Council of the European Union
General Secretariat

Interinstitutional files:
2021/0240 (COD)

Brussels, 04 December 2023

WK 16298/2023 INIT

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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:	AMLA: Commission services non-paper on Articles 12 and 13 - technical drafting plus recital on residual risk

Please find attached the suggested text for 4CT of Articles 12 and 13 plus the relevant recitals on selection process with adjustments to fit redrafted provisions and also to explain the expectations for residual risk methodology in the first selection.

In the normative provisions only residual risk is left as the basis of selection from the very beginning, hence the inherent risk from transitional provision is deleted. The recital does not change anything just explains that the very first methodology will not have been tested in practice and so will be a bit more crude and refined in subsequent rounds.

All the other changes in Arts 12 and 13 compared to the previous version in the Commission's non-paper are highlighted in green and explained.

They are:

1. Accommodating the EP amendment to require AMLA to share the outcomes of assessment with prudential supervisors, prior to publication of the list (placed in Art.13 instead of Art. 12)
2. Accommodating the PCY request to mandate in the RTS that AMLA specifies how direct provision of services would be evaluated for the purposes of assessment
3. The transitional arrangements are put in a single Article, so it is together the transitional regime for database transfer from EBA and for direct supervision (1 entity per MS disapplication, 40 entities cap in the first round). It is suggested to place it in Art. 91a (just before the article on commencement of Authority's tasks at the end of the Regulation)
4. Minor quality of legal drafting adjustments suggested by the legal service or correction of some mistakes

Direct supervision (Art. 12 and 13 + recital) – drafting for 4CT for the PT on 7th

RECITALs:

Commented [redacted]: All changes to original recitals highlighted in yellow

(15) With the objective of ensuring a more effective and less fragmented protection of the Union's financial framework, a limited number of the riskiest obliged entities should be directly supervised by the Authority. As ML/TF risks are not proportional to the size of the supervised entities, other criteria should be applied to identify the most risky entities. In particular, two categories should be considered: high-risk cross-border credit and financial institutions with activity in a significant number of Member States, selected periodically; and, in exceptional cases, any entity whose material breaches of applicable requirements are not sufficiently or in a timely manner addressed by its national supervisor. Those entities would fall under the category of 'selected obliged entities'.

(16) The first category of credit and financial institutions, or groups of such institutions should be assessed every three years, based on a combination of objective criteria related to their cross-border presence and activity, and criteria related to their ~~inherent~~ ML/FT risk profile. Only ~~large complex~~ **credit or financial institutions or groups thereof, which are** present in a **significant** number of Member States, **regardless of whether they operate through establishments or under the freedom to provide services in Member States, and for which supervision** ~~at that could be more efficiently supervised~~ at Union level~~,~~ **would therefore be more adequate and efficient,** should be included in the selection process. ~~With respect to credit institutions, minimal cross-border presence for inclusion in the selection process should be based on the number of subsidiaries and branches in different Member States, because risky banking activities of significant volume require a local presence in a form of an establishment. Other financial sector entities may, in contrast, carry out activities that can be sufficiently risky from an ML/TF perspective by means of direct provision of services, for example via a network of agents, but may not have established subsidiaries or branches in a large number of Member States. Therefore, applying the same cross-border criteria, that is to say the one related to freedom of establishment, would result in scoping out large financial sector entities that can have a significant risk profile in a number of Member States, without being established there. Since the volume of activities via direct provision of services is generally smaller than the volume of activities carried out in a branch or a subsidiary, it is appropriate to consider only groups that are established in at least two Member States, but provide services directly or via a network of agents in at least eight more Member States.~~

(17) In order to ensure that only the riskiest obliged entities among those with significant cross-border operations are supervised directly at the level of the Union, the assessment of their **inherent and residual** risk **profile** should be harmonised **for the purpose of the selection process.** Currently, there are various national approaches and supervisory authorities use distinct benchmarks **and methodologies** for assessment and classification of the **risk** inherent **of the business model of the obliged entities as well as the assessment of residual risk which is the risk that remains after measures to mitigate the inherent risk have been put in place.** Using these national methodologies for selection of entities for direct supervision at Union level could lead to a different playing field among them. Therefore, the Authority should be empowered to develop regulatory technical standards laying out a harmonised methodology and benchmarks for categorising the inherent **and residual** ML/TF risk profile as low, medium, substantial, or high. **As regards the inherent risk,** the methodology should

