



EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Company law, corporate governance and financial crime

Brussels, 12 September 2005

INVITATION FOR PUBLIC COMMENT

Working document in relation to the Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

DG Internal Market services are making public a Working Document related to Chapter VI of the draft Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (both institutions have reached an agreement on the text of the draft directive, formal adoption and publication in the OJ is foreseen shortly). Chapter VI of this directive provides for the adoption of **implementing measures** by the Commission.

This working document is available on the European Commission's website. Publication of this Working Document is part of the open and transparent regulatory process the Commission follows for drawing up technical implementing measures in the financial area (see recital 47 of the Directive).

This Working Document is therefore informal and not definitive. It does not have the status of a Commission official draft for implementing measures and is without prejudice to any final decisions that might be taken by the Commission in this area. The Commission may in particular decide not to take measures at all. The document covers only part of the possible implementing measures that the Commission is entitled to adopt.

Since this working document is not a formal Commission proposal, **the period for the Committee on the Prevention of Money Laundering and Terrorist Financing to vote on the measures, and for the European Parliament to consider them, is not triggered at this stage.**

Any comments should be sent to the Commission to the following e-mail address by 21 October 2005: Markt-F2@cec.eu.int . All comments sent to the Commission may be made public and posted on the above-mentioned website, unless authors specifically request the contrary.

Working Document in relation to the Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

1. INTRODUCTION

Following the vote by the European Parliament on 26 May 2005, the Council reached an agreement on a text for a **third Directive on the prevention of the use of the financial system for the purpose of Money laundering and terrorist financing**¹ (hereinafter the “Third Directive”).

The main content of the Directive. The Third Directive will prohibit money laundering as well as terrorist financing. It is applicable to the financial sector as well as to some non-financial professions (e.g. lawyers, notaries, accountants, auditors, tax advisors, trust and company service providers, real estate agents and casinos, as well as all providers of goods to the extent payments are made in cash in excess of €15.000). In essence, the Directive requires these institutions and persons (a) to identify and verify the identity of their customer and of its beneficial owner and to monitor transactions with the customer, while taking into account a risk-based approach; (b) to report suspicions on money laundering and terrorist financing to the national authorities (e.g. normally the Financial Intelligence Unit); and (c) to take supporting measures, such as record keeping, training of personnel and the establishment of internal policies and procedures. The Directive is completed with a section on supervision and monitoring by national authorities and it also calls on Member States to establish appropriate penalties in case of non respect.

2. IMPLEMENTING MEASURES IN THE THIRD DIRECTIVE: GENERAL ORIENTATION

The new third Directive calls for implementing measures. Chapter VI of the Third Directive², as agreed, provides for the adoption of implementing measures by the Commission in order to complete the legal framework created by the Directive. Three different kinds of measures can be adopted:

- those referred to in paragraph 1 of Article 40 to take account of technical developments in the fight against money laundering or terrorist financing and to ensure uniform application of the Directive;
- those referred to in paragraph 3 of Article 40 to adapt the amounts mentioned in the Directive;

¹ See IP/05/682 of 7/6/2005.

² References to Chapters and Articles of the Third Directive in this text correspond to the numbering of the draft Directive as it appears in document n° PE-CONS 3631/05 of 9 August 2005 (unofficial draft text of the Directive), available at the register of Council documents: <http://register.consilium.eu.int/pdf/en/05/st03/st03631.en05.pdf>.

- those referred to in paragraph 4 of Article 40 related to anti-money laundering and counter terrorist financing measures in third countries.

General orientation. There is no obligation to adopt all the possible implementing measures at the same time. Bearing this in mind, this document intends to provide a general orientation on this subject.

Hence, DG Internal Market proposes to prioritise the subjects, concentrating, in the first stage, on those measures that are essential for the effective entry into force of the Directive:

- first, Article 40(2) requires that the Commission shall adopt, in any case, the first implementing measures to give effect to Article 40(1)(b) [**situations representing a low risk of money laundering in the context of simplified customer due diligence** – see section 3 of this paper] and Article 40(1)(d) [**financial activity on an occasional or very limited basis** – see section 4 of this paper], within 6 months following the date of entry into force of the directive;
- second, the definition of **Politically Exposed Persons** under Article 3(8), referred to in Article 40(1)(a) needs some clarification – see section 5 of this paper;

Additionally, in order to be prepared for any possible implementing measures under Article 40(4) – see section 6 of this paper – information of cases where institutions and persons covered consider that a **third country** meets the conditions laid down in the directive will be useful.

