Guernsey Financial
Services Commission

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Please use our reference on all correspondence

Dear Sirs

The Risk Factor Guidelines

I refer to the joint consultation paper published on 21 October 2015 regarding the draft Joint Guidelines to be issued under Article 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions.

The European Supervisory Authorities ("ESA") have asked respondents to consider whether these guidelines are conducive to firms adopting risk based, proportionate and effective AML/CFT policies and procedures and whether they are conducive to competent authorities effectively monitoring firms' compliance with AML/CFT requirements.

There are four broad areas of concern in these draft Joint Guidelines which could make it difficult for EU financial institutions to conduct business on a cost effective basis with customers established in third countries. As a third country is any country which is non-EU these Guidelines will impact smaller jurisdictions such as the Bailiwick of Guernsey, but also larger jurisdictions such as the United States of America, China and India.

The four broad areas of concern are detailed below: -

Assessing and Managing Risk

The Commission had the benefit of attending the public hearing on 15 December 2015 at which it was emphasised by the Panel that the presence of one isolated high risk factor may not necessarily place a business relationship or occasional transaction into a high risk category of client to which enhanced due diligence must be applied. There is reference in the draft guidelines to firms taking a holistic view but these are only short paragraphs at 10 and 17 of the document. The Commission proposes that additional clarification would be of benefit.

Country and Geographical Risks

There are various references to terms such as *"tax haven, secrecy haven and offshore jurisdiction"* which are generalised terms the interpretation of which is subjective. In the absence of any agreed definitions for these terms, it is likely to be interpreted differently across the EU Member States by competent authorities and firms alike and consequently will lead to divergence rather than harmonisation.

Equivalence with Directive (EU) 2015/849

Notwithstanding the statement that the Fourth AML Directive does not require equivalence of third countries, the Risk Factor Guidelines includes references to equivalence with the Directive. It is unclear if this technical equivalence or outcomes based equivalence. If it's technical equivalence, it will be both costly and time consuming for firms and competent authorities to assess, as third countries' AML/CFT regimes are based on the FATF Recommendations rather than Directive (EU) 2015/849.

Intermediaries

Paragraph 212 of the Risk Factor Guidelines states that where a firm uses a financial intermediary to distribute fund shares, e.g. a regulated platform, a bank or a financial adviser, that intermediary may be regarded as the firm's customer. However, Paragraph 215 states that where the financial intermediary is established in a third country this concession cannot be used. Whilst this provision will not be difficult for Guernsey firms which are intermediary customers of EU firms to provide

CDD information on its customers it will place a large compliance burden on EU firms dealing with both intra-group companies and third parties located in third country jurisdictions.

Please find enclosed a memorandum which expands on the above issues in greater detail and proposes some alternative forms of wording for your consideration.

The Bailiwick of Guernsey is committed to meeting international standards and evaluations of our prudential, conduct and AML/CFT supervisory regimes confirm this. However, should you require any information on the Bailiwick of Guernsey's AML/CFT Framework, please feel free to contact me or my Deputy Director, Nick Herquin.

Yours faithfully

Fiona Crocker

Memorandum to EBA

Directive (EU) 2015/849

The Risk Factor Guidelines – Consultation Response

Guernsey Financial
Services Commission

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1. Regulatory Framework

a) Commission Functions

The Guernsey Financial Services Commission ("the Commission") is the sole regulatory body responsible for licensing and supervising financial services in the Bailiwick of Guernsey ("the Bailiwick").

The Commission's primary objective is to regulate and supervise financial services in the Bailiwick, with integrity and efficiency, and in so doing help to uphold the international reputation of the Bailiwick as a finance centre.

The Commission is committed to international regulatory co-operation and is a signatory to the IOSCO MMoU and the IAIS MMoU. It also has numerous bilateral regulatory co-operative agreements in place; and, through ESMA, has in place MoUs covering AIFMD with 27 members of the EEA.

