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SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Eurofinas observations on the Commission's Proposal for a Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (COM(2013) 45 final)

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ABOUT EUROFINAS

Eurofinas, the European Federation of Finance House Associations, is the voice of the specialised consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent finance houses, universal banks, specialised banks and captive finance companies of car, equipment, etc. manufacturers. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. Consumer credit facilitates access to assets and services as diverse as cars, education, furniture, electronic appliances, etc. It is estimated that together Eurofinas members financed over 326 billion Euros worth of new loans during 2011 with outstandings reaching 815 billion Euros at the end of the year.

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INTRODUCTORY OBSERVATIONS

Eurofinas, the voice of consumer credit providers at European level, takes note of the publication of the European Commission's Proposal for a 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 (COM(2012) 45 final) (4th AML Directive).[1]

The Commission's Proposal aligns the European rules to the revised Financial Action Task Force (FATF) Recommendations, adopted in February 2012. During the past decade, the European financial industry has invested considerable resources in measures concerning anti-money laundering (AML), combat of terrorist financing (CFT) and prevention of financial crime. Financial institutions are obliged to have special dedicated staff. This ensures that all business units comply with regulations and are well trained to recognise risks of money laundering.

APPLICATION TO THE CONSUMER CREDIT INDUSTRY

Consumer credit providers active in Europe fall within the scope of the 3rd Anti-money Laundering Directive[2] and Commission Directive 2006/70/EC.[3] Where consumer credit providers come under the scope of these rules, three customer due diligence (CDD) scenarios can apply:

1. Regular CDD requirements;
2. Simplified CDD requirements (in situations of little risk when certain provisions under Articles 11 and 12 of the 3rd AML Directive, as clarified by its recitals and Articles 3 and 4 of the Implementing Measures, become relevant);
3. Enhanced CDD requirements (in situations, which by their nature can present a higher risk of money laundering or terrorist financing under Article 13 of the 3rd AML Directive).

In addition to the above, where there is a suspicion of money laundering or terrorist financing, CDD measures apply, regardless of any derogation or exemptions contained in the 3rd AML Directive or its Implementing Measures.

The Eurofinas observations and concerns on the Commission Proposal for a 4th AML Directive should be read in light of the specificities of the industry as well as the response of the Federation to the European Commission consultation on the Report to the European Parliament and the Council on the application of Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (COM(2012) 168 final).[4]

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[1] *Proposal for a 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, COM(2013) 45final*

[2] *Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, 25.11.2005, OJ L 309/15*

[3] *Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of 'politically exposed person' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis, 4.8.2006, OJ L 214/29.*

[4] *Eurofinas response to the Commission consultation on the Report on the Application of the 3rd Anti-Money Laundering Directive (COM(2012) 168 final), available here: http://www.eurofinas.org/uploads/documents/positions/Eurofinas%20response%20-%20application%20report%20-%20final.pdf*

SPECIFIC OBSERVATIONS

1. Scope and definitions– Article 3

The Commission's Proposal introduces an explicit reference to tax crimes, as a serious crime which falls within the scope of the definition of "criminal activity".

Eurofinas welcomes that serious tax crimes have been included in the proposed 4th AML Directive as a special category of "serious crimes" in line with the revised FATF Recommendations. However, we would like to warn against any potential extension of the list of predicate offences to "low level offences", which creates an additional administrative burden and associated high costs for the industry. Therefore, a clear definition of the offence/crime is crucial for the efficient functioning of financial institutions' AML/CFT compliance procedures and operations.

2. Risk Assessment – Article 6-8

The Commission's Proposal provides that the European Supervisory Authorities (ESAs), the Member States and the obliged entities shall carry out assessments of the money laundering/terrorist financing (ML/TF) risks facing them.

Eurofinas recognises the importance for the industry of the risk based approach as a cornerstone of the 3rd AML Directive. We welcome the provisions obliging the Member States to carry out national risk assessments, as these may become valuable tools for financial institutions operating in that market.