Finally, **other issues** could be addressed at a later stage, if need be – see section 7 of this paper.

3. SIMPLIFIED CUSTOMER DUE DILIGENCE (CDD)

3.1. General considerations on CDD: simplified vs. normal CDD; the risk based approach.

The normal application of the CDD rules and the risk based approach. The general provisions on CDD are contained in Articles 7 to 9 of the directive, establishing in which circumstances should CDD procedures be conducted, what to be done and at what moment in time. In this context, Article 8(2) of the Directive provides for the application of a “**risk based approach**” in relation to the normal CDD procedures. As a result, institutions and persons covered by the directive may determine the extent of the CDD measures on a risk-sensitive basis depending on the type of customer, business relationship, product or transaction. Hence, the application of the risk-based approach is the normal tool for institutions and persons covered by the directive to deal with possible low risk customers and products/transactions³. The use of this approach facilitates an easy adaptation to the changes in the trends of money launderers and terrorist financiers. It is noted that the application of the risk-based approach pursuant to Article 8(2) does not need further legislative development at European level.

³ For example simple banking services to children or simple contractual financial services involving low amounts of money which cannot easily be used for money laundering or terrorist financing purposes.

The derogation to the general rules on CDD: the so-called “simplified CDD”. By way of derogation to the general rules on CDD, the directive foresees in its Article 11 the application of the so-called “simplified CDD” procedures to a limited set of categories of “low risk” customers or products and transactions, where adequate checks and controls exist elsewhere. Therefore, this derogation is reasonable in such cases as credit and financial institutions where legislation on the supervision of such institutions exist as well as to listed companies taking into account legislation on the supervision of regulated markets. This list of categories of customers or products and transactions may be developed through Commission’s implementing measures.

In “simplified CDD” procedures, the CDD requirements are limited, but they certainly do not disappear. First of all, the institutions and persons covered by the directive shall in any case gather sufficient information to establish if the customer qualifies for an exemption according to Article 11(1) or (2). Secondly, in accordance with Article 7(c), CDD measures should be applied “when there is a suspicion of money laundering or terrorist financing, regardless of any derogation, exemption or threshold”. Furthermore, institutions and persons should pay special attention to any activity which they regard as particularly likely, by its nature, to be related to money laundering or terrorist financing (cf. Article 20). In addition, Articles 22 and 24 require institutions and persons to inform the relevant authorities of suspected transactions and to refrain from carrying out suspected transactions. Finally, it is noted that the combined application of these provisions therefore implies the need to continuously monitor the business relation, at least to a certain extent.

The possible extension of the list of customers, products and transactions justifying the application of simplified CDD procedures. While the risk of money laundering and terrorist financing is not the same in every case, one could, however, question the need of extending the list of low risk situations qualifying for simplified CDD at legislative level:

- on the one hand, the aim of the directive is the prevention of the misuse of the financial system. Therefore, exceptions to the rules should be carefully considered and interpreted restrictively. A too lenient approach could undermine the purpose of the directive;
- on the other hand, there is the risk of adopting a too detailed casuistic approach that may increase the burden and cost of compliance by institutions and persons covered by the Directive.

Having said this, this paper identifies in the following sub-sections (3.2 for customers and 3.3 for products and transactions) a number of possible situations that could be considered at this stage for possible implementing measures pursuant to Article 40(1)(b) of the directive.

Question 1: Would the application of the risk based approach in connection with normal CDD procedures be in your view enough for institutions and persons covered by the directive to deal normally with the low risk situations?

If a case-by-case approach implying the need to adopt implementing measures is followed, would the practical application of the directive rules be more difficult for the institutions and persons covered by the directive?

What would be, in your view, the costs and benefits of both approaches?

