EFAMA
European Fund and Asset Management Association

MEMO

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Proposal for a Regulation prevention of the use of the financial system for the purposes of Money Laundering or Terrorist Financing

EFAMA welcomes the progress made to date on the European Commission's proposal for a Regulation prevention of the use of the financial system for the purposes of Money Laundering or Terrorist Financing. Below we have set out some points for concern which we wish to share with the co-legislators to inform their discussions in the coming weeks.

A. Concept of Beneficial Ownership

The identification of Beneficial Owners is critical to increasing transparency in the fight against money laundering and terrorist financing. We have three crucial points to emphasise in this regard to ensure this concept remains clear and effective: (1) maintain the existing threshold of 25% with respect to control via an ownership interest; (2) do not introduce novel rules attempting to analogise all CIU structures to corporate entities and trusts; (3) avoid overcomplicating the definition of Beneficial Ownership in a way that may diverge from international standards, in particular the ongoing review of FATF guidance on Recommendation 24.

1. Maintaining the threshold of 25%

We strongly recommend against lowering the threshold for an individual to be considered a 'Beneficial Owner' by virtue of an ownership interest.

- The concept of 'Beneficial Owner' focusses on those individuals who **exert some degree of control over the customer** – either through a certain level of ownership interest or through other means. The FATF refers in its 2012 Recommendations to the need to identify natural persons 'who ultimately have a controlling ownership interest in a legal person'. An individual with a minimal ownership interest will not be capable of influencing the decisions of the customer, unless they are shown to exercise 'control via other means' aside from ownership.

- Lowering the threshold would **depart from international standards**, with the FATF in its 2012 Recommendations noting that the determination of what is a 'controlling ownership interest' may be based on a threshold, suggesting a 25% ownership interest.

- The focus of policymakers on **transparency of legal structures/arrangements to identify the ultimate beneficial owner would be frustrated** if resources are diverted instead to recording the

names of all of those with a minor interest in the customer and who exercise no control over the customer. We point to the FATF's recent amendments to Recommendation 24 which focused on ensuring that the true ultimate Beneficial Owner who is in reality controlling the customer is not being obscured by a complex chain of legal entities and other legal arrangements. The fact of being Beneficial Owner in itself is not an indication of suspicious activity or an AML/CFT predicate offence. Understanding and monitoring of the business relationship and proper **scrutiny of the purpose of a structure and of a transaction is far more critical** in ensuring transparency and is more oriented to the risk-based approach.

2. Collective Investment Undertakings

We are very concerned with the Council's suggestion to include a specific provision on the identification of the beneficial owner of a collective investment undertaking (CIU). These rules do not accurately reflect the characteristics of the full range of possible CIUs, which differ between Member States, nor the existing national rules in place. We would call for the deletion of draft Article 43a, 43b and 44(1)(e) for the following reasons:

- It is **incorrect to assimilate all CIUs as being analogous to either corporate entities or trusts**. For instance, co-owned contractual funds do not have legal personability (meaning they are not corporate entities) nor can they be compared to a trust (as there is no split of legal and beneficial ownership by which legal title would be vested in a trustee). The investors together co-own the fund as tenants-in-common, with their ratio of ownership represented by 'units', and appoint the manager to conduct investment decisions on their behalf. Trying to identify an individual analogous to a trustee or settlor would simply lead to legal uncertainty as these arrangements are not analogous to trusts. Furthermore, imposing such an obligation would require managers to seek out information which would not be possible to obtain in certain jurisdictions as the management company does not obtain that information under certain national legal regimes. As such, we see no benefit in this initiative.

- The structures of CIUs differ between Member States, and we do not believe the AML Regulation, as **harmonizing legislation**, is the correct place to set out a one-size-fits all approach to these national specificities.

- **Existing rules and practices have already been put in place at the national level** to accommodate different types of fund structures. For instance, existing Beneficial Ownership registers have been structured to recognize that contractual funds are not considered legal arrangements and would need to be modified to account for this change, along with changing the AML procedures of obliged entities. Notably national rules, such as the Irish Investment Funds, Companies and Miscellaneous Provisions Act 2005, already sets out a definition of the Beneficia Owner of a common contractual fund as being the individual who either is entitled to or controls a greater than 25% share of the capital, profits or voting rights of the CCF or otherwise controls the CCF. Furthermore, certain national legal regimes do not allow for the identification of underlying investors of certain types of investment funds and as such the suggested amendments would require changes to be made to existing legal regimes applicable to funds.

- The proposal in addition appears to allow for **more opacity rather than transparency** by providing that the class of beneficiaries will automatically be designated as the Beneficial Owner rather than through an analysis of control by ownership interest or other means.

3. Avoid over-complicating the concept and identification of Beneficial Owners

We recommend that any amendments to the existing concept of Beneficial Owner should remain targeted and effective:

- **Any changes must align with upcoming FATF Guidelines on Recommendation 24** to ensure a consistent and comprehensive ruleset for obliged entities. We note that these are currently the subject of public consultation and are estimated to be finalised by February 2023.

- **The impact on Beneficial Ownership Registers** must be borne in mind. The information within the Beneficial Ownership Registers must remain useful and user-friendly in order to help market participants detect any suspicious transactions. Rehauling and overcomplicating the concept of Beneficial Owner would create unreadable and complex registers with too much information which is difficult to keep up-to-date. This would not only be counterproductive but may also provide an opportunity for criminals to use this as a loophole and benefit from the complexity created and may also induce undue de-risking to the disadvantage of European citizens.

- **Beneficial Ownership is only one element of the AML/CFT process**. Understanding and monitoring the business relationship and properly scrutinizing the purpose of the transaction and legal structure used are equally if not more critical to supporting transparency, ensuring the correct channels are used in assessing the vulnerabilities arising from the specific features of the legal persons and arrangements in question. This is highlighted by FATF Recommendation 10, the practical cases and indicators issued by FATF and Egmont Group paper on the concealment of beneficial ownership and the EBA ML/FT Risk Factor Guidelines more generally. Understanding specific vulnerabilities, through sectorial, national and supranational risk assessments and sanitized cases from FIUs, are key to mitigating vulnerabilities associated with the concealment of beneficial ownership. We are concerned that the Council's proposal creates unnecessary focus on the concept of Beneficial Owner, generating an unnecessary administrative burden for professionals and overcomplicating the current regime.

B. Outsourcing of the Role of Compliance Officer

The initial proposal of the European Commission provided that the compliance officer may only be an individual performing that function in another entity within the group (at Article 9(3)). We note the EBA's recent and more specific Guidelines on Compliance Management (14 June 2022) which, at para. 35, recognize that the specific nature of the collective investment undertakings sector may require that the compliance officer be permitted to operate for several funds which may not necessarily be part of the same 'group'.

We do not agree with the Council's proposed amendment whereby the compliance officer may only be appointed from within an entity located in the same Member State as the obliged entity. This is extremely restrictive and would disproportionately impact the operations of existing obliged entities with no clear justification.

ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages over EUR 30 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors. More information available at www.efama.org.

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