AECM's Suggestions to Finding a Solution for Guarantee Institutions to the Double-Monitoring Obligations Under the 4th AML Directive

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Introductory Remarks

European SMEs make up to two thirds of EU28 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'[1]). 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'[1]).

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.

It is also important to note, that some of AECM's members have been using EU Financial Instruments, which are designed by the European Commission and managed by the European Investment Fund (EIF), right from the start in 1998. About two thirds of the investments generated via the SME Guarantee Facility under the EU programmes MAP, CIP and COSME were / are channelled via AECM's members.

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 i.e. stabilising economies in Europe.

Yet one such barrier is created for those guarantee institutions that are considered as financial i.e. credit institutions, and under the 4AMLD: Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 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 by definition both considered as 'credit institutions' or 'banks' and hence as 'obliged entities' i.e. 'designated bodies' under the 4AMLD 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 4AMLD and argue for an exemption of such guarantee institutions for their monitoring obligations i.e. for a systematic and analogical interpretation of an already existing exemption under the 4AMLD.

The barrier directly leading to this double-documentation and double-due diligence obligation as well as a possible solution to this barrier will be explained more in detail in this position document.

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** as stipulated in the "Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or

[1] OECD Scoreboard 2016: Financing SMEs and Entrepreneurs, OECD Publishing, Paris, Chapter I.7.a 'Government Policy Responses 2014-15', p.71, retrieved from the www via http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/financing-smes-and-entrepreneurs-2016_fin_sme_ent-2016-en#.WlPgVa6nHIU , see also OECD Scoreboard 2015 (under 'previous versions')

terrorist financing and amending Directive 2009/201/EC" from 19 December 2017. 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 4th Anti-Money Laundering Directive 4AMLD.

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/borrower has a sound business project and asks the borrowers' main bank for a loan to realize it but at the same time lacks the necessary collateral to back her / his project, the bank will contact the guarantee institution. The guarantee institution will then, upon thourough judgement of the business plan and all involved risks, decide to issue a guarantee for a specific loan to the bank, who is now in a position to grant the loan to the SME. In this 'best-case' scenario, the entrepreneur (SME) 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 scenario described in (a), and provided the guarantee institution is operating as a credit granting financial institute, the guarantee institution under Article 2(1)(3) of the 4AML Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 is considered as a

> *"(…) credit or financial institutions (including funds and fund service providers, money lenders and money transmission or bureaux de change businesses) unless specifically excepted (..)*

and hence as an 'obliged entity', i.e. 'designated body' under the 4AMLD. According to Art (14) of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015, any obliged entity is

> *" (…) responsible for filling in the central register holding adequate, accurate and current information on their beneficial ownership, in addition to basic information such as the company name and address and proof of incorporation and legal ownership. Member States should further make sure that in all cases that information is made available to competent authorities and Financial Intelligence Units (FIUs) and is provided to obliged entities when the latter take customer due diligence measures. (..)"*

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 (Art. (35) of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015)

> *"(35) to allow customers whose identification has been carried out elsewhere to be introduced to the obliged entities. Where an obliged entity relies on a third party, the ultimate responsibility for customer due diligence should remain with the obliged entity to which the customer is introduced. The third party, or the person that has introduced the customer, should also retain its own responsibility for compliance with this Directive, including the requirement to report suspicious transactions and maintain records, to the extent that it has a relationship with the customer that is covered by this Directive."*

However, the mentioned possibility to have the identification made by a reliable third party (bank, notary, etc), which had already figured in the former Anti-money laundering Directive, 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.

One other remark, that AECM would like to raise is related to ongoing discussions on the **proportionality principle in regulatory requirements for smaller and non-complex i.e. less risky financial institutions** that led to substantial revisions in the Capital Requirements Regulation and Capital Requirements Directive accounting for these institutions.

By the same token, we would kindly ask to also consider the **very low-risk operation model guarantee institutions represent in the financial industry and 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 (2) of the "Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/201/EC" from 19 December 2017 acknowledges that

> (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**;

fall under the "non-exhaustive list of customer risk factors and types of evidence of potentially lower risk" referred to in Article 16 for assessing the risks of money laundering Member States and obliged entities should take into account when assessing potential risk situations.

AECM and its membership network fully supports the objectives pursued by the ongoing debate on relieving smaller and less-complex institutions from such 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**.

We at AECM are therefore convinced that a solution to the issue at hand can be found either by

1) amending and systemically interpreting Art. 2 between the borrower's main bank and the guarantee institutions, having only the entity granting the loan as 'obliged entity' for the due diligence and reporting requirements or use a reliable third party as described under (d) or
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 criteria for simplified customer due diligence procedures

Concluding remarks

We cordially ask you to take our reflections on an eventual relief for guarantee institutions under the 4th AML – Directive as explained in this position paper into your kind consideration and would be available at any time for a further exchange of ideas on this topic. The extension of the possibility to use a reliable third party to including monitoring responsibilities i.e. a possible exemption of the double-monitoring obligation for guarantee institutions under Annex II (2) as described above would be very helpful for our organization and we would be honored if the European Commission were prepared for an exchange of thoughts with us in order to find a more viable solution.

Annexe: About AECM

AECM's 42 members, who are mutual / private sector guarantee schemes, public institutions or mixed, all have in common the mission of providing guarantees for entrepreneurs, small and medium-sized enterprises (SMEs) and freelance professions who have an economically sound project but do not dispose of sufficient bankable collateral. The guarantee provided by AECM's members constitutes a full-value collateral and for a significant amount of AECM's members it reduces the capital adequacy requirements in favor of credit institutions. AECM represents the political interests of its member organizations both towards the European Institutions, such as the European Commission, the European Parliament and Council, as well as towards other, multilateral bodies, among which the European Investment Bank (EIB), the European Investment Fund (EIF), the Bank for International Settlement (BIS), the OECD, the World Bank, etc. It deals primarily with issues related to prudential supervision, to state aid regulation relevant for guarantee schemes within the internal market and to European support programs. The development and maintenance of SMEs is paramount for AECM and its members given that SMEs and entrepreneurship are key to ensuring economic growth, innovation, job creation, and social integration.