The voice of banking & financial services

7 January 2011

The FATF Secretariat

By email to fatf.consultation@fatf-gafi.org

Dear Sirs,

Re: The Review of the Standards

The British Bankers Association (BBA) is grateful for the opportunity to respond to the consultation on the review of the FATF Standards, and the preparation for the 4th round of mutual evaluations. With over 240 member banks from over 60 countries the BBA is the authoritative voice of the banking industry in the UK, representing members' interests in both wholesale and retail markets.

The BBA supports strongly the FATF decision that, in line with good practice, it should re-examine its standards periodically to ensure that they remain relevant and consistent with the implementation and evaluation of the current standards. It is particularly welcome too that the FATF is carrying out this public consultation involving the private sector and indeed all stakeholders. The BBA's members are at the forefront of the UK's endeavours to combat money laundering and terrorist financing, they have extensive practical knowledge and they deploy sophisticated systems to make sure that their compliance is of the highest quality.

We note that the issues to be addressed are the following:

- the Risk Based Approach
- Recommendation 1, and whether tax crimes should be included as a predicate offence for money laundering
- Recommendation 5, Customer Due Diligence
- Recommendation 6, Politically Exposed Persons (PEPs)
- Recommendation 9, Third Party Reliance and
- Special Recommendation VII, Wire Transfers.

In addition, we note that the FATF would welcome comments on the usefulness of Mutual Evaluation Reports.

Our comments on all of the above are attached, and we would be happy to provide further information or comment if required.

Yours sincerely,

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FATF Proposals on the Risk-Based Approach ("the RBA") and related Recommendations

Key proposals:

- Assessing the risk based approach
- Developing a single comprehensive statement on the risk based approach
- Clarifying the requirements regarding legal persons and arrangements
- Beneficiaries of life insurance or other investment related insurance policies

BBA Comment

1. We strongly support the recommendation to consolidate the existing RBA standards into one comprehensive statement and also support the inclusion of more detail and granular examples. However, we have a concern that this will provide Competent Authorities in different jurisdictions with the ability to mandate either stricter or lesser requirements through regulation and legislation, which could lead to unequal standards being adopted across the world.

2. There is a link to Recommendation 8 regarding new technologies and specific reference to mitigating risks in developing new products. This would have to be considered regarding any exploitation of e.g. faster payments or prepaid cards. The suggested EDD requirements under new technologies is also welcomed as is the inclusion of applying FATF regulations to other designated non Financial Institutions ("FIs").

3. We would also point out that our members have welcomed the RBA in terms both of proportionality and in providing some flexibility in targeting their systems and controls where required. But it must be recognised that this means that individual FIs will operationalise their approach, eg by putting in their own policy and standards. A direct consequence of this is that processes and procedures will vary between institutions and will also vary within a single institution depending on the different risk assessment of different business units.

4. In terms of the RBA, it is important too to recognise that managing this approach can, in practice, be highly complex especially for large internationally active banks. It is therefore important for international standard setters and for individual regulators to recognise that such operational standards are unique to each and every FI. This has the potential to cause problems where there are expectations from international standard setters and regulators that all firms will adopt the same standard. The variety of approach to how FIs individually operationalise the RBA standards reduces the opportunities for those who seek to launder funds for criminal or terrorist ends.

Recommendation 1 (tax crimes as a designated category of predicate offence for money laundering)

Key proposals

- Considering including tax crimes as a predicate offence for money laundering
- To include a designated offence: tax crimes – related to direct taxes and indirect taxes

BBA Comment

5. In the United Kingdom and many other jurisdictions, tax evasion is already a crime and therefore would be subject to the usual ML Reporting requirements. However, there will need to be clear definitions of tax crimes to avoid unnecessary reporting where legitimate tax avoidance is allowable.

Recommendation 5 (Customer Due Diligence)

Key proposals

- Assessing in the light of the risk based approach
- Clarifying the requirements regarding legal persons and arrangements
- Beneficiaries of life insurance or other investment related insurance policies

BBA Comment

6. Overall, we support the proposals regarding beneficial owners. The proposed requirement to evaluate the beneficiaries of life insurance policies may be disproportionate to the risk of usage of this kind of product for money laundering or terrorist financing, given the circumstances required to pay out on these types of policy. These requirements could prove challenging from a wider Investment/Trust perspective where beneficial owners may not be identified at incept. Trust products such as Insurance wrappers should also look closely at these proposed recommendations.

7. On the screening of life policy beneficiaries to identify PEPs, taking 2.3 and 3.2 together, it is ambiguous as to when it is expected that screening should be performed. The FATF appears to accept that beneficiaries need not be verified until payment, but if there is to be a requirement that names (where specifically named, ie not a class) are taken up front, does that imply that they should be screened up front? It appears to us that it would be sensible to suggest that it should be within a firm's discretion, based on their risk based approach as to when screening of beneficiaries takes place.

