

MEMO# 25371

August 1, 2011

FATF Consultation - Second Phase of the Review of the Recommendations

[25371]

August 1, 2011

TO: AML COMPLIANCE WORKING GROUP No. 3-11 RE: FATF CONSULTATION - SECOND PHASE OF THE REVIEW OF THE RECOMMENDATIONS

On June 27, 2011, the Financial Action Task Force ("FATF") issued a Consultation Paper (the "June Paper") for a second phase of their review of the FATF 40+9 Recommendations ("Recommendations" or "Standards") in preparation for the 4th Round of Mutual Evaluations. [\[1\]](#) In October 2010, FATF consulted on its preliminary conclusions regarding its review of the Standards. [\[2\]](#) The June Paper seeks public comment on certain issues identified in the second phase of FATF's review, which was undertaken between October 2010 and June 2011. FATF's goal for this limited review is to maintain the stability of the Standards while also addressing deficiencies and emerging threats.

The Recommendations, endorsed by more than 180 countries and jurisdictions, have been recognized as the international standard for anti-money laundering measures and combating the financing of terrorism ("AML/CFT"). Comments are due September 16, 2011. The revised Standards will be adopted in February 2012. The Institute intends to submit a comment letter.

Key Proposals

FATF is seeking comment on the following issues:

- Clarification of requirements for identifying beneficial owners and of measures that could be used to ensure that beneficial ownership information is available.
- A general requirement that the authorities responsible for AML/CFT and those responsible for data protection have effective mechanisms in place to enable them to cooperate and coordinate on this issue.
- A requirement that financial groups have group-wide AML/CFT programs, and that these programs include policies and procedures for sharing information for the purposes of global risk management.
- Enhancements to the transparency of electronic fund transfers.
- Implementation of targeted financial sanctions in the terrorist financing context, as

prescribed by the United Nations Security Council.

- Clarification of the role and functions of financial intelligence units, including an emphasis on their analysis function.
- Strengthening international cooperation agreements.
- Other issues, such as strengthening obligations to mitigate country risks and enhanced due diligence measures relating to the monitoring of Politically Exposed Persons (“PEPs”). This would include consideration of additional due diligence for family and close associates of PEPs, as well as the identification of high-level individuals in international organizations as PEPs.

Recommendations 5, 33, and 34 (Beneficial Ownership)

FATF states that its current standards call for transparency regarding legal persons and arrangements, including through Recommendation 5, which requires financial institutions to identify beneficial owners, and through Recommendations 33 and 34, which require countries to prevent the misuse of legal persons or arrangements. FATF seeks to clarify its expectations for countries and financial institutions, but does not propose to change the Recommendations on beneficial ownership.

Recommendation 5 (Customer Due Diligence)

The main change proposed in Recommendation 5 is to specify the types of measures that financial institutions would be required to undertake in order to (a) identify and verify the identity of customers that are legal persons or legal arrangements and (b) understand the nature of their business, including their ownership and control structure. FATF lists the information that it believes would normally be needed to satisfactorily perform these functions:

- Identification of the customer and verification of its identity, including: (1) name, legal form, and proof of existence; (2) powers that regulate and bind the entity, e.g., articles of incorporation; (3) names of individuals in senior management positions; and (4) the address of the registered office or principal place of business.
- Identification of beneficial owners of a legal person and reasonable measures to verify their identity: (1) the identity of natural persons who ultimately have a controlling ownership interest in a legal person; (2) if no natural person has a controlling interest (e.g., too widely dispersed), the identity of persons exercising control through other means; or, in their absence, (3) the identity of the senior managing official. These requirements would not apply if a customer is a listed company on a recognized exchange (and therefore subject to disclosure requirements).
- Identification of beneficial owners of a legal arrangement and reasonable measures to verify their identity: the identity of the settlor, trustees, beneficiaries or class of beneficiaries, and any other natural person that exercises “ultimate effective control” over the trust (including through a chain of control).

FATF states that “[t]he types of information listed above will in effect define what is meant by beneficial ownership and what should be considered adequate information concerning beneficial ownership of a legal person or arrangement.” [\[3\]](#)

Recommendation 33 (Legal Persons)

FATF is considering an Interpretive Note for Recommendation 33 in order to clarify the steps countries should take to prevent the misuse of legal persons and to outline a standard for adequate information regarding beneficial ownership. FATF is considering whether: (1) companies should be responsible for holding information about beneficial ownership and authorities should have access to the beneficial ownership information (e.g., through the company itself, a company register, or a regulator); (2) a requirement that certain basic information on legal persons be available from company registries, including at a minimum, name, proof of incorporation, legal form and status, address of registered office, basic regulating powers, and list of directors; (3) preventing the misuse of bearer shares and bearer share warrants by prohibiting them, converting them to registered shares or share warrants, or requiring them to be held with a regulated financial institution or professional intermediary; (4) preventing the misuse of nominee shareholders by either requiring them to disclose the identity of their nominator to the company or registry, and including them in the register of directors, or by requiring that they be licensed, have their nominee status recorded in company registries, and for them to maintain information identifying their nominator.

