AFME response to JMLSG guidance revision – Part I Chapters 4, 5 and 7 and Part III Chapter 3

3 April 2020

The Association for Financial Markets in Europe (AFME)[1] is pleased to respond to the Joint Money Laundering Steering Group (JMLSG) guidance revision to Part I Chapters 4, 5 and 7, Part III Chapter 3[2]. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

Please see below our detailed comments to the proposed revisions in Part I Chapters 4, 5 and 7, and Part III Chapter 3.

Chapter 4: Risk based approach

Annex II: IV Delivery channel risk factors

We note that the below paragraph has been added in Annex II: IV *delivery channel risk factors*.

We think it would make more sense to add it under Annex II: III *products, services and transactions risk factors*. Could JMLSG consider this change?

Is there a transaction related to oil, arms, precious metals, tobacco products, cultural artefacts, ivory and other items related to protected species (*), and other items of archaeological, historical, cultural and religious significance, or of rare scientific value, where the ML/TF risk is raised? (*) Protected species: illegal wildlife trade can be defined as the illegal hunting, poaching, taking, possession, sales, transport, smuggling, trade or trafficking of CITES designated species and/or other protected wildlife, including their parts and products, according to specific national laws or international treaties.

Here are some additional comments to the quoted paragraph in Annex II.

Risk based measures: We note that it is not risk based or operationally feasible for any firm to review every inbound/outbound transaction/payment it processes in relation to the stated commodities/products.

Therefore, AFME would welcome if JMLSG could provide more guidance in respect of the risks that firms should consider when dealing with transactions involving commodities/products stated in Annex II so that appropriate risk based measures can be adopted by firms.

We would also welcome further guidance in relation to risk factors in different commercial contexts, for example:

[1] AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

[2] https://jmlsg.org.uk/consultations/consultation/

- an occasional transaction;
- trade finance transactions as part of an ongoing business relationship;
- open-account payment activities of customers known to have their expected business activities as traders of the respective commodities/items (e.g. oil) and;
- open account payment activities of customers which do not have their expected business activities as traders of the respective commodities/items, but which may make a one-off purchase/sale of the commodities/items.

ECDD measures: We ask JMLSG to clarify how a *transaction related* to products characterised by risk factors can be identified in the context of a customer-relationship in order to satisfy ECDD requirements.

We believe that adding detection scenarios in the transaction monitoring or surveillance systems would generate an increased number of false positive hits. This approach would further distract front line units from the real risk. We recommend that JMLSG clarifies in the guidance that the increased control on transactions and possible EDD measures could be achieved via identifying sectoral red flags for each sector, which can be subsequently embedded in the design and delivery of training to front line units.

With regard to *transactions related* to the named commodity/product and due to visibility limitations, AFME notes that a firm is not always able to identify every possible payment where a non-customer 3rd party transacting counterparty has certain elements of their-own business activities involved in any of the listed commodities/items. This is due to identification and verification of business activities being a customer-centric requirement and not required of all third party counterparties (either buyers and/or sellers of such commodities/items) under the ML regulations.

Additional questions:

- Could JMLSG explain whether the risk assessment, which allows to assess the nature of each transaction, should be performed on a transactional basis irrespective of the client's business activity? Our view is that this approach would not always be risk-based.

- Could JMLSG clarify that the purpose of the wording *where the ML/TF risk is raised* means that a transaction related to commodities/products will only be considered high risk when additional ML/TF risks are raised? And add some examples?

- We believe that since *oil* has no regulatory definition it could be extrapolated in application to *olive oil* or any other oil based products which we think is not the purpose of this paragraph.

  JMLSG is asked to provide a clear definition of *oil* in the context of commodity-based tradable crude oil and refined derivatives.

- We would also welcome a clear definition of *cultural artefacts, items of rare scientific value* and *precious metals*. Could JMLSG make cross reference to the appropriate FATF reports?

- We would like to request that JMLSG provides more clarity and guidance on the scope of the transactions related to:

  - *Oil.* Would this include extraction, refining and/or distribution of oil?
  - *Tobacco:* Would this include planting, manufacturing of wholesale and retail tobacco products?

