Leaseurope

The Voice of Leasing and Automotive Rental in Europe

Leaseurope Observations on the European Commission's Proposal for a *Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing* ('4th AMLD')

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INTRODUCTION

ABOUT LEASEUROPE

As a Federation, Leaseurope brings together 43 Associations throughout Europe representing either the leasing, long term and/or short term automotive rental industries. The scope of products covered by Leaseurope's members ranges from hire purchase and finance leases to operating leases of all asset types (automotive, equipment and real estate) and also includes the rental of cars, vans and trucks. It is estimated that Leaseurope represents approximately 92% of the European leasing market. More information on Leaseurope and its members can be found at www.leaseurope.org

LEASING IN EUROPE

Leasing is a major source of investment support for European businesses[1]. It is used across the board by companies of all sizes and in all industries, as well as being extremely useful to support consumers and the public sector (i.e. leasing to schools and hospitals). In 2011, European leasing companies (lessors) financed assets worth more than €256 billion and enabled 20.8% of all equipment investment in Europe[2]. Leasing is particularly appropriate for small businesses[3]. Over 50% of all leasing to businesses is made to SMEs and an estimated 40% of all European SMEs used leasing in 2010, which is more than any other individual form external funding[4].

WHO ARE EUROPEAN LESSORS?

Leasing companies can be banks or bank-owned subsidiaries, the financing arms of manufacturing companies, which are known as captive lessors, or independently owned companies[5]. There are about 1,300 leasing firms in Europe.

LEASING AND ANTI-MONEY LAUNDERING/COUNTER TERRORIST FINANCING LEGISLATION

Within existing EU legislation financial leasing companies fall within the definition of 'financial institution'. They are therefore deemed as obliged entities that must comply with anti-money laundering (AML) and counter terrorist financing (CFT) requirements.

Where financial leasing companies come within the scope of the 3rd AMLD[6] and its Implementing Measures[7] three customer due diligence (CDD) scenarios can apply.

1. Normal CDD requirements apply under Articles 7, 8 and 9(6) of the 3rd AMLD.
2. Reduced CDD requirements apply under Articles 11 and 12 of the 3rd AMLD in situations of lower risk, as clarified by the Recitals. Articles 3 and 4 of the Implementing Measures are also relevant.
3. Enhanced CDD requirements apply in situations which by their nature can present a higher risk of money laundering or terrorist financing under Article 13 of the 3rd AMLD.

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[1] *Sources: Leaseurope; Eurostat (2011) Access to Finance Statistics; Oxford Economics (2011) The Use of Leasing Amongst European SMEs; International Finance Corporation (2009) Leasing in Development: Guidelines for Emerging Economies; European Investment Fund (2012) The importance of leasing for SME finance; and UEAPME (2012) UEAPME Newsflash.*

[2] *Leaseurope calculation based on new leasing volumes as a percentage of gross fixed capital formation (GFCF) in equipment. Leasing volumes are taken from Leaseurope's Annual Statistical Enquiry 2011, GFCF equipment figures are taken from the European Commission's DG ECFIN database AMECO extracted on 12/09/2012.*

[3] *Oxford Economics (2011) The Use of Leasing Amongst European SMEs and European Central Bank (November 2012) Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area.*

[4] *Oxford Economics (2011) The Use of Leasing Amongst European SMEs Report.*

[5] *We refer to bank and independently owned lessors as 3rd party lessors as opposed to manufacturer owned lessors known as captive lessors.*

[6] *Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.*

[7] *Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of 'politically exposed person' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis.*

In addition to the above criteria, when there is a suspicion of money laundering, or terrorist financing, CDD requirements apply regardless of any derogation or exemptions contained in the 3rd AMLD or its Implementing Measures.

The Leaseurope position is that leasing is a low risk avenue for money laundering and terrorist financing, most notably due to the presence of the asset and in the majority of lease relationships there is usually always a third party involved for example a manufacturer, a distributer, a remarketing party etc. which significantly reduces the risk of money laundering and terrorist financing. This position is further supported by further evidence under Section 5.