Recommendation 6 (Politically Exposed Persons)

Key points:

- Proposal to include UN Convention on Corruption in Recommendation 35, and this would impact also Recommendation 6 re PEPs

- UN Convention does not distinguish between foreign or domestic PEPs and based on principle that a Convention should be interpreted in the widest sense possible, it s the understanding that enhanced scrutiny on both domestic and foreign PEPs should be required. FATF is considering the following approach:

1. leaving the requirements relating to foreign PEPs as they are, ie they are always higher risk

2. requiring financial institutions to take reasonable measures to determine whether a customer is a domestic PEP, and

3. requiring enhanced CDD measures for domestic PEPs if there is a higher risk.

- The FATF is also reviewing the obligation with respect to family members and close associates of PEPs. Instead of requiring financial institutions to determine whether a customer or beneficial owner is a family member or close associate of a PEP, it proposes to focus on the cases where the PEP (either foreign or domestic) is a beneficial owner of the account, ie on situations where a family member or close associate has a business relationship with a financial institution and a PEP is the beneficial owner of the funds involved in such a relationship.

BBA Comment

8. We support the move to identify domestic PEPs and many of our members have already been doing this for a number of years. We note however that while it is accepted that corrupt PEPs can cause significant damage to the countries they abuse, in some respects, they simply represent another category of higher risk customer. Having a PEP specific regulation, and extending this, means that a significant amount of time and cost can be incurred on additional due diligence on legitimate customers.

9. Our members believe that consideration needs to be given to institutions with multiple presences in different jurisdiction outside of the UK when considering domestic PEPs. A domestic PEP for such institutions will invariably be interpreted in a different context. For the sake of consistency, some of our members take the approach of including all PEPs but they vary the level of due diligence undertaken taking into account the nature of the relationship and risks of the jurisdiction from where the PEP originates. For example, a Russian oligarch who is now settled and has taken UK residency/citizenship could be classified as domestic and therefore not currently subject to PEP due diligence requirements. But our members believe it prudent to consider the country of association of the PEP in such circumstances, ie taking into account where they have undertaken political office, or other positions such as being Chairman of a state owned entity.

10. Subject to our comment above under Recommendation 5, we also support the screening of life insurance policy beneficiaries/beneficial owners, although this does need to be balanced against the risks posed by such products, which could mean that this approach is considered disproportionate.

11. However we are not entirely supportive of the recommendation to focus its identification of family members or close associates to just those situations where a family member or close associate has a business relationship with a financial institution and a PEP is the beneficial owner of the funds involved in such a relationship. We believe that most financial institutions will take a risk based approach in this area according to their assessment of the risk posed by the particular PEP. While it is accepted that foreign PEPs must be treated as higher risk, not all are necessarily “high” risk.

Recommendation 9 (Third party reliance)

Key proposals

- Who can rely on a third party and who can be relied upon – FATF considering extending discretion regarding the types of third parties that can be relied upon and to go beyond the financial sector to include other types of businesses as long as they are subject to AML/CFT requirements and effective regulation and monitoring
- Where are the boundaries between third party reliance and outsourcing or agency – FATF proposes to distinguish what constitutes third party reliance through a functional definition with a set of positive or negative elements with situations or elements characteristic in a reliance context
- Intra group reliance – taking a more flexible approach where the third party is part of a financial group

BBA Comment

12. Whilst the proposal to consider amending Recommendation 9 to extend beyond FIs and include other professional bodies is welcomed, this could require a whole new structure/approach to ensure that any other professions comply with the standards and that the FIs can rely on the supervisory bodies that have the responsibility for oversight. This will not remove the requirement for ensuring that third parties meet FI own standards/requirements but could create issues where the third party provides services to multiple unconnected businesses which each have a different set of requirements.

13. On the positive side this is a move in the right direction and will have benefits as seen in the Channel Islands where, for example, Trust Companies are required to maintain the same standards and are monitored by the regulators and therefore greater use of introductory certificates and reliance, notwithstanding the independent checks that FI and others might want to take.

Special Recommendation VII and its Interpretative Note

Key proposals

The FATF is seeking private sector input with respect to discussions to amend Special Recommendation VII (SR.VII) and its Interpretative Note (INSR.VII) for the purpose of enhancing the transparency of cross-border wire transfers.

- to further enhance the transparency of the international payments system, the FATF is now considering incorporating beneficiary information into the international AML/CFT standard governing cross-border wire transfers;
- the FATF asks whether FIs require accurate information on beneficiary names in order to process a transaction
- whether it would be feasible and useful in managing the ML/TF risks for FIs to have additional beneficiary information
- what beneficiary information could be required that would be feasible, useful to financial institutions, practical for originating parties and proportionate so as not to push transactions underground.

