Eurofinas response to European Commission consultation on the Report on the Application of the 3rd Anti-Money Laundering Directive (COM(2012) 168 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 328 billion Euros worth of new loans during 2011 with outstandings reaching 821 billion Euros at the end of the year.

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INTRODUCTORY OBSERVATIONS

Eurofinas, the voice of specialized consumer credit providers at European level welcomes the opportunity to respond to the consultation on the Report from the Commission 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, hereafter: the Report).

SPECIFIC OBSERVATIONS

1. Applying a risk-based approach (RBA)

Eurofinas recognises the importance for the industry of the risk based approach as a cornerstone of the 3rd AML Directive.

Consultation of our members has shown that any issues that may arise in practice regarding the risk based approach do not stem from the Directive itself, but rather from national implementation and interpretation of the rules. We therefore do not feel that, at this stage, any introduction of additional rules on the risk based approach *per se* would be appropriate.

Difficulties that have arisen in national contexts could be resolved by principle-based guidelines on the application of the risk based approach for financial institutions, as have been developed in some Member States.[1] However, it is crucial that any such guidelines will remain examples and not, in practice, be enforced as indicators on a compulsory basis.

Eurofinas would not support the suggested granting to the Joint Committee of the European Supervisory Authorities' Sub Committee on Anti-Money Laundering the power to provide guidance on issues affecting financial sector supervision. As referred to above, many sectoral guidelines are in place and new guidelines may therefore not provide added value or even conflict with existing mechanisms which function well.

2. Scope

2.1 Serious crimes

The revised FATF Recommendations have included "tax crimes (related to direct taxes and indirect taxes)" as a predicate offence. The Federation considers that this represents an opportunity to clarify the scope of this concept, in particular with respect to income tax, VAT, benefits, etc. We would therefore be in favour of the introduction of a clear, workable concept of serious tax crimes to facilitate compliance with the legal framework.

2.2 Broadening the scope to other types of financial agents

The Commission notes in the Report that over the course of consultations with Member States, some respondents suggested that the scope of the 3rd AML Directive should be extended to all agents operating on behalf of financial institutions, given the suggestion that there may be AML risks linked to the activities of such agents. The Commission could therefore give consideration to reflecting the roles of agents either in their own right or within the obligations applied to financial institutions, in particular where they provide cross-border financial services.

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[1] *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.*

Eurofinas believes that a clear distinction must be made between entities that provide credit mediation to third parties for remuneration as their main activity (e.g. brokers, agents, etc.) and entities that practice credit mediation as an ancillary activity (i.e. dealers and retailers involved in the distribution of credit at the point of sale). Eurofinas believes that subjecting retailers and motor dealers to the same requirements as credit brokers would inhibit the supply of sustainable credit, particularly to those most in need.

Eurofinas firmly believes that should financial agents be included in the scope of the AML Directive, those intermediaries acting under the full responsibility of a financial institution should be exempted from the scope. This due to the specificities of the industry Eurofinas represents and the processes it has in place. Please find more information on Point of Sale finance, the selection of partners, the processes in place and compliance with rules in the Annex to this consultation response.

With regard to anti-money laundering legislation the intermediaries Eurofinas members work with act under the full responsibility of the lender, who does the required verifications and implements the necessary processes for fulfilling these obligations. This is however not the case for brokers and agents. Therefore, should financial agents be included in the scope of the AML Directive, those intermediaries acting under the full responsibility of a financial institution should be exempted from the scope.

3. Customer Due Diligence (CDD)

Firstly, we would like to remark that Eurofinas believes that the provision of consumer credit is fundamentally a low risk transaction for AML purposes. This is also evident in the Implementing Measures[2] to the 3rd AML Directive:

Extract of Recital 9 of Commission Directive 2006/70/EC

"It should be possible to apply simplified customer due diligence procedures to products and related transactions in limited circumstances, for example where the benefits of the financial product in question cannot generally be realised for the benefit of third parties and those benefits are only realisable in the long term, such as some investment insurance policies or savings products, or where the financial product aims at financing physical assets in the form of leasing agreements in which the legal and beneficial title of the underlying asset remains with the leasing company or in the form of low value consumer credit, provided the transactions are carried out through bank accounts and are below an appropriate threshold..."

What makes consumer credit a low risk product?

The banking industry, supervisory authorities and law enforcement officials have historically considered consumer credit transactions as posing a lower risk of money laundering compared with 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

[2] *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.*

payments will already have been placed into the local regulated banking system before reaching the credit provider)[3].

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.

CDD checks made by another financial institution, and conducted before any credit agreement has been made, ensure 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[4] 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.

