the case of death), the exception should be broader than in the case of death in order to cover other insurance event: e.g. the insurance holders' age (e.g. age 75) or disablement. Additionally, the benefits could be for a third party in some cases (e.g. a child or the spouse). On criterion 5 (maximum annual amount), it is suggested to increase the threshold (e.g. to €15000). The preference would also be for the deletion of criterion 6 (product defined and controlled by the State). Although one respondent claims that this criteria, in isolation, would cover the UK Child Trust Fund which otherwise would not fulfil all the criteria (e.g. higher threshold, or benefit realisable for a third party), which is an acceptable goal. It has also been stated that State control, as is suggested as a possible sixth criterion, should be provided as a method for varying the other criteria individually.

It is suggested to add a further (non-cumulative) criterion to the second set: the possibility for a company to check a person's identity through a public register (e.g. a register with social security numbers).

(4) In addition, some other situations that could benefit from simplified CDD have been identified: retail products; contracts on capital-forming investments; consumer loans; credit agreement where the credit in question serves exclusively to finance an agreement concerning the supply of goods or the provision of a service; loan agreement, in which the loan account is used for loan processing only, and the loan repayment is to be debited from an account opened in the customer's name with a credit institution subject to the 3rd Directive; business relations with condominium-owners associations (e.g. jointly-owned buildings); proprietary trading; foreign exchange transactions with own (already identified) customers; transactions with companies subject to appropriate supervision by public authorities (in the EU/EEA); transactions with state-recognised

religious organisations; (card) payment products representing the same low risk as the electronic money transactions listed in Article 11(5)(d); saving contracts with premium bonus and standard contract sums (e.g. similarly to life insurance policies mentioned in Article 11(5)(a)); insurance premium funding.

Finally, respondents representing interests of regulated professionals made no comments on these criteria to the extent that they were concerned with financial services and products. Some of them noted that the working document has not covered any low risk transactions and situations that would be of assistance to regulated professionals. This would create the impression that the professions are covered by anti-money laundering legislation that is really aimed at banks and they are expected to implement systems and controls that have no relevance to their businesses and operate under legislation which does not identify risks that are relevant to their practices.

Question 5: Do you agree with the approach [*in relation to the duplication of customer due diligence procedures*]?

Many respondents did not provide a reply to this question.

Some respondents broadly agree with the approach described in the working document in relation to the duplication of CDD procedures. It has been suggested, nevertheless, that inserting a reference to the need to avoid CDD duplication in special situations may be considered.

Some others accepted that it would be inappropriate to examine the circumstances described in the Working Document within the context of simplified CDD. It is underlined, however, that situations of that type should be capable of providing satisfaction as to the identity of the customer as part of a risk-based approach, without reference to the "reliance" provisions under Section 4 of the Directive, which would not be relevant for this purpose.

There is a suggestion to facilitate the transfer of information by creating at national level a standard for the communication between regulated entities.

Some respondents considers that the issue of duplication of CDD has not been effectively addressed in the Directive (the provisions on the performance of CDD by third parties would be unlikely to be widely depended upon by institutions, in that responsibility for the adequacy of CDD remains with the contracting institution) and that the Commission should consider whether there is an opportunity to address this problem in the context of technical measures. The duplication of CDD is particularly important to firms with offices or branches in other Member States. Another respondent considers in this connection that there should be mechanisms in place for mutual recognition or 'passporting' of CDD between member states and between differing members of the regulated sector.

4. FINANCIAL ACTIVITY ON AN OCCASIONAL OR LIMITED BASIS

Question 6: Do you agree with these criteria regarding the definition of occasional or very limited financial activity?

What would be, in your view, the costs and benefits of such criteria?

Many respondents did not provide a reply to this question.

Some respondents⁴ broadly agree with the criteria described, although being very restrictive and possibly *de facto* inapplicable in some countries. It was underlined that the criteria should be used for the exclusion of categories of institutions/situations (rather than for the exclusion of individual institutions) provided a clear justification applies. A respondent was opposed to the possibility to withdraw the exemption at short notice, as it would be costly for institutions to cope with the requirements of the anti-money laundering legislation at short notice.

