

July 6, 2020

Mr. Jose Manuel Campa  
Chairperson  
EUROPLAZA  
20 Avenue André Prothin  
92400 Courbevoie  
France



Dear Mr. Campa:

**RE: Revised Guidelines on Money Laundering/Terrorist Finance Risk Factors**

The Institute of International Finance (“IIF”) is grateful for the opportunity to respond to the European Banking Authority (“EBA”) Consultation on Revised Guidelines on Money Laundering/Terrorist Finance (“ML/TF”) Risk Factors (the “Consultation” or the “Guidelines”/“Guidance”).<sup>1</sup> As you know, financial crime is a contributor to societal ill and a threat to both financial stability and financial inclusion.<sup>2</sup> The IIF strongly supports the work of the EBA in bolstering the efforts of the European Union (“EU” or the “Union”) to prevent the misuse of the financial system for the purposes of illicit activity.

In particular, we welcome the EBA’s revised role in leading the development of anti-money laundering and countering the financing of terrorism (“AML/CFT”) policy, coordinating and communicating on these matters across the Union and with third countries and monitoring the implementation of EU standards in this area. As we have stressed to you, the European Commission and the other relevant EU institutions and authorities in the past<sup>3</sup>, there is an urgent need to ensure that all pertinent stakeholders effectively and consistently address the risks arising from financial crime and cooperate to share information that will help safeguard international finance against illicit use. A more coordinated framework in the EU for implementation and oversight of measures used in combating threats to the integrity of the financial system is imperative. The EBA’s new mandate plays an important part in these efforts.<sup>4</sup>

As such, we very much appreciate the EBA’s close attention to the guidelines on ML/TF risk factors and we support its work in providing timely updates to these guidelines. We agree that it is important to take into account factors which foster greater convergence of supervisory practices in areas where supervisory effectiveness has been hampered by divergent approaches in the implementation of the same European

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<sup>1</sup> European Banking Authority, *Consultation Paper: Draft Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 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 (“The Risk Factors Guidelines”), amending Guidelines JC/2017/37*, February 5, 2020.

<sup>2</sup> For further information on these issues, please also see: IIF/Deloitte, *The Global Framework for Fighting Financial Crime: Enhancing Effectiveness and Improving Outcomes*, October 2019: <https://www.iif.com/Publications/ID/3606/The-Global-Framework-for-Fighting-Financial-Crime-Enhancing-Effectiveness-Improving-Outcomes>

<sup>3</sup> IIF, *RE: Communication from the Commission to the European Parliament and the Council towards better implementation of the European Union’s anti-money laundering and countering the financing of terrorism framework*, October 2019.

<sup>4</sup> The IIF also very much looks forward to providing comments on the European Union Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing, in which we will also reflect on a number of the issues raised in this letter: European Commission, *COMMUNICATION FROM THE COMMISSION on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing*, 7 May 2020.

legal requirements. A consistent approach to adoption of this guidance across member states will be imperative in this regard.

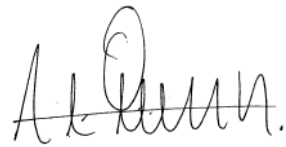
In order to constructively assist in the finalization of the guidelines, we are pleased to outline herein our reactions to amendments concerning both Title 1 (General Guidelines) and Title 2 (Sector Specific Guidelines) and we reflect on the questions raised in the Consultation. Though we understand the scope of the Consultation concerns specific updates, we also believe it is important to highlight issues that arise in other areas as well.

We are also pleased to offer our comments via the EBA's online questionnaire; however, we submit this letter in order to provide a more comprehensive review of the proposals along with supporting information which may not be easily referenced through the website feedback.

Generally, we believe the final guidance would benefit from a more even balance between the urgent need for further harmonization of standards across member states and the application of the risk based approach as set out by the Financial Action Task Force ("FATF"). We emphasize the need for having effectual guidance on ML/TF risk factors is also not an issue unique to the EU. It is important that all jurisdictions take into account the work of the FATF in this area and in particular the FATF Recommendations and the FATF Risk Based Approach Guidance as it pertains to the relevant supervised sectors to ensure the maximum level of international consistency. This will also assist in ensuring the final guidelines contribute to a more effective and uniformly implemented framework for risk mitigation across the Union and at the international level.