3.2. Customers

Article 11(1) and 11(2)(a) to (c)

11(1) *By way of derogation from articles 7(a), (b) and (d), 8 and 9 (1), the institutions and persons covered by this Directive shall not be subject to the requirements provided for in those Articles where the customer is a credit or financial institution covered by this directive, or a credit or financial institution situated in a third country which imposes equivalent requirements to those laid down by this directive and supervised for compliance with those requirements.*

11(2) *By way of derogation from Articles 7(a), (b) and (d), 8 and 9(1) Member States may allow the institutions and persons covered by this Directive not to apply customer due diligence in respect of*

(a) listed companies whose securities are admitted to trading on a regulated market within the meaning of Directive 2004/39/EC in one or more Member States and listed companies from third countries which are subject to disclosure requirements consistent with Community legislation;

(b) beneficial owners of pooled accounts held by notaries and other independent legal professionals from the Member States, or from third countries provided that they are subject to requirements to combat money laundering or terrorist financing consistent with international standards and are supervised for compliance with those requirements and provided that the information on the identity of the beneficial owner is available on request to the institutions that act as depository institutions for the pooled accounts;

(c) domestic public authorities;

or in respect of any other customer representing a low risk of money laundering or terrorist financing which meets the technical criteria established in accordance with Article 40(1)(b)

Further to the general considerations (see above), the following sets of cumulative “technical criteria for assessing whether situations represent a low risk of money laundering or terrorist financing” could be considered at this stage for any possible implementing measure pursuant to Article 40(1)(b). They build on the criteria underlying some of the situations foreseen in Article 11 of the Directive.

(i) The first set of cumulative technical criteria. The combination of the following technical criteria within the sense of Article 40(1)(b) would allow to identify customers “representing a low risk of money laundering or terrorist financing”:

- (1) The customer is an entity which is itself subject to the obligations of national legislation pursuant to the third directive, including entities caught under national legislation in the case foreseen in Article 4 This criterion should only apply to the customer, not to its subsidiaries, unless they also fulfil the criteria on their own.
- (2) The customer’s identity is publicly available, transparent and certain.

- (3) The customer is subject to mandatory licence by law and licensing may be refused if competent authorities are not satisfied that the persons who effectively direct or will direct the business of such entity or its beneficial owner are fit and proper persons. The activity conducted by the customer is supervised⁴ by competent authorities.
- (4) The customer is subject to supervision⁵ by competent authorities as regards the compliance with the national legislation pursuant to the third directive obligations and, where applicable, additional obligations under national legislation. This criterion is key for assessing whether the customer could qualify as low risk.
- (5) Lack of compliance with these obligations may be subject to effective, proportionate and dissuasive sanctions including the possibility to take appropriate administrative measures or impose administrative sanctions.
- (6) Additionally, it could be considered to add a further criterion: the only material source of income is known, stable and of impeccable repute.

It may appear difficult to identify entities capable of respecting these criteria apart from the “credit and financial institutions” (as defined in the directive) which are already subject to simplified CDD in accordance to the third directive. However, in practice, other institutions conducting financial activities, but not caught under the directive definition on “financial institutions” (e.g. general insurance), may also be subject to anti-money laundering/counter terrorist financing obligations under national legislation. These entities could possibly be assessed under these criteria.

(ii) The second set of cumulative technical criteria. Additionally, DG Internal Market notes that European institutions, bodies, offices and agencies, including the European Commission and the European Central Bank (ECB), do not qualify in the Directive for simplified CDD: neither under the “domestic public authority” category, nor under the “credit and financial institution” (for the ECB) category⁶. However, in principle none of the European institutions, bodies, offices and agencies, appears to raise a high risk of money laundering or terrorist financing, rather the contrary⁷. A similar situation exists in respect of international financial institutions, such as the World Bank or the International Monetary Fund. Therefore, there could be value in addressing this specific situation through a second set of cumulative technical criteria. The combination of the following technical criteria would allow to identify customers “*representing a low risk of money laundering or terrorist financing*”:

⁴ I.e. supervision is to be understood in this context as meaning the type of supervisory activity with the highest supervisory powers, including the possibility to conduct on-site inspections. Such inspections should include the review of policies, procedures, books and records, and should extend to sample testing. See as well paragraphs 1 to 3 of Article 37, in particular paragraph 3.

