ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

September 16, 2011

Giancarlo Del Bufalo
President
Financial Action Task Force
2, rue Andre Pascal
75016 Paris
France

Dear Mr. Del Bufalo:

On behalf of the members of the ICSA Working Group on AML, we would like to thank you for the opportunity to comment on the proposed revisions to the FATF 40+9 Recommendations that FATF is currently considering.[1] ICSA members appreciate and strongly support the open dialogue that FATF has established with private sector representatives in order to enhance AML/CFT regimes at both the international and domestic level and look forward to continuing to work closely with the FATF in the future.

ICSA members generally support the recommendations set out in FATF's most recent consultation paper (hereinafter referred to as the Report). In particular, ICSA members strongly support the FATF's proposal to require that details of beneficial ownership be made readily publically available. At the same time, we still have some concerns in specific areas. These concerns, which are discussed more in depth below, are the following:

- There is a continued lack of precision in the definition of beneficial ownership. This is difficult to avoid since the terms used to describe beneficial ownership, such as "controlling ownership interest", are inherently ambiguous and therefore subject to differing interpretations.

- To eliminate as much of the ambiguity as possible, we suggest that FAFT should adopt a risk-based approach to identifying and verifying beneficial ownership. Such an approach would include specific ownership thresholds that would apply to beneficial owners, consistent with those that have already been established in a number of jurisdictions.

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[1] ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. ICSA's Working Group on AML participates in FATF's Consultative Forum as the representative of the global securities industry.

- ICSA continues to recommend that FATF adopt a risk-based approach that treats all PEPs equally, whether they are domestic or foreign PEPs. Such an approach, which would also apply to the family members and close associates of both foreign and domestic PEPs, would require financial institutions to undertake enhanced CDD only if the financial institution deemed a specific PEP, whether 'foreign' or 'domestic', to represent a higher risk.

As noted above, ICSA strongly supports the FATF's proposal to require that details of beneficial ownership be made readily publically available. However, we have a number of recommendations that would help to ensure that the information provided on beneficial ownership is both comprehensive and updated on a regular basis. Our detailed comments on these and other issues are below.

1 Beneficial Ownership: Recommendations 5, 33 and 34

1.1 Recommendation 5

ICSA members appreciate the FATF's attempt to provide greater clarity regarding the definition of beneficial ownership. However, we remain concerned that, even with the additional information that would be available if the proposals in the Report for Recommendations 33 and 34 were implemented, financial institutions would still face considerable difficulties in identifying and verifying the identity of beneficial owners because of the continued imprecision in the concept of beneficial owner.

Regarding the first proposal, to identify and verify the identity of the customer, ICSA agrees that financial institutions should obtain the basic information regarding the identity of their customers including, as is specified in the Report, the name of the customer, legal form, proof of existence, the powers that regulate and bind the entity and the address of the registered office or place of business.

However, we suggest that the requirement to obtain the names of individuals holding senior management positions at the client could be both problematic and of limited usefulness. First, there is no clarity regarding what is actually meant by the term "senior management". For example at one firm the position of Senior Vice President may indicate a very senior position while for another firm the same title would not indicate a particularly senior position. Second, any information that is collected regarding the senior management of a specific firm is only valid on the day that the information is documented and, therefore, it is of limited usefulness.

To identify the beneficial owner, the Report proposes that financial institutions should obtain information about the identity of the natural persons, if any, who ultimately have a "controlling ownership interest in the customer". If the ownership interests are widely dispersed the Report proposes that, "…information would be required on the identity of the natural persons exercising control through other means; or in their absence on the identity of the senior managing official". The Report goes on to say that the requirements, "…would not apply if the customer or its owner

is a company listed on a recognized stock exchange and subject to proper disclosure requirements."

We agree in theory with the proposal that financial institutions should obtain information about the identity of the natural person(s) who ultimately have a controlling ownership interest in the customer, as long as that information is publicly available (as discussed below). However, there are a number of practical problems with the proposal. First, the FATF does not specify what level of ownership would be required in order for an individual to have a "controlling ownership interest". Since there is no hard and fast rule that financial institutions can follow, the requirement could be interpreted differently by different financial institutions and by regulators in different jurisdictions.

