AECM’s suggestions to resolve double documentation within the 5th Anti-Money-Laundering Directive

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EUROPEAN ASSOCIATION OF GUARANTEE INSTITUTIONS

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About AECM

The 48 members of the European Association of Guarantee Institutions (AECM) are operating in 28 countries in Europe. They are either private sector guarantee schemes or public promotional institutions or banks. Their mission is to support SMEs in getting access to finance. They provide guarantees to SMEs that have an economically sound project but do not dispose of sufficient bankable collateral. AECM's members operate with counter-guarantees from regional, national and European level. At the end of 2017 AECM's members had over EUR 126 bn of guarantee volume in portfolio, thereby granting guarantees to more than EUR 3.2 m SMEs. AECM's members are by far the most important counterparts of the EIF concerning EU counter-guarantees, handling EU guarantees from the very beginning in 1998.

Introductory Remarks

European SMEs make up to two thirds of EU employment and are therefore rightly referred to as being the backbone of the European economy. A reliable supply of loans to SMEs is vital in order to enable them to create continuous innovation and economic growth.

One of the most widespread instruments to facilitate this supply of loans are guarantees. Credit guarantees remain the single most important economic policy and continue to be "the most widely used instrument at governments' disposal to ease SME access to finance" (OECD, 'Financing SMEs and Entrepreneurs: An OECD Scoreboard 2016'). They expanded substantially in the years 2007-2011, as governments responded to the financial crisis and are "increasingly targeting young and innovative firms to boost employment and value added" (OECD, 'Financing SMEs and Entrepreneurs: An OECD Scoreboard 2016').

One of the reasons is that guarantee products have positive macroeconomic effects, meaning that the costs for the taxpayers due to running of guarantee institutions and default payments are outweighed by the positive stimulating effects of guarantees – such as on employment and innovation – for the economy.

To unleash the full potential of the guarantee tool, it is of paramount importance to ensure the smooth running of guarantee institutions and avoid barriers that would hinder them from fulfilling their function of stimulating and stabilising the European economy.

Yet one such barrier is created for those guarantee institutions that are considered as financial i.e. credit institutions, and under the 5th Anti-Money-Laundering Directive[1] (5AMLD) are treated as 'obliged entities'. We will see in the following sections that this leads to the unfortunate situation, that both the borrower's main bank and the guarantee institution, which are both considered as 'obliged entities' under the 5AMLD will have the same monitoring obligations, implying duplication of efforts of those entities in every step of the customer due diligence process.

It is the aim of this position paper to create awareness of this barrier within the 5AMLD and argue for an exemption of such guarantee institutions for their monitoring obligations.

[1] EU Directive 2018/843 of the European Parliament and of the Council of 30 May 2018

Main positions

First and foremost, AECM and its members acknowledge the efforts of the European Commission to further strengthen EU rules on anti-money laundering and counter-terrorist financing. At the same time, AECM members would like to draw attention to a double documentation and double due-diligence barrier its members are facing regarding the monitoring responsibilities of obliged entities under the 5AMLD.

Before going into the details of the issue at stake and understand the difficulties encountered to its full extent, it is important to illustrate the functioning of the guarantee instrument and give a brief overview of the entities that are involved in issuing a guarantee to an SME (a). This will ultimately allow to comprehend on what level the barrier arises (b), on what level similar barriers are already addressed (c) and how an eventual solution to the encountered problem could look like in a latter part (d) before giving supporting arguments to these suggestions in a final section (e).

a. Entities involved in the issuance of the guarantee instrument

Faced with a situation where an entrepreneur has a sound business project and asks its main bank for a loan to realise it but at the same time lacks the necessary collateral to back the project, the bank will contact the guarantee institution. The guarantee institution will then, upon thorough judgement of the business plan and all involved risks, decide to issue a guarantee for a specific loan to the bank that is then in the position to grant the loan to the SME. In this 'best-case' scenario, the entrepreneur (mostly SMEs) would be able to put the business project into action and stay a reliable and financially sound partner in an ongoing bank-client relationship.

b. On what level the double-monitoring obligations arise

In the situation described in (a), and provided that guarantee institutions are operating as a credit granting financial institutes, the guarantee institutions under Article 2/1 of the 5AMLD are considered as

> *1) credit institutions;*
>
> *2) financial institutions;*

and hence as 'obliged entities'under the 5AMLD. Article 14 of 5AMLD stipulates that

> *1. Member States shall require that verification of the identity of the customer and the beneficial owner take place before the establishment of a business relationship or the carrying out of the transaction. […]*
>
> *5. Member States shall require that obliged entities apply the customer due diligence measures not only to all new customers but also at appropriate times to existing customers on a risk-sensitive basis, or when the relevant circumstances of a customer change, or when the obliged entity has any legal duty in the course of the relevant calendar year to contact the customer for the purpose of reviewing any relevant information relating to the beneficial owner(s) […]*

Due diligence measures referred to under Article 14 are laid down in detail under Article 13:

> *1. Customer due diligence measures shall comprise:*
>
> > *(a) identifying the customer and verifying the customer's identity on the basis of documents, data or information obtained from a reliable and independent source, […]*