⁵ See footnote 4.

⁶ It is noted that the national Central Banks would normally be included under the notion of domestic public authority.

⁷ See §10 of the opinion of the ECB on the draft directive, as far as the ECB and the NCBs in the ESCB are concerned, OJ C40, 17.02.2005. Available at: http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2005/c_040/c_04020050217en00090013.pdf

- (1) The customer has been entrusted with public functions pursuant to the Treaties on the European Union or the European Communities and/or Community secondary legislation (this criterion should be construed as covering the European institutions as well as the bodies, offices and agencies,); or

the customer has been entrusted with public functions in the field of international finance pursuant to an International Treaty or agreement to which either the European Community or the Member States or both are parties.

- (2) The customer's identity is publicly available, transparent and certain.
- (3) The customer is accountable either to a European institution or to EU Member States authorities, or otherwise appropriate check and balance procedures exist ensuring proper supervision of the customer's activity.
- (4) The source of income of the customer is known, stable and of impeccable repute.

Paying attention to trends and typologies. In any event, for the purposes of identifying low risk customers the context of Article 40(1)(b), Member States authorities should bear in mind the relevant evaluations (at national or international level) on trends and typologies in relation to money laundering and terrorist financing: e.g. there should not be information available to suggest that the risk of money laundering or terrorist financing may not be low.

Question 2: Do you agree with these sets of technical criteria? Can you identify other relevant technical criteria? Can you identify any entity which could possibly meet the first set of technical criteria further to the entities already covered by the directive?

Do you prefer having broader (non cumulative) technical criteria? If so, please specify those broader criteria. Please specify as well which checks and balances would justify the application of simplified CDD in those circumstances.

What would be, in your view, the costs and benefits of such criteria?

The approach for other situations. It could be argued that simplified CDD could be applicable to situations where the information on the identity of the customer and of its beneficial owner is publicly available pursuant to a legal obligation, the customer and its beneficial owner have an obligation to maintain this information up to date on an ongoing basis, the respect of the obligation is monitored and lack of compliance is subject to sanctions. In essence, these criteria are respected by listed companies to which simplified CDD may be applied according to Article 11(1)(b). However, in the absence of effective legislation on transparency of legal entities beyond listed companies, it is unclear that these criteria could be applicable at this stage to other types of entities.

As regards situations similar to the one described in Article 11(1)(c) of the Directive (beneficial owners of pooled accounts held by independent legal professionals) in which the relevant identification information is held by other entities subject to the directive obligations and is available to the institution conducting the CDD on request, DG Internal Market considers that this kind of situations should not be examined in the context of simplified CDD. Indeed, the Third Directive includes new provisions on the performance of CDD by third parties subject to the Directive obligations (cf. Articles 14 to 19) which could allow for the examination of this kind of situations.

Concerning domestic public authorities, they are considered in the Directive as low risk customers *per se* within their own jurisdiction justifying customer due diligence, because of the checks and supervision as well as the balances and accountability rules that exist within the public domain. Hence, the technical criterion allowing for the domestic public authority exception does not easily allow for consideration of further entities. Having said that, the notion of “public authority” in this context may be interpreted in a wider manner to cover also bodies (including bodies having corporate form) entrusted with public tasks/functions and subject to public accountability. These bodies are generally regarded as part of the administration. In the view of DG Internal Market, this is a matter of national implementation.

Question 3: Do you agree with the approach in relation to transparency of legal entities, to beneficial owners of pooled accounts and to the implementation of the domestic public authority exception in respect of simplified customer due diligence?

