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EPIF'S POSITION PAPER ON THE EUROPEAN COMMISSION'S PROPOSAL FOR THE 4TH ANTI-MONEY LAUNDERING DIRECTIVE

ABOUT EPIF (EUROPEAN PAYMENT INSTITUTIONS FEDERATION)

EPIF, founded in 2011, represents the interests of the non-bank payment institutions ("PI") sector at the European level. We currently represent over 250 PIs offering services in every part of Europe. Our diverse membership includes the broad range of business models covered by the PSD including:

- 3-party Card Network Schemes
- Acquirers
- Money Transfer Operators
- FX Payment Providers
- Mobile Payments
- Payment Processing Service Providers
- Card Issuers

EPIF seeks to represent the voice of the PI industry with EU institutions, policymakers and stakeholders. We aim to play a constructive role in shaping and developing market conditions for payments in a modern and constantly evolving environment. It is our desire to promote a single EU payments market via the removal of excessive regulatory obstacles.

We wish to be seen as an infrastructure provider for efficient payments in that single market and it is our aim to increase payment product diversification and innovation tailored to the needs of society (e.g. via mobile and internet).

INTRODUCTION

EPIF welcomes the publication of proposals for the 4th Anti-Money Laundering Directive (4AMLD). EPIF was involved in the private stakeholder consultation on the review of the 3rd Anti-Money Laundering Directive (3AMLD) and put forward a position paper setting out EPIF's recommendations for the review.

PI's compliance with anti-money laundering and combating the financing of terrorism (CFT) obligations is a prerequisite for their authorisation under the Payment Services Directive (PSD).

The current framework under the 3rd AMLD was established prior to the opening of the payment institutions market and subsequently aspects could be argued to not cater to the needs of the various PI's business models, nor do they cater for the emergence of new technologies in the payments space and the increasing reality of non face to face transactions. Additionally, the existing AML rules in the EU and in the proposed directive should not be making assumptions that PIs operate around the traditional account based model. AML rules need to be calibrated to reflect the reality of PI's operating models.

EPIF would like to take the opportunity to identify some key areas that EPIF believes the 4AMLD should seek to address but currently does not. This includes, amongst other things, the legislative method applied (minimum harmonisation as opposed to maximum harmonization), risk based approach, customer due diligence measures and data protection issues.

We have expanded on these themes below and would welcome further consideration and dialogue on these and other points.

We have not commented on the related legislation i.e. New Funds Transfer Regulations which amends the existing Wire Transfer Regulations.

THE 4TH ANTI-MONEY LAUNDERING DIRECTIVE (4TH AMLD)

1. MINIMUM HARMONISATION

As a general observation, EPIF notes with disappointment that the new regime under the 4AMLD will not be based on the maximum harmonisation principle. **In EPIF's view, by not adopting the maximum harmonisation legislative method, the Commission is missing out on a key opportunity to push strongly towards the PSD's aspirations for a Single Market for payments and a level playing field for market participants.**

AML rules should be more harmonized at the EU level. Currently, the Single Market for payments includes 27 different AML regimes, soon to be 28 regimes. Many technically difficult matters have been subject to maximum harmonisation (e.g. the PSD) while AML/CFT rules remain harmonised at a minimum level. The need for PIs to adapt to local AML legislation means that the maximum harmonisation sought by the PSD is far from being achieved as payment products and services cannot be offered cross-border in a cost efficient manner. This is not in the best interests of consumers or market competition in the EU because the increase in resources needed for the application of different AML rules in each country drives up the costs of services.

It remains unclear why customers in different parts of Europe are not subject to the same level of AML/CFT protection. For example, in the case of money remittance, some EU states require customer identification from the first euro prior to a money transfer operation whereas other EU states do not require ID until a certain threshold is reached. In the UK, this threshold is EUR 1,000. In France where ID is required from the first euro, the average amount of money transferred is typically around EUR 420. Spain similarly requires ID from the first euro and the average amount of money transferred is EUR 250. If France and Spain were to apply the same threshold as the UK, most money transfer operations in France and Spain would not require customer identification.

2. THE RISK-BASED APPROACH

EPIF is supportive of the proposed Directive reinforcing the emphasis on EU States and PIs taking a risk-based approach to complying with the AML regime. Making the new Directive less prescriptive in some respects than before is a positive move. Overall, EPIF supports legislative proposals that seek to strike a balance between the need for businesses to be allowed the latitude to make informed decisions as to the levels of risk in individual transactions, whilst encouraging greater collaboration, co-operation and

consistency of approach between national authorities. Over-arching guidance at an EU level as to how the risk-based approach should be applied would be required so as to ensure that the discretionary element does not lead to further divergences in Member States' interpretation. **Inconsistencies in Member States' application of the risk-based approach will lead to barriers to entry and reduced competition in the market.**

3. CUSTOMER DUE DILIGENCE ("CDD")

As a general point, CDD measures are critical to all PIs in ensuring compliance with AML obligations. CDD requirements typically include the following:-

- (i) Customer profile data gathered at source to verify the identity and legitimacy of the customer during the boarding approval process and
- (ii) On-going monitoring of customer activity to identify high risk transactions of a potential money-laundering nature.