3. Role of the European Supervisory Authorities

Opinion on risks affecting the internal market – Article 6

The European Commission envisages empowering the ESAs to adopt an opinion on ML/TF risks affecting the internal market within 2 years from the adoption of the 4th AML Directive.

The ESA opinion may, given that the ESAs have 2 years to develop this text, conflict with the risk assessment work carried out in the meantime by the Member States (see above).

As the Proposal only provides for an opinion to be provided by the ESAs in the area of financial services, this contradicts with the approach taken by the Commission to ensure that a wide range of activities, such as the non-financial professions, gambling, etc., should fall within the scope.

Guidelines on risk factors – Articles 15 - 16

The Commission Proposal furthermore provides that the ESAs should develop guidelines on risk factors, in particular for simplified and enhanced due diligence.

Eurofinas is of the opinion that the tasks to be conferred to the ESAs should not lead to any regulatory overlap and unnecessary duplication of successful national standard setting. Indeed, in many Member States guidelines are already in place[5] and new guidelines may therefore not provide added value or even conflict with existing mechanisms which function well.

The relationship between the to-be-developed ESAs guidelines and the Annexes provided in the Proposal, which also outline risk factors is unclear and introduces the potential for contradicting requirements. It is crucial that any such guidelines, and equally the indictors set out in the Annexes, will remain examples rather than be enforced as compulsory indicators.

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[5] *Such as the Joint Money Laundering Steering Group – Guidance for the UK Financial Sector in the United Kingdom, available here: http://www.jmlsg.org.uk/industry-guidance/article/part-i-part-ii-part-iii-and-treasury-ministal-approval.*

4. Customer Due Diligence (CDD)

General remarks

The banking industry, supervisory authorities and law enforcement officials have historically considered consumer credit transactions as posing a lower risk of money laundering compared to most other financial products and services. The sophisticated application screening and fraud monitoring systems employed in relation to consumer credit products combined with restrictions on cash payments, cash access and credit balances, make them less effective as a vehicle for money laundering.

Using credit cards as an example, the nature of the product itself creates certain "structural" controls/restrictions at the 'placement' and 'integration' stages of the money laundering lifecycle (e.g. i) credit line facilities generally limit the amount of money that can be accessed by account holders; ii) there are similar limitations on the ability of a card holder to insert cash (e.g. through repayments) into the financial system; and iii) settlement payments by card holders are generally required to be denominated in local currency, and therefore the funds used to make loan payments will already have been placed into the local regulated banking system before reaching the credit provider)[6].

Another basic reason why consumer credit transactions show a low risk of money laundering is due to the payment methods used to repay a consumer credit loan. Generally speaking, loan repayments are debited from a current account at a financial institution subject to the provisions of the 3rd AML and its Implementing Measures.

This means that an applicant borrower has already been identified and customer due diligence (CDD) conducted on him/her by the financial institution holding their current account i) at the time the current account was opened and ii) as part of the financial institution's ongoing security checks. This ensures that when loan repayments are made in the future from a borrower's (usually current) account via a direct debit or standing order, as is commonly the case, the 'paper trail' for the loan repayments cannot be concealed. The origin of these repayments can thus be traced back without difficulty.

When a consumer credit provider then carries out its own CDD during the credit granting process, this is the second time that those checks are being made[7] on the applicant borrower. This means that a high level of CDD is built into any given consumer credit transaction, even in Member States where consumer credit providers can apply Simplified Due Diligence to consumer credit transactions.

Furthermore, as a customer is generally unlikely to have the option to repay the loan, or to settle the loan early, other than via their bank account (e.g. direct debit/standing order or national schemes such as the Bankers' Automated Clearing Service in the United Kingdom), it is extremely unlikely, if not impossible, for a criminal to launder money by repayment through a large cash deposit in favour of the credit provider. This fact in itself acts as a deterrent to criminals wanting to launder money in consumer credit transactions.