Guernsey was one of the first jurisdictions to establish a comprehensive licensing and supervisory regime for trust and corporate service providers ("TCSPs") in 2001. The Commission ensures the Bailiwick's regulatory framework and practice meets international standards and is a committed participant in discussions of international standards. It does so through membership of, or association with, the following international organisations:

(i) The Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL).
(ii) The International Organisation of Securities Commissions (IOSCO);
(iii) The International Association of Insurance Supervisors (IAIS) and the Group of International Insurance Centre Supervisors (GIICS);
(iv) The Group of International Finance Centre Supervisors (GIFCS)
(v) The Organisation for Economic Co-operation and Development (OECD) - through the UK's membership; and

Through its membership of the Group of International Finance Centre Supervisors, it works with:

(i) The Basel Committee on Banking Supervision (BIS);
(ii) The Financial Action Task Force (FATF) on money laundering.

The Commission also led GIFCS's development of an international standard for the supervision of TCSPs.

b) Benefits to the UK and Europe

The Guernsey funds industry provides a clear benefit to the UK and Europe as follows: -

(i) The Guernsey funds industry acts as a conduit for £24.6bn of inward investment into the UK from global investors;
(ii) The Guernsey funds industry acts as a conduit for £51.4bn of inward investment into Europe from global investors;
(iii) European investment companies earn £800mn of fees per annum from managing assets in Guernsey funds sourced from non-European investors;
(iv) Guernsey funds facilitate access for UK investors investing £26.5bn into global assets; and
(v) The Guernsey funds industry facilitates inward and outward investment to and from the UK and wider Europe with a robust and internationally recognised regulatory platform.

The aforementioned is an executive summary of KPMG's report of international capital flows dated January 2015. For full details, please see: -
http://www.guernseyfinance.com/media/593548/international-capital-flows.pdf.

2. Consultation Response

The European Supervisory Authorities ("ESA") have asked respondents to consider whether these guidelines are conducive to firms adopting risk based, proportionate and effective AML/CFT policies and procedures and whether they are conducive to competent authorities effectively monitoring firms' compliance with AML/CFT requirements.

In the following pages we have expanded on the broad issues raised in the covering letter and propose, where applicable, alternative forms of wording for your consideration.

3. Assessing and Managing Risk

a) Obtaining a Holistic View – Paragraphs 10 and 17

The Commission had the benefit of attending the public hearing on 15 December 2015 at which it was emphasised by the Panel that the presence of one isolated high risk factor may not necessarily place a business relationship or occasional transaction into a high risk category of client to which enhanced due diligence must be applied. There is reference in the draft guidelines to firms taking a holistic view but these are only short paragraphs numbered at 10 and 17 in the document. The Commission proposes that additional clarification would be of benefit. Such text could take the form of emphasising that the presence of a single high risk factor should be assessed in the context of all factors, both higher and lower risk, which are present within the overall relationship or transaction, or that firms must derive the overall risk level from taking into account all risks and not just higher risk factors.

b) Proportionality

The language which is used in paragraph 23 for factors for consideration of country and geographic risks is more prescriptive compared to that of the language used for factors for consideration of customer, product or service and delivery channel risks. This appears to run counter to the aim of the Guidelines to encourage a risk-based, proportionate and effective risk assessment.

Paragraph 23 starts "Risk factors firms should consider when identifying the level of ML/TF risk associated with a jurisdiction include" whereas many other paragraphs commence with "Risk factors that may be relevant when considering the risk" (please see as examples paragraphs 19, 20, 21, 26, 27 and 28).

We agree that firms should consider a jurisdiction's memberships of the FATF or FATF style regional body ("FSRB"), the FATF's list of high risk and non-cooperative jurisdictions, whether there are financial sanctions in place and the findings from mutual evaluation reports produced by these bodies and assessments by the OECD and IMF. However it is not proportionate to apply a similar emphasis to other factors under paragraph 23 which are more subjective or which reference very general terms open to various interpretations.

A distinction should therefore be drawn between the various factors listed under paragraph 23. This could be brought out by separating the factors listed in paragraph 23 into two separate paragraphs, one

containing "risk factors firms should consider when identifying the level of ML/TF risk associated with a jurisdiction" to cover FATF/FSRB membership in the aforementioned FATF list, financial sanctions and mutual evaluation reports by these bodies and assessments by the OECD and IMF; and the other paragraph, which would contain the more subjective "risk factors that may be relevant when considering the risk."