EPIF has the following concerns with regards to the application of the risk based approach to CDD requirements under the current regime and as proposed for the new Directive.

A) Inconsistency on Simplified Customer Due Diligence ("SCDD")

Whilst EPIF supports the broadening of the risk-based approach in the proposals, EPIF has concerns around giving individual EU States discretion as to when SCDD is permitted and some discretion as to when Enhanced Customer Due Diligence ("ECDD") is required (so long as certain risk factors and guidelines from the European Supervisory Authorities ("ESAs") are taken into account). **Our concern is that this could give rise to greater uncertainty as to whether and when SCDD will be available at a national level, and less consistency of approach across the EU.**

A key question will be what is deemed low risk and how this will be assessed, especially also in a consistent way across borders. In implementing this risk-based approach EPIF advocates the promotion of a level playing field between PIs by requiring States to adopt a neutrality of treatment approach across different business models, and that States not be allowed to treat some models as riskier than others.

B) Innovative Payments

In the EU, EPIF members have experienced that the national implementation and application of the 3rd AMLD often discourages product innovation and the roll-out of innovative, low-principal, low-risk products.

Innovative products often involve a non-traditional business setting ('non face-to-face'), e.g. mobile/online or staged transactions. Despite transaction thresholds (per transaction and aggregated), some local EU AML supervisors require CDD including verification of the data at the "point-of-sale" due to:

- (i) Some supervisors assuming that a "business relationship" has been established despite the nature singular nature of the transaction (for instance, with regards to the transaction-based money transfers); or
- (ii) Other supervisors regarding certain types of transactions as inherently risky, regardless of the amounts involved or whether or not they actually present specific risks. This is the case, for instance, with non-face-to-face transactions or with money transfers.

Such Enhanced Customer Due Diligence requirements are very costly, impracticable, and arguably not necessary and not proportionate for certain transaction types which do not represent a high risk of Money Laundering or Terrorist Financing (for instance, for Secure Internet, electronic or mobile remittances up to a certain amount). **Such requirements serve as a clear obstacle to the development, innovation and provision of online and/or mobile payment products as they jeopardise the business case behind many of these low-margin payment services.** As a result, payment innovation in these segments does not take place within Europe but elsewhere (see for instance the vibrant mobile payments and remittance markets in several African countries (e.g. Kenya) or Asian countries (e.g. Philippines)).

Following a risk-based approach, EPIF does not think such requirements are necessary or appropriate, but are in fact counterproductive with regards to product innovation and financial inclusion. On top of that, such requirements are often impracticable. Legislators should not be making assumptions that the risk and security profile of a transaction automatically changes just because the transaction is delivered using new technology. Innovation should not be treated as being automatically synonymous with risk.

For electronic money products, the 3rd AMLD provided for optional exemptions from CDD requirements if certain monetary and aggregate thresholds are observed. This exemption has been deleted in the current proposal.

EPIF proposes to reintroduce the optional exemption for electronic money products and apply it also for non-electronic money products if the same quantitative thresholds are observed and a low-risk environment is maintained.

c) Low Value Payments - Simplified and Enhanced Customer Due Diligence

As a principle, **EPIF believes CDD requirements should be consistent across the EU and should increase in line with the risk profile of the activity, without hampering low-value payment products from being developed and offered.**

In our view the Money Laundering risks associated with low value payments are mitigated via the different AML controls applied to reduce the risks (e.g. customer profiling, ongoing transaction monitoring, legal thresholds and the obliged entity's internal thresholds). From EPIF's perspective the risks associated with low value payments are strictly related to Terrorism Financing rather than Money Laundering and in our view such Terrorism Financing risks are sufficiently mitigated via the ongoing checking of customer data against the various official international sanctions lists developed and constantly updated by different governments and international bodies. These sanctions lists include the EU Sanctions List, ONU Sanctions List and OFAC List.

Accordingly, EPIF recommends that Member States should be explicitly allowed to apply SCDD to low-value retail payment products if the maximum transaction amount is no more than EUR 250 supplemented by an aggregate limit, and a "low-risk scenario" is maintained (e.g. via CDD checks at the back-end of the transaction). The ESAs should establish or revise the technical criteria for assessing whether situations represent "low risk", in particular for innovative payment products with a low risk profile (limits on transaction values, volume or frequency). Overall, and in light of the continuously sizeable informal remittance sector in Europe, this will foster a higher efficacy of the overall AML/CFT framework in Europe.