Others indicated that the criteria create a complex and impractical exemption, jeopardising the application of the risk based approach. Indeed, they called for avoiding undermining the integrity of the system created by the Directive through the use of lots of exemptions, based upon different interpretations, in different countries. For one respondent, a casuistic approach should not be followed. Establishing a threshold amount per transaction was mentioned as an alternative.

Some views suggest that national authorities deal with this issue directly. It was mentioned that dealing with this problem in any Commission implementing measure would constitute a merely theoretical approach to the problem.

Finally, it was recalled that the risk of terrorist financing is different from the one of money laundering.

Question 7: Do you consider that not all financial activities could be exempted from the scope of application of the Directive?

If so, which ones should not be exempted because of the risk of money laundering or terrorist financing?

The majority of respondents made no comments on this question.

Among those who replied, **several views were expressed that not all financial activities could be exempted from the scope of application of the Directive**, in particular those more likely to be used for money laundering (such as money remittance or activities relating to NCCT countries).

However, it is underlined that it will be impossible to draw up an exhaustive list of financial activities that are either suspicious in all situations or of permanently low risk: formalising products and transactions that will be exempt from scrutiny will drive criminals to seek creative methods to exploit the situation. Indeed, a respondent called for conducting a specific study, concerted among all the parties involved, in order to produce a full list of activities (to be implemented over time with the emergence of new activities) that are not to be covered by the Directive.

⁴ The criteria were to some extent misunderstood by three respondents in so far as they did not understand that the criteria were addressed to Member States and believed that institutions would need to apply the criteria themselves to their customers.

5. POLITICALLY EXPOSED PERSONS (PEPs)

Question 8: Do you agree with this approach leading to the interpretation of the three main parts of the definition of PEP or do you consider that a close list of categories of persons should be established?

What would be, in your view, the costs and benefits of the two options?

An important number of respondents called for the establishment by the Commission (or by national authorities) of an official list of PEPs or closed/static list of functions that would be regarded as giving political exposure⁵. Establishing this (electronic) list should not imply significant costs. In cost-benefit terms, the list would not only ensure certainty and uniformity of interpretation but would also permit greater control by intermediaries. Indeed, it is added that this procedure is the only possible solution for financial institutions to manage the processing of such important data flow with efficiency. It is further added that any other solution will lead to huge identification problems and costs: it will be very difficult for banks to open accounts for clients residing in other countries; the possibility of opening accounts through the Internet will be severely limited; EU financial institutions will have important disadvantages in relation to banks offering similar services from countries outside the EU. Finally, it should be made clear that access to lists which are accessible by institutions/persons and which define, on a daily basis, who currently is/is not or was/was not a PEP at a relevant time, constitute sufficient verification of such status.

Other voices accept that establishing a list of persons would not be an appropriate task for the Commission because of its prescriptive element to a requirement which should be carried out on a risk-sensitive basis. It has been mentioned as well that Member States should retain flexibility to further clarify the notion.

Some of these respondents considered simple clarification of the interpretation of the terms of the Directive (amounting if possible to a list of categories) is the more appropriate approach to take. Institutions/persons should (as a starting point) require the customers of the institutions/persons to identify themselves, if applicable, as PEPs (or immediate family members or close associate of PEPs), in the same way that they are obliged to explain the source of funds being lodged.

Some others indicated that (in addition to or alternatively) it would be important for the Commission to explore different means of assisting persons and institutions covered by the Directive to cope with the obligations. This relates primarily to the preparation of guidance about sources of PEPs lists in all MS and third countries (although it is accepted that this list could be prepared by Member States⁶). Additionally, this could consist of: guidance providing warning signs to consider when dealing with PEPs in order to help excluding those who are not at risk; of an interpretative note on 'reasonable measures' that can be taken to establish the source of funds; of guidance assisting to cope

⁵ Reference has been made to the list provided by the Commission for the application of the EU financial sanctions (e.g. freezing of assets).

⁶ It has been mentioned in this context that national banks do have this kind of lists in some cases. It has also been mentioned that the US CIA publishes on-line a world factbook which contains PEPs from the executive, legislative, political party leaders and pressure group leaders for all countries. This list is considered as an invaluable standard.

with difficulties in accessing information (i.e. from foreign jurisdictions, in a foreign language etc.).

A respondent called for a sufficiently precise definition of the different PEP categories in the Member States so that the institutions/persons can apply the CDD procedures in full respect of the procedural rights of the PEPs in relation to **data protection rules**. In particular, this respondent fears complaints by possible PEPs on this ground.