3.3. Products and transactions

Article 11(5)(a) to (d)

11(5) *By way of derogation from Articles 7(a),(b) and (d), 8 and 9(1), Member States may allow the institutions and persons covered by this Directive not to apply customer due diligence in respect of:*

(a) life insurance policies where the annual premium is no more than EUR 1000 or the single premium is no more than EUR 2500;

(b) insurance policies for pension schemes if there is no surrender clause and the policy cannot be used as collateral;

(c) a pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme rules do not permit the assignment of a member’s interest under the scheme;

(d) electronic money, as defined in Article 1(3)(b) of Directive 2000/46/EC⁸ of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions, where, if the device cannot be recharged, the maximum amount stored in the device is no more than EUR 150; or where, if the device can be recharged, a limit of EUR 2500 is imposed on the total amount transacted in a calendar year, except when an amount of EUR 1000 or more is redeemed in that same calendar year by the bearer as referred to in Article 3 of Directive 2000/46/EC;

or in respect of any other product or transaction representing a low risk of money laundering or terrorist financing which meets the technical criteria established in accordance with Article 40(1)(b)

⁸ OJ L 275, 27.10.2000, p. 39.

Further to the general considerations on the limits of a casuistic approach and the advantages of the risk based approach (see above), the scope of any possible implementing measure pursuant to Article 40(1)(b) in relation to products or transactions “*representing a low risk of money laundering or terrorist financing*” is, in view of DG Internal Market, limited.

Having said that, consideration could be given at this stage to whether the following sets of technical criteria could justify the applicability of simplified CDD to other products or transactions. Further examination might be needed in any case.

(i) The first set of (cumulative) technical criteria:

- (1) The financial transactions are imposed by legislation, by State authorities (e.g. State fees, fines and other duties) or relate to a service of general interest;
- (2) The beneficiary of the transaction is either a public authority (e.g. a low risk customer mentioned in Article 11) or has been entrusted by a public authority with the operation of services of general interest (e.g. water distribution);
- (3) The financial transactions are conducted at the counter of a credit or financial institution;
- (4) The financial transactions are simple (e.g. direct payments on public authorities’ account);
- (5) The account on which funds are credited is an account specifically devoted for this kind of transaction and the credit and financial institution monitors its use; and
- (6) The beneficiary of the transaction has taken publicity measures to ensure that the designation of this account is known.

(ii) The second set of (cumulative) technical criteria:

- (1) the financial transactions have a written contractual base;
- (2) the financial transactions are related to products whose benefits are only realisable in the long term;
- (3) the benefits cannot be realised for the benefit of third parties (except in the case of death);
- (4) the financial transactions are done through a bank account;
- (5) the product or transaction is subject to a maximum annual amount of [e.g. EUR 1000], in one or several transactions that appear to be linked, and not capable of being paid out to third parties⁹.
- (6) Additionally, it could be considered whether a further criterion should be added: the product concerned should be defined and controlled by the State.

⁹ E.g. similarly to the situation for life insurance described in Article 11(5)(a).

Paying attention to trends and typologies. In any event, for the purposes of identifying low risk products and transactions in the context of Article 40(1)(b), Member States authorities should bear in mind the relevant evaluations (at national or international level) on trends and typologies in relation to money laundering and terrorist financing: e.g. there should not be information available to suggest that the risk of money laundering or terrorist financing may not be low.

Question 4: Do you agree with these criteria? Can you identify other relevant technical criteria?

Do you prefer having broader (non cumulative) technical criteria? If so, please specify those broader criteria. Please specify as well which checks and balances would justify the application of simplified CDD in those circumstances.

What would be, in your view, the costs and benefits of such criteria?

The approach for other situations. It might be possible that as a result the application of the Directive rules, financial flows may be subject to situations of duplication of customer due diligence procedures by different institutions and persons covered (e.g. each and every transaction between the credit or financial institution and its customer goes through an account opened in a credit institution that properly identified the account holder when the account was set up and also performs – on going – due diligence). While there could be some value in examining whether, at least for credit and financial institutions, the institution acting in the second stage could be satisfied that adequate anti-money laundering and counter terrorist financing measures in respect of customer due diligence exist at an earlier level of the financial sector, DG Internal Market believes that this issue should not be examined in the context of simplified CDD. Indeed, the Third Directive includes new provisions on the performance of CDD by third parties subject to the Directive obligations (cf. Articles 14 to 19) which could allow for the examination of this kind of situations.

Question 5: Do you agree with the approach?