be tailored to particular types of risks and therefore should follow different categories of obliged entities which are financial institutions in accordance with the Regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing [OP please insert the next number for COM(2021)420]. That methodology should be sufficiently detailed and should establish specific quantitative and qualitative benchmarks considering at least the risk factors related to types of customers served, products and services offered, and geographical areas, including third country jurisdictions that obliged entities operate in or are related to. **For the purposes of assessing the residual risk, the methodology should also include benchmarks for the assessment of the quality of internal policies, procedures and controls put in place by the obliged entities to mitigate their inherent risk.** Each assessed obliged entity **or group thereof** would have its inherent **and residual** risk profile classified in a manner consistent with the classification of any other obliged entity in the Union. ~~The quantitative and qualitative benchmarks would allow such classification to be objective and not dependent on the discretion of a given supervisory authority in a Member State, or the discretion of the Authority.~~ **Given the current wide diversity of approaches adopted by national authorities to the evaluation of the residual risk profile of obliged entities, the process of regulatory development of a refined and detailed harmonised methodology allowing for assessment of residual risk with comparable outcomes is evolving. Therefore, the methodology for the categorisation of residual risk to be applied for the first identification of selected obliged entities will have to be more basic than the different diverse approaches applied at national level. The Authority should review the methodology it is to apply every three years, taking account of the evolution of the relevant knowledge.**

Commented [redacted]: This is the main explanation of the expectations towards residual risk assessment in the first round

LEGAL DRAFTING OF NORMATIVE PROVISIONS

Article 91a

Transitional arrangements

Commented [redacted]: We suggest to make it article 91a just before the article on commencement of AMLA's activities

Also, transitional arrangements are for the entire Regulation so this Article would be for direct supervision as well as the AML/CFT database transitional EP has suggested for EBA-AMLA transfer of database, so we put the two together

The paragraphs start with "By derogation from Article (…)" because our LS advises us that it's the typical wording for transitional we have to use

2. By way of derogation from Article 11, for the purposes of establishing and maintaining the database referred to in Article 11, the Authority shall conclude a bilateral agreement with the European Banking Authority on access to, as well as the financing and the joint management of, the AML/CFT database established in accordance with Article 9a of Regulation EU (No) 1093/2010 (EuReCA). The arrangement shall be established for a mutually agreed period of time which can be extended until no later than [18 months] after entry into force of this Regulation.

Commented [redacted]: Database transitional

During this period, the European Banking Authority shall at least be able to continue receiving information, analysing it and making it available in accordance with Article 9a of Regulation EU (No) 1093/2010 or in accordance with this Regulation on behalf of the Authority and based on the financing made available by the Authority for this purpose.

1. By way of derogation from Articles 12 and 13, paragraph [1b] of Article 13 shall not apply during the first selection process.

Commented [redacted]: Selection process transitional: disapplication of 1 entity per Member State in first selection and application of 40 entities cap in first selection
Nothing for residual risk because recitals above is the only thing we suggest to add

So effectively the normative provisions only have residual risk as basis for selection, from the very beginning

In case more than [40] obliged entities would be selected pursuant to paragraph 1, the Authority shall carry out the tasks listed in article 5(2) in respect of the 40 obliged entities or groups operating in the

highest number of Member States either through establishments or under the freedom to provide services.

In the case that the criterion referred to in the first subparagraph yields more than 40 obliged entities or groups, the Authority shall select, from the obliged entities or groups that would be selected in accordance with paragraph 1 and that actively operate in the smallest largest number of Member States, those which have the highest ratio of the volume of transactions with third countries to the total volume of transactions measured in the last financial year.

Article 12

1. For the purposes of carrying out the tasks listed in Article 5(2), the Authority, in collaboration with financial supervisors, shall carry out a periodic assessment of credit and financial institutions and groups of credit and financial institutions referred to in paragraph 3 where they operate in at least [six] Member States, including the home Member State, either through establishments or under the freedom to provide services in the Member States other than the Member State where the obliged entity's head office is established, regardless of whether the activities are carried out through an infrastructure in their territory or remotely.