The IIF looks forward to working with you on these important issues. If you have any questions, please contact me or Matthew Ekberg at [mekberg@iif.com](mailto:mekberg@iif.com).

Very truly yours,

A handwritten signature in black ink, appearing to read 'A. Portilla', with a stylized flourish at the end.

Andrés Portilla

## Revised Guidelines on Money Laundering/Terrorist Finance Risk Factors

### **Background:**

It is well recognized that given the legal architecture underpinning the AML/CFT framework of the EU, inconsistencies can arise in regard to application of rules across member states. As noted by the European Commission, minimum harmonization of rules at EU level coupled with the lack of integration of AML/CFT concerns in prudential supervision - especially in cross-border situations - has led to gaps in the oversight and enforcement regime.<sup>5</sup>

Therefore, guidelines which set out factors firms should consider when assessing the ML/TF risk and adjusting customer due diligence (“CDD”) commensurate to identified ML/TF risks is highly useful at Union level. It is also highly beneficial that these guidelines make clear that the risk-based approach outlined by the guidelines and the underlying EU Directive does not require the wholesale exiting of entire categories of customers irrespective of the ML/TF risk associated with individual business relationships or occasional transactions.

However, the IIF believes that reform in certain areas of the guidelines considered in the Consultation may move them in a direction which becomes more prescriptive rather than relying on the risk based approach taken by the FATF Recommendations. As such, we highlight herein a few key areas for consideration in the finalization of the guidance: 1. Issues for High Risk Third Countries and Enhanced Due Diligence; 2. Issues for the Guidelines on Risk Assessment; 3. Issues in Customer Due Diligence Measures; 4. Reviewing Effectiveness; and 5. Sector Specific Guidelines for Account Information and Payment Initiation Service Providers and Correspondent Banking. As noted earlier, we also raise some issues outside the scope of the Consultation revisions which we consider important for possible reconsideration.

We emphasize that greater harmonization of EU standards through these guidelines is not mutually exclusive from consideration of greater alignment of the guidelines with the FATF risk-based approach. Indeed, international and Union level harmonization of standards in line with the FATF Recommendations will benefit cross-border efforts to detect and prevent criminal activity in the global financial system.

### **Key Issues for Consideration:**

#### *1. High Risk Third Countries and Enhanced Due Diligence*

We note that the definition of ‘jurisdictions associated with higher ML/TF risk’ has been modified so as to exclude high risk third countries, given that Anti-Money Laundering Directive V (“AMLD5”) will require specific Enhanced Due Diligence (“EDD”) measures to be applied to them. The EBA notes that this amendment is aimed at better distinguishing those countries from the jurisdictions associated with higher ML/TF risks. We also note that with regard to high risk third countries and other high risk situations, the paragraphs of the original Risk Factors Guidelines on ‘high risk third countries and other high risk situations’ (paragraphs 58 to 61) have been split into two different sub-sections; one dedicated to ‘high risk third countries’ and the other one to ‘other high risk situations’ so as to clarify the respecting obligations.

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<sup>5</sup> European Commission, *Communication: Towards a better implementation of the EU's anti-money laundering and countering the financing of terrorism framework*, July 2019.

The IIF believes that the EBA guidelines take a more prescriptive, rules-based approach to EDD in this area and the final guidance should reflect more cogently upon the risk-based approach for EDD as outlined in the FATF Recommendations. The FATF makes clear that the risk-based approach ensures that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified.<sup>6</sup> This approach should be an essential foundation to efficient allocation of resources across the AML/CFT regime.

Specifically, it should be clear that financial institutions should apply enhanced due diligence measures to business relationships and transactions with natural and legal persons, and financial institutions, from countries for which this is called for by the FATF (and, in this circumstance, where required by the Union). The type of EDD measures applied should be effective and proportionate to the risks and in line with FATF Recommendation 19.

EDD under the guidelines should also be commensurate with the FATF Recommendations Interpretative Note 10, para 20. As such, financial institutions should examine, as far as reasonably possible, the background and purpose of all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or lawful purpose. Where the risks of money laundering or terrorist financing are higher, financial institutions should conduct enhanced CDD measures, consistent with the risks identified.

