EFAMA

European Fund and Asset Management Association

EFAMA's Views on the Anti-Money Laundering Package

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INTRODUCTION

As the European Union's financial system has become more complex, it has also opened the door to new risks of money laundering and terrorist financing. EFAMA supports the new regulatory package proposed by the Commission on 20 July 2021, believing this initiative will make strides in ensuring that no loopholes or weak links in the internal market allow criminals to use the EU to launder the proceeds of their illicit activities.

I. Views on the AMLA Regulation

The first element of the Commission's package comprises a draft regulation to establish a new AML authority ('**AMLA'**) (the '**AMLA Regulation'**).

EFAMA welcomes this proposal as useful in order to tackle the increasingly cross-border nature of financial crime. As a pan-European problem, financial crime cannot be addressed by national authorities acting in isolation within their regulatory borders. A more comprehensive legal framework and supervisory architecture will better prevent financial criminals from exploiting mismatches in national laws and will alleviate possible obstacles faced by national prosecutors in taking action cross-border.

The introduction of a dedicated AMLA for the purposes of coordinating supervision at the EU level is welcomed as a means of ensuring enhanced coordination. Compared to the current architecture, in which such functions are entrusted to the European Banking Authority ('**EBA'**), the EU-level supervisor of national AML supervisors for banks, we believe a dedicated authority for AML at EU level will facilitate coordination between regulators of the various sectors involved, thereby ensuring that all relevant expertise is available to the new authority.

1. Governance

In order to ensure that the AMLA can effectively carry out its functions in respect of the financial industry as a whole, it is necessary to ensure that sector-specific business models, such as that of the asset management industry, are appropriately taken into account and supervised where this responsibility falls within the remit of the AMLA. The staff of AMLA should thus be comprised of **experts from across the financial industry and from the competent departments of existing supervisory authorities**, and should be sufficiently aware of the activities of each sector.

We note with approval the proposed composition of the Executive Board of the AMLA, to be made up of five full-time members to be selected having respect the principles of experience, qualification and, to the extent possible, gender and geographical balance. We would add that the selection criteria should also ensure that **all sectors of the financial industry are sufficiently represented** in terms of expertise and qualifications of the members. This is of particular importance given the scope of powers to be exercised by the Executive Board and the absence of representation of sector-specific supervisory bodies within its composition.

We also welcome the possibility to include within the General Board observers including representatives from each of the ESAs where matters within the scope of their respective mandates are being discussed, together with the commitment that the AMLA closely cooperate with the ESAs. This input will be valuable in ensuring that decisions have regard to the specificities of the individual sectors within the financial industry.

2. Scope of Supervisory Powers

In terms of which entities fall within the scope of EU supervision, EFAMA is in agreement that the AMLA should have indirect powers over all obligors with the possibility of direct intervention in justified cases of high risk and cross-border impact. We note that the AMLA is entrusted with the task of developing criteria as to which entities will be directly supervised – however, we believe it is critical that **national competent authorities should also be involved in the development of these criteria**, due to their greater proximity to the obliged entities and understanding of types and level of AML-related risks presented by such entities.

In the case of direct intervention, EFAMA is of the view that the AMLA should not interfere in national cases and the day-to-day operations of national supervisors. Local regulators have a deeper knowledge of the local market and local conditions and this knowledge should be preserved. In setting up the new framework, it is key to specify the tasks of the AMLA and the tasks of the local supervisory authorities and that an exchange of information is kept between central and national level.

In this respect, in the case of direct supervision of selected obliged entities, EFAMA supports the establishment of joint supervisory teams for each selected obliged entity to be composed of staff from the financial supervisors responsible for supervision for the selected obliged entity at national level as well as staff from the AMLA. However, it should be clarified that the **powers of direct supervision conferred on the AMLA under Articles 16 – 20 of the AMLA Regulation are to be exercised by the joint supervisory team as opposed to solely by the AMLA.**

3. Supervisory and Risk Assessment Methodology

It is vital that the supervisory methodology adopted by the AMLA in its risk-based supervision of obliged entities in the EU should take into account the specificities of each category of financial entity. In this respect, we welcome the obligation on the AMLA in developing this methodology to 'make a distinction between obliged entities based on the sectors in which they operate'.

In addition to the above, the AMLA's risk assessment methodology for identifying obliged entities for direct supervision should equally take into account the specificities of each category of financial institutions. For this reason, EFAMA supports the proposal that this methodology will be developed separately for different categories of obliged entities, notably for UCITS, AIFs and investment firms.