1a. The supervisory authorities and the obliged entities subject to periodic assessment shall supply the Authority with any information necessary to carry out the periodic assessment.

2. The inherent and residual risk profile of the assessed obliged entities referred to in paragraph 1 shall be classified by the Authority as low, medium, substantial or high, based on the benchmarks and following the methodology set out in the regulatory technical standard referred to in paragraph 5. Where the assessed obliged entity is a group of credit institution and/or financial institutions, the risk profile should be classified at group-wide level.

3. The methodology for classifying the inherent and residual risk profile shall be established separately for at least the following categories of obliged entities:

(a) credit institutions;

(b) bureaux de change;

(c) collective investment undertakings;

(d) credit providers other than credit institutions;

(e) e-money institutions;

(f) investment firms;

(g) payments service providers;

(h) life insurance undertakings;

(i) life insurance intermediaries;

(j) crypto-asset service providers;

(k) Other financial institutions.

Commented [redacted]: We left clean text without prior mixed formatting only because it will be easier for you to read and to incorporate it in 4CT

We highlight all the differences with previous drafting you have already seen in green with explanations - it's either adjustments for quality of legal drafting proposed by our LS, or a few things you requested (e.g. EP requested the point on informing pru supervisors, PCY requested two cuff off criteria for the flexible cap etc)

Commented [redacted]: Mirroring the language of the paper on FoE-FPS for Article 29 AMLD

4. For each category of obliged entities referred to in paragraph 43, the benchmarks for the assessment of inherent risk in the assessment methodology shall be based on the risk factor categories related to customer, products, services, transactions, delivery channels and geographical areas. ~~The assessment methodology shall also include benchmarks for the assessment of risk mitigation and management systems put in place by the obliged entities for the purposes of the assessment of their residual risk.~~ The benchmarks shall be established for at least the following indicators of inherent risk in any Member State they operate in:

(a) with respect to customer-related risk: the share of non-resident customers from third countries identified pursuant to in Chapter III Section 2 of [please insert reference – proposal for Anti-Money Laundering Regulation]; the presence and share of customers identified as Politically Exposed persons ('PEPs');

(b) with respect to products and services offered:

(i) the significance and the trading volume of products and services identified as the most potentially vulnerable to money laundering and terrorist financing risks at the level of the internal market in the supra-national risk assessment or at the level of the country in the national risk assessment;

(ii) for money remittance service providers, the significance of aggregate annual emission and reception activity of each remitter in countries identified pursuant to in Chapter III Section 2 of Regulation [please insert reference to Anti-Money Laundering Regulation];

(iii) the relative volume of products, services or transactions that offer a considerable level of protection of client's privacy and identity or other form of anonymity~~, such as crypto-assets which have in-built anonymisation~~;

(c) with respect to geographical areas:

(i) the annual volume of correspondent banking services, or correspondent crypto-asset services, provided by Union financial sector entities in third countries identified pursuant to Chapter III Section 2 of Regulation [please insert reference to Anti-Money Laundering Regulation];

(ii) the number and share of correspondent banking clients or crypto-asset clients in third countries identified pursuant to Chapter III Section 2 of Regulation [OP please insert reference to for Anti-Money Laundering Regulation].

4a. For each category of obliged entities referred to in paragraph 3, the assessment of residual risk in the assessment methodology shall include benchmarks for the assessment of the quality of internal policies, controls and procedures put in place by obliged entities to mitigate their inherent risk.

5. The Authority shall develop draft regulatory technical standard specifying:

(a) the minimum activities to be carried out by a credit or financial institutions under the freedom to provide services, whether through an infrastructure or remotely, for it to be considered as operating in a Member State other than that where it is established;

(b) the methodology based on the benchmarks referred to in paragraph 4 and 4a for classifying the inherent and the residual risk profile of credit or financial institution or groups thereof as low, medium, substantial or high;

Commented [redacted]: Our LS has suggested to put this in separate para below for the sake of clarity of legal drafting and to put the emphasis on residual risk which will be the basis of selection, see also a more detailed explanation below

Commented [redacted]: This suggestion by EP deleted as we are banning the provision of anonimity-enhancing coins by CASPs

Commented [redacted] We suggest to move the 2nd sentence of Article 12(4) on the residual risk to a selfstanding new paragraph 4a.