OBSERVATIONS

Leaseurope welcomes the European Commission's *Proposal for a 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.* (Herein '4th AMLD').

However, there are a variety of provisions within the new Proposal which Leaseurope considers:

- were better dealt with in the 3rd AMLD;
- require further clarification; and
- require EU intervention (namely the provision of Politically Exposed Persons (PEPs) and Beneficial Ownership (BO) lists).

1. TAX CRIMES AS PREDICATE OFFENCES TO MONEY LAUNDERING - ARTICLE 3(4)(F)

The European Commission in its Proposal for a 4th AMLD proposes to include a specific reference to tax crimes within the category of serious crimes which can be considered as predicate offences to money laundering. This action is in line with the new Financial Action Task Forces (FATF) Revised Recommendations, as they related to predicate offences.[8]

LEASEUROPE'S VIEWS

Leaseurope generally warns against the extension of the list of predicate offences with low level offences such as tax crimes, as this would create an additional administrative burden and associated high costs for the industry, not to mention the tedious task involved in the identification of such offences.

The required monitoring, research and investigation to combat tax crimes and any other emerging threats cannot be carried out without proper access to reliable information from the relevant competent government authorities. The failure to report a suspicious transaction to the authorities in this respect could potentially result in disproportionate administrative sanctions for the obliged entity. In this context it is important that the authorities fulfill their role in detecting and identifying emerging threats pursuant to Article 43(2).

A clearer definition of the crime is crucial for the efficient functioning of the leasing industry's AML/CFT compliance operations. Although we doubt that the AML/CFT regime is the appropriate framework for the combatting of tax crimes, the leasing industry should be required to only focus on serious tax crimes**.** Leaseurope therefore welcomes the fact that only serious tax crimes have been included in the Proposal for a 4th AMLD as a special category of "serious crimes". This serves to enhance legal certainty and avoids different interpretations at national level.

[8] *See FATF Recommendations, February 2012, Recommendation 3 & Interpretive Note to Recommendation 3.*

2. BENEFICIAL OWNERSHIP – ARTICLES 3(5), 11, 29 & 30

The Proposal for a 4th AMLD contains new measures in order to provide enhanced accessibility of BO information. It requires corporate entities to hold adequate, accurate and current information on their own BO. This information should be made available to both competent authorities and obliged entities, upon request.

In addition, in relation to the control factor for BO purposes, the Proposal has maintained the 25% ownership threshold for direct ownership but also applies the same threshold to all levels of indirect ownership and also for cases where the customer is part of a multi-layered corporate structure.

LEASEUROPE'S VIEWS

For leasing companies the most challenging element of the CDD requirements is the identification of the BO of a corporate entity i.e. in the natural persons controlling more than 25% of the shares of a legal entity.

Leaseurope would like to advocate for the distinction to be noted between small and large ticket leases. Taking this distinction into account, and the larger monetary amounts involved in large ticket leases, it should only be required to identify the BO for large ticket leases, due to the fact that leasing is considered by the Implementing Directive to the 3rd AMLD as a low risk avenue for money laundering and terrorist financing.

In the Proposal for a 4th AMLD Leaseurope acknowledges that the European Commission has made some attempts to ease the difficulty stemming from the identification of BOs, by proposing to compel corporate entities to hold adequate, accurate and current information on their BO. Nonetheless, this is not a complete solution to the identification difficulties, as the onus still remains on the obliged entity to verify the BO information pursuant to Article 11(1)(b).

In addition, leasing companies as obliged entities do not have sufficient means to ensure the effective cooperation of their corporate customers in this respect. In addition to this fact, often corporate customers are part of a multi-layered corporate structure and do not have sufficient knowledge of the entire ownership structure and/or the BOs involved.