BBA Comment

14. On beneficiary information, our members believe that FIs ought to require accurate information on beneficiary names in order to process a transaction - if payments are processed without a beneficiary name (even though technically they can be) there has to be a significant sanctions risk.

15, However, we have reservations about going any further than name and account number. Would the provision of additional information bring additional responsibilities on the receiving bank which would be incompatible with 'straight-through processing'? In other words would the receiving PSP be expected to check that all the quoted information aligned to what is held on the bank customer database.

16. Indeed, while we agree that it is highly desirable from a processing perspective to include the beneficiary name, we have significant reservations about the wisdom or practicality of making the account number a unique and mandatory identifier. In many cases, the ordering customer will have the beneficiary account number – for domestic or SEPA payments it is effectively mandatory – but this is not always the case for general cross-border payments, where traditionally the ordering customer does not always have the beneficiary's account number available, and these payments can be, and are, made with beneficiary name and address (and probably also the beneficiary's bank). The beneficiary bank then identifies the correct account, or alternatively mails a cheque. Under the proposal, if the beneficiary account number is not available, what unique identifier would the sender be expected to provide, how would the ordering bank enforce this, and how would the beneficiary bank check it? The payment transaction reference number could serve as a unique identifier in these circumstances, but to avoid ambiguity it would be necessary for any new requirements making name + account number/UID mandatory (if that were the outcome) to provide explicitly that where an account number is not supplied by their customer, the sending bank is not required to insist on it and the beneficiary bank can rely on the transaction reference as the UID and does not have to query absence of account number back to the sending bank.

17. We note that the overall objective is for more transparency in the process, indeed to move from supplying just originator to some beneficiary information and cover payments. We would point out that transparency has to be trumped by traceability and it is essential that this principle continues to apply in the projected wider context of originator + beneficiary information. Just as compromises have had to be acknowledged for originator information because of system constraints or differences of interpretation in certain scenarios around what information could or should go into wire transfers, it is essential that any enlarged requirement is grounded in the practical and does not seek to impose rigid and unrealistic information demands.

18. It is recognised that FIs do not own the beneficiary relationship and so could not verify the details. Obtaining full beneficiary details might be difficult for a FI's customers. There might be field restrictions within a FI's systems and potentially SWIFT. More payment schemes now try to route using just ID codes (BICS and IBANS) – SEPA is one example. Routing using numbers rather than names is easier for systems and leads to higher rates of straight through processing, the holy grail of payments. Would the recipient beneficiary bank have to ratify all details, assuming they had them on record? Currently it is believed that FI's do not confirm that account number and name match and just rely on the account number. Whilst account name primacy still exists, a UK legal opinion a few years ago took the view that, if brought to court, the account number would probably be deemed to take primacy over name.

19. Overall, our view is that it would be unrealistic and disproportionately burdensome on FIs to expect them to monitor beneficiary information for accuracy, completeness, alignment of name and number information. It is our strong view that any mandatory requirement for beneficiary information should ideally be limited to name only.

20. Another question that must be addressed is whether FI's would have to consider how to monitor; would they be able/prepared to apply the payment and monitor retrospectively for beneficiary details as they do for remitter details?

21. On the possibility of incorporating into the international standard an obligation to screen all wire transfers in order to comply with the UNSCRs to combat terrorist financing, we would note that standards and the extent of screening do still vary among FIs. Amongst our member banks, the majority report that they do screen wire transfers where there is meaningful information.

22. It would be helpful if the FATF could specify a minimum watch list package so that all financial institutions are looking at the same list and also a list of recommended extra watch lists that may be used.

Usefulness of Mutual Evaluation Reports

Key proposals

- Considering how they could be made more useful under six headings:

1. focus of mutual evaluations, reports could be made shorter
2. the executive summary – set out more clearly the overall level of compliance?
3. risk information – give more emphasis to risk factors and how they are or could be mitigated
4. timeliness – publication of reports is some time after the evaluation – is this a problem?
5. structure – could be improved to make them more easily understood?
6. sectoral information – reports could include additional information in specific areas eg for those recommendations which apply to several different areas eg banking, securities, insurance, conclusions on risk and compliance could potentially be set out for each type of institution

BBA Comment

23. Our members have said that they find the FATF country assessments are of limited value. Our members suspect that the assessment system is so highly politically charged that the assessments could be seen as being deeply flawed. For example, there is very limited information indeed on the ownership of Russian corporate structures, but no comment is made about this. And with regard to the assessments of India and Pakistan, India should more realistically be rated as much less compliant with AML standards than Pakistan.

24. Our members nevertheless seek to take into account the FATF country assessments as best they can when carrying out their own risk and business assessment programmes.