Second, we question the usefulness of the second step in the proposed requirement, which would apply when ownership interests were widely dispersed. In that case, FATF proposes that financial institutions should obtain information, "…on the identity of the natural persons exercising control through other means; or in their absence on the identity of the senior managing official". The concepts of "control through other means" and "senior managing officials" are both quite ambiguous and raise questions regarding which individuals would be identified. For example, the board members of a customer could be identified by a financial institution as beneficial owners because they could be seen as "having control through other means". However, taken individually each board member does not have the power to influence the outcome of the company and use it as a vehicle of money laundering and terrorist financing. Similarly, as noted above, there is no clarity regarding what is meant by the term "senior managing official", as similar titles at different firms could have very different implications regarding the extent of control exercised by the individual in question.[2]

The Report also proposes that financial institutions should identify and verify the identity the beneficial owners of a legal arrangement by obtaining the identify of, "…the settler, the trustees, the protector (if any), the beneficiaries or class of beneficiaries and any other natural person exercising ultimate effective control over the trust…". Consistent with the comments made above, because FATF does not define what is meant by the term, "exercising ultimate effective control", the proposal would involve a judgment on the part of financial institutions that would result in divergent results between firms and may be subject to second guessing by regulators/examiners.

Because of the difficulties inherent in both defining and verifying beneficial ownership and the risk that the requirement could result in administrative processes that do no actually contribute to the fight against money laundering, we suggest that financial institutions should be permitted to use a risk-based approach to determine when it is necessary to obtain beneficial ownership information. Reliance on the risk-based approach would allow the financial institution to determine, as a result of its own evaluation, when and if beneficial ownership information

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[2] We also note that while FATF lists the types of information that should be gathered to identify and verify a customer, it stays silent as to the ones related to the identification and verification of beneficial owners. ICSA suggests that FATF clarify that the types of information to gather for beneficial owners is consistent with the customer information in the Recommendation.

needed to be collected for a specific client and whether verification was warranted, thereby allowing securities firms and other financial institutions to more efficiently allocate their limited AML/CFT resources. For example, it is generally the case that beneficial ownership information is collected at time of the commencement of the relationship. However, in keeping with a risk-based approach, in those relationships that a financial institution deems to be of lower risk in accordance with its own evaluation, we suggest that it would be appropriate for the financial institution to only collect beneficial ownership information when an event triggers the financial institution to place more scrutiny on that specific client. In effect, consistent with the risk-based approach, we suggest that the identification and verification of beneficial ownership could be event driven rather than automatic at the outset of a relationship.

In addition, we suggest that the application of the risk-based approach to the identification and verification of beneficial ownership should include exemptions for particular entity types in order to harmonize practices around the world. For example, as the FATF proposed in the Report, the beneficial ownership requirement, "…would not apply if the customer or its owner is a company listed on a recognized stock exchange and subject to proper disclosure requirements." The risk-based approach to the identification of beneficial ownership should also include an exemption for the identification of authorized individuals who work in trading rooms, as there are other processes in place in the firms to ensure that only authorized persons have access to trading systems, mainly stemming from fraud prevention measures. Requiring these firms to establish and communicate to counterparties lists of authorised traders therefore does not add to the fight against money laundering and creates legal risk for firms, as these lists become obsolete very quickly.

Finally, we suggest that the application of the risk-based approach to the identification and verification of beneficial ownership should include ownership thresholds similar to those already in place in various jurisdictions. Both because of the definitional and practical difficulties involved in identifying beneficial owners, as discussed above, and in order to ensure greater consistency on a global basis, we suggest that the FATF should formally establish in its Recommendations standard thresholds for beneficial ownership for both lower risk and higher risk relationships.[3] As is the case in jurisdictions which already have established specific thresholds for identifying and verifying beneficial ownership, the Recommendations could also provide for some specific exemptions, which each financial institution could make use of in accordance with its own risk-based approach. As a first step in this process, we suggest that FATF should carry out a review of those jurisdictions that have implemented specific thresholds and exceptions for beneficial owners, such as the EU, Canada and Australia, and examine how financial institutions in those jurisdictions have implemented the requirements.[4]

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[3] This standard threshold would be for AML/CFT purposes only, and would be separate from thresholds that have been established by regulators for other purposes.

[4] For example, the EU provides for a percent threshold to define what constitutes beneficial ownership and allows the private sector to utilize exceptions, for example if the customer is publicly traded on a recognized exchange or is regulated by an approved regulator.

1.2 Recommendations 33 and 34

ICSA members do not believe that privately owned financial institutions or any private sector bodies should be charged with collecting information on beneficial ownership when that information is not publicly available, as is currently the case in most if not all jurisdictions. Since corporate entities can be formed only with the approval of public sector bodies, only the public sector has the capacity to compel firms and other legal entities to supply the necessary information, which would in turn allow financial firms to identify and verify the identity of beneficial owners. Therefore**,** ICSA supports the FATF proposal that details of beneficial ownership be made readily publically available. ICSA notes that such a proposal is consistent with the November 2009 Stockholm Declaration by the European Commission to bring greater transparency to beneficial ownership details of companies, the recommendation by Deloitte for greater transparency of beneficial ownership details following their review of the implementation of the EU's Third Money Laundering Directive and the October 2009 UK Treasury's "Foot Review" recommendation for greater transparency of beneficial ownership of companies and trusts. It is also consistent with the World Bank's recent recommendation that jurisdictions establish and maintain: (1) publicly available registries, including company registries; and (2) national bank registries with account identification information, including information on beneficial owners.[5]

In addition, we suggest that the information on beneficial ownership that is included in the official register of companies should be updated on a regular basis and should be available to private sector entities at minimal cost. Moreover, to encourage the full disclosure of this information, we believe that public sector officials need to have the ability to levy appropriate and proportionate fines and/or criminal penalties on firms that do not provide the required information for the registries. If there were no legal penalties or those penalties were not sufficient to act as a deterrent, some beneficial owners may evade the requirements in order to preserve their anonymity.