In connection with the above, we welcome the use of public consultations in developing regulatory technical standards, implementing technical standards and guidelines and recommendations as mandated in the draft AMLA Regulation. As stated above, we consider it would be appropriate to consult national competent authorities in the development of the above-mentioned supervisory methodology and risk assessment methodology. In addition, we also consider that the methodology for classifying the inherent risk profile of an obliged entities for direct supervision should take into account residual risk in addition to the risk factor categories currently listed in Article 12(4) of the draft AMLA Regulation.

4. Supervisory Teams

Where entities are selected for direct supervision, we would also note the importance of ensuring that the dedicated joint supervisory team for that entity be composed of individuals knowledgeable of the asset management industry, as appropriate. In this respect, we support the current drafting which requires the joint supervisory teams to be composed of staff from the AMLA and from the financial supervisors responsible for supervision of the selected obliged entity at national level.

5. Coordination and Support Mechanism for Financial Intelligence Units

EFAMA supports the replacement of the current FIU platform structure with a European level FIU function. We believe this will better facilitate the analysis of data received by the FIUs and enhance information exchange between relevant bodies.

EFAMA welcomes the proposed role of the AMLA in coordinating the work of FIUs and in improving cooperation between FIUs though facilitating joint analyses. We also welcome the role of the AMLA in facilitating training programmes and exchanges of practices and expertise between FIUs, and in establishing a central AML/CFT database of information collected from supervisors and supervisory authorities, together with the sharing of this information with supervisors and supervisory authorities.

We also welcome the inclusion of a requirement within the draft proposed AML Directive for FIUs to provide feedback to all obliged entities on the reports which they file. It is **vital that firms receive feedback on the SAR/STR reports which they file with their national FIUs, in order to equip firms to more efficiently identify and prevent potential instances of ML/FT**.

II. Views on the AML Regulation

A harmonised AML regulation (the '**AML Regulation'**) will better ensure a cohesive single rulebook across the internal market and close possible loopholes which may otherwise have benefitted those seeking to profit from ML/TF.

1. Internal Policies, Controls and Procedures

EFAMA welcomes the clarity given around the internal policies, controls and procedures to be implemented by obliged entities. It is important that such rules reflect best practice, are proportionate to the size and risk profile of the entity in question and that the independence of both the compliance manager and compliance officer in the performance of their functions be ensured, in line with the 'Three Lines of Defense' model of risk management.

We would suggest that it should be possible for the functions of the compliance manager to be carried out by one **or more** executive members of the board of directors or equivalent governing body, in line with market practice. The benefits of this approach are recognised in the draft EBA Guidelines on the role of AML/CFT compliance officers, which also emphasises the need for collective responsibility of the management body for compliance with AML/CFT obligations, noting the importance of cultivating the collective knowledge, skills and experience of management to be able to understand the ML/TF risks related to the financial sector operator's activities and business model.

The recognition afforded in the draft AML Regulation to the principle of proportionality in the exercise of the compliance function is very much welcomed, and this is also echoed in the draft EBA Guidelines referred to above. We would suggest that, in line with adopting a proportionate approach, the requirement for senior management to approve internal policies, controls and procedures with regards to AML/CFT be subject to the **possibility to delegate this approval to other appropriately qualified and experienced members of the relevant entity**. This is because, as currently defined, senior management equates for many entities to the board of directors, for whom it would be disproportionate in terms of time and cost to sign off on all such items.

In line with the above, we would also suggest that the duties of the compliance officer be tailored to be more **proportionate to smaller and lower-risk entities**. We would in this respect suggest allowing the compliance officer to be appointed from outside of the group where the entity in question is insufficiently resourced to appoint an appropriately skilled and experienced officer from among their ranks. Similarly, the requirement to exercise 'continuous' as opposed to 'day-to-day' control would also be more appropriate for smaller sized entities. This also aligns with the aforementioned draft EBA Guidance, which recognises instances where, due to the size of the operation, the nature of the business and associated risks, among other factors, it may not be appropriate to appoint a compliance officer on a full-time basis.

2. Nominee Disclosures

The proposed AML Regulation requires nominee shareholders and nominee directors of corporate or other legal entities to maintain adequate, accurate and current information on the identity of their nominator and the nominator's beneficial owners. This information, and the status of nominators, is also required to be reported to the relevant beneficial ownership registers as well as to obliged entities when such obliged entities are taking customer due diligence measures.

EFAMA supports in principle the rationale for this provision as stated in the preamble (Recital 74) of the proposed AML Regulation – i.e., that nominee arrangements enable the identity of beneficial owners to be concealed. However, we would highlight that attention has been given in guidance issued at both national and EU level to the legitimate use of nominee arrangements within the funds industry, notably by both the FATF and the ESAs,[1] and would request that **clarification be included that this pre-existing guidance remains valid**.

