FLA RESPONSE TO IMPLEMENTING THE THIRD MONEY LAUNDERING DIRECTIVE: AN HMT CONSULTATION DOCUMENT

FLA (Finance & Leasing Association) welcomes the opportunity to comment on the HMT's consultation on the Third Money Laundering Directive.

INTRODUCTION

FLA is the main representative organisation for the UK consumer credit, motor finance and asset finance sectors, and the largest organisation of its type in Europe. Our members comprise banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms. The facilities they provide include finance leasing, operating leasing, hire purchase, conditional sale, personal contract purchase plans, personal lease plans, secured and unsecured personal loans, credit cards and store card facilities.

FLA members achieved £87.3 billion of new business in 2005. Of this £27.2 billion was provided to the business sector and UK public services, representing 30.4% of all fixed capital investment in the UK in 2005 (excluding real property).

The remaining £60.1 billion was provided to the consumer sector, which included 25.5% of all unsecured lending in the UK. Included in this is £18.6 billion of finance provided to the motor sector. FLA members financed at least 50% of all new car registrations in the UK in 2005.

1. OVERALL COMMENTS

We would like clarification on whether HM Treasury intends to clarify the term 'financial leasing' which has no meaning in UK law. This is for the purposes of legal certainty given that FLA members will, as a matter of good practice, regard all their business as covered by the JMLSG Guidance, without prejudice as to whether it is caught by the scope of the directive.

In order to ensure consistency of approach we believe that the provisions in the Directive permitting reliance by FSA-regulated firms on third parties should be extended to firms in our sectors regulated by other competent authorities be it the OFT or HMRC. We would also urge HM Treasury to make explicit in the Regulations that a finance company may rely on agents such as motor dealers and retailers to perform customer due diligence.

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2. SPECIFIC COMMENTS

Chapter 2 - Scope and definitions

Defining the scope of the regulated sector in the Money Laundering Regulations: The Government would welcome your views on whether the Government should define the scope as a list of categories or whether the Government should keep the current activity approach.

FLA Response: We note that the current definition of relevant business in the Money Laundering Regulations 2003 (the Regulations) is compliant with the scope of the Third Directive. In consideration of this we would urge the government to ensure that scope is not altered in any way that would result in over implementation of the Directive. We support the Government's proposal to simplify the Regulations and align them more closely to the provisions of the Directive by defining relevant business as being the business, professional or commercial activities of the categories of persons included within Article 2 of the Third Money Laundering Directive, rather than the activity approach adopted by the UK when implementing the Second Money Laundering Directive, which defined the scope of the sector by activity performed rather than by reference to professional sectors.

The definition of financial Institutions: Do you agree with the Government's approach of clarifying which firms fall within the definition by excluding certain categories where there are clear grounds for doing so? Do you have any examples of such persons or undertakings?

FLA Response: We note that the definition of "Financial Institution" remains unaltered. "Financial Leasing" is undefined but explicitly included in the scope, "Credit Institutions" and "Financial Institutions" are also explicitly included. We believe that EU legislation can govern a definition in national legislation, where an EU definition exists. We are not aware of any definition of leasing in EU law, or UK law for that matter. We would appreciate a view on whether the Government plans explicitly to clarify this situation or leave implementation and application of the Third Money Laundering Directive to interpretation in respect of "Financial Leasing". As a matter of good practice, FLA members will regard all their business as covered by the JMLSG Guidance, without prejudice to whether it is caught by the scope of the directive.

We believe that as a matter of common usage, "Financial Leasing" means "finance leasing". The implication of this is that operating leasing is outside scope. We also assume that pure broking – where an intermediary does not carry out leasing on their own account – is outside scope. We would welcome confirmation.

Financial activity on an occasional and limited basis: Do you agree that the UK should implement the Article 2.2 of the Third Directive and exclude financial activity that is on an occasional and limited basis and represents a low risk of money laundering and terrorist financing?

FLA Response: In line with the risk-based approach promoted in JMLSG Guidance and in consideration of the broad and wide-reaching definition of financial institutions, we support the Government's proposals to take advantage of the derogations offered by article 2(2). We believe that by doing so the Government can apply a risk-based approach and avoid unduly burdensome regulation where there is a low risk of

money laundering and terrorist financing and for those businesses who are not regularly or significantly engaged in financial activity.

Thresholds: Do you agree with the thresholds the Government proposes using for criteria b and c?

FLA Response: We agree with the proposed thresholds.

Additional changes to the scope of the regulated sector: Do you agree that the Government should not extend the Regulations to any other sectors other than those listed in the Directive?

FLA Response: FLA does not recommend the extension of the scope of the sectors under Regulations to include any activity over and above those that are now included in the scope of the Third Money Laundering Directive.

Chapter 3 - Customer due diligence

FLA Response: FLA has no specific comments on the proposals set out in this chapter. However, we note the Government's intention to transpose the requirements of the Third Money Laundering Directive in respect of Customer Due Diligence and Beneficial Ownership directly into the Regulations without adding additional detail. In respect of the requirement stated in article 9.1 of the Directive to verify the identity of the customer and beneficial owner before the establishment of the business relationship and as soon as reasonably practicable after contact is first made, we support the Government's proposal to take advantage of all three derogations.