We also note that the FATF's proposal is broadly consistent with the OECD's Tax Transparency Project, one of whose aims is to assist national governments to identify which of their nationals and residents own or control assets located in another jurisdiction, for the purpose of ascertaining possible tax evasion/avoidance.[6] ICSA respectfully suggests that national governments and financial institutions both have the objective of ascertaining beneficial ownership of corporate and other legal arrangements and that FATF explore, with their OECD colleagues, how mandatory public disclosure of relevant details under Recommendations 33 and 34 be harmonised with the work being undertaken in the Tax Transparency Project.

On another note, ICSA supports the FATF's proposal of prohibiting bearer shares but suggests that the concept of bearer shares should be defined, as it can cover very different types of

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[5] Kevin M. Stephenson, et. al. (May 2011), "*Barriers to Asset Recovery: An Analysis of the Key Barriers and an Analysis for Action***",** World Bank and UNODC Stolen Asset Recovery Initiative.

[6] Along similar lines, ICSA also welcomes the recent introduction to the US Congress of the Incorporation Transparency and Law Enforcement Assistance Act which, if approved, among other measures would require U.S. States to obtain the names of beneficial owners of corporations or limited liability companies (LLCs) formed in their jurisdictions, ensure that the information is updated, and provide the information to law enforcement upon receipt of a subpoena or summons.

securities in different jurisdictions, some of which are properly registered and not transferrable without proper re-registration. Because of the differences in the way that different jurisdictions define bearer shares, it is crucial that FATF clarify what is meant by this term.

In addition, ICSA supports the FATF proposal that nominee shareholders be required to declare details of their nominee status and details of their principals. However, ICSA respectfully suggests that an exemption be granted to regulated financial services companies that control nominee companies which offer administrative services to the customers of the financial services companies. Such services are generally offered to assist customers with the holding of investments and the collection of dividends and interest payments rather than offering a "shield" to preserve anonymity.

2. Data Protection and Privacy: Recommendation 4

ICSA supports the FATF proposals regarding Recommendation 4. At the same time, however, we also encourage FATF to require or otherwise encourage governments to ensure that their AML and data protection agencies are well coordinated with one another.

3. Group-wide Compliance Programs: Recommendation 15

ICSA supports the FATF proposals regarding Recommendation 15. However, we also suggest that Recommendation 15 should be amended in order to ensure that local bank secrecy laws do not prohibit group subsidiaries and branches from transferring customer data and due diligence documentation to other group subsidiaries, branches and/or the head office for AML/CFT purposes. This is important since if a group subsidiary is unable to transfer relevant customer details, including Suspicious Activity Reports because of strict local banking secrecy laws, that branch or subsidiary is effectively a black hole, from a group AML point of view. The branch or subsidiary is unable to notify other group members and headquarters if it has concerns about a specific client and Group headquarters cannot properly manage its AML risk on a group basis since it does not have information about what is happening in the branch or subsidiary.

4. Other Issues included in the revision of the FATF Standards

4.1 Adequate/inadequate implementation of the FATF Recommendations

As you are well aware, the IMF has recently published research on international compliance with the FATF standards. The IMF found that in general compliance with the FATF standards was low due to a variety of factors, including the quality of the domestic regulatory framework and the level of economic development in the individual country.[7]

As the IMF report notes, one clear conclusion of the research was that elements of the FATF standards that have been in place longer have higher compliance ratings. Thus, the degree of

[7] Concepcion Verdugo Yepes (July 2010), "*Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis*", IMF Working Paper, WP/11/177.

compliance for the 40 AML Recommendations was considerably higher than for the 9 Special Recommendations on CFT, which were added to the standard relatively recently. Even more striking, Recommendations concerning designated nonfinancial businesses and professions, which were made subject to the FATF standard only in 2003, had some of the lowest compliance scores, averaging only 12.1 percent of the theoretical maximum. The IMF report also notes, diplomatically, that "…it appears to be easier to enact legislation and set up government institutions than to ensure that the system functions well on an ongoing basis."[8]

We understand that many of the policy implications stemming from the IMF report are beyond the control of FATF. At the same time, however, we welcome the results of the IMF's work in this area and look forward to working with the FATF in its efforts to improve global AML/CFT standards and implementation in response to research conducted by the IMF.