Chapter 5: Customer due diligence

Regulation 5(1)(3) Paragraph 5.3.9

We think that the definition of beneficial owners (BO) referenced in paragraph 5.3.9 (and elsewhere in the JMLSG guidance e.g. Paragraph 5.3.170) should include a word *ultimately*, for example:

Paragraph 5.3.9 "The ML Regulations define beneficial owners as individuals who <u>ultimately</u> own or control more than 25% of body corporates (…)" (with our underlining).

Regulation 27(8)(zb) Paragraph 5.3.17

We request that JMLSG provides some clarification in relation to the CDD measures that firms must apply when they have to fulfil any duty under the International Tax Compliance Regulations 2015 (e.g. FATCA, CRS, DAC2).

- We note that tax compliance obligations also permit firms to meet due diligence obligations through alternative documentation (i.e. leveraging AML/CDD information/documentation). In such circumstances *contacting clients* is not necessarily required.

  Due to this, we understand that the CDD Review obligation does not apply when a firm meets its tax obligations without contacting the client. Can JMLSG please confirm?

- We would like to understand whether CDD will be required for a pre-existing client which has never been classified under FATCA/CRS (e.g. because they have never held a financial account).

- We would like to understand how UK based firms should apply the FATCA form expiry to their U.S. offices who as U.S. withholding agents are required to refresh their U.S. Tax forms every 3 years for overseas clients. We wonder whether this rule requires the UK firms to also undertake a periodic review every 3 years.

- AFME advises JMSLG to add the following statement at the end of Paragraph 5.3.17 in order to avoid any confusion.

  Aside from obligations under International Tax Compliance Regulations 2015 and the Money Laundering & Terrorist Financing (Amendment) Regulations 2019, there are no other legal duties to apply CDD measures under UK law.

Regulation 33(1) Paragraph 5.5.9

We suggest that JMLSG adds a word *or* between the second and third bullet points in Paragraph 5.5.9 as follows (with our underlining):

Regulation 33(1) Paragraph 5.5.9

- *in any case where:*
  - *a transaction is complex or unusually large; or there is an unusual pattern of transactions, or*
  - *the transaction or transactions have no apparent economic or legal purpose; <u>or</u>*

- *in any case which by its nature presents a higher risk of money laundering or terrorist financing.*

Moreover, we believe that JMLSG should further elaborate on the definition of *complex* transactions as noted under the first bullet point of the above mentioned paragraph.

We note that wholesale markets and other corporate/institutional transactions are often defined as *complex* from a structural perspective. This does not mean that every business relationship requires ECDD and/or constitutes a higher risk from money laundering or terrorist financing perspective.

In addition, Annex 5-IV on unusual transactions should be changed in line with the proposed changes in Regulation 33(1) Paragraph 5.5.9.

Regulation 30(A)1 Paragraph 5.3.129A

Regulation 30A(1) 5.3.129A requires firms to *obtain proof of registration or an excerpt of the register of the company, unregistered company or the limited liability partnership (…)* in order to report discrepancies in registers.

We note that this requirement is only relevant when onboarding UK entities.

JMLSG is asked to consider the following questions in respect of Regulation 30A(1) 5.3.129A:

- We wonder whether this obligation extends to foreign subsidiaries of UK regulated entities.

- We wonder whether the definition of *entities* can be aligned with Companies House guidance meaning *company, limited liability partnership, or Scottish limited or qualifying partnership*.

- We note that reporting PSC beneficial ownership discrepancies in line with Regulation 3(A)(1) will be impossible as obtaining a company overview extract (PDF) of the register will not feature PSC information.

  We would therefore welcome if JMLSG could clarify that firms must obtain the PSC register and then report discrepancies on that basis.

- We wonder whether a download from a Third Party Provider can be used to satisfy this requirement.

- Can JMLSG clarify the obligations for Intermediary holding companies in the client's structure in terms of checking the PSC register?