4. FINANCIAL ACTIVITY ON AN OCCASIONAL OR LIMITED BASIS

Article 2(2)

2(2) Member States may decide that legal and natural persons who engage in a financial activity on an occasional or very limited basis and where there is little risk of money laundering or terrorist financing occurring do not fall within the scope of Article 3(1) and (2).

In accordance with Article 40(1)(d), **the DG Internal Market considers that it could be justified not to apply the Directive to certain legal and natural persons carrying out a financial activity provided that the following cumulative technical criteria are respected** in any possible national decision pursuant to Article 2(2):

- (1) The financial activity should be limited in absolute terms: a cap on the maximum turnover of the ancillary activity should be applied. In order to ensure that the financial activity in question is conducted on a limited basis, it should be ensured that the total turnover of the financial activity does not exceed a sufficiently low threshold. This

criterion would need to be adjusted at national level depending on the type of financial activity.

- (2) The financial activity should be limited in relative terms: it should not be the main activity of the person concerned. This could be measured on a percentage of the overall business of the person, possibly not above 5% of total turnover.
- (3) The financial activity is limited on a transaction basis: a maximum threshold per single transaction (or several transactions which appear to be linked), customer and period should be applied. This criterion would need to be adjusted at national level depending on the type of financial activity. The maximum threshold should, in any event, be sufficiently low in order to ensure that the services in question are impractical and inefficient method for laundering money or for financing terrorism.
- (4) The financial activity should be directly related to the main activity of the person, but not a totally independent financial activity. It will be generally expected that the person in question will not be providing a full range of financial services but only those needed for improving the performance of the main business.
- (5) The main activity of the person in question should not be an activity falling under any of the situations mentioned in Article 2(1) of the Third Directive.
- (6) The financial activity should be provided to own customers only (i.e. those who are also customers of the main activity) and it is not offered to the public (i.e. it is not advertised). In such a situation, the risk of money laundering is limited because the number of customers is reduced and the customers in question will in any event be forced to pay for the delivery of (more expensive) non-financial services.
- (7) The national decision pursuant to Article 2(2) should be either an individual or a category decision clearly providing for an exemption from the coverage of the rules: i.e. it should not be a general blank exemption on the definition of the scope of the law. To that extent, it should be based on justified grounds and the possibility to revert to the original situation on a short notice basis should be provided for.
- (8) There should be a mechanism to ensure that the exemption possibility granted by the national decisions pursuant to Article 2(2) is not abused by possible money launderers or terrorist financiers to circumvent the scope of application of the directive. The decision on the type of anti-abuse mechanism would be left to Member States. The mechanism could consist of: (a) effective, proportionate and dissuasive penalties (whether criminal penalties or administrative measures or sanctions); and/or (b) risk based monitoring activities.
- (9) Where monitoring by competent authorities is difficult as a result of possible concurring competence by authorities of different MS (e.g. provision of financial activities onboard mobiles such as ships), the exemption pursuant to Article 2(2) should not be granted.

Question 6: Do you agree with these criteria regarding the definition of occasional or very limited financial activity?

What would be, in your view, the costs and benefits of such criteria?

In addition, Article 2(2) requires that there is little risk of money laundering occurring in those circumstances. Article 2(2), as any exception, should be interpreted and applied in a restrictive manner. Hence, Member States should put particular attention to the possible risk of money laundering or terrorist financing in implementing this article. Indeed, Member States authorities should bear in mind the relevant evaluations (at national or international level) on trends and typologies in relation to money laundering and terrorist financing: e.g. there should not be information available to suggest that the risk of money laundering or terrorist financing may not be low.

In this context, DG Internal Market believes that not all financial activities could be exempted from the scope of application of the Directive. This would be the case in particular for those activities which are more likely to be used for the purposes of money laundering or terrorist financing, such as money transmission and remittance services.

Question 7: Do you consider that not all financial activities could be exempted from the scope of application of the Directive?

If so, which ones should not be exempted because of the risk of money laundering or terrorist financing?

5. POLITICALLY EXPOSED PERSONS (PEPs)

Article 3(8)

3(8) *“politically exposed persons” means natural persons who are or have been entrusted with prominent public functions and immediate family members or persons known to be close associates, of such persons;*

In accordance with Article 40(1)(a), the Commission is empowered to clarify the technical aspects of the definition in Article 3(8).

DG Internal Market believes that clarification of this definition is needed in order to facilitate the implementation of the Directive and to avoid distortions, uncertainty and different interpretations in the application of this provision. However, such clarification should not impede the necessary flexibility of Member States in implementing the Directive and should also take into consideration the application of the risk-based approach principle.

In this context, DG Internal Market considers that drawing up an exhaustive list of categories¹⁰ of persons to be considered as PEPs in all cases will be a too rigid approach that risks leaving aside relevant persons. Indeed, any list cannot be definitive taking into consideration the social, political and economic differences between countries concerned, which in the end are essential for defining what a PEP is.

Therefore, DG Internal Market is of the view that the clarification of the technical aspects in the implementing measures should be limited to the interpretation of the three main

¹⁰ DG Internal Market understand, as a starting point, that drawing up a list of individual persons to be considered as PEP would not be an appropriate task for the Commission. In this context, it is noted that some list of this kind are already prepared by specialised institutions in the financial sector.

parts of the definition: (1) prominent public functions; (2) immediate family members; and (3) persons known to be associates of PEPs.

Question 8: Do you agree with this approach leading to the interpretation of the three main parts of the definition of PEP or do you consider that a close list of categories of persons should be established?

What would be, in your view, the costs and benefits of the two options?

(1) Prominent public functions. Two different concepts need clarification: “public function” and “prominence”.

DG Internal Market is of the view that “public function” should encompass:

- positions in the public administration and bodies (including military authorities), legislative organs and judicial/semi-judicial bodies;
- positions in State Own Enterprises charged with the exploitation of natural resources or which obtain monopoly revenues; and
- positions in the ruling political party when there is only a single or largely dominant political party and the identification between the administration and the ruling political party is high.

Concerning the prominence of the public functions:

- as regards the State administration (and bodies), the public functions should be sufficiently important to be in a position to have a dominant/decisive influence in the decision making process (e.g. heads of State and of government, ministries, high ranking officials) or to a dominant/decisive influence in major public expenditure (high ranking officials);
- as regards the judiciary (including semi-judicial authorities such as courts of auditors), prominent positions should be those which are more likely to be abused (e.g. members of judicial bodies controlling State conduct etc) and those which are more relevant to prosecution of money laundering or terrorist financing (e.g. members of judicial bodies applying criminal justice). Key officials (other than judges) in judicial bodies should be covered only to the extent they could materially influence the process;
- as regards State Own Enterprises, prominent positions should be those allowing to exert managerial responsibilities (e.g. members of the board, persons holding executive powers);
- as regards the legislative bodies, given their nature, all their members should be covered by the definition of prominence;
- as regards the positions in ruling parties, only the high ranking positions could be considered as prominent.

The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.

It is noted that the notion of PEP extends to the persons having held public functions. Consideration should be given in this context as to the timeframe within which a person having held public functions should still be considered to be a PEP.

There is no evidence at this stage that the risk of money laundering or terrorist financing is lower with respect to persons exercising public functions at local or regional level as opposed to national/federal level. Hence, there is no need to make a distinction in this regard.

Question 9: Do you agree with this definition of “prominent public functions”?

In the case of persons having held public functions, when, in your view, they no longer should be included in the PEP category?

What would be, in your view, the costs and benefits of these options?

(2) Immediate family members. This notion should normally only encompass the spouse (or any partner of the PEP considered by national law as equivalent to the spouse), children (including laws-in) and parents of the person considered as a PEP¹¹. It should additionally include any legal entity or legal arrangement whose beneficial owner is any of the immediate family members mentioned.

In this context, the question arises as to whether the notion of family members may be larger in third countries which are not so close to the European traditions. If a definition of family members would take this into account (e.g. requiring to pay particular attention in those cases etc), this would inevitably lead to differences depending on the country of origin, which may create difficulties for the enforcement of the definition as well as increasing the cost of compliance. It is assumed that additional risk factors in this respect will follow from the risk based approach applied by the entities subject to the Directive..