We believe that better alignment of the definitions and the guidelines with the FATF Recommendations would ultimately benefit both international consistency in the determination of EDD in this area and the efficacy of the approach taken by supervisors and financial institutions.

We also note that section 4.46 of the Guidelines suggests that certain situations must always be treated as high risk. We believe this to be generally disproportionate to the risk-based approach, as the underlying EU rules merely require EDD to be completed, not that the customer to be treated as high risk. Such measures may unnecessarily shift the focus away from actual risk to a more prescriptive methodology.

## *2. Guidelines on Risk Assessment*

The IIF believes it is very important that the final guidance supports the ability of financial institutions to manage risk arising from ML/TF in an effective manner. As such, we believe the EBA should reflect the aspects of risk assessment in line with the risk based approach and the FATF Recommendations on customer due diligence and risk assessment. In particular, we encourage the final guidelines to foster a more common industry approach to identifying, addressing and managing customer and third-party risk through the principles of 1. identifying/verifying customer identity; 2. beneficial ownership identification and verification; 3. appropriate risk based screening; 4. ongoing due diligence; 5. enhanced due diligence as required in line with risks identified; and 6. documentation and record keeping.

The final guidelines should reflect where possible this approach in line with FATF Recommendation 10 to ensure international consistency and, importantly, consistency in approach across member states. This will also alleviate issues which may arise in the guidance whereby they may reflect a more prescriptive rather than risk-based approach to risk assessment. Finally, the guidelines should leave room for financial institutions to set their own risk tolerance in line with their business judgment.

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<sup>6</sup> FATF, *The FATF Recommendations*, Updated June 2019

### 3. Customer Due Diligence Measures

The Consultation outlines changes to the guideline's CDD measures in terms of, *inter alia*, beneficial ownership, digital identification, politically exposed persons ("PEPs") and transaction monitoring. We agree that the guidelines should be kept current especially in areas where there has been a lack of consistent application of EU or international standards and in areas of technological innovation. These issues in particular reflect the need for regularity in a Union approach aligned with international standards; however, we recommend consideration of the following in relation to the final guidance:

*First*, we see changes to Guidelines 4.12 to 4.25 clarifying the CDD expectations regarding beneficial owners as important. We believe, however, that the final guidance should reflect more upon addressing the weaknesses in transparency, reliability and access to information in public registers and ensuring information in beneficial ownership registries is up-to-date and accurate. While further legislative efforts may be required in this area, the final guidelines would benefit from clearer discussion on how these registries are made more effective and reliable in line with the letter and spirit of the EU Directive and the FATF standards.

A broader question relates to the use of beneficial ownership registries for the purposes of CDD and the onus on financial institutions in this regard. Section 4.13 of the guidelines notes that "*Firms should be mindful that using information contained in beneficial ownership registers does not, of itself, fulfil their duty to take adequate and risk-sensitive measures to identify the beneficial owner and verify their identity.*" In line with a risk-based approach, we believe the information contained in the registers would generally be sufficient to satisfy at a minimum the 'identification' step, as that is critical purpose of such registers. There should, however, be an increased emphasis on requiring the legal entities *themselves* to be more forthcoming in a verifiable, public way to satisfy CDD requirements. Independent, public and reliable registries should be encouraged, actively policed and backed by governments as a reliable source of due diligence information. Governments should stand by the contextual reference data they provide, ensuring it is a source upon which the regulated sector can rely both practically and legally. This approach is more likely to support consistency of information available to both financial institutions and government authorities, as well as help contain compliance costs that are factored into the commercial decisions that impact financial inclusion.

A wider issue that should also be considered when reviewing these guidelines is that although no FATF recommendation - nor any provision of EU AML Directives - requires banks to conduct Know Your Customer ("KYC") checks on beneficial owners, CDD measures requested by these guidelines are the same for customers and for beneficial owners. This can put financial institutions in a difficult situation as they cannot always obtain such information on beneficial owners and they are supposed to terminate or refuse entering into relationship if the appropriate level of CDD measures is not met.