- Can JMLSG address the case where reliance is being used to satisfy Reg 28 i.e. does the need to perform a PSC check be addressed via reliance?

- Confirmation Statements vs PSC: Does reconciling Conformation Statement information from Companies House against the PSC register at Companies House achieve the intended outcome of the regulation?

  We note that in such situation Companies House will be informed of differences between the data that they already hold i.e. Confirmation Statement versus PSC (please also note that a Confirmation

Statement is only filed annually, whereas PSC changes should be updated within 30 days of any change).

Regulation 28(3) Paragraphs 5.3.151 and 5.3.152

We would welcome if JMLSG could clarify whether information from Companies House and/or the PSC register has to be provided in order to satisfy the application of customer due diligence measures under Paragraphs 5.3.151 and 5.3.152.

Reg 28 (3A): can JMLSG clarify that the 'listed companies exemption' applies?

Regulation 5 Regulation 28(3)(9) Regulation 28(3A) Regulation 28(8)(b) Paragraph 5.3.170

Can JMLSG provide more guidance in respect of record keeping of difficulties in identifying UBOs.

We wonder whether a risk based approach can be taken around how the notional UBO needs to be verified.

Regulation 33(3) Paragraph 5.5.11

We request that the correct link referring to the High Risk Third Countries (HRTC) is inserted in the guidance.

In our view, the definition of *established in* seems to be incomplete. Therefore, we propose to add the following wording (underlined).

Being 'established in' a country for a legal person means being incorporated in or having its principal place of business in that country, for a financial or credit institution it means having its principal regulatory authority in that country, or for an individual it means being resident in that country (not just being born there).

We note that Regulation 33(3) Paragraph 5.5.11 reads (with our underlining): *In any business relationship with a person established in a high risk third country or in relation to any relevant transaction where either party is established in a high risk third country, EDD measures must include obtaining:*

- *additional information on the customer and their beneficial owner;*
- *additional information on the intended nature of the business relationship;*
- *information of the source of funds and source of wealth of the customer and their beneficial owners;*
- *information on the reasons for the transactions;*
- *approval of senior management for establishing and continuing the business relationship;*
- *conducting enhanced monitoring of the business relationship by increasing the number and timing of controls, and selecting patterns of transactions that need further examination.*

We would like to understand what *additional information* means in this context.

In our view ECDD requirements will contextually differ in practice when the customer is a corporate vs a financial institution (principal-to-principal business only). Therefore, AFME would welcome more clarity in respect of practical application of each ECDD measure in this context.

We request that JMLSG clarifies what would constitute *information on the reasons for transaction*.

We ask JMLSG to clarify that the approval of the Money Laundering Reporting Officer (MLRO) (including nominated deputy) would constitute the *approval of senior management for establishing and continuing the business relationship.*

In addition, we would like to understand whether the enhanced monitoring indicates enhanced post-transaction monitoring calibration/approach or where *controls* are mentioned, independent quality assurance controls.

Regulation 43 Paragraph 5.3.144

We note the under Paragraph 5.3.144 *UK body corporates must inform the firm with which they have a business relationship of any change to the above information within 14 days of becoming aware of the change.*

We would like to understand how the 14 day notification requirement for UK corporates to inform firms of CDD changes can be enforced.

Chapter 7 Staff awareness, training and alertness

Regulation 24(1) Paragraph 7.11

We note that Paragraph 7.11 reads (with our underlining): *The ML Regulations require firms to take appropriate measures to ensure that relevant employees and agents are made aware of the law relating to money laundering and terrorist financing.*

We would like to ask for more guidance on what *appropriate measures* in this context mean.

Can JMSLG explain who the *agents* in this context are?

Part III: 3 Equivalent markets

Paragraph 3.1

Under paragraph 3.1 we read: '*Equivalence' may also be considered under Regulation 18.5 which permits certain CDD derogations for customers whose securities are listed on equivalent markets.*

We wonder whether the right reference to Regulation 18.5 is made as it does not seem to be related to equivalent markets and rather risk assessment. Can JMLSG cross-check this?

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