To rectify this on-going difficulty Leaseurope would like to advocate for the Proposal for a 4th AMLD to allow for the inclusion of harmonized, reliable, transparent, detailed, updated and relevant shareholdings, as well as BO information concerning non-listed companies in the form of public registries. This could have easily been done by optimising on *Directive 2012/17/EU on the Interconnection of central, commercial and company registers* and by promoting the "European Business Register" project which provides company information directly from participating Member States' official registers on an online basis.[9] These standards of transparency on the BO of corporate entities are set out in Recommendation 24 of the revised FATF Recommendations and its interpretive notes. On this basis, it is imperative that the EU ensures a robust implementation of these standards.

Leaseurope is aware that not all national registers contain the same information, and this could pose as a barrier to optimizing on the *Directive on the interconnection of central, commercial and company registers*. Therefore Leaseurope wishes to advocate for the information contained in national registers to be harmonized and to include at minimum BO information and ownerships thresholds of 25%.

Additionally, Leaseurope welcomes that the Commission has maintained the 25% ownership threshold for direct ownership from the 3rd AMLD. This is a very helpful criterion, as it allows leasing companies to obtain a clear and appropriate picture regarding the control aspects pertaining to a corporate entity, in cases of direct ownership.

However, in practice it should be mentioned that cases of complex multi-layered corporate structures often appear, whereby the natural persons as the ultimate BOs do not directly hold any shares in the corporate entity. These are scenarios in which the obligation to identify the BO proves to be very difficult to comply with. Therefore the 4th AMLD should provide for a clear cut definition of the concept of "control" exercised by BOs.

[9] *See* http://www.ebr.org

3. POLITICALLY EXPOSED PERSONS – ARTICLES 3(7), 18, 19, 21 & 22

The Proposal for a 4th AMLD provides further elaboration on who exactly constitutes as a PEP, i. e. people who may represent higher risk by virtue of the political positions they hold.

- "Foreign PEPs" are those who are/have been entrusted with a prominent public function by a third country;
- "Domestic PEPs" are those who are/have been entrusted with a prominent political function in an EU Member State;
- "PEPs in international organisations". Article 3(7)(c) states that PEPs are also deemed to be "*Persons who are or who have been entrusted with a prominent function by an international organisation*". This essentially means directors, deputy directors, Board members and those with an equivalent function in an international organization.

The PEP definition also includes among others head of State, heads of government, Members of Parliaments and judges of supreme courts pursuant to the Implementing Measures, which will be completely transposed into Article 3(7) by the 4th AMLD.

LEASEUROPE'S VIEWS

Leaseurope welcomes the recognition in the in the Proposal for a 4th AMLD of the European Union as one single jurisdiction regarding the definition of domestic PEPs. This will allow obliged entities to take into consideration other risk factors (for example the level of corruption in a given Member State) and thus enable them to focus their resources more effectively on PEPs associated with higher risks. This will also allow obliged entities to control the level of new administrative burdens created by the inclusion of domestic PEPs within the scope of the 4th AMLD.

However, for the sake of consistency PEP term should be defined more precisely. In addition demanding that obliged entities assess PEPs on a risk-sensitive basis and requiring them to identify the PEP's family members and close associates, presents a major operational difficulty.

Therefore the leasing industry would appreciate if firstly the EU could compile and publish a regularly updated PEP list (at least for intra-EU PEPs, including their family members and close associates), so that obliged entities could use it as a substantive tool to discharge their CDD obligations independently of any lists purchased from commercial providers.

Failing this if the EU authorities are not in a position to provide a PEP list, they should at least include an annex in the Directive containing a list of relevant functions/categories of PEP for every Member State. Additionally, in order to aid obliged entities in the tedious task of identifying family members and close associates of PEPs, the proposed Directive should provide more detail on how far an obliged entity should be required to drill down in order to identify such family members and close associates of PEPs.

Additionally, in the essence of avoiding time wasting exercises and for the purposes of legal certainty the definition of international organisations in Article 3(7)(c) should be stated more explicitly and clearly reference the fact that it is intended to only constitute public international organisations. As it currently appears in the Proposal, it could be taken to encompass all private organisations operating internationally.