Specifically in relation to non-financial professions, some respondents expressed their view that more consideration needs to be given to how the measures in relation to CDD to PEPs will be translated into procedures within non-financial businesses. Their concern is that the Directive has been drafted with financial institutions in mind and without proper consideration of its impact on the regulated professions, which in its large majority are small businesses: e.g. it would be difficult to identify PEPs without investing in expensive software and without undertaking potentially onerous investigative work.

Finally, some of these respondents raised the problem of PEPs being beneficial owners of legal entities and of dealing with companies that may have PEPs on their board, even if officially/ostensibly they do not have control over the direction of the business (e.g. the PEP is non-executive director).

Question 9: Do you agree with this definition of “prominent public functions”?

In the case of persons having held public functions, when, in your view, they no longer should be included in the PEP category?

What would be, in your view, the costs and benefits of these options?

Some respondents broadly agree with the proposed definition of "prominent public functions".

Others suggest limited modifications: to clarify that EU-level PEPs are included (e.g. high ranking officials from EU institutions/bodies, members of the EP etc.); to circumscribe the definition specifying that it refers to governmental offices; to include senior members of the armed forces; to clearly define the roles, instead of broad principles. Concerning the definition of state own enterprises, for one respondent it is too broad; for another one, there is no legal basis to treat them as political office; others suggest to limit the PEP category to members of the management body; another respondent would prefer a non-sector approach (e.g. either all SOE or those having monopoly revenue, irrespective of industry sector).

It was asked, in relation to public function, what would be the position when a government contracts out the allocation of economic business or activity to a private/mixed public/private partnership body. Concerning the prominence of the judiciary functions, it has been stated that it is not clear that anyone would have sufficient knowledge to be in a position to form a judgement on which persons fell into these categories.

Furthermore, **some respondents propose far reaching modifications to the definition**. Some of them would appreciate limiting PEPs to non EU PEPs (e.g. domestic=EU) as financial institutions are normally able to deal with EU PEPs using in-house checks and controls already in place, in application of the risk based approach.

Some other respondents suggest to limit the prominence criterion to the federal/national level (i.e. inclusion of regional/local level would cause considerable additional cost). A respondent provided a full list of core public functions to be covered, as a minimum.

For some respondents, the proposed definition is of little help: the category of persons covered by the term PEP would still be too broad and extremely vague (thus, only a list of names would be a right solution). Such a definition would unreasonably inflate the number of PEPs and would make them subject to a bureaucratic approach (e.g. separation of clients in PEPs and non-PEPs; documentation, filing of documents and justification of treatment vis-à-vis supervisors, regulators and auditors etc.). In the end, this would "desensitise" this issue, which might mean losing sight of genuinely high-ranking PEPs. It is requested that the definition of PEP, in addition to the function criterion, should also include a risk factor criterion: e.g. institutions/persons should apply the measures where additional evidence, information or sign raise doubts about the integrity of the clients and/or his activities. Otherwise, any politician within the EU will be *de facto* monitored. In addition, the currently proposed criteria are likely to require legal and/or technical advice on their interpretation, and systems to implement them, which would be both costly and impractical given that whatever test is to be applied will need to be applied to both individuals as well as legal entities. The Commission should focus on practical definitions in order to provide legal certainty and better implementation efficiency of AML rules. The broader the definitional criteria the more complex the procedures for identifying them are likely to be needed, but without any corresponding gain in effectiveness.

There is a **call for further assistance/guidance from the Commission** on certain aspects of the definition or on easy access to publicly available sources of this type of information (e.g. difficulties to interpret the notion of prominence, in particular in other jurisdictions; customers may not identify themselves as PEPs even if they are; etc).

Concerning when persons having held public functions should no longer be included in the PEP category, **some respondents agreed that PEP status should be limited in time after retirement from office.** The Wolfsberg anti-money laundering principle (one year) has been suggested as proportionate. Others propose a longer term period: two, three, four or even ten or fifteen years, without prejudice to the possibility by institutions/persons to apply longer periods. Others would prefer a flexible, case-by-case approach based on the implementation of the risk based approach, without prejudice to the possibility for the Commission to, at a later stage, suggest a more precise timeframe on the basis of accumulated experience. In any event, it has been underlined that what is important is to ensure uniformity in its application.