Finally, EPIF also wishes to comment that in the specific examples of money remittance and non-face-to-face transactions, the current approach of several regulators is to consider all cash-based money transfer products by default as falling under the 'high/highest' risk category, regardless of the risks that they involve on a case-by-case basis (i.e. amounts transferred, the geographies of the business, the frequency of the operations or the level of authentication on Internet transactions). This one-size-fits-all approach does not help financial inclusion and payment innovation and should be discouraged via more guidance from the ESAs.

4. BUSINESS RELATIONSHIP

The current proposal does not change the existing definition of “Business Relationship” under the 3rd AMLD and the European Commission does not provide any further guidance regarding the definition of a Business Relationship or any other relevant aspect. In practice, national supervisory authorities come to different conclusions as to when a Business Relationship is being formed (e.g. based on frequency or principal, or whether loyalty cards/programs exist). Additionally, greater clarity about when verification of source of funds should be applied is also required.

As in the 3rd AMLD, an “occasional transaction” is not defined. More clarity on the definition of an occasional transaction would be welcome in the 4th AMLD.

5. CENTRAL CONTACT POINT

EPIF notes that under the new Directive it is proposed that Member States may require payment providers established on their territory, and whose head office is situated in another Member State or outside the Union, to appoint a central contact point in their territory to oversee the compliance with AML and CFT rules. This new requirement does not explicitly exist under the current regime.

EPIF believes that the criteria for the central contact points should be flexible allowing obliged entities to comply with the rule without adding unnecessary burdens. Obligated entities should be able to appoint an AML trained person from their own staff or, as currently allowed by most regulators under the current regime, be able to appoint AML trained staff based in another EU country or an AML trained person from a third party (e.g. an agent or a partner) in the respective country. Some objective criteria e.g. a minimum number of Suspicious Transactions Reports filed in a Member State, should be clarified before a Member State can use this option.

Additionally, the obligation should apply to **all** Payment Services Providers, not just for PIs and E-Money Institutions. No un-level playing field or bias in favour of the banks should be created under this requirement.

6. SUPERVISORY CO-OPERATION

EPIF views the strengthening of the powers of Host State Supervisors as positive provided this is coupled with closer Home and Host State Supervisory Authority and FIU cooperation. **PIs face significant operational challenges where there is a lack of co-ordination and agreement between Home and Host State Supervisory Authorities.** For example, in the case of Regulatory Reporting Requirements, pan-

European operators are faced with diverging reporting requirements and/ or lack of clear guidelines around timelines for submission, types of reports required (SAR, CTR, objective transaction reports etc.), reporting fields and formats and reporting languages. The lack of consistency around such requirements leads to potential duplication of efforts and consequently inefficient deployment of costs and resources.

EPIF believes there should be a central European committee/forum of all supervisors with whom and where companies which operate cross border can raise issues around supervisory matters. This would lead to better clarity of approach.

7. DATA PRIVACY

EPIF is of the opinion that applicable data privacy rules should not unduly restrict its members' ability to process relevant data for AML, CFT or Fraud Prevention purposes.

EU rules on data must enable businesses to collect (and use) data (including data already collected) to deliver AML, Fraud and Risk management programmes. Companies need to be able to utilise the collected data and should only be held accountable for the way they use such data.

Allowing data to be collected and/or used for legitimate purposes such as AML, CFT, Fraud and Payment Risk Management is critical to the payments industry and must be allowed under the new rules.

At present, it is unclear if, or how, common AML and permitted customer insight analysis such as profiling is going to be impacted or restricted by new data protection legislation. EPIF advocates that the requirements of the Data Protection and AML regimes be brought into alignment by clarifying that only profiling that causes serious and unjustified prejudice is prohibited, and not profiling done for legitimate AML, CFT and Fraud prevention purposes.

Additionally, the 'right to be forgotten' must not allow data that is needed for delivering AML, CFT, Fraud and Payments Risk Management obligations to be deleted if this would undermine such legitimate efforts. Such data uses should therefore be exempt from this right.

Accordingly, EPIF believes that the best approach is to clearly mention in the current proposal that data can be collected/ or used when a business needs to do so for the pursuit of its 'legitimate interests' (including AML, CFT, Fraud and Risk Management). Combined with the increased accountability rules proposed in the new data protection rules, this would provide flexibility for businesses, whilst still allowing regulators to make sure that this provision is not abused.

EPIF has produced a specific advocacy document on the new Data Protection Regulation and this Position Paper is available on our website www.paymentinstitutions.eu.

CONCLUSION

Finally, EPIF welcomes the opportunity to engage further with relevant EU Institutions on the issues highlighted above. EPIF would be happy to provide any technical input or any other helpful information, including the substantiation of the points made above or with regards to explaining how the different AML Rules apply to the different business models we represent.

For more information about the PI sector, the EPIF organisation and its members or our position papers, please contact us via our website or secretariat.