> *(b) identifying the beneficial owner and taking reasonable measures to verify that person's identity so that the obliged entity is satisfied that it knows who the beneficial owner is, […], taking reasonable measures to understand the ownership and control structure of the customer; […]*
>
> *(c) assessing and, as appropriate, obtaining information on the purpose and intended nature of the business relationship;*
>
> *(d) conducting ongoing monitoring of the business relationship including scrutiny of transactions undertaken throughout the course of that relationship […]*

Because both the borrowers' main bank (which grants the credit/loan) as well as the guarantee institution (which gives the necessary security) are 'obliged entities' in the same financial process, they have the same legal obligations and the same monitoring and due-diligence responsibilities towards competent authorities designated for combating money laundering or terrorist financing for the same SME clients. This leads to the fact that both obliged entities are fully legally bound to provide supervisory authorities the same information on documentation, control, monitoring and updating of customer data of the SME that is applying for a grant which constitutes a substantial bureaucratic burden for all parties involved thereby causing redundant duplication of efforts, tasks and inefficient use of resources.

c. On what level repeated customer documentation is already addressed

Findings from existing solutions and exemptions to avoid repeated customer identification procedures that could lead to delays and inefficiency in business, suggest that in the customer identification process it has been considered appropriate, subject to suitable safeguards (Article 25 of 5AMLD):

Member States may permit obliged entities to rely on third parties to meet the customer due diligence requirements […]. However, the ultimate responsibility for meeting those requirements shall remain with the obliged entity which relies on the third party.

However, the mentioned possibility to have the identification made by a reliable third party (bank, notary, etc), would unfortunately not address the mentioned monitoring and documentation obligations as it does not apply to the customer due diligence processes but merely to customer acceptance i.e. identification processes.

d. Possible solution to the double-monitoring obligations

Following the above-mentioned and already existing possibility of being able to employ a reliable third party (bank, notary) for the identification of customers, this could however, in the view of AECM members, constitute a solution to the mentioned 'double-monitoring and double-due diligence obligations' on the level of customer data updates, monitoring and documentation. In this eventual case, the guarantee institution that would guarantee the loan to the SME would also be authorised to rely on the borrowers' main bank or any other account with respect to the person who is entitled to the funds. This would allow to have one obliged entity instead of two and centralise monitoring and documenting of customer data at one level thereby reducing the bureaucratic burden of all parties involved including the guarantee institution, the bank and the SME that applies for a grant.

e. Other arguments against the double-monitoring obligations

It is important to note that for the case at hand, the contracts made between guarantee institutions and the borrowers' banks are sometimes based on the principle of "accessoriness" meaning that the contract with the guarantee institution is determined by the contract with the bank in terms of the secured amount and scope and their relevant deadlines (non-abstractness). This implies that the guarantee provided by the guarantee institution cannot exist without the loan thereby challenging the use of documentation, reporting and due diligence on both ends, the bank and the guarantee institution.

As we see that in the course of the revision of the Capital Requirements Regulation and the Capital Requirements Directive there are high chances to introduce simplifications for small and less risky business model financial institutions with a view to honour the principle of risk proportionality in the 5AMLD better to guarantee institutions, we would kindly ask to also consider the very low-risk operation model that guarantee institutions represent in the financial industry. One should acknowledge the important role in supporting SMEs access to finance that smaller, regionally-based and medium-sized banks and most prominently guarantee institutions, played in some of our member countries such as Italy, France, Germany, Belgium, Poland and Estonia in absorbing some of the negative effects of the crisis and re-establishing basic economic principles and stability.

Indeed, Annex II of the 5AMLD acknowledges the following:

> *The following is a non-exhaustive list of factors and types of evidence of potentially lower risk referred to in Article 16:*
>
> *(2) Product, service, transaction or delivery channel risk factors:*
>
> > *(d) financial products or services that provide appropriately defined and limited services to certain types of customers, so as to increase access for financial inclusion purposes;*

AECM and its membership network fully supports the objectives pursued by the ongoing debate on relieving smaller and less-complex institutions from operational barriers and more concretely demand to apply the same reasoning when considering exemptions i.e. extensions of already existing exemptions for guarantee institutions in terms of the above-described double-monitoring and double due diligence obligations.

AECM therefore suggests the following alternative solutions

1. Article 2 shall be amended in a way that makes sure that only the entity granting the loan is considered to be an 'obliged entity' for the due diligence and reporting requirements, but this only in situations where guarantees are granted for a specific loan and where the guarantee cannot exist without the loan
2. amending Annex II in such way as to include the 'accessory guarantee of payment of a loan if there is an obliged entity granting the same loan' as criterion for simplified customer due diligence procedures

Concluding remarks

We cordially ask decision takers on the EU level to take our reflections on an eventual relief for guarantee institutions as explained in this position paper into their kind consideration and would be available at any time for a further exchange of ideas on this topic. A relief for guarantee institutions would allow them to concentrate on their primary mission: the facilitation of SME's access to finance.