Similar measures should be applied to foundations and limited partnerships, while additional flexibility is appropriate for other legal persons. Companies that are subject to adequate transparency requirements, such as listed companies, state-owned entities, and financial institutions or designated non-financial businesses and professions (“DNFBPs”) subject to AML/CFT requirements, could be exempt.

Recommendation 34 (Legal Arrangements)

Similar to its approach on Recommendation 33, FATF is considering amendments to Recommendation 34 to clarify the types of measures to be used to ensure timely access to beneficial ownership information for trusts and other legal arrangements. FATF is also interested in whether and how the requirements should be applied in countries that do not allow the creation of legal arrangements such as trusts. FATF’s proposals to prevent the misuse of trusts include: (1) a legal obligation for trustees to obtain and hold beneficial ownership information; (2) ensuring that authorities can access identifying information about the trustee, the trust’s beneficial ownership and its assets, from one or more sources including financial institutions and DNFBPs; (3) requiring trustees to disclose their status to authorities and to financial or other institutions when entering a business relationship; (4) empowering authorities to obtain information about trusts and share it as necessary; and (5) incorporating analogous requirements for trust-like legal structures.

FATF will continue its efforts in this area, including balancing responsibility between countries which are the source of law for legal arrangements and those which are not. FATF will also consider the whether to apply additional measures (e.g., registration) to countries which are the source of trust law in order to ensure the availability of beneficial ownership information, and how these requirements should be adapted to the particularities of other types of legal arrangements.

Recommendation 4 (Data Protection and Privacy)

FATF is considering an amendment to Recommendation 4 to mitigate conflicts between data protection rules and the implementation of AML/CFT measures. Specifically, FATF

proposes adding a general requirement that authorities responsible for AML/CFT and those responsible for data protection have effective mechanisms that enable cooperation. FATF acknowledges the importance of data protection for international financial services groups that rely on cross-border transfers of information, but believes that in many countries, better coordination can reduce potential conflicts between AML/CFT goals and data protection rules.

Recommendation 15 (Group-wide Compliance Programs)

FATF proposes that financial groups be required to implement group-wide programs against money laundering and terrorist financing. [\[4\]](#) These programs would include policies and procedures related to sharing information for the purposes of global risk management. When necessary, branches and subsidiaries would provide customer, account, and transaction information to group-level compliance, audit and/or AML/CFT units. [\[5\]](#)

Special Recommendation VII (Wire Transfers)

FATF is considering amendments to Special Recommendation VII to enhance the transparency of all types of wire transfers, including, for example, serial payments [\[6\]](#) and cover payments. [\[7\]](#) When processing all cross-border wire transfers, ordering financial institutions would need to include both full originator information (name, account number or unique transaction reference number, and address, as currently required) and full beneficiary information (name and account number or unique transaction reference number). Intermediary financial institutions would be required to screen cross-border transactions in a manner consistent with straight-through processing. Beneficiary financial institutions receiving wires missing full originator or beneficiary information would take measures that are consistent with automated processes. FATF recognizes that financial institutions are unable to verify the identity of parties to a transaction who are not their customer, i.e., beneficiary financial institutions cannot identify the originator and intermediary financial institutions cannot verify either the originator or the beneficiary.

FATF seeks input on: (1) what types of procedures are currently used by intermediary financial institutions for handling wire transfers that lack full originator information and whether these procedures are risk-based; (2) whether and what kind of procedures financial institutions apply to cross-border wire transfers to detect if information about non-customer parties is meaningful; and (3) whether and how financial institutions apply screening procedures to cross-border wire transfers below the threshold.

Special Recommendation III (Targeted Financial Sanctions)

The changes to Special Recommendation III would address the implementation of targeted financial sanctions in the terrorist financing context. The proposed language makes explicit the obligation to take provisional measures and to confiscate terrorist assets in other contexts. FATF does not intend to widen the scope of the existing requirements, but instead to update Special Recommendation III and its Interpretive Note to reflect existing obligations.

To implement these obligations, countries should require all natural and legal persons

within the jurisdiction to: (1) freeze funds or other assets belonging to designated persons and entities without delay and without prior notice; (2) respect prohibitions on making funds or other assets available for the benefit of designated persons, entities controlled by designated persons, and persons and entities acting on behalf of designated persons; and (3) report any assets frozen or compliance actions taken to the appropriate authorities, including attempted transactions. Financial institutions should be subject to monitoring for compliance with obligations under Special Recommendation III, and failure to comply should result in civil, administrative, or criminal sanctions.