The status of consumer credit as a low risk transaction is evidenced by the low number of suspicious transaction reports.[8]

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[6] *Wolfsberg AML Guidance on Credit/Charge Card Issuing and Merchant Acquiring Activities*

[7] *As explained above, the first time CDD was carried out it was by the applicant borrower's own bank (i.e. the financial institution holding the applicant borrower's current account).*

[8] *In Germany, between 30 June 2002 and 1 January 2007, a survey on suspicious transactions was carried out by the Bankenfachverband, Eurofinas' German member association. During this period, automotive captive banks, corporate and private banks had an average loan portfolio monitored of 7,823,600 credit agreements with private customers and 1,823,600 credit agreements with companies or self-employed persons. Of these 9,647,200 monitored transactions there were only 16 transactions classified as suspicious. 4 out of these 16 reported suspicious transactions regarded fraud against a financial institution and the suspicion for AML purposes was precautionary only. Hence only 0.0001% of these credit agreements studied in Germany over a five and a half year period were held to be suspicious transactions (and even then these were only classified as precautionary for AML purposes).*

Rules applicable to consumer credit

Eurofinas regrets that consumer credit has not, as was the case in the Implementing Measures to the 3rd AML Directive, been explicitly recognised as a low risk transaction for AML purposes. In particular in Member States where this was also explicitly transposed and providers were able to apply simplified due diligence measures, it is now unclear what rules providers should apply. **There is no evidence supporting this change.**

In light of the characteristics of consumer credit, Eurofinas would like to stress that in future anti-money laundering legislation a differentiated regulatory approach should remain with regard to customer due diligence and the risk level of a product. This is the only way to ensure that the CDD regime in place is proportional, both on the institutions that implement the measures as well as on their customers who have to provide documents and data when applying for consumer credit.

Given the inherently low money laundering risk of consumer credit products, their main features should be included as indicators in any risk factors outlined, such as in the Annex to the Proposal. Such indicators could include:

- That the financial product aims at financing physical assets or specific services;
- Where the financial product does not aim at financing a physical asset or specific service, that the financial product concerns low value consumer credit[9]; and
- Repayment is conducted through a bank account in the name of the customer who took out the consumer credit.

Listing examples of ML/TF risk factors in the Annexes carry the risk of regulators developing static indicators. It is, therefore, important that they remain indicative examples and are not generalised. In addition, their use as indicators should not be prescribed on a compulsory basis and they would be better placed in (national) industry guidance.

These lists also do not take into account the risks faced by different sectors, especially those faced by smaller or specialised credit or financial institutions with less risky business models.

Enhanced CDD

Eurofinas agrees with the European Commission that obliged entities should take enhanced measures where risks are demonstrated to be greater. However, we regret that the approach taken to enhanced CDD, does not take into account the different levels of risk for money laundering and terrorist financing that exist depending on various financial products.

For example, regulation of non face-to-face transactions should be minimised where the product in question is inherently low risk, such as consumer loans. The fact that the application stage for a distance contract for consumer credit is typically a non-face-to-face process does not, by itself, mean that this stage is “high risk”. Rather, it means that a credit provider must fully evaluate its risk assessment procedures (most notably the non-documentary identity verification alternatives) to address potential risks.

A prescriptive regulatory approach limits a credit provider’s possibilities to use flexible and dynamic methods to assess the risks identified at this stage of the credit lifecycle. These risk assessment methods are a necessary part of a true risk-based approach for AML compliance.

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[9] In 2011, the average loan for personal consumption amounted to 3,735 EUR (excl. revolving credit. Eurofinas 2011 Annual Statistics). Low value could thus be interpreted as below 5,000EUR. However, in some Member States national regulators have set the threshold for “low value consumer credit” at 15,000EUR (DK), following the threshold set out in Article 3(3) of Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC. Market characteristics may thus influence what is understood under this concept.

5. Politically Exposed Persons (PEPs)

The Proposal for a 4th AML Directive expands the provisions dealing with PEPs to include domestic PEPs as well as PEPs in international organisations.