Negligible levels of suspicious transactions over a five and a half year period

In Germany, between 30 June 2002 and 1 January 2007, a survey on suspicious transactions was carried out by the Bankenfachverband[5].

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).

[3] Wolfsberg AML Guidance on Credit/Charge Card Issuing and Merchant Acquiring Activities
[4] 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).
[5] Eurofinas' German Member Association, representing consumer credit providers in Germany.

3.1 Regular CDD

The Commission is considering harmonising the approach to identification and/or compiling a list of EU-wide recognised identity documents issued by Member States in order to facilitate customer identification/verification. Eurofinas would support such steps as this would greatly facilitate the identification by financial institutions, also in a cross-border context. A harmonised approach to identification would be particularly helpful for financial institutions.

However, a list of EU-wide recognised identity documents issued by the Member States should adhere to the following criteria:

- the list should only include existing documents issued by the Member States and not aim to harmonise or introduce any requirements for national identity documents;
- the list should be non-exhaustive, to allow Member States to adopt new documents as they see fit and to avoid that any identity documents in use at national level would not be "recognised" for anti-money laundering purpose because they do not feature on the list. It should be pointed out that a notification regime whereby the Member States notify the Commission of the documents in place could create legal uncertainty for financial institutions should any Member State fail to notify its documents to the Commission; and
- the list should only pertain to the identity documents in question, not the biometric data connected to the documents.

The Federation would also like to point out that any such list could prove ineffective if it does not address the issue of identification for distance sales. In some Member States, national digital solutions for e-identification are not recognised by the supervisory authorities for anti-money laundering purposes, making it impossible for customers with national identity documents to identify themselves in an online environment. This also entails that financial institutions are restricted in terms of innovation regarding the development of distribution channels.

Furthermore, we call on the Commission to take into account the work conducted by the Commission on eID and eSignature. In particular the Proposal for a Regulation adopted at the start of June 2012, which envisages ensuring cross-border legal recognition of electronic IDs, eSignatures and other electronic Authentication services in Europe.

3.2 Enhanced CDD

The Report states that: "a number of stakeholders have suggested that a more flexible approach could be applied as to when and which EDD measures need to be applied, commensurate to the risks that are being addressed. For example, some Member States have asked for reconsideration of the approach whereby non face-to-face situations are automatically classed as high risk, and to ensure that the Directive appropriately takes account of new payment methods/new technologies. Consideration could be given to an approach which incorporates the FATF revisions, looking at types of factors that ought to be considered (e.g. customer risk, geographical risk and product, service or delivery channel risk factors), whilst recognising that risk is variable and the factors should not be considered in isolation."

Eurofinas would fully support an approach to enhanced CDD which takes into account the different levels of risk for money laundering and terrorist financing that exist depending on the factors and between various financial products.

Regulation of non face-to-face transactions and also of PEPs, for example, should be minimised where the product in question is inherently low risk, such as consumer loans. Even when a consumer loan is concluded at a distance or 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 of that transaction is low.

What is more, the very classification of a distance contract for consumer credit (an inherently low AML risk product) as needing enhanced CDD should be re-examined. As explained earlier in this document, a consumer credit transaction is fundamentally low risk, regardless of the transaction type (face-to-face/online/telephone).

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. Under the current prescriptive enhanced CDD regime, consumer credit providers cannot take full advantage of a risk based approach to AML compliance.

3.3 Simplified Due Diligence

In the Report, the Commission indicates that the EU regime of simplified due diligence has come under criticism from the FATF as in some Member States' legislation, simplified due diligence appears to amount to a total exemption from CDD measures.

However, the arguments set out above have shown that even where Member States have implemented the 3rd AML Directive and its Implementing Measures designating consumer credit as a low risk product allowing financial institutions to apply the simplified due diligence regime, the identity of the customer is in practice always verified.

Consumer credit providers have to determine the identity of the client, prior to the establishment of any credit agreement, in order to fulfill their legal obligation to assess the creditworthiness of the consumer.[6] Consumer credit providers, as responsible lending institutions, ascertain the identity of their consumers to assess risk and prevent fraud.[7]

Eurofinas therefore supports an amendment of the simplified due diligence regime clarifying that the identity of the client should be ascertained, taking into account the specificities of the product and the distribution channel in question. This includes, as outlined in the revised FATF recommendations[8] the possibility to verify the identity after the establishment of the business relationship, reducing the frequency of customer identification updates, not collecting specific information or carrying out specific measures to understand the purpose and intended nature of the business relationship but inferring it from the type of transactions or relationship established, etc. This last point is especially relevant for consumer credit, where the product often serves to finance specific goods and/or services.