4. SUPRANATIONAL, NATIONAL AND INDUSTRY RISK-ASSESSMENTS – ARTICLES 6, 7 & 8

- The European Supervisory Authorities (ESAs – EIOPA, ESMA & EBA) are required to carry out an assessment and provide an opinion on the money laundering and terrorist financing risks facing the EU;
- The individual Member States are mandated to formulate a national risk assessment response to money laundering and terrorist financing threats in their respective Member States; and
- Obliged entities will also have to take the appropriate steps to identify and assess their money laundering and terrorist financing risks.

LEASEUROPE'S VIEWS

Leaseurope welcomes the efforts in the Proposal for a 4th AMLD to extend the Risk Based Approach (RBA) to the work of national supervisors, including efforts to conduct national and supranational risk assessments, in order to increase the awareness of potential threats faced by the obliged entities. Although, this will only prove to be a successful exercise if the national supervisors have the expertise and resources.

Generally, the RBA has been a successful tool for dealing with risks and has resulted in the efficient allocation of resources within the obliged entities. In addition, it has enabled obliged entities to tailor their systems towards a more focused manner for seeking out riskier transactions and/or customers. Therefore, it is important to take into consideration the risks prevailing in different sectors, especially those faced by smaller financial institutions with less risky business models such as leasing, as noted in the Implementing Measures[10].

Nonetheless, Leaseurope would, like to stress that the results of the risk assessments conducted in the future should not lead to the creation of hard risk indicators. They should remain as indicative examples.

5. SIMPLIFIED CUSTOMER DUE DILIGENCE MEASURES – ARTICLES 13, 14 & 15

The revised Directive tightens the rules on simplified CDD and does not permit situations where exemptions apply. Instead, decisions on when and how to undertake simplified CDD have to be justified on the basis of risk, while minimum requirements for factors of potentially lower risk situations are provided for via Annex II.

The European Supervisory Authorities are also tasked with the issuance of guidelines within two years of the Directive coming into force on the risk factors to be taken into consideration and/or the measures to be taken in situations where simplified due diligence measures are appropriate.

LEASEUROPE'S VIEWS

Leaseurope regrets that the Commission has employed such a list of factors as indicators of potentially lower risk situations via Annex II and the fact that European Supervisory Authorities has been tasked to issue guidelines on the risk factors to be taken into consideration and/or the measures to be taken in situations where simplified due diligence measures are appropriate within two years of the Directive coming into force. Instead Leaseurope advocates that the provisions of the 3rd AMLD and the Implementing Measures Directive regarding simplified CDD should remain in force. Despite the fact that they are overly detailed regulations, they have proved to be helpful in identifying low risk situations, for example leasing transactions.

Extract of Recital 9 of Commission Directive 2006/70/EC

"It should be possible to apply **simplified customer due diligence procedures to products and related transactions in limited circumstances**, for example where the benefits of the financial product in question cannot generally be realised for the benefit of third parties and those benefits are only realisable in the long term, such as some investment insurance policies or savings products, or **where the financial product aims at financing physical assets in the form of leasing agreements in which the legal and beneficial title of the underlying asset remains with the leasing company** or in the form of low value consumer credit, provided the transactions are carried out through bank accounts and are below an appropriate threshold..."

The low risk of money laundering that is posed by leasing transactions, whilst reflected in European legislation is also backed up by firm evidence, such as data on suspicious transactions reports.

Statistics of the German Federal Crime Police Office

[10] *Implementing Measures Directive 2006/70/EC, Recital 9.*

Using Germany (one of the largest European leasing markets) as an example, the statistics of the Federal Crime Police Office (BKA) show that there were approximately 36,000 suspicious transaction reports reported between 2006 and 2009. Out of these 36,000 reports filed, only ten of those were leasing related. Hence this further illustrates that leasing is a low risk product for money laundering purposes.