As reflected in existing guidance, intermediaries are commonly used in the distribution and subscription of shares and units of investments funds (a graphical representation being included in the Annex to this paper). Intermediaries often act on behalf of a large number of underlying investors, with shares/units in the fund being registered in the name of the intermediary on behalf of the underlying investor and the intermediary holding funds on behalf of those investors in separate or co-mingled (omnibus) accounts. This allows for investors avail of cost and trading efficiencies which would not be feasible if legal title remained with each individual investor, as well as providing a means of safeguarding the assets managed on behalf of investors while investors retain the beneficial interest in the assets, protecting investors from the risk of insolvency of the asset manager.

As investment funds typically have a large number of underlying investors, each being entitled to a very small proportion of the fund, requiring disclosure by the intermediary to the fund manager of each underlying investor would be disproportionate to the stated aim of ensuring that the identity of beneficial owners is not obscured. This is particularly the case where the intermediary in question is an AMLD regulated entity, in which case the underlying investors will have been subject to due diligence by the intermediary itself. Any requirement to further verify the identity of underlying investors by the fund manager would then result in the duplication of diligence checks on the same investor, leading to inefficiencies in terms of cost and time particularly in light of the typically large number of underlying investors in question. Furthermore, intermediaries may be prevented from disclosing details of their customers to third parties by virtue of data privacy and bank secrecy restrictions imposed by both national law and in their contractual relations with their customers. These considerations are addressed in more detail in the existing guidance.

As such, we would suggest that it be made clear, by way of clarifying recital, that the **existing guidance of the EBA and FATF continue to apply as regards the use of intermediaries in the subscription and distribution of shares and units within investment funds**.

3. Risk-Based Approach to Politically Exposed Persons

EFAMA supports the risk-based approach adopted in the draft AML Regulation to the treatment of different categories of politically exposed persons (**PEPs**), the guidelines in relation to which are to be drafted by the AMLA.[2] The risk of corruption which may attach to persons holding important public functions mandates the application of enhanced due diligence measures where such individuals present a higher risk. However, PEPs appear in a wide variety of circumstances, reflected in the very broad definition of the term, and a risk-based approach allows for the effective screening of PEPs to whom such enhanced measures should apply.

In line with this risk-based approach, the enhanced due diligence measures applicable with respect to transactions or business relationships with PEPs should **depend on the risk categorisation of the PEP as determined by the AMLA guidance**. Indeed, this is the essence of a risk-based approach to enhanced due diligence. However, as currently drafted, **the risk categorisation appears to have no bearing on the measures to be applied by obliged entities**. Rather, all enhanced measures under Article 32, as well as under Article 28, appear to apply without distinction to all PEPs, irrespective of their

[1] FATF (2018), *Guidance for a risk-based approach for the securities sector* ("The complexity of the securities sector and the variety of intermediary roles involved highlight that no one-size-fits-all AML/CFT approach should be applied."); EBA (2021), *Guidelines on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions under Articles 17 and 18(4) of Directive (EU) 2015/849*; US Department of Treasury Financial Crimes Network Enforcement (2016), *Final Rules on Customer Due Diligence Requirements for Financial Institutions* (Federal Register Vol. 81, No. 91).

[2] Recital 55 and Article 32(3)(b) of the draft AML Regulation.

risk level under the AMLA guidance, with the consequence of all PEPs being de facto categorised as high risk.

EFAMA is of the view that clarification is needed to give effect to the aim of a risk based approach, as stated in Recital 55, such that the enhanced measures set out in Articles 28 and 32 of the draft AML Regulation are applied in a manner which is proportionate to the corresponding risk categorisation of the PEP. This risk based approach is also reflected in the FATF Guidelines on Politically Exposed Persons, which notes that normal CDD and monitoring may apply to domestic and international organisation PEPs which do not present a higher risk.[3]

By way of illustration, we would note instances in which a customer is a state owned entity (**SOE**) whose beneficial owner is determined to be its senior managing official (**SMO**) due to Article 18(2). Where that SMO is also a PEP by virtue solely of its position in the SOE,[4] it would be disproportionate from a risk perspective for the PEP status of the beneficial owner, who is a beneficial owner not by virtue of control or ownership of the SOE but rather by default as the SMO as the residual criteria, to automatically give rise to a high risk categorisation and consequent application of enhanced due diligence measures. Furthermore, it would also appear disproportionate to require the source of wealth of such PEPs to be established in such instances. As noted in the Wolfsberg Principles on Politically Exposed Persons,