In addition to the verification of the identity of the client, we wish to remark that ongoing monitoring of the relationship has to be conducted, even when a simplified due diligence regime applies.[9] Thus, if one of the aspects that make the transaction low risk alters, such as cash repayment instead of direct transfers from a current account, or if any other suspicion of money laundering arises this will be detected by the lending institution through the processes it has put in place, allowing it to take the appropriate measures in response. Therefore, no additional measures need to be outlined in the 4th AML Directive for simplified due diligence.

In light of the above 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

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[6] *Article 8 Directive 2008/48/EC of the European Parliament and of the Council of 23 April on credit agreements for consumers and repealing Council Directive 87/102/EEC.*
[7] *See for example the Joint Money Laundering Steering Group – Guidance for the UK Financial Sector – Part II Sectoral Guidance, Section 11, Motor Finance, pg 94. Available here: http://www.jmlsg.org.uk/industry-guidance/article/part-i-part-ii-part-iii-and-treasury-ministal-approval.*
[8] *Interpretative note to Recommendation 10 (customer due diligence), revised FATF Recommendations, 16 February 2012.*
[9] *Art. 8 (1) (d) 3rd AML Directive.*

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 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. Low value meaning consumer credit below 5,000 EUR; and
- Repayment is conducted through a bank account in the name of the customer who took out the consumer credit.

This value above can be justified considering that in 2011 the average loan for personal consumption amounted to 3,754 EUR (excl. revolving credit)[10].

Eurofinas does not consider that further guidance on risk factors by bodies, such as the Joint Committee's Sub Committee on Anti-Money Laundering, would be necessary or provide additional value.

4. Politically Exposed Persons (PEPs)

Eurofinas recognises the money laundering risk that politically exposed persons (PEPs) can pose. However, Eurofinas would like to stress that 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.

Eurofinas would like to remark that a clear, limited definition of this concept is essential for consumer credit providers.

With respect to "immediate family members, or persons known to be close associates, of such persons", we feel that:

- Only first degree family members should be included and that there is no evidence for a need for any extension of the definitions provided in the Implementing Directive;
- Any definition of close associates should only be based on a business relationship.

As the revised FATF Recommendations call for the inclusion of PEPs from international organisations within the scope of the 4th AML Directive, a clear definition and comprehensive list of organisations and respective positions that would fall under the scope of the 4th AML Directive should be provided by the Commission.

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.

[10] *Eurofinas 2011 Annual Statistics. This figure does not include Denmark.*

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

Furthermore, we repeat the call to the European Commission that we would endorse treating intra-EU PEPs as domestic PEPs and that the EU can be considered to be a single jurisdiction for this purpose.

Eurofinas is not in favour of any clarification that would entail the obligation to apply a risk-based approach to PEPs even beyond one year after they have left office.

6. Group compliance

Eurofinas would welcome provisions allowing for greater compliance at group level.

Eurofinas would strongly welcome the explicit clarification in the future that intra-group flows of information on potentially suspicious transactions prior to filing a report should be permitted. Otherwise the risk exists that the new data protection framework would not allow such transfers, undermining the capabilities of financial institutions to detect money laundering and terrorist financing. “Group” should be defined widely, to allow financial institutions to benefit to the fullest extent of such provisions, which are extremely valuable to the prevention of money laundering.

7. Data protection

Eurofinas is in favour of clear rules regarding the treatment of personal data being introduced in anti-money laundering legislation. Currently, our members may be severely impeded from fulfilling their AML/CTF obligations due to the national interpretations of data protection rules, such as in the area of PEPs.

However, the introduction of such rules should lead to a clear, workable regime for financial institutions. Caution should be exerted as to the extent to which and how any of the Article 29 WP recommendations are included. For the sake of clarity, aspects already featured in the revised data protection framework, such as the obligation to appoint a data protection officer under certain conditions, should not be repeated. Rather, specificities regarding anti-money laundering data processing should be addressed, such as retention periods, data which should be processed, etc.

Further interaction between AML regulators and the data protection supervisors is essential to achieve this balance and consistency between AML and data protection rules.

Annex 1: Credit intermediation

Point of Sale financing

Eurofinas member companies provide a variety of different kinds of loans, the majority of which are granted to individuals. These loans can be divided into the following broad categories: personal loans, motor finance, store/credit cards and credit at the point of sale. The principle objective of consumer loans is to finance the acquisition of goods, services and vehicles.