Leasing is fundamentally a low risk transaction for money laundering and terrorist financing purposes and this view is shared by the banking industry, supervisory authorities and law enforcement officials. Leasing is considered to pose a lower risk of money laundering compared with other traditional financial products and services as it is generally a long term relationship, whereas money laundering is by its nature a hit and run activity.

Leasing is low risk due to the fact that the lease agreement does not result in the lessee receiving funds. Rather, the lessee receives the usage of an asset e.g. a vehicle or a piece of machinery. Hence the initial leasing transaction is unlikely to be vulnerable to money laundering.

The funds to finance the asset are mostly directly paid into the supplier's bank account. Following this action the assets are made available to the lessee under the long term lease contract. Most contracts have a term exceeding one year.

Another basic reason why leasing transactions represent a low risk of money laundering is due to the payment methods used to remunerate the lease installments. Repayments by the lessee are almost always made through the lessee's bank account via direct debit or standing order. The lessee's bank account is held within a financial institution subject to the provisions of 3rd AMLD and its Implementing Measures.

This means that the lessee has already been identified and CDD has already been conducted by the financial institution holding the lessee's bank account:

i) At the time the bank account was opened; and

ii) As part of the financial institution's ongoing security checks.

If these checks were to be repeated for a leasing transaction then this situation would result in repeated customer identification procedures, delays and inefficiencies. In fact the European Commission aims to avoid this by virtue of Recital 27 of the 3rd AMLD.[11]

These CDD checks made by another financial institution, and that are always conducted before any lease agreement has been made, ensure that when lease installments are made in the future from a lessee's account via a direct debit or standing order, the 'paper trail' for the lease installments cannot be concealed. The origin of the lease installments can thus be traced back without difficulty.

When a lessor then carries out its own CDD measures before the conclusion of a lease agreement, this is the second time that those checks are being made on the lessee.[12] It should be noted that leasing companies in principle are not banks, but use the banking services for the operation of their leasing businesses.

Furthermore, as a lessee is unlikely to have the option to pay the lease installments in ways other than direct debit/standing order[13], it is extremely unlikely, if not impossible, for a criminal to launder money by payment through a large cash deposit in favour of the lessor. In fact repayments in cash are exceptional. This fact in itself acts as a deterrent to criminals that wish to launder money through leasing transactions.

In addition leasing companies will only accept repayment of lease installments from the lessee named on the agreement, and in cases of overpayment will only make repayment to the lessee named on the agreement.

[11] *Extract from Recital 27 of the 3rd AMLD: In order to avoid repeated customer identification procedures, leading to delays and inefficiency in business, it is appropriate, subject to suitable safeguards, to allow customers to be introduced whose identification has been carried out elsewhere.*

[12] *As explained above, the first time CDD was carried out it was by the lessee's own bank (i.e. the financial institution holding the lessee's bank account).*

[13] *We note that in Germany, 90% of leasing transactions are paid for via direct debit.*

As a vehicle for money laundering and terrorist financing, leasing is ineffective

The nature of the leasing product itself creates certain "structural" controls/restrictions at the 'Placement' and 'Integration' stages of the money laundering lifecycle. For example (i) leasing agreements do not give access to funds for the lessee; (ii) there are limitations on the ability of the lessee to insert cash (e.g. through lease installments) into the financial system; and (iii) settlement payments (in the case of a financial lease with an obligation to purchase) are generally required to be denominated in local currency, and therefore the funds used to make the final payment will already have been placed into the local regulated banking system before reaching the lessor.

As shown in the following table, sophisticated preventative measures contribute to making leasing ineffective as a vehicle for money laundering.

A prescriptive regulatory approach for such a low risk transaction is not necessary; lessors have thorough risk management systems in place

All aspects of the leasing transaction must be considered from an AML perspective, as well as controls to mitigate and manage these risks.