Definitions – Article 3

Eurofinas welcomes the recognition of the EU as a single jurisdiction by providing that intra-EU PEPs can be treated as domestic PEPs.

However, with regard to PEPs working for international organisations, it has not been clarified that this applies to "***public*** international organisations". This clarification should be introduced to avoid that all companies operating abroad would fall under these provisions.

The definitions of 'family members' and 'close associates' are clear. The difficulty for lenders is how to assess the level of influence. The further the firm drills down, the more costly and burdensome the process becomes.

Customer Due Diligence – Article 18-19

Eurofinas recognises the money laundering risk that PEPs can pose. Any amendments to the existing politically exposed persons' rules should take into account the different levels of risk for money laundering and terrorist financing that exist between various financial products.

Regulation of PEPs should be minimised where the product in question is inherently low risk, such as consumer loans. Even when the consumer in question applying for a consumer loan has the capacity of a PEP, it is the character of the product that determines in practice that the risk for money laundering or terrorist financing is low.

Duration of Enhanced Due Diligence measures – Article 22

The Commission's Proposal extends the obligation to apply a risk-based approach to PEPs from 1 year after they have left office to 18 months. Eurofinas does not support such an extension, especially for intra-EU PEPs.

Information on PEPs

Given the increased burden, responsibility and risk for liability that the enlargement of the scope of the FATF Recommendations to domestic PEPs and PEPs in international organisations will entail for consumer credit providers, we would like to stress that appropriate measures are required to ensure that consumer credit providers can fulfill these obligations.

In order to effectively and efficiently detect PEPs, the industry needs to have objective ways and tools for determining whether someone is a PEP. We firmly believe that this objective can only be achieved through the establishment of one PEPs list, managed by public authorities. Currently the industry has to rely on costly, commercial lists.

In the absence of a public list, if financial institutions decide to use the services of commercial providers, it should be recognised that this ensures an adequate measure for PEP determination and therefore fulfills their CDD obligations. The 4th AML Directive should recognise this.

6. Beneficial Owner – Article 29-30

The definition of 'beneficial owner' is clear. However, businesses find it difficult to gauge the extent to which they should analyse potential beneficiaries at a secondary/tertiary etc level.

7. Group compliance – Article 42

The Commission proposes that Member States shall require obliged entities that are part of a group to implement group-wide policies and procedures, including data protection policies and policies and procedures for sharing information within the group for anti-money laundering and combating terrorist financing purposes.

Eurofinas fully supports an explicit reference in Article 42(7) to allow intra-group flows of information. This should be done in adherence to data protection requirements. It is indeed crucial for consumer credit providers to be able to process data on AML/CFT and financial crime risks and exchange information in an effective way.

The wording used is however vague, creating the risk that the new data protection framework or national laws would not allow such transfers, undermining the capabilities of financial institutions to detect money laundering and terrorist financing.

8. Data protection – Articles 39-41

Whilst the Proposal for a 4th AML Directive does introduce some clarifications with regard to the processing, storage and deletion of personal data, experience in practice shows that it is often difficult to be able to process customers' data with legal certainty. We therefore regret that the Commission has not gone further in its Proposals.

Financial institutions should be able to process personal data to allow them to fulfil their AML/CTF purposes.

9. Financial Intelligence Unit (FIU) feedback – Article 43

The Proposal requires that Member States shall ensure that, **wherever practicable**, timely feedback on the effectiveness of and follow- up to reports of suspected money laundering or terrorist financing is provided.

The Commission proposal falls short of a strengthening of the feedback clause and is non-committal. It should be amended to reflect a more binding obligation focusing on the aspect of a "timely and specific feedback to obliged entities on the effectiveness of and follow-up to reports of suspected money laundering and terrorist financing transactions".

10. Level of sanctions – Articles 55-58

The Proposal introduces severe administrative sanctions which supervisory authorities can impose on obliged entities. We feel that the sanctions should be proportionate to any breach of the provisions of the 4th AML Directive.

As a counterbalance to the sanctions, it is crucial that the obligations and duties of obliged entities are clear.