4. Countries and Geographical Risks

a) General Guidelines - Paragraph 23

We agree that country risk should be based on objective criteria and rely on credible and trustworthy sources, and, as stated in point 1b) above, we support placing the emphasis upon assessments by the FATF, FATF regional style bodies, OECD and IMF as these are detailed analyses of a jurisdiction based upon empirical evidence. Factors listed in Paragraph 23 generally conform to this approach. However, we have concerns with the wording as proposed: "*Is the jurisdiction a known tax haven, secrecy haven or offshore jurisdiction?*" We believe this relies on very generalised terms, the interpretation of which is subjective. In the absence of any agreed definitions for these terms, it is likely to be interpreted differently across the EU member states by competent authorities and firms alike. This will lead to divergence rather than harmonisation. Furthermore, such a criterion is absent from the country or geographic risk factors proposed by the FATF in the Interpretative Note to Recommendation 10.

As there is no clear agreed international or EU definition for these terms, our suggestion is that this wording should be removed. We believe it would be more effective if these references were replaced with reference to the OECD's Global Forum on Tax Transparency and Exchange of Information for Tax Purposes and the Common Reporting Standard, and FATF or FATF style regional body's mutual evaluation reports which cover an assessment against FATF Recommendations 9, 24 and 25 which concern secrecy and transparency of beneficial ownerships of legal persons and legal arrangements. Alternatively, given the EU context, we suggest that the wording 'Does the jurisdiction meet standards of good governance in corporate tax? (as outlined in the European Commission Communication of December 2012)'.

The term "offshore" can be applied to many parts of the world. Whilst the Panel explained at the public hearing that not all offshore jurisdictions would be regarded in the same light the current draft Guidelines do not provide this clarity for competent authorities and firms to make an informed decision. We would suggest if there are offshore jurisdictions with specific characteristics which could foster financial crime including terrorism these characteristics should be referenced, for

example, if the concerns relate to tax or secrecy, the factors that firms could consider would be those we identify in the preceding paragraph of this memorandum regarding the relevant OECD initiative and FATF Recommendations, against which jurisdictions are assessed.

b) Sectorial Guidelines – Paragraph 196

We note that in the sectorial guidelines for investment managers, in particular, paragraph 196 states that the following may indicate higher risk:

"the investor or their custodian is based in a high risk jurisdiction, including off-shore jurisdictions; the funds come from a high risk jurisdiction, including off-shore jurisdictions."

We do not consider that all offshore jurisdictions should be considered high risk, and therefore, suggest that this risk criterion be based on objective criteria rather than subjective criteria. We consider that jurisdiction risk should be based on international standard setter reports such as those compiled by the IMF, FATF and FATF style regional bodies such as MoneyVal. Please also refer to our comments under point 4(a) above. Alternatively both these factors under paragraph 196 could be amended to "*in a high risk jurisdiction, in particular those associated with higher levels of predicate offences to money laundering.*" This would then be consistent with the language used in paragraph 209.

c) Sectorial Guidelines - Article 9 of Directive (EU) 2015/849

It is unclear from the guidelines as to why references are made to high risk jurisdictions, including those identified by the European Commission as having strategic deficiencies in line with Article 9 of Directive (EU) 2015/849 in some sectorial guidelines and not others. Would it not be more conducive for both firms and competent authorities if greater emphasis was placed on Article 9 of Directive (EU) 2015/849 throughout the Risk Factor Guidelines?

d) Products, Services and Transaction Risk Factors

There is reference in paragraph 26 to "offshore and certain onshore trusts" as factors to consider under products, services and transactions risks but there is no explanation in the guidelines on what are "certain onshore trusts" or why a distinction can be made between onshore and offshore. A number of international offshore finance centres, including Guernsey, have long established and tested prudential, conduct and AML/CFT supervisory regimes of trust and corporate service providers, which mitigate the risks to which trusts might be abused. We would propose that rather than draw an

arbitrary distinction between a trust governed by the laws of an "onshore" or an "offshore" jurisdiction when various types of trusts exist onshore and offshore, it would be more beneficial to include reference to establishing whether the trustee is appropriately licensed and supervised and ascertaining the rationale for the use of a trust as mitigating factors.

Again at paragraph 194 there is reference to "offshore company or trust" where the reason for the offshore distinction is unclear. In addition it would appear that the Guidelines run counter to the FATF's which draws no such distinction between onshore and offshore companies and trusts as factors which would be considered higher risk.