Other respondents consider this limitation difficult to apply: e.g. persons abandoning governments' positions are likely to return to office at a later stage; former heads of state carry risk long after they have left office (and the risk is carried out by their relatives/close associates after their death), etc.. A respondent is of the view that the persons having held public functions should not be included as PEPs at all.

Question 10: Do you agree with the definition of "immediate family member"?

Do you see value in extending the definition of family member to other relatives in the case of PEPs originating from specific world regions?

What would be, in your view, the costs and benefits of these options?

Some respondents broadly agree with the proposed definition of "immediate family members", though difficulties are signalled in relation to the routine identification of these people (e.g. differences in names through marriage, persons who are former spouses etc.); in relation to the identification of beneficial owners; and in relation to those persons which live together without a formal marriage relationship.

Limited modifications have been suggested: children in-law should be excluded; siblings could be included; the legal entities and arrangements should not be included in this category; "normally" should be deleted from the definition.

Other respondents do not agree with the definition. For one of them, the proposed definition is of little help (see general comments to question 9). Another respondent would prefer a detailed definition. Another one would prefer to restrict it to persons "known to be" family members. Another one suggests the use "immediate folks" instead of "immediate family members". Another one proposes to extend the definition to cover other relationships.

No respondent is in favour of adapting the definition to suit different cultural norms in other regions of the world. However, there is an understanding that this is an additional factor that may be considered by the institution/person as part of the overall risk assessment.

A respondent calls for a **register of the immediate family members** of PEPs. While this list is difficult, it is more difficult for each institution/person to go about the task individually.

Question 11: Do you agree with this definition of "persons known to be close associates of PEPs"?

What would be, in your view, the costs and benefits of this option?

Some respondents broadly agree with the proposed definition of persons known to be close associates of PEPs", although operational difficulties in the identification are anticipated.

Some respondents disagree with the definition. Some of them consider that the definition should be focused on the capacity of identifying these persons "as being known" to be close associates. The definition should be modified accordingly. Additionally, the business relationship with these close associates should be substantial. It has been suggested to further define that "known" should imply knowledge from publicly available sources (if not meant to be knowledge that a person is a beneficial owner of a client's property).

Others consider that this definition excludes close associations where potential links are through means other than common beneficial ownership of an entity (e.g. reciprocal arrangements, etc), while some persons captured may be of no interest. Other respondents would prefer a detailed definition or a definition completed with a list.

Additionally, it is underlined that the responsibilities of a financial institution that finds itself to be a close associate of a PEP through common shareholdings in an entity would need to be made clear.

Question 12: Do you find that these indicators [e.g. *Transparency International* etc.] provide a useful basis in evaluating the risk of dealing with PEPs originating from high risk countries as far as corruption is concerned?

The majority of responses provided considered these (and other) indicators to be generally useful to firms as guidance to a certain extent provided institutions are given the necessary flexibility when relying on them. It was, however, underlined that the usefulness of individual sources of information is likely to vary over time and new sources may arise. Some respondents requested guidance from the Commission regarding the importance it gives to specific indicators of existing sources (i.e. *Transparency International/OECD*) to evaluate the risk of corruption (e.g. which rating level to be considered relevant for widespread corruption).

On the contrary, a respondent indicated that these indicators would be useful only if institutions could limit their control to the countries listed (i.e. to render these indicators compulsory).

Question 13: Do you agree with this approach [e.g. *guidance*] in relation to the identification of PEPs *in concreto*?

There was **support for the proposal to provide some guidance in the near future on this issue.** However, it was made clear that this guidance should not become compulsory/prescriptive and that the Commission should be alert to the dangers of introducing unnecessary additional costs, by the inadvertent proliferation of competing sources of requirements and guidance, that have to be taken into account by Member States and institutions.

Another respondent, however, indicated that the responsibilities of institutions, clients and supervisors in identifying PEPs, together with their immediate family members and close associates, must be appropriately defined before reasonable agreement on practices could be reached.

6. INFORMATION ON CONDITIONS IN THIRD COUNTRIES

Question 14: Do you at this stage wish to provide any relevant information in relation to the application of anti-money laundering/counter-terrorist financing measures by third countries?