In addition, it would be helpful for the EBA to reflect more extensively upon the use of Legal Entity Identifiers ("LEI") to enhance methods and tools for transparency. The LEI provides for the unambiguous identification of legal entities and could be very effectively leveraged by law enforcement and regulators in identifying the actual entity that owns a structure or in monitoring of activity. Incorporating further use of LEI into beneficial ownership registries as a required field and encouraging its use would aid in securing further reliable information on overall control and enhance customer due diligence generally.

*Second*, it is very important that Guidelines 4.32 to 4.37 deal with the use of innovative technological means to verify identity so as to promote convergence among firms. Technological innovation is moving rapidly across the finance industry and particularly in the areas of financial crime risk management and compliance. Digital Identities have great potential in expanding access to finance, improving risk management, and driving broader digital transformation of financial services.

The EBA should ensure that the recently issued FATF guidance on Digital Identity is properly reflected in the final guidelines to ensure they are in line with the approach addressed at the international level.<sup>7</sup> Internationally aligned measures such as this will assist joint public and private sector efforts in identifying areas of digital identity which contribute to AML/CFT regimes, while at the same time enhancing financial inclusion.<sup>8</sup> Given the ongoing Covid-19 crisis situation, there will be a growing need for electronic means of customer onboarding and maintenance and we believe the final guidelines should properly assist with the enhanced use of Digital ID as far as practicably possible.<sup>9</sup>

*Third*, Guideline 4.49 provides guidance to firms that use commercially available PEP lists on ensuring that information on these lists is up to date and that they understand the limitations of those lists. We believe, however, that when the onus of validating information on commercially available PEP lists falls to the private sector, the guidance should refer to the fact that the limitations in commercially available lists are often driven by regulatory divergence and lack of common definitions when dealing with public sector PEP identification across jurisdictions. Again, international consistency is important in this regard and the guidelines should reflect current limitations.

*Fourth*, we believe there is a lack of evidential support which shows real time AML transaction monitoring indicated in Guideline 4.74 will improve AML coverage or has shown it would have prevented previously identified ML or TF related activity. There is a dearth of justification to substantiate the significant changes the guidelines would require to transaction processing systems and remote channel customer platforms. Most importantly, it does not take into account the impact it would have on the customers of financial institutions.

The vast majority of automated AML transaction monitoring tools are not designed to allow for real time monitoring. They are instead tools that look for patterns of transactional behavior, utilizing scenarios/rules with applied look-back periods determined by the related AML red flag/typology. To implement real time AML transaction monitoring would require significant re-tooling of the automated platforms and impact legitimate flows, delaying payments and potentially removing access to financial services for participants if the resource burden of processing their transactions makes the relationships unviable.

Further, in most cases, looking at a single transaction without the context provided by a more holistic review of a customer's behavior over time will not give a reliable indication of whether the activity is suspicious. This is accomplished by looking at the related customer's activity, sometimes over extended periods of time. Financial institutions already apply real time monitoring (*e.g.*, fraud) requiring customer confirmation, which customers accept because there is a perceived benefit. AML transaction monitoring

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<sup>7</sup> FATF, *Guidance on Digital Identity*, March 2020.

<sup>8</sup> IIF, *Digital IDs in Financial Services Part 1: Embedding in AML Frameworks*, August 2019: [https://www.iif.com/Portals/0/Files/content/Innovation/08272019\\_iif\\_digital\\_id\\_part\\_1.pdf](https://www.iif.com/Portals/0/Files/content/Innovation/08272019_iif_digital_id_part_1.pdf).

<sup>9</sup> We note that the FATF has called on countries to explore using digital identity, as appropriate, to aid financial transactions while managing ML/TF risks during the COVID-19 crisis. FATF, *FATF COVID-19 Statement*, April 1, 2020.

has a high level of false positives, so delaying their transactions would be problematic and possibly result in unintended financial exclusion that could lead customers towards other, less regulated payment methods. Financial institutions will likely have to delay customer transactions/payments related to real time AML transaction monitoring alerts to comply with the rules as interpreted in these Guidelines. As a result, they will have much shorter timeframes to resolve these alerts, increasing the compliance risk.

