AECM position on the AML legislative package

The European Association of Guarantee Institutions (AECM) and its members acknowledge the efforts of the European Commission to further strengthen EU rules on anti-money laundering and counter-terrorist financing. Since all EU-based AECM members are either credit or financial institutions, they 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 raise the following comments.

Background

Guarantee institutions are a very particular kind of financial institution. They have 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 enabler 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.

Business relationship – AMLR Art. 2

That said, it is important to properly define the "business relationship" in a way that does not allow for any doubt about who the customer of the guarantee institution is. It needs to be clear, that CDD and other reporting 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

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financing bank. This is crucial in order to avoid an inflationary increase of reporting requirements and a multiplication of reporting on the same business transaction.

Risk assessment – AMLR Art. 8

The risks of money laundering and terrorist financing are very low in the area of promotional SME finance because 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 are typically very small in size (on average around kEUR 35[1]) 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[2]. Risks of money laundering are therefore very limited. In order to allow for a level playing field, national supervisors shall be encouraged not to require individual documented risk assessments, as foreseen in paragraph 3 of article 8. Furthermore, we would like to suggest that the frequency of updating a risk assessment shall depend on the risk profile of the transaction type.

Compliance functions – AMLR Art. 9

The regulation 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.

In our view, the obliged entity should have the right to decide whether to appoint a member of the board or of an equivalent governing body. The members of the board are usually representatives from the shareholders and they do not necessarily dispose of technical knowledge to occupy such a position. It would be in the public interest to fill this position with a senior manager with some technical knowledge in the area of anti-money laundering, be it a member of the board or of any equivalent governing body. This is in the interest of a diligent exertion of the prescribed function.

[1] 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.
[2] This requirement is legally laid down in the guarantee agreements with the public counter-guarantors as well as in state aid law.

Customer Due Diligence – AMLR Art. 18

The new regulation substantially expands reporting requirements under the CDD. The requirement to collect information on the profession and the employment status of a customer as well as the tax identification number and the legal entity identifier might well be justified for a high-risk transaction. However, in a low-risk transaction such as the granting of a promotional SME guarantee, the administrative burden to collect this information largely exceeds any potential benefits of disposing of this data. We therefore call on to the legislators to take a risk-sensitive approach and to widen reporting requirements only for high-risk operations.

Ongoing monitoring – AMLR Art. 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 to 15 years shall be maintained and this in order not to unduly increase red tape for SMEs and their financiers.

Reliance on third parties – AMLR Art. 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 reporting on the very same business transaction already needs to be done by the financing bank. It would therefore make sense, if a guarantee institution could – in case of a low-risk operation – rely on the financing bank also regarding the ongoing monitoring, i.e. the reference to *customer due diligence requirements laid down in Article 16(1), points (a), (b) and (c), […]* should be completed by mentioning point (d).

Identification of Beneficial Owners – AMLR Art. 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 reportings. It should be clarified that only entities that hold at client level more than 25+x% (directly or through accumulation of direct and/or indirect shares), need

to be reported. On higher levels of ownership, a threshold of 50+x% 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% on second or higher level of an entity A that holds 25+1% 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 a situation of low risk.

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 for low-risk operations, only beneficial owners that effectively exert a control over the client (direct, indirect and/or accumulated) need to be identified.

Beneficial Ownership Information – AMLR Art. 44

The information required on beneficial owners would - according to the current proposal - exceed by far the requirements under current legislation where obliged entities only have to collect a copy of the company registry. On this point as well, we recommend a risk-based approach, allowing for lighter requirements in case of low-risk business.

Furthermore, we 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 to 15 years, as it is currently the case.

Lower risk factors – AMLR Annex II

To our understanding, point 2.d covers financial guarantees to small and medium-sized enterprises that serve as collateral in a loan granting process. We would kindly ask the legislators for confirmation of this understanding. If this understanding cannot be confirmed, we would like to ask for a clarifying amendment of the annex.

Beneficial Ownership registers – AMLD Art. 10

Registers of beneficial ownership managed by the member states need to have the quality that obliged entities can rely on them. If the quality is not good enough to ensure legal reliance on the register, its value could be put in question.

Conclusions

While supporting the overall objectives of the current legislative package on AML, we are calling on to the legislators to take a more risk-based approach and to restrict tightened reporting rules 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 reportings and the increase in bureaucratic burden hampering promotional SME finance.

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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-2020, AECM's members had about bEUR 330 of guarantee volume in portfolio, thereby granting guarantees to around 5.2 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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