Returning to the FATF Report, we note that the FATF proposes that financial institutions should not rely solely on the FATF country assessments but should instead use their own resources to consider the overall risk posed by a country. Apart from the fact that the concept of "overall risk" is unclear, especially with respect to ML/TF, a privately owned financial institution is certainly not better placed than the FATF when assessing the ML/TF risk of a country. By requiring all financial institutions to carry out their own risk assessments, without having the ability to rely on the FATF's reviews, FATF would be placing an unnecessary burden on those firms. Private sector organisations generally do not have the resources that would allow them to make such assessments, which we suggest should be properly left to FATF or national governments. We understand that in some cases a financial institution might have a particular view on an individual country, for example because it has subsidiaries in that jurisdiction or a long standing relationship with it. In that case, we believe that the financial institution should be able to consider its view of the country while also taking into account the results of the FATF assessment when deciding whether or not enhanced due diligence should be applied. However, this should be a possibility and not an obligation. ICSA therefore suggests that financial institutions should continue to be able to rely on the FATF assessments (and lists) or similar assessments (and lists) produced by national governments.

4.2 Further consideration of Politically Exposed Persons

The Report proposes that:

1. Individuals who have been entrusted with prominent functions by an international organizations should be considered PEPs and treated in the same way as domestic PEPs; and,

2. The requirements for foreign and domestic PEPs should apply equally to family members or close associates of such PEPs. This would mean that enhanced CDD measures would be required automatically for family members and close associates of a foreign PEP and could be required (on a risk-based approach) for family members and close associates of a domestic PEP.

[8] Ibid., pg. 11.

In relation to the first proposal, the addition of a new category of PEP may not be a significant issue in practice, as most financial intermediaries will simply add the category to their existing due diligence and customer identification and verification processes. However, it will be necessary for FATF to more precisely define the scope of what is considered to be an "international organization", and what constitutes the performance of "prominent functions" of behalf of that organization. This is important since there are a number of international organizations that have been delegated powers by governments or whose members are government representatives, or whose primary role is to set standards or rules that governments or government agencies of the member countries of the organization agree to abide by, or that have a governance role in relation to international activities, or is the governing body of a sport, or is an international body that has humanitarian and charitable goals.

The addition of a new category that encompasses these types of organizations would be consistent with the concept of political exposure, given that these types of organizations perform government-like or governance functions. However, a new "international organization" category need not include organizations that are more in the nature of a collective of like-minded domestic organizations or associations, where the international body does not have a governance power or ability to exercise discretion or control over its members.[9]

Regarding the second proposal, ICSA continues to recommend that FATF adopt a risk-based approach that treats all PEPs equally, whether they are domestic or foreign. Reliance on a risk-based approach to PEPs would be consistent with the FATF's general endorsement of the risk-based approach. Under a risk-based approach, FATF would require financial institutions to undertake enhanced CDD on a specific PEP only if the financial institution deemed that individual, whether 'foreign' or 'domestic', to represent a higher risk. Treating all PEPs in a consistent manner would provide greater clarity for financial institutions that operation on an international basis, as this would allow those firms to have a harmonised group policy and a consistent approach towards PEPs.[10] Reliance on a risk-based approach for all PEPs would also help to eliminate possible confusion, since internationally active financial institutions work with a multiplicity of national regulators.

Responding specifically to the recommendation in the Report, we agree that the risk-based approach should be applied to the family members and close associates of domestic PEPs. However, it is not clear to us why the family members and close associates of foreign PEPs should automatically be considered to be of higher risk than the family members and close associates of domestic PEPs. Therefore, consistent with our recommendation above, we suggest

[9] We also suggest that a new category of "international organization" should explicitly exclude corporations or companies that operate on a multinational basis as these organizations do not perform any government-like or governance functions that are consistent with the concept of political exposure and the need to protect against corrupt activities by persons who are politically exposed. If these types of entities were to be included, there would be a vast increase in the number of persons who would need to be treated as PEPs because they perform or are entrusted with "prominent functions" on behalf of the organization. This would become unmanageable for financial intermediaries with AML obligations, and the associated costs would be prohibitive.

[10] Under the current policy, a domestic PEP for one subsidiary of an internationally active financial group is a foreign PEP for another subsidiary of the group, which may results in an inconsistent groupwise AML policy.

that the risk-based approach should be applied to the family members and close associates of both foreign and domestic PEPs.

In closing, we would once again like to express our appreciation once again to the FATF for the opportunity to comment on the proposed revisions to the FATF 40+9 Recommendations. Please do not hesitate to contact us if you have any questions about the comments in this letter.

Best regards,

Kung Ho Hwang, Chairman
International Council of Securities Associations