> *"Many state owned entities and public sector bodies will have PEPs in controlling positions within the organisation. However, this does not always mean that the PEP will transfer corruption risk to that organisation. In some cases, the individual will only be classified as a PEP as a result of their position within that organisation, in which case it is not appropriate to subject the organisation itself to the PEP control framework."*[5]

In summary, EFAMA supports the risk-based approach as a practical means of ensuring the widest variety of PEPs are brought within the scope of enhanced monitoring while at the same time ensuring that the effectiveness of PEP screening is not diluted by virtue of the vast array of individuals encompassed by the broad definition. In order to give effect to the risk categories to be developed by AMLA, clarification is needed that enhanced due diligence measures will be applicable having regard to the level of risk of the PEP in question.

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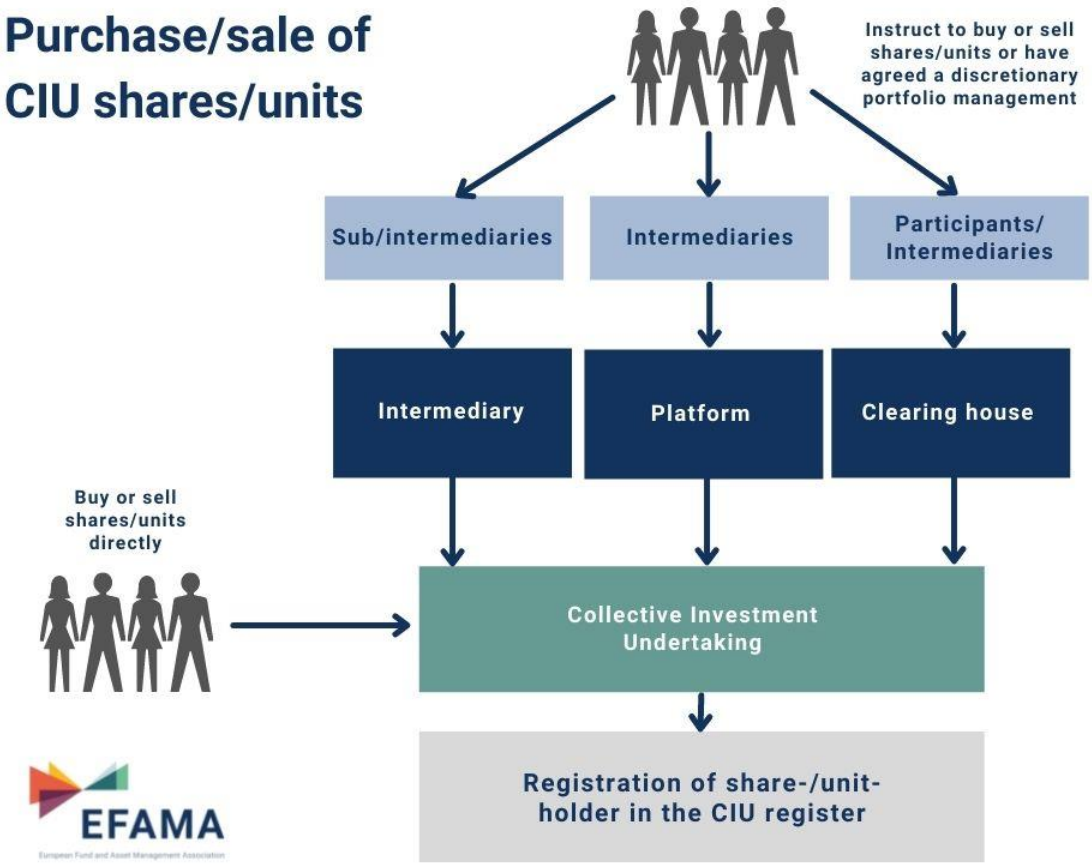
[3] FATF Guidelines on Politically Exposed Persons, para. 99 and Annex 1 para. 1.
[4] Per Article 2(25)(a)(vii) of the draft AML Regulation.
[5] Wolfsberg Principles on Politically Exposed Persons (May 2017) p. 6. The Wolfsberg Group is an association of thirteen global banks which aims to develop frameworks and guidance for the management of financial crime risks.

Annex


Purchase/sale of CIU shares/units
Instruct to buy or sell shares/units or have agreed a discretionary portfolio management
Sub/intermediaries
Intermediaries
Participants/ Intermediaries
Intermediary
Platform
Clearing house
Buy or sell shares/units directly
Collective Investment Undertaking
Registration of share-/unit-holder in the CIU register
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About EFAMA

EFAMA is the voice of the European investment management industry, which manages over EUR 27 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.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

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