The reason for this is that the first and the last sentence of para 4 are about the "inherent risk", so having the sentence on residual risk in a 'sandwich' position between them is odd.

Moreover, if it is put as a separate para after para 4, it highlights even more that the residual risk builds on the inherent risk.

Commented [redacted]: This is our proposal as an alternative to the concept of "active" provision of services to address the concern of the Council in counting the threshold of MSs of operation

The Authority shall submit the draft regulatory technical standards to the Commission by [1 January 2026].

6. The Authority shall review the benchmarks and methodology at least every three years. Where amendments are required, the Authority shall submit amended draft regulatory technical standards to the Commission.

Article 13 – COM proposal

1. The credit institutions, financial institutions and groups thereof whose residual risk profile has been classified as high pursuant to Article 12 shall qualify as selected obliged entities.

1a. Where more than 40 selected obliged entities are identified pursuant to paragraph 1, the Authority may, in consultation with the supervisory authorities, agree on limiting the selection to a specific different number of entities or groups that is greater than 40 [and that shall not exceed 60.]

In deciding on the number of selected obliged entities, the Authority shall take into account its own resources capacity to allocate or additionally hire the necessary number of supervisory and support staff and shall ensure that the increase in the financial and human resources is feasible.

Pursuant to the decision of the maximum number, the selected obliged entities shall be the obliged entities and groups among those qualifying under paragraph 1, which are operating in the highest number of Member States either through establishments or under the freedom to provide services or those which have the highest ratio of the volume of transactions with third countries to the total volume of transactions measured in the last financial year.

1b. Where in a Member state no credit, financial institution or a group of credit and/or financial institutions which is established, authorised or registered, or has a subsidiary therein whose risk profile is classified as high, qualifies as a selected obliged entity pursuant to paragraphs 1 and 1a, an additional selection process shall be carried out by the Authority in that Member State, based on methodology referred to in Article 12(5).

Following the additional selection process, the credit or financial institution or a group of credit and/or financial institutions established or registered in this Member State whose risk profile qualifies as high shall qualify as a selected obliged entity.

Where several credit or financial institutions or groups thereof in the Member State in question have a high risk profile, then the selected obliged entity shall be the one operating in the highest number of Member States through either free establishment or active free provision of services. If several credit or financial institutions or groups thereof operate in the same number of Member States, the entity with the highest ratio of transaction volume with third countries to total transaction volume as measured over the last financial reporting year shall qualify as a selected obliged entity.

2. The Authority shall commence the first selection process [by 1 July 2027] and shall conclude the selection within [six] months. The selection shall be made every three years after the date of commencement of the first selection, and shall be concluded within [six] months in each selection process. The list of the selected obliged entities shall be published by the Authority without undue delay upon completion of selection process. The Authority shall commence the direct supervision of the selected obliged entities [six] months after publication of the list.

Commented [redacted]: We have added the highlighted bit because LS pointed out that without it, AMLA could actually decide on lower No than 40, and in the last PT it was clear that you both agree that 40 only applies in 1st selection, and after AMLA can only go higher not lower

Commented [redacted] We keep this highlighted even though you have seen it already just to flag to you that theoretically we do not need the upper limit - it's a policy choice

Commented [redacted] This is following the suggestion of the PCY to have a double cut-off criterion in case the first one (No of MSs) will result in legal uncertainty (e.g. AMLA decided on 55 entities and there are 56 because No54, 55 and 56 are in the same No of MSs)

However, we still suggest to give AMLA a bit of flexibility to apply whichever criterion is handier, we don't need to make it cascading like in the first selection where we have a hard 40 entities threshold

2b. Prior to the publication of the list of the selection obliged entities, the Authority shall inform the relevant non-AML authorities of the outcomes of the process of assessment and classification of inherent and residual risk of the obliged entities subject to assessment.

3. A selected obliged entity shall remain subject to direct supervision by the Authority until the Authority commences the direct supervision of selected obliged entities based on a list established for the subsequent selection round which no longer includes that obliged entity.

Commented [redacted]: This is based on the amendment of the EP to inform relevant non-AML authorities especially banking pru supervisors

It would be better placed in Art.13 and we have specified that they should be informed specifically of the risk classification and in advance, before publication of the list