5. Equivalence with Directive (EU) 2015/849 – Paragraphs 30, 78, 99, 180 & 210

We have noted in the following circumstances, the Risk Factor Guidelines include references to equivalence with Directive (EU) 2015/849: -

a) Paragraph 30 refers to intermediaries which are subject to AML obligations that are consistent with those of the Directive;

b) Paragraph 78 states that in a correspondent banking relationship the correspondent may consider a respondent as lower risk if the respondent's AML/CFT controls are in line with the Directive;

c) Paragraphs 99 states that transactions must be carried out through an account in the customer's name at a credit or financial institution that is subject to AML/CFT requirements equivalent to those required by the Directive; and

d) Paragraph 180 states in the case of corporate owned life insurance the credit of a financial institution may be considered lower risk if it's subject to AML/CFT requirements consistent with the Directive.

It is unclear if this is technical equivalence or outcomes based equivalence. If it is technical equivalence, it will be both costly and time consuming for firms and competent authorities to assess, as third countries' AML/CFT regimes are based on the FATF Recommendations rather than Directive (EU) 2015/849. It is therefore suggested that references to equivalence with Directive (EU) 2015/849 be replaced with equivalence to the FATF Recommendations or that equivalence with the FATF Recommendations is an acceptable alternative. Using this approach will enable both firms and competent authorities to assess a third country's AML/CFT framework using FATF evaluation reports or a FATF style regional body evaluation reports e.g. MoneyVal.

6. Distribution and Channel Risk Factors – Paragraph 145

This paragraph indicates that the risk may be higher where a firm facilitates the customer being provided with a product or service by another financial institution which is not part of its group. It would appear that this could hinder or counter efforts to ensure that firms treat their customers fairly as there may be sound reasons for such a referral when the firm considers that better value or service could be achieved for its customer by seeking the service from outside of its group or where the group does not offer the service. We would suggest that additional clarification is added to this paragraph referencing that firms should consider the reasons for establishing a relationship outside of group.

7. Third Country Intermediaries – Paragraph 215

Paragraph 212 of the Risk Factor Guidelines states that where a firm uses a financial intermediary to distribute fund shares, e.g. a regulated platform, a bank or a financial adviser, that intermediary may be regarded as the firm's customer. Paragraph 213 states that SDD may be applied provided three conditions hold, the first of which is that the intermediary is subject to AML/CFT in an EEA jurisdiction and Paragraph 215 states that where the financial intermediary is established in a third country this concession cannot be used.

Unlike analogous provisions for correspondent banks, where Article 19 of the Directive provides the legal basis for the preclusion of application of SDD for third country correspondent banks (although we feel obliged to point out that the European Commission, through the European Banking Committee on advisement from the EBA, has previously made equivalence assessment of third country regulatory regimes for credit institutions where adherence to global AML/CFT standards was just one criteria), there is no legal basis in the Directive to apply this preclusion. As was explained by the Panel at the public hearing held at the EBA on 15 December 2015, the proposed exclusion was merely a result of discussions within the working group. We concur that it is rationale to default to inclusion of all EEA jurisdictions though we believe that it does not follow it is rationale or proportionate on a risk based basis to default to exclusion of all third country jurisdictions.

Whilst this provision will not be difficult for Guernsey firms which are intermediary customers of EU firms to provide CDD information on their customers it will place a large compliance burden on EU firms dealing with both intra-group companies and third parties located in third country jurisdictions. We consider that the use of simplified due diligence, in particular, the intermediary provisions, should be assessed on the basis of risk and not whether the party is based outside of the EU. Paragraph 215 could become burdensome for EU firms at a time when the EU is endeavouring to open its capital markets.

We propose the following amendments (strikethrough means deletion, italics means addition):

a) Paragraph 213

'In those situations the firm may apply SDD measures provided that:

The financial intermediary is subject to AML/CFT obligations in an EEA *or other non-high risk* jurisdiction *(following guidance as set out in paragraph 23)*.

b) Paragraph 215

'Where the financial intermediary is not established in a non-high risk jurisdiction ~~third country,~~ or where there are indications the risk associated with the business relationship is high……..'