Chapter 4 - Simplified and enhanced due diligence

Simplified due diligence: Do you agree that a category for simplified due diligence is necessary and useful or would you wish all customers and products to undergo some form of customer due diligence but on a risk based approach?

FLA Response: We agree that a category for simplified due diligence is necessary in the context of a risk-based approach to anti-money laundering and anti-terrorist financing and in the interest of ensuring that the burden of regulation on businesses is reduced where appropriate.

Examples: Even if you agree with the category of simplified due diligence are there any of the examples listed in the Directive that you think should not be included in the updated Money Laundering Regulations?

FLA Response: FLA agrees with the examples provided by the Directive. However in the interest of ensuring the consistent application of simplified due diligence we would like to see an explicitly defined and finite list of customers and products included when the Directive's requirements in relation to the creation of a category for simplified due diligence are transposed into the UK Regulations.

The Commission's implementing measures for simplified due diligence: What are the examples of customer, products or transactions that you believe meet the Commission's criteria?

FLA Response: One such product that we believe meets the Commission's criteria is Insurance Premium Funding. UK insurers require that motor, home and business insurance premiums are paid in full at the beginning of the insurance period. Lenders are prepared to advance the full premium amount to the insurance broker or insurer and the individuals or businesses repay the loan by instalments. Should the insurance be cancelled and, therefore, the loan, any return of premium due is repaid to the lender; not to the individual or business that takes out the insurance. The loan is linked to the premium and the money laundering risk is very low.

The generic nature of this product means that no monies are due to the borrower because the contract only exists as long as the borrower pays by regular instalments and secondly the monies are only channelled between the insurer and the lender via the broker i.e. the borrower cannot benefit from money laundering activity because s/he has no recourse to the funds. Furthermore, no cash is transacted at any stage. All payments and collections are strictly undertaken by the BACS process and in exceptional circumstances monies are transferred by CHAPS or cheque.

We believe that the total market funded by Premium Funders in the UK at present is circa £5 billion (€7.3 billion). As far as we are aware, the Republic of Ireland is the only other Member State to offer such a product.

In accordance with the criteria for simplified due diligence and the definition of low-risk products set out by the Commission in the Third Money Laundering Directive, Insurance Premium Funding operates within a low risk classification based on the cumulative technical criteria for customers. As a result we would like to see the product explicitly included in the category of products eligible to apply simplified due diligence in the Regulations. We have made the assumption that Premium Funders' "customers" are the introducing brokers and not the borrowers themselves. In this context, Insurance Premium Funding meets criteria set out by the Commission in the following way:

- Insurance Premium Funders' customers – the brokers – are regulated by the FSA.

- Insurance Premium Funders will only deal with brokers who are registered on the FSA website. This information is verified on the FSA database before business commences.

- Under FSA regulation, broker conduct of business is reviewed. Non-compliant brokers are struck off and will be unable to trade.

- Premium Funders only take monthly premiums by direct debit from bank accounts and the funds that are paid to brokers have to be maintained in 'client' designated accounts.

Chapter 5 - Reliance on third parties

Who should be a third party: Do you agree with the Government's proposed approach to implementing the reliance provisions of the Directive? Namely a staged approach to which sectors can be relied upon.

FLA Response: We note that the Government plans to transpose the requirements of the Directive in respect of reliance on third parties in such a way that will, in the first instance, allow credit and financial institutions currently authorised and supervised by the FSA, as well as legal and accountancy professionals that are members of professional bodies to be relied on as third parties. The Government also proposes that UK firms should be able to rely on MSB's, Casino's and TCSP's only when the new supervisory systems have been established and there is evidence of widespread compliance with the customer due diligence requirements of the Directive in the UK.

We cannot agree with the Government's proposed approach to implementing the reliance provisions of the Directive in their current format. The proposal seems to have no regard to the Government's own proposals in respect of Monitoring and Supervision (Chapter 10) and the model that is set out in Annex 1 for the supervision of financial institutions not presently monitored for money laundering purposes.

Under the proposed approach to the supervision of these institutions the Government sets out a range of options which will result in the establishment of new regulatory regimes for money laundering purposes under the competent authority of either HMRC, FSA, OFT or DTI. However, the staged approach to implementing the reliance provisions of the Directive makes no reference to these new regimes for money laundering regulation, several of which already represent well established and tested supervisory systems for other aspects of regulation.

FLA suggests that the reliance provisions of the Directive should be implemented in such a way that recognises the competent authority of the regimes proposed in Chapter 10 and allows firms to rely on third parties regulated for the purposes of money laundering by HMRC and OFT, in the same way they are able to rely on third parties regulated by FSA. In particular, FLA believes that firms licensed by OFT under the stricter regime of CCA 2006 should be admitted to the category of firms which can be relied on as third parties. This would reflect the close regulatory cooperation between the two regulators which has been set in train.

Article 19 of the Directive specifically refers to situations where an agency relationship exists. Article 19 makes provision to permit firms to use agents to perform customer due diligence as long as they are regarded as part of the institution. The responsibility for customer due diligence measures, therefore, remains with the firm covered by the Directive. These provisions seem to require little if any change to current UK practice and we note that the Government proposes transposing Article 19 directly into the updated regulