AECM updated comments on the AML legislative package

The European Association of Guarantee Institutions (AECM) and its members acknowledge the efforts to further strengthen EU rules on anti-money laundering and counter-terrorist financing. All EU-based AECM members will be obliged entities under the Anti-Money Laundering Regulation (AMLR). The new legislation will therefore have important impacts on their daily business which is the reason why we would like to reiterate our comments made in September 2021 and April 2022 as well as to comment amendments tabled by MEPs.

Background

Guarantee institutions are financial institution with a promotional mission to support entrepreneurs that have a sound business project but lack the necessary collateral in order to obtain bank financing. In this situation, the guarantee institution jumps in, providing a guarantee that serves as collateral to the house bank. Guarantee institutions thereby play an important role as enablers of SME loans and in overcoming market failure in the area of SME finance.

There are two major ways of granting a guarantee: individual guarantees and portfolio guarantees. In the first case, the financed company – in most cases a small or medium-sized company - is the customer of the guarantee institution. In the latter case, the guarantee institution grants a portfolio guarantee to a commercial bank under which the commercial bank then issues loans to its customers. Here, the customer of the guarantee institution is the financing bank.

Definitions – Article 2

In view of the above-mentioned distinction, it is essential to properly define the "business relationship" as a direct contractual relationship. It needs to be clear, that CDD and other obligations only apply to direct customers and not to the customers of the customer, i.e. in the case of a portfolio guarantee, the CDD should apply to the financing bank which is the customer of the guarantee institution and not to the final beneficiaries that are the customers of the financing bank. This is crucial in order

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to avoid an inflationary increase of CDD requirements and a multiplication of requirements for the same business transaction. **We therefore strongly support amendment 278 which clarifies the definition of a *"business relationship"***.

Amendment 285 suggests to modify the definition of a *"beneficial owner"* by adding to the natural persons owning and controlling a legal entity also those "benefiting" from a legal entity. The term "benefit" is very vague, it is not clearly delimitated and it could potentially be interpretated in a very wide sense with no possibility to define any thresholds due to the non-quantitative character of this term. **We strongly oppose this amendment since it creates legal uncertainty on the question which persons count as beneficial owners and due to the potential enormous extension of the number of beneficial owners**. Furthermore, this modification strongly deviates from international FATF standards where the definition of beneficial owners is linked to ownership and control[1].

Several amendments in the draft Parliament report tent to strongly widen the definition of politically exposed persons as well as of their family members (for which there are similar provisions) to include amongst others heads of regional and local authorities, members of local executive bodies as well as siblings of PEPs (see amendments 26 to 27, 300 to 304). This would largely increase the circle of PEPs requiring enhanced CDD and consequently leading to a sharp increase in CDD requirements to be fulfilled by obliged entities. The vast majority of heads of regional and especially local authorities as well as of enterprises that are wholly or partly owned by a regional or local government do not qualify as PEP according to the FATF recommendations[2]. The suggested widening of the PEP definition is an inappropriate and not risk based gold-plating of international standards. It would create an immense bu-

[1] *"Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those natural persons who exercise ultimate effective control over a legal person or arrangement. Only a natural person can be an ultimate beneficial owner, and more than one natural person can be the ultimate beneficial owner of a given legal person or arrangement."* P. 119, The International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations, updated March 2022: https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf

[2] *"Domestic PEPs are individuals who are or have been entrusted domestically with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. […] The definition of PEPs is not intended to cover middle ranking or more junior individuals in the foregoing categories."* p. 129, FATF Recommendations, see footnote 1.

reaucratic burden, especially in countries with many local entities. In France, for example, there are almost 35,000 local entities[3]. **We therefore oppose this extension of the PEP definition and recommend to reject amendments 26 to 27 and 300 to 304 and thereby compromise amendment B.**

Compliance functions – Article 9

The Commission proposal foresees that an executive member of the board of directors of an obliged entity needs to be appointed as compliance manager and only if there is no board, this position can be conferred to a member of an equivalent governing body.

From a risk point of view, it is not necessary that compliance is directly managed by a member of the board. Actually, the members of the board are usually representatives from the shareholders and they do not necessarily dispose of technical knowledge to occupy the position of a compliance manager. It would be in the public interest to allow the obliged entity to fill this position with a senior manager with technical knowledge in the area of anti-money laundering that is directly accountable to the board.

Amendment 420 allows for the delegation of the tasks of a compliance manager to a member of the senior management staff. This is a good solution that AECM fully supports. This solution, however, is to our understanding unfortunately not transposed into compromise amendment K.

Sanctions lists – Article 16 and 21a

Amendments 490, 494 and 566 would require *"credit and financial institutions [to] screen the customer's identity as well as the beneficial owner's identity against the relevant sanctions lists […] in order to verify that the customer is not a designated individual, entity or group subject to targeted financial sanctions"*. Such a provision is of course fully understandable in the light of the current events in Ukraine. Nonetheless, **we are of the opinion that this should not be regulated via AMLR, but rather under the dedicated sanctions regime.**

[3] https://www.insee.fr/fr/statistiques/4277602?sommaire=4318291#:~:text=Au%201er%20janvier%202019,vivent%20en%20France%20hors%20Mayotte

Identification and verification of the customer's identity – Article 18

Article 18 of the proposed regulation sets out the information that an obliged entity shall obtain in order to identify the customer. It would include for natural persons, their occupation, profession, employment status and tax identification number as well as for legal entities the registration number, the tax identification number and the Legal Entity Identifier. In our view, this goes too far and the thereby created bureaucratic burden would in no means be proportionate to potential benefits of the collection of this information. **We therefore support amendments 503 to 504 and 506 to 507 aiming to restrict required information to what is needed.**

Regarding the required information on beneficial owners, we support amendment 511 that limits required information to the name and date of birth of the beneficial owner.

Amendments 520, 522, 536, 537, 541 and 544 suggest simplifications for the identification of customers and beneficial owners and are therefore welcome as a measure that keeps the bureaucratic burden on obliged entities at a manageable level.

Ongoing monitoring – Article 21

Regarding the ongoing monitoring, we call for a risk-based approach. A frequency of updating of customer information of five years or less is surely justified for high-risk transactions. In the case of low-risk business relations, such as the granting of promotional SME guarantees, the current maximum frequency of ten years shall not be reduced and this in order not to unduly increase red tape for SMEs and their financiers. **Amendments 560 to 563 reject the suggested five years frequency in favour of a ten years frequency respectively an undetermined frequency. Both options are preferred to the frequency proposed by the Commission proposal.**

Simplified customer due diligence measures – Article 27

According to the draft Parliament report, such simplified measures shall be disallowed for situations where politically exposed persons or their family members or close associates are involved in the business relationship. This is not justified from a risk perspective. Such persons could be entrepreneurs seeking a financial guarantee for the financing of their small business project. Their financing request will be checked as diligently as other financing requests and are exposed to similarly low

risks of money laundering as any other SME financing request. **We therefore recommend members of the Parliament not to back amendment 71.**

Reliance on third parties – Article 38

Reliance on third parties is very important in the case of individual guarantees where the guarantee institution guarantees a loan transaction between the financing bank and the beneficiary company. Here, the very same due diligence measures on the very same business transaction already need to be undertaken by the financing bank. It would therefore make sense, if a guarantee institution could rely on the financing bank also regarding the ongoing monitoring. **Amendments 708 and 709 would allow for such reliance in the case of ongoing monitoring and are therefore strongly backed by AECM members.**

Furthermore, amendments 711 and 712 allow for re-use of relevant customer due diligence information from other obliged entities relied upon. This is very helpful since it makes clear that information on the customer that has already been collected does not need to be requested another time.

Outsourcing – Article 40

Outsourcing is vital, especially for small financial institutions since not all tasks can be ensured in-house due to lack of resources. That is why we very much welcome suggestions to reduce the list of tasks that cannot be outsourced:

- **Amendments 720 and 721 suggest to take *"internal controls"* from the list**
- **Amendments 723 to 725 suggest to take *"the drawing up and approval of the obliged entity's policies, controls and procedures to comply with the requirements of this Regulation"* from the list**
- **Amendments 727 to 729 suggest to take *"the attribution of a risk profile to a prospective client and the entering into a business relationship with that client"* from the list**
- **Amendments 731 to 734 suggest to take *"the identification of criteria for the detection of suspicious or unusual transactions and activities"* from the list**
- **Amendments 735 to 738 suggest to take *"the reporting of suspicious activities or threshold-based declarations to the FIU pursuant to Article 50"* from the list**

These tasks are in our view all tasks that can without any problem be outsourced to an experienced external service provider. In some cases, this might even improve the quality of the accomplishment of these tasks thanks to the fact that an entity more familiar with the tasks is in charge. The financial institutions will be able to concentrate on their core business. **We therefore fully support the amendments listed above.**

Identification of Beneficial Owners – Article 42

Depending on the interpretation of the formulation, the current proposal for the identification of beneficial owners could foresee an immense increase of entities that would need to be reported. Currently, the maximum number of beneficial owners to be reported is three. If ownership for 25% plus one of the shares would have to be reported on every level of ownership, this would lead to an inflationary increase of requirements. It should be clarified that only entities that hold at client level more than 25 % (directly or through accumulation of direct and/or indirect shares), need to be reported. On higher levels of ownership, a threshold of more than 50 % shall apply in order to identify the beneficial owner (replacing the entity through which it controls the client) and to thereby limit reporting to meaningful information.

For example, an entity B holding 25% +1 share on second or higher level of an entity A that holds 25% + 1 share of the client cannot exert control of the client to a significant degree. The identification of this entity B would not have any informational value.

In our view, article 42 requires some clarification in order not to allow for room for interpretation. To strike the right balance between the need for transparency and the need to keep the bureaucratic burden at a manageable level, it should be made clear that only beneficial owners that effectively exert a control over the client (direct, indirect and/or accumulated) need to be identified.

Amendments 750, 758, 760 and 761 suggest in our view a good solution to the above-mentioned problem since they clarify that the 25% + one share threshold does not apply to all levels of ownership.

We firmly oppose thresholds of 10%, 5% or even 0% plus one share as suggested in the by amendments 13, 90, 751, 752, 754, 755, 759, 762 and 512. An entity holding between 0 and 25% of the shares does not exert control of the client. Such a decrease of the threshold would substantially increase the bureaucratic burden for the financing institutions without creating any value added for the

fight against money laundering. We strongly advocate for sticking to the international FATF standards that suggest the threshold of 25%. The standards clearly refer to *"controlling ownership"* and not just to simple *"ownership"*[4].

The definition of *"control via other means"* is vague and difficult – if not impossible – to check. In particular, it is impossible to consider all *"family members of managers or directors/those owning or controlling the corporate entity"*. Moreover, this provision goes far beyond FATF recommendations. **We therefore recommend deleting the definition of *"control via other means"* as suggested by amendment 764 (amendment 772 deletes the bullet point regarding family ties).**

Beneficial Ownership Information – Article 44

The information required on beneficial owners would - according to the current proposal - exceed by far the requirements under current legislation. **In order not to create additional red tape, we recommend to limit required information to the name, date and place of birth as well as country of residence and nationality as suggested by amendments 803 and 804.**

Furthermore, we strictly object the requirement to update beneficial ownership information on an annual basis. For low-risk business, not-change-induced updates shall be required only after ten years, as it is currently the case. **We support amendment 812 that deletes the requirement of an annual update.**

Lower risk factors – Annex II

To our understanding, point 2.d of AMLR Annex II covers financial guarantees to small and medium-sized enterprises that serve as collateral in a loan granting process. This is justified, for the risks of money laundering and terrorist financing are very low in the area of promotional SME finance. There are no (cash) payment services and promotional guarantee business is long lasting, so it is itself not attractive for money laundering. Besides, promotional guarantees granted by our members

[4] *"The identity of the natural persons […] who ultimately have a controlling ownership interest in a legal person; and"* p. 65
„A controlling ownership interest depends on the ownership structure of the company. It may be based on a threshold, e.g. any person owning more than a certain percentage of the company (e.g. 25%)." p. 65, FATF Recommendations, see footnote 1.

are typically very small in size (on average around kEUR 35[5]) and either the guarantee institution (in the case of individual guarantees) or the financing bank (in the case of portfolio guarantees) or both follow the financed projects closely. In order to be eligible for guarantee support, beneficiary companies need to submit a viable business plan[6]. Risks of money laundering are therefore extremely limited. **For this reasons and in order to increase clarity, we suggest to support amendments 956 and 957 which explicitly mention SME loan guarantees in the list of lower risk factors.**

Higher risk factors – Annex III

According to annex III of the proposed regulation, *"new products and new business practices, including new delivery mechanism, and the use of new or developing technologies for both new and pre-existing products"* are defined as higher risk of money laundering. This provision would heavily penalise innovation without necessarily reducing risks (we are not aware of any study that finds that innovative products pose a higher risk of money laundering). **AECM supports amendment 971 that suggests to delete innovative products from the high risk list.**

Conclusions

While supporting the overall objectives of the current legislative package on AML, we are calling on to the legislators to take a risk-based approach and to limit stricter requirements to high-risk sectors/operations.

Promotional SME guarantees are due to their size, their nature and their way of implementation, highly unsusceptible to being used for purposes of money laundering and terrorist financing. Stepping up regulation in the same way as it is stepped up in the case of average and high-risk sectors/operations comes at a high cost for guarantee institutions and ultimately for their clients, the small enterprises. At the same time, no additional informational value is created. It is therefore of utmost importance to strike the right balance between the value added of additional information requirements and the increase in bureaucratic burden hampering promotional SME finance.

[5] This refers to the long-term pre-crisis level. During the covid pandemic the average guarantee size strongly increased to kEUR 55 due to the extensive support programmes implemented by our members. This increase, however, is expected to be a short-term effect. P. 18 AECM Statistical Yearbook 2021, https://www.flipsnack.com/aecmeurope/aecm-statistical-yearbook-2021.html

[6] This requirement is legally laid down in the guarantee agreements with the public counter-guarantors as well as in state aid law.

Many of the amendments tabled by MEPs go into the right direction and would lead to clearer and more targeted rules. We strongly encourage the Parliament to adopt those amendments and we ask the Council to also back these improvements of the text.

Nonetheless, numerous amendments foresee a strong increase in requirements without providing a material reduction of money laundering risks. We would ask the co-legislators to treat these proposals with caution and to thoroughly deliberate the consequences of their introduction.

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About us

The 48 members of the **European Association of Guarantee Institutions (AECM)** are operating in 31 countries in Europe. They are either private / mutual 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. This so-called SME financing gap is recognised as market failure. By guaranteeing for these enterprises, guarantee institutions help to address this market failure and facilitate SMEs' access to finance. The broader social and economic impact of this activity includes the following:

- Job creation and preservation of jobs by guaranteed companies
- Innovation and competition: crowding-in of new ideas leading to healthy competition with established market participants
- Structure and risk diversification of the European economy
- Regional development since many rural projects are supported
- Counter-cyclical role during crises

SME guarantees generally pursue a long-term objective and our members, if public, private, mutual or with mixed ownership structure, have a promotional mission.

AECM's members operate with counter-guarantees from regional, national and European level. As of end-2021, AECM's members had about bEUR 312 of guarantee volume in portfolio, thereby granting guarantees to around 5.9 million 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.

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