Recommendation 26 (The Financial Intelligence Unit)

The proposed changes to Recommendation 26 focus on the core functions of financial intelligence units (“FIUs”), specifically the receipt and analysis of suspicious transaction reports (“STRs”), and the dissemination of the results of the analysis. The changes reflect the standards of the Egmont Group of FIUs, and are intended to apply to all FIU types. The proposed Interpretative Note to Recommendation 26 emphasizes the analysis function and highlights the importance of the ability to obtain additional information from reporting entities as needed.

Recommendation 40 (International Cooperation)

FATF believes that Recommendation 40 should be revised to ensure more effective cooperation between authorities. The proposed changes outline broad principles of cooperation as well as more detailed recommendations. These recommendations include clarifying safeguards on the use and confidentiality of information exchanged, specifying the information authorities should be able to exchange, and describing the channels or mechanisms the authorities should use. FATF highlights two deficiencies that have hindered cooperation in the past: (1) the imposition of overly restrictive measures by some authorities; and (2) the lack of mechanisms for some authorities to share information with non-counterparts. FATF proposes to address these issues by setting standards for “diagonal cooperation” between non-counterpart authorities and by prohibiting the use of unduly restrictive measures to restrain cooperation.

Politically Exposed Persons

FATF proposes that individuals who hold prominent functions in international organizations should be considered PEPs and should be treated in the same way as domestic PEPs. FATF is also considering applying the requirements for foreign and domestic PEPs to family members and close associates of PEPs. According to FATF, this proposal means that enhanced due diligence measures would be required 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.

Other Issues Included in the Revision of FATF Standards

FATF proposed changes to the risk-based approach in its 2010 consultation that included strengthened obligations on financial institutions to identify and mitigate country risks. FATF proposes revising Recommendations 9, 21, and 22 to ensure consistency with the risk-based approach. FATF proposes that financial institutions be required to apply

enhanced due diligence measures based upon a country's risk profile, instead of upon the adequacy of compliance with the Standards. The enhanced due diligence measures applied should be effective and proportionate to the risks. These changes would replace the current requirement to pay "special attention" to noncompliant countries.

FATF also proposes to expand the set of examples of actions that countries could take in the implementation of countermeasures. Countries would not be required to implement all such measures, but they should be capable of a flexible response when another country is noncompliant and/or poses a risk to the financial system. The proposed additional examples of countermeasures include: prohibiting financial institutions from relying on third parties in the country at issue; prohibiting the establishment of subsidiaries or branches or representative offices of financial institutions from the country; enhanced relevant reporting mechanisms; constraining correspondent relationships with financial institutions in the country; and applying increased supervisory examination and/or external audit requirements for financial institutions based in the noncompliant country.

Finally, FATF proposes that a risk-based approach should apply to the supervision of financial institutions and DNFBPs, including supervision by Self-Regulatory Organizations.

Susan Olson
Senior Counsel - International Affairs

endnotes

[1] See FATF-GAFI, Consultation Paper: The Review of the Standards – Preparation for the 4th Round of Mutual Evaluations, Second Public Consultation (June 2011), available at <http://www.fatf-gafi.org/dataoecd/27/49/48264473.pdf>. The purpose of the mutual evaluations is to assess, with respect to each member, whether the necessary laws, regulations, or other measures required under the Standards are in force, that there has been proper implementation of the measures, and that the system in place is effective. The evaluations are conducted by the FATF Secretariat and a team of experts. Findings are compiled in a mutual evaluation report, describing the system in place and an assessment and rating for effectiveness.

[2] FATF last sought comment on the Standards in October 2010. See FATF-GAFI, Consultation Paper: The Review of the Standards – Preparation for the 4th Round of Mutual Evaluations (October 2010), available at <http://www.fatf-gafi.org/dataoecd/3/30/46266717.pdf> ("October Paper"). ICI submitted a letter to FATF on January 7, 2011 that commented on several of FATF's proposals; it is available at <http://www.ici.org/pdf/24890.pdf>.

[3] See June Paper at paragraph 9.

[4] In the October Paper, FATF addressed the possibility of a more flexible approach for reliance when a third party is a part of a financial group and stated it was considering encouraging countries to require financial groups to have an AML/CFT program at the group level, i.e., applicable to all branches and majority-owned subsidiaries. Such a program, however, should be appropriate to the business of the branches and subsidiaries. See October Paper at paragraphs 37 and 38.

[5] FATF wants the requirements to be consistent with those of the Basel Committee on

Banking Supervision.

[6] A “serial payment” is a direct sequential chain of payment, of the type originally contemplated by the Special Recommendation VII, where the wire transfer and accompanying payment message travel together from the ordering financial institution to the beneficiary financial institution either directly or through one or more intermediary financial institutions such as correspondent banks.

[7] A “cover payment” is a particular type of payment that typically involves both (i) a transaction in a currency other than that of the country in which the originator’s or beneficiary’s bank is domiciled, and (ii) the originator’s and beneficiary’s banks not having a relationship with each other that allows them to settle with each other directly.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.