As indicated, real time monitoring may be appropriate when it is more precisely targeted, including to protect vulnerable customers against fraud. However, any further expansion of this into AML transaction monitoring should involve financial institutions in an assessment of the threat, expected reduction of AML risk and the potential impact of unintended consequences to evaluate its usefulness in improving AML risk mitigation.

#### 4. *Reviewing Effectiveness*

Guideline 7 references the requirement that banks should regularly review the effectiveness of their approach to AML/CFT and the Consultation proposes updating the guidelines to reflect consideration of an independent review on effectiveness where warranted. We would emphasize, however, that the scope of the consultative proposal in this area is not clear. There should be a greater focus in the final guidance on the specificity of this requirement, the rationale for engaging an independent review and what type of review that would entail.

We also note that as this guidance is designed for common understanding by both firms and competent authorities across the EU, there is scope for ensuring the concomitant effectiveness of member state supervisory communication with regulated entities in order to increase effectiveness for both the public and private sector financial crime risk management frameworks.

EBA guidance should be directed where possible at improved information sharing between Financial Intelligence Units, law enforcement and the private sector as a means of measuring effectiveness. In the longer term, legislative action will be required to fully integrate information sharing bank-to-bank, government-to-bank, and enterprise wide for financial institutions.<sup>10</sup> However, incorporating an expectation of increased information sharing as a means of measuring effectiveness in AML/CFT compliance would be a beneficial step for the final guidelines.

#### 5. *Sector Specific Guidelines*

##### a. *Guideline 8 for correspondent banks*

We note that 8.17 c of the draft guidelines states that correspondent should consider on-site visits and/or sample testing to be satisfied that the correspondent's AML policies and procedures are implemented effectively and that 8.24 states *"to discharge their obligation under art. 18a (1)c of Directive (EU)2015/849, correspondents should apply guideline 8.17 (c) c and take care to assess the adequacy of the respondent's policies and procedures to establish their customers' source of funds and source of wealth and carrying out on-site visits or sample-checks...."*

We would suggest that in reference to this aspect of the guidelines correspondent banks should refrain from on-site visits and sample-checking which stand against the confidentiality of business. Single sample

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<sup>10</sup> IIF, RE: *Communication from the Commission to the European Parliament and the Council towards better implementation of the European Union's anti-money laundering and countering the financing of terrorism framework*, p. 4-5, October 2019.

testing will also not be sufficient for assurance that procedures are effectively implemented. This is foremost the duty of internal audit and supervisors.

b. Guideline 18 on account information and payment initiation service providers

In the additional sector specific guideline 18, it is mentioned that with reference to payment initiation service providers (“PISPs”) and the account information service providers (“AISPs”) that although being obliged entities under the AML directive (EU 2015/849), the inherent ML/TF risk associated with them is limited. We note, however, that regulators within the EU have a different opinion as to what an AISP and the PISP should do to comply with the law. Some have even excluded these service providers from their obligation. A level playing field for all companies within the Union is important. We stress that through these guidelines all regulators should harmonize their obligations towards these institutions.

In 18.4 the EBA obliges the PISPs and the AISPs to monitor the transactions of the customers. In principal an AISP has more information about the client due to the fact that they receive account information from different banks. However, the monitoring of this information is a challenge because of the following reasons:

1. Account information is not the same as payment transaction data - necessary fields for monitoring effectively are missing or combined in one field;
2. Not all ASPSPs structure (the content of) data fields in the APIs in the same way;
3. Not all ASPSPs send the same amount of data - generally some may share three months of data, some nine months and others a year.

Without more harmonization and standardization of the data of the API, the obligation to monitor the account information is not effective and is therefore not useful for the fight against economic crime.

Lastly, under 18.4.c. it is stated that when assessing ML/TF risks, PISPs and AISPs should take into account the following factors as potentially contributing to increased risk “.....*customer receives funds from, or sends funds to, jurisdictions associated with higher ML/TF risk or to someone with known links to those jurisdictions.*”

The last part of 18.4.c could lead to confusion, because the terms “*known links*” is so equivocal that every large company with activities in high risk countries could be flagged. We would suggest removing this reference.