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WORKING DOCUMENT

From:	General Secretariat of the Council
To:	Financial Services Attachés Working Party on Financial Services and the Banking Union (AML)
Subject:	AML working party 13.11.23 Non paper by DE, LU, NL on the risk based approach in the AML package

Non paper on the risk based approach in the AML package

The European Commission has presented on July, 20th 2021, a legislative package aiming at strengthening the European framework for anti-money laundering and combatting the financing of terrorism (hereafter: AML/CFT). By now, the Council and the European Parliament (hereafter: EP) have agreed on their positions and the trilogues have started. In its press release[1] the EP states that the MEPs have 'approved stricter rules to close existing gaps'.

Germany, Luxembourg and The Netherlands unequivocally share the EP's goal of closing existing gaps to strengthen the framework. However, we are concerned that some of the EP's proposals for stricter rules undermine the risk based character of the framework. Counterintuitively, this might actually weaken the framework. Therefore, we call on the EP to uphold the risk based approach as the foundation of the AML/CFT framework.

The risk based approach is central to an effective EU AML/CFT framework.[2] It entails that countries, competent authorities, and gatekeepers identify, assess, and understand the money laundering and terrorist financing risk to which they are exposed, and take the appropriate mitigation measures in accordance with the level of risk. This flexibility allows countries, competent authorities and gatekeepers to mitigate the money laundering and terrorist financing risks they have identified effectively, by prioritising their effort and resources to mitigate risks in the highest risk areas. It enables them to take enhanced measures in situations where the risks are higher, apply simplified measures where the risks are lower and exempt low risk activities. In short, the risk based approach is necessary for an effective AML/CFT framework.

The **two main risks** of undermining the risk based approach are:

- It is **ineffective and inefficient**, as it prevents gatekeepers from prioritising their efforts and by nature limited resources towards the highest risk areas and instead forces them to apply strict measures regardless of the risk a client poses.
- It is **disproportionate**, which will **negatively impact EU citizens** as well as the internal market, bearing in mind that an overwhelming majority of gatekeepers' clients are bonafide EU citizens. Forcing the application of stricter rules throughout the entire spectrum of clients might:
    - enhance unintended consequences like a higher administrative burden on EU citizens and inappropriate de-risking, endangering financial inclusion within the EU.
    - enhance the administrative burden on gatekeepers which they most likely pass onto their clients in terms additional fees. This might also negatively impact the internal market.

[1] New EU measures against money laundering and terrorist financing | News | European Parliament (europa.eu).
[2] The FATF recognises the risk based approach as the cornerstone of the FATF Recommendations. FATF Recommendations (fatf-gafi.org).

We note that some of the EP's proposals in the AMLR and AMLD[3] for stricter rules seriously undermine the possibilities for gatekeepers to apply a risk based approach. Examples of these proposals are:

- Expansion of the scope of the entire framework and its obligations to **new sectors**, such as professional football actors, online platforms and traders in luxury goods. Although some of these sectors pose a significant ML/TF risk, this in itself is not a reason to designate these sectors as gatekeepers, as their risks can be mitigated through the existing gatekeepers.
- Extension of detailed **customer due diligence** requirements, irrespective of individual risk. Examples are specific provisions for all high net worth customers, restricting the flexibility to perform proportionate standard or simplified due diligence, the requirement to perform at least one enhanced due diligence measure in cases of high risk and the obligation to verify the identity of beneficial owners, without the addition of reasonable measures. The latter might have the following effect in practice.

> **Practical example**
> *If a student association with barely any assets or transactions, whose beneficial owners are the senior management (students), would want to open a bank account, it would have to provide extensive personal data on the individual students that comprise the board. Even though this information was already provided – by the same entity – in the central BO-register and checked by the entity in charge of the register.*

- Expanded understanding of which legal entities from third countries need to register with the transparency register.
- Expanded definition of **politically exposed persons**, such as including local level for state-owned enterprises and widened understanding of close associates. The latter might have the following effect in practice:

> **Practical example**
> *If someone's brother has a public office in the municipality, when opening a bank account, that person will have to produce additional information on their person, the intended nature of the business relationship, the source of funds, such as tax returns, or explain certain transactions.*

- Expanding requirements for creating new registers, such as setting up a new partial asset register.
- Proposition to publish a **list of high risk financial institutions**.

Recently, the FATF and national AML/CFT supervisors[4] have observed that overcompliance results in unintended consequences and ineffective application of the current AML/CFT framework. This has

[3] AMLAR's provisions are not a part of this non-paper.
[4] See this FATF report: https://www.fatf-gafi.org/en/publications/Financialinclusionandnpoissues/Unintended-consequences-project.html. See this report from the Dutch AML/CFT supervisor De Nederlandsche Bank: https://www.dnb.nl/media/mdgafi3a/from-recovery-to-balance.pdf.

resulted in the insight that a more risk based approach is warranted. Instead of creating a less risk based framework, we should look for ways to strengthening the risk based approach and focus on a cooperative approach of public and private stakeholders in pursuing the common goal of preventing on money-laundering and terrorist financing.

In the end, the EP and the Council have the same objective for the AML package: to create an effective European AML/CFT framework. We call on the PCY to address the core principle of the AML/CFT framework as a horizontal issue during the trilogues and engage with the EP to uphold the risk based approach as the foundation of the AML/CFT framework.