Question 10: Do you agree with the definition of “immediate family member”?

Do you see value in extending the definition of family member to other relatives in the case of PEPs originating from specific world regions?

What would be, in your view, the costs and benefits of these options?

(3) Persons known to be close associates of PEPs. DG Internal Market is of the view that this notion aims at encompassing those persons that are known as having close business relationships with the PEPs. In this respect, are to be considered of particular interest the persons, who together with the PEP, are the beneficial owner of a customer of entities subject to the Directive.

¹¹ The attention is drawn to Article 1(2) of the Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC in relation to insider trading/market abuse (OJ L 167/70 of 30.4.2004), available at: http://europa.eu.int/comm/internal_market/securities/abuse/index_en.htm

Article 1(2) provides a definition of person closely associated with a person discharging managerial responsibilities within an issuer of financial instruments.

Question 11: Do you agree with this definition of “persons known to be close associates of PEPs”?

What would be, in your view, the costs and benefits of this option?

The link to corruption. As highlighted in Recital 25 of the Directive, the reputational and even legal risk to which the financial sector is exposed as a result of its relations with PEPs is significantly high concerning PEPs coming from countries where corruption is widespread. In this context, DG Internal Market notes that different international observatories provide indicators to evaluate which countries are generally more susceptible to generate funds from corrupt activities, *inter alia*, Transparency International (www.transparency.org) or the OECD (http://www.oecd.org/topic/0,2686,en_2649_37447_1_1_1_1_37447,00.html).

Question 12: Do you find that these indicators provide a useful basis in evaluating the risk of dealing with PEPs originating from high risk countries as far as corruption is concerned?

The problem of identifying PEPs *in concreto*. DG Internal Market is aware that identifying PEPs *in concreto* is not an easy task for the institutions and persons covered by the Directive obligations. This is why a particular attention should be put by institutions and persons in conducting the customer due diligence procedure with regard to non residents.

Bearing this in mind, it could be envisaged that the Commission, in cooperation with Member States, prepare in the near future a guidelines paper, on the basis of existing or developing best practices in relation to the identification of particularly risky customers that could be applied to the identification of PEPs. Those guidelines could additionally contain a minimal list of categories of PEPs identified in the different Member States. Any work of this kind should be based on extensive consultation with institutions and persons covered by the directive and other relevant industry. It is noted in this connection the intention of the FATF to work in the near future on the issue of PEPs.

Question 13: Do you agree with this approach in relation to the identification of PEPs *in concreto*?

6. INFORMATION ON CONDITIONS IN THIRD COUNTRIES

According to Article 40(4) of the Directive, the Commission is empowered to adopt decisions finding a third country does not meet the conditions laid down in the Directive in relation to the application of the Directive rules concerning simplified customer due diligence (art. 11), disclosure of suspicions to third parties (art. 28) or performance of customer due diligence by third parties (art. 16); or finding that a third country does not permit the application by subsidiaries and branches of Community credit and financial institutions of measures equivalent to those set out in the Directive with regard to customer due diligence and record keeping (art. 31).

Question 14: Do you at this stage wish to provide any relevant information in relation to the application of anti-money laundering/counter-terrorist financing measures by third countries?

7. ANY OTHER POSSIBLE IMPLEMENTATION MEASURES

Against the backdrop of the use of the Euro as an international reserve currency, it has been suggested by the European Central Bank¹² that correspondent banking relations with foreign central banks, monetary authorities and international financial institutions should not be subject to enhanced CDD, with the exception of entities from high-risk countries or jurisdictions (such as the FATF list of non-cooperative countries and territories).

Question 15: Do you see value in clarifying when enhanced CDD should be applicable in respect of corresponding banking relations with central banks and monetary authorities from third countries? Or, should the risk assessment be left to the credit and financial institutions covered by the Directive?

Question 16: Would you consider necessary to address, at this stage, any other of the possible implementing measures presented in Article 37?

¹² See §9 of the opinion of the ECB on the draft directive, as far as the ECB is concerned. OJ C40, 17.02.2005. Available at:
http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2005/c_040/c_04020050217en00090013.pdf