Eurofinas member companies offer these loans either through direct distribution channels or Point of Sale (PoS) Finance. PoS finance is an indirect distribution channel through which lenders distribute their products at the point of sale. In this particular context, intermediaries are retailers or motor dealers practicing credit intermediation as an ancillary activity. Retailers and motor dealers act on behalf of credit providers, receive no fee from consumers and are not entitled to advise them.

Point of sale finance is instrumental for:

i) Motor dealers for which point of sale finance is an indispensable tool for the sale of vehicles;
ii) Retailers for which point of sale is a commercial tool and a vital need for `big ticket´ items (goods sold for more than 500 Euro);
iii) Consumers for which point of sale finance is crucial when considering the purchase of a vehicle or big pieces of white or brown goods (refrigerators, televisions, computers etc.)[11]; and
iv) Manufacturers as a key tool to distribute their production.

Selection of intermediaries and relationship with the lender

A careful selection of retailers and motor dealers, using all available data, is conducted by lenders to ensure high-quality partnerships.

In order to create a commercial partnership with a retailer or a motor dealer, lenders will typically analyse extensive data such as solvency, reputation as well as the overall working and trading environment of the store/motor dealership. Only after this will the lender propose a commercial partnership. The details for negotiation will include the nature of the partnership (exclusive or non-exclusive), its duration and how products are priced. This relationship may be restricted to a single independent store/motor dealership or extended to wider distribution network in case of national or international chain stores.

Lenders first have to make sure that retailers/motor dealers comply with all the components of the credit application process. The former will offer assistance to immediately remedy any shortcomings. In addition, lenders need to assess and understand retailers/motor dealers' expectations which comprise the i) speed of credit decision and the offer, ii) regular visits by lenders' representatives to the point of sale, iii) advertising and legal support and iv) bespoke training sessions.

All contracts, products and processes are created and approved by lenders in accordance with the relevant legislation in force. Retailers/motor dealers play no part in this. It is their contractual duty to respect lenders' processes and to circulate all pre-approved documentation to borrowers.

Any breach of the agreement by retailers / motor dealers could lead to the termination of the partnership.

It is the lenders' responsibility to comply with all potential legal changes to the applicable regulatory framework, such as regarding consumer credit precontractual and contractual information, credit products or advertising

[11] White goods: large household appliances, as ovens and refrigerators. Brown goods: audio/visual and consumer electronic products such as televisions, radios, and stereo sets.

practices and it is the lenders' responsibility to make all appropriate modifications to their offers at the point of sale. Retailers/motor dealers are informed of the legal changes and all materials are accordingly updated by lenders. The involvement of lenders in informing and explaining legal changes is essential for retailers/motor dealers' understanding.

Credit intermediaries' role and duties

If a consumer requests finance at the point of sale, retailers/motor dealers will inform them about how the product works and its key features. Pre-contractual information is provided by retailers/motor dealers to consumers on behalf of the lender.

Information on product features and functioning is available at all stages (description of each product along with potential supporting documents). Retailers/motor dealers do not provide advice to consumers. The credit application process is completed by the retailer/motor dealer via an online application or through a standardised application form. In the latter circumstance, the retailer/motor dealer has to call the lender for decision or fax the application form. Both application processes are underpinned by training and testing programmes, regulatory requirements and regular controls. Given their speed, efficiency and built-in security, online applications tend to be the preferred working method of lenders and retailers/motor dealers.

The retailer will usually have to connect to the online application form by filling in his store identification number and his personal employee identification number. Such a step is often required in big chain stores where several dedicated staff can be in charge of PoS finance in order for the lender to ensure a complete overview of the credit applications.

The retailer will then collect numerous data including, inter alia, the customer's ID number, identity, address and home phone number. Accuracy of information will be checked by lenders once the application has been completed. In other cases, the latest online application tools instantly confirm whether the ID number and the address are valid and linked to the applicant. In such cases, should the data be incorrect, the system will not allow the retailer to continue the online application process unless the data is changed.

All the information collected on the applicant is checked by the lender before any credit decision is made, whether this is done instantly via online application or later on as if it is conducted via another channel.

The ability to repay and/or the credit limit are never driven by the retailer but by the lender (through IT scoreboards). Retailers play no role in the credit granting decision.

If the application is accepted, the retailer will give the customer a contract for agreement and signature. Borrowers address any finance-related questions directly to the lender. This could include additional information on products or procedures, to complain or in case of any difficulties arising during the duration of the contract. Lenders are responsible for dealing with customer complaints, withdrawal, early settlement and debt recovery.

If the application is refused, the retailer will inform the consumer that his application has been refused. Consumers can get explanations by contacting the lender or alternatively the credit bureau to find out about their credit history file.

Online application processes tend to be the norm. High automation responds to the need for speed, quality of decision and operational risks management.