AECM 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 to concretise our proposals for amendments.

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

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 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

Brussels, April 2022

not to the final beneficiaries that are the customers of the financing bank. This is crucial in order to avoid an inflationary increase of CDD requirements and a multiplication of requirements for the same business transaction.

We suggest to amend the definition in the following way:

AMLR Article 2
(16) 'business relationship' means a **direct contractual** business, professional or commercial relationship which is connected with the professional activities of an obliged entity and which is expected, at the time when the contact is established, to have an element of duration, including a relationship where an obliged entity is asked to form a company or set up a trust for its customer, whether or not the formation of the company or setting up of the trust is the only transaction carried out for that customer;

Furthermore, we recommend adding a definition for the term "customer":

AMLR Article 2
(16a) 'customer' means a natural or legal person that has a direct contractual business relationship with the obliged entity;

The draft Parliament report tents to include heads of regional and local authorities into the definition of politically exposed persons (see amendment 26). 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 do not qualify as PEP according to the FATF recommendations[1]. Amendment 26 suggests inappropriate and not risk based gold-plating of international standards. We therefore oppose this extension of the PEP definition.

[1] "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
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

Compliance functions

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 such a position. 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.

We suggest to amend the proposal in the following way:

AMLR Article 9
1. Obliged entities shall appoint **either** one executive member of their board of directors or, ~~if there is no board,~~ of its equivalent governing body **or of its senior management** who shall be responsible for the implementation of measures to ensure compliance with this Regulation ('compliance manager'). ~~Where the entity has no governing body, the function should be performed by a member of its senior management.~~ **In the latter case, the compliance manager shall be directly accountable to the board as concerns his role as compliance manager.**

Ongoing monitoring

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 exceeded and this in order not to unduly increase red tape for SMEs and their financiers.

We suggest the following change to the AMLR proposal:

AMLR Article 21
2. […] The frequency of updating customer information pursuant to the first subparagraph shall be based on the risk posed by the business relationship. The frequency of updating of customer information shall ~~in any case~~ not

exceed five years. **In the case of low risk transactions according to Annex II, the frequency of updating shall not exceed ten years.**

Simplified customer due diligence measures

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 (to AMLR Art. 27).

Reliance on third parties

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 – at least in case of a low-risk operation – rely on the financing bank also regarding the ongoing monitoring.

Our suggestion for amending this article is set out in the following:

AMLR Article 38

1. Obliged entities may rely on other obliged entities, whether situated in a Member State or in a third country, to meet the customer due diligence requirements laid down in Article 16(1), points (a), (b)**,** ~~and~~ (c), **and (d)** provided that:

   […]

Identification of Beneficial Owners

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.

AMLR Article 42
1. […] For the purpose of this Article, 'control through an ownership interest' shall mean an ownership of 25% plus one of the shares or voting rights or other ownership interest in the corporate entity, including through bearer shareholdings~~, on every level of ownership~~. **This ownership of 25% plus one share may be held directly, indirectly or via accumulation of several holdings.**

We firmly oppose a threshold of 5% plus one share as suggested in the first draft of the Parliament report (amendments 13 and 90). An entity holding between 5 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"[2].

[2] "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.

Beneficial Ownership Information

The information required on beneficial owners would - according to the current proposal - exceed by far the requirements under current legislation where information from the company registry is sufficient. In order not to create additional red tape, we recommend a risk-based approach, allowing for lighter requirements in case of low-risk business.

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.

AMLR Article 44

1. […]

   For a business relationship that qualifies as low risk according to Annex II, beneficial ownership information shall be limited to those presented in the company registry where needed.

2. […]

   For a business relationship that qualifies as low risk according to Annex II, beneficial ownership information shall be obtained within 14 calendar days from the creation of legal entities or legal arrangements. It shall be updated promptly, and in any case no later than 14 calendar days following any change of the beneficial owner(s), and every ten years.

Lower risk factors

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 would be 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 are typically very small in size (on average around kEUR 35[3]) 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

[3] 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.

viable business plan[4]. Risks of money laundering are therefore extremely limited. For this reasons and in order to increase clarity, we suggest to explicitly mention SME loan guarantees in the list of lower risk factors.

AMLR Annex II
(2) (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; **This category includes SME loan guarantees;**

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 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.

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

About us

The 47 members of the **European Association of Guarantee Institutions (AECM)** are operating in 30 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.

European Association of Guarantee Institutions – AECM
Avenue d'Auderghem 22-28, bte. 10, B-1040 Brussels
Interest Representative Register ID number: 67611102869-33

Brussels, April 2022