ICAEW representation

# ICAEW REP 07/05

## IMPLEMENTATION OF THE THIRD EU MONEY LAUNDERING DIRECTIVE

**Memorandum of Comment submitted by the Institute of Chartered Accountants in England & Wales, to the European Commission, in October 2005, in response to the 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**

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## Introduction

The Institute of Chartered Accountants in England and Wales welcomes the European Commission's consultation on implementing measures for the Directive, which we believe will assist in ensuring that the Directive is implemented in a way which is effective, while minimising unnecessary costs. The Institute is the largest accountancy body in Europe, with more than 127,000 members operating in business, public practice and within the investor community. The Institute operates under a Royal Charter, working in the public interest.

Responses are given to the specific questions posed in the working document, and are set out below under the related questions. The word "institution" has been used to indicate all the persons and institutions that come within the scope of the requirements of the Directive, or which might do so.

## Simplified Customer Due Diligence

***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?***

Yes. The principles-based approach to risk adopted in the Directive should be sufficient to ensure that institutions and persons covered by the Directive to deal appropriately with low risk situations. The terms of the Directive will undoubtedly be supported by informal Guidance in individual Member States, which will assist institutions which are uncertain as to the standards of CDD that they should maintain. The maintenance of adequate standards will be sufficiently supported by the monitoring of institutions, as required by the Directive.

***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?***

Yes. The more complex the approach taken in the design of implementing measures, the more likely it is that institutions will incur unnecessary costs in implementation, without significantly reducing the risk of their being used for money laundering purposes.

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

See above.

## Simplified Customer Due Diligence – Derogations for certain categories of low risk customers

***Question 2: Do you agree with these sets of technical criteria? 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?***

The first set of technical criteria seek to identify those categories of institutions which qualify as being "low risk", and which therefore will not need to be subject to all of the detailed due diligence requirements contained in the Directive Articles 7 to 9, when seeking a business relationship with another institution within the scope of the Directive. The criteria seek to define well regulated, licensed and monitored institutions, subject to the requirements of the Directive and whose compliance with those requirements is enforced. In our view, the first five criteria are sufficient for that purpose, and we do not think that institutions outside the scope of the Directive could meet these criteria.

A sixth criterion has been identified which could be considered for inclusion, namely that "the only material source of income is known, stable and of impeccable repute". We would argue strongly against the addition of this criterion. We do not consider that it is reasonable to expect institutions to assess all the material sources of income of their fellow authorised institutions at the outset of a business relationship. Nor is it necessary, as the client institutions are themselves required to be properly regulated, licensed and monitored.

The second set of criteria have been given, which seek to identify those categories of international institution which qualify as being "low risk" by reason of their high status and clarity of purpose, with international institutions such as the European Central Bank and the International Monetary Fund being given as examples. We have no problem with these criteria, though consideration could be given to removing the fourth criteria, that "the source of income of the customer is known, stable and of impeccable repute". We do not consider this necessary for the identification of such low risk institutions and some of them may have complex sources of information not easy to assess at the outset of a business relationship.

***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?***

In this case, the categories of institution to which the derogations will comply will generally be easily recognised and categorised in each member state. For these reasons, we would support the use of the technical criteria given, rather than the use of broader non-cumulative technical criteria. This would provide more transparency and ease of use by institutions within the scope of the Directive, and therefore maximise effectiveness, at least cost.

***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?***

Yes. We agree that any clarification of the application of derogations in respect of these categories of lower risk institution should be left as a matter of national implementation.

**Simplified Customer Due Diligence – Derogations for certain categories of low risk products and transactions**

***Question 4: Do you agree with these criteria? 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?***

We have no comments to make on these criteria, which are mainly concerned with financial services products and transactions, which are not the main focus of our profession.

***Question 5: Do you agree with the approach (on the duplication of CDD procedures)?***

We note that the Directive already includes provisions for the avoidance of duplication of CDD provisions, by the inclusion of provisions on the performance of CDD by third parties, though these are unlikely to be widely depended upon by institutions, in that responsibility for the adequacy of CDD remains with the contracting institution. We understand that in many cases the costs inherent in the duplication of CDD are minimised by the forwarding of certified copies of core identification documents between regulated institutions, where this situation arises and the contracting institution believes this to be an appropriate use of the risk related approach to CDD. However, it would be appropriate for this matter to be given further consideration, of whether further relaxation, including the right to depend on the initial CDD undertaken by the forwarding institution.

**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?***

We are broadly content with the criteria for the definition of the occasional or limited financial activity, for use by Member States in deciding on actions pursuant to Article 2(2). The criteria are complex and inappropriate for institutions to apply directly, but are not inappropriate for Member States to use in identifying categories of institutions or situations which should properly fall outside the scope of the Directive. Providing these decisions are made on an appropriate basis, we believe that they will reduce costs without significantly undermining the effectiveness of the Directive.

We do not believe that these criteria should be used for the exclusion of individual institutions from scope of the Directive, as opposed to categories of institution or situation. Such an ability is unnecessary, and could lead to abuse.

Criterion 7 includes a provision that exemptions from the scope "should be based on justified grounds and the possibility to revert to the original situation at short notice should be provided for". While we strongly agree that categories should only be exempted with clear justification for them, we do not agree that the exemption should be capable of being withdrawn at short notice. It would be unfair, and very costly, for institutions to be brought within the scope of the anti-money laundering requirements at short notice, when they had planned their systems and procedures on the basis of not having to comply.

***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?***

We do not consider that money transmission, remittance services or other elements of a normal banking service should be capable of exemption from the scope of the Directive. Nor should the provision of trust or company services.

The risks of these exemptions would be further reduced if Member States were required to publicise to the institutions taking advantage of the exemption the dangers of committing the criminal offences of participation in money laundering schemes which we understand are in place in all Member States.

**Politically Exposed Persons**

***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?***

We agree that a close list of categories of PEPs is unnecessary, and simple clarification of the interpretation of the terms of the Directive is the more appropriate approach to take.

***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?***

We are broadly content with the proposed definition of "prominent public functions".

***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?***

We are content with the definition of "immediate family member". We do not believe that any advantages to an adaptation of the definition, to suit different cultural norms in specific world regimes would outweigh the costs and complexities that these would introduce.

***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?***

We are content with this definition.

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

Yes, we find the indicators of the likelihood of corruption in various jurisdictions published by such organisations as Transparency International and the OECD a useful toll in assessing the risks of corruption and the subsequent laundering of the proceeds. However, the usefulness of individual sources of information is likely to vary over time, and new sources may arise. We therefore would not find it appropriate for them to be mentioned by name in any implementing measures.

***Question 13: Do you agree with this approach in relation to the identification of PEPs in concreto?***

We would have no problem, in principle, with the production of Guidance by the Commission, applicable across the European Union, but 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.

**<u>Information on Conditions in Third Countries</u>**

***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?***

No.

## Other Possible Implementing 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?***

We do not feel ourselves competent to respond to this question, which is not within the core competencies of our profession.

***Question 16: Would you consider necessary to address, at this stage, any other of the possible implementing measures presented in Article 37?***

No.

Felicity.banks@icaew.co.uk