For example, lessors:

- Verify information through credit bureau checks to obtain objective information on a lessee;
- Check the price paid for the acquisition of a leased asset with independent sources to avoid paying inflated prices for assets thus reducing the financial crime risk;
- Visit the potential lessee prior to agreeing to finance an asset in order to try to understand the client's business, so as to verify that that the nature of the asset for which funding was sought is consistent with the client's business;
- Research suppliers and inspect the leased asset on delivery in order to prevent financing of non-existent assets;
- Audit the asset over the lease term to prevent unauthorized disposal of the asset; and
- Register the lessor's title to an asset on a central register to prevent unauthorized asset disposal (in Member States where such central registers exist).

6. DATA PROTECTION – ARTICLE 42

The Proposal for a 4th AMLD contains provisions that aim to clarify the relationship between AML/CFT and Data Protection obligations. In addition, the recent European Commission Proposal for a review the EU Data Protection framework[14] attempts to provide further clarification concerning some of the broad and complex issues which will have a direct impact on leasing companies and their compliance with AML/CFT requirements.

The Proposal for a 4th AMLD recognises the need to strike a balance between establishing systems, controls and preventative measures against AML/CFT on the one hand, protecting the rights of data subjects on the other, and claims to be fully in line with the approach set out in the European Commission's Proposal for a review the EU Data Protection framework (currently being discussed in the European Parliament and Council).

In particular a specific provision[15] of the Proposal for a review the EU Data Protection framework empowers the EU or national legislation to restrict the scope of obligations and rights provided for in the Proposal on a number of specified grounds, including the prevention, investigation, detection and prosecution of criminal offences.

[14] *European Commission Proposal for a Regulation of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation) COM(2012) 11 final.*

[15] *Proposal for a General Data Protection Regulation, Article 21.*

LEASEUROPE'S VIEWS

Leaseurope acknowledges the fact that conflicting objectives and requirements exist between AML and Data Protection legislation. On the one hand, Know Your Customer (KYC) obligations require the collection of all necessary data to ensure a robust level of knowledge about the customer and their transactions, in order to prevent the business relationship from being misused for money laundering/terrorist financing purposes.

On the other hand, collecting information which is adequate, relevant and not excessive for the processing of data on the agreed purpose is an acknowledged principle of protecting customers' data. Being able to process customers' data with legal certainty is a priority for leasing companies. However, given that both instruments are being revised concurrently, it is important that the legislative framework is coherent on how to tackle potential inconsistencies between EU Data Protection legislation and requirements of the 4th AMLD, as well as other domestic, European and international regulations or standards from a compliance risk management perspective.

Moreover, Recital 34 of the Proposal for a 4th AMLD should be amended in order to permit a limitation of the rights of access to all the information collected for AML purposes, not only to information contained in a suspicious transaction reports. Limitations in this sense are consistent with the current provision of Article 13 of the current EU Data Protection Directive.[16]

7. FEEDBACK CLAUSE – ARTICLE 43(3)

The Proposal for a 4th AMLD requires that whenever possible, Member States shall ensure timely feedback on the effectiveness of and follow-up to reports of suspected money laundering or terrorist financing.

LEASEUROPE'S VIEWS

The European Commission's Proposal falls short of a strengthening the feedback clause. Leaseurope regards the wording of the feedback obligation pursuant to the new Article 43 as too non-committal. Therefore Leasuerope suggests that the wording of Article 43(3) be amended to reflect a more binding obligation, so as to ensure that obliged entities received the necessary feedback required with the view to deploying their resources as efficiently and effectively as possible.

8. SANCTIONS – ARTICLES 55, 56, 57 & 58

In the Proposal for a 4th AMLD the European Commission proposes to harmonise administrative sanctions by stipulating that Member States should ensure that administrative sanctions are available for systematic breaches of key requirements, including CDD requirements, record keeping, suspicious transaction reporting and internal controls.

LEASEUROPE'S VIEWS

Leaseurope considers the proposed sanctions disproportionately severe and generally too prescriptive. The pecuniary sanctions proposed in particular are too high for compliance breaches. It would be more appropriate for administrative sanctions to be administered by nature of the particular breach in question.

[16] *Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.*