The majority of respondents made no comments on this question, indicated that they did not have relevant information available, or considered that information on this field should not be provided to the Commission by the financial services industry.

Some views support the adoption by the EU Commission of a list of third countries which do not impose requirements (prudentially) equivalent to those laid down in the Directive. Such list should be official, kept up-to-date and available in electronic form. This list would be essential to maintain a level playing field. Furthermore, such a list would certainly be of great help in classifying customers' group and correspondent banking relation with third countries according to the risk-based approach. Finally it would represent a positive development with a view to provide more legal certainty and efficiency regarding implementation, while limiting the burden on credit institutions.

One of these respondents suggested that in the meantime, the Commission could already publish more precise guidance concerning the technical criteria to be applied for listing those countries. This respondent stated that Article 40(4) of the Directive should be enough as legal basis to allow the Commission to establish the criteria that Member States must apply in this regard, or at least lay down what criteria it expects to implement in the future in declaring that a country should not be considered as equivalent to European countries from the viewpoint of its system for preventing money laundering. Those criteria could be based on certain principles, such as: (a) it should solely respond to the system for preventing money laundering in each Member State, and should not extend to other points such as the tax system or the level of co-operation with authorities from other countries in different areas; (b) it should be as simple as possible, so that the financial institutions themselves are not forced to run checks or complex assessments to determine what countries can be considered comparable; (c) it should allow a smooth, flexible relationship with financial institutions in as many countries as possible.

Other views, while not referring specifically to the Commission, called for publication by an authoritative body (i.e. it could also be the FATF) of lists/information on the status of countries and territories with regard to risk of money laundering activity, including identification of specific risk types associated with different territories. Those lists could be used as a reliable source of information.

It was also suggested that cooperation of third countries should be ensured in order to get a better understanding of their socio-economic situation and their laws and regulations in this matter. A respondent called for the Commission to create a system whereby information on anti-money laundering measures adopted in third countries circulate among credit and financial institutions, in order to help the institutions concerned with assessing the risks connected with a transaction.

7. ANY OTHER POSSIBLE IMPLEMENTATION MEASURES

Question 15: Do you see value in clarifying when enhanced CDD should be applicable in respect of corresponding banking relations with central banks and monetary authorities from third countries? Or, should the risk assessment be left to the credit and financial institutions covered by the Directive?

The majority of respondents made no comments on this question. Some respondents indicated that this should be left to the reporting institutions. Two respondents also made their explicit support for the analysis of the ECB: e.g. no need to apply enhanced (or even normal) CDD in relation to corresponding banking accounts with central banks or monetary authorities from third countries, as long as they are not subject to financial sanctions or designated a NCCT-country.

Other respondents would welcome clarification of when enhanced CDD should be applied, though not necessarily in prescriptive form. Only two of these respondents made an explicit support for implementing measures in this regard.

Question 16: Would you consider it necessary to address, at this stage, any other of the possible implementing measures presented in Article 40?

The majority of respondents made no comments on this question or did not consider it necessary to address any other possible implementing measures. Only two respondents suggested:

- to clarify, as part of the implementing measures, that Article 3(2)(d) is intended to apply only to "self-managed" funds that are directly accountable for the promotion of and dealing in units/shares. In the UK it is the operator of the collective investment scheme, who is subject in full to regulation under the Directive, that is responsible for these activities and so to also subject the scheme itself to such regulation would be unnecessary and a source of confusion;
- that the implementing measures might be used to clarify the boundaries of the definition of "business relationship" in Article 3(9), which are too open to interpretation. In particular, what is meant by "expected...to have an element of duration", perhaps referring to an objective of facilitating frequent or regular transactions.
- that, in the context of Article 13(2), the higher risk attached to non-face-to-face transactions is further identified as being relative to the equivalent transaction conducted in person: i.e. non-face-to-face business should not be seen necessarily as higher risk in absolute terms.
- to clarify what to do in case that refraining from carrying out suspected transactions transaction risks tipping-off;
- to clarify how should supervisors and institutions decide what constitutes adequate monitoring;
- to clarify the role of regulators within Member States in respect of implementation of the various provisions in the 3rd Directive;
- to give more guidance in relation to the ability to undertake effective CDD in relation to legal entities, their complex structures and the beneficial owners, especially where multiple jurisdictions are involved; also in relation to the verification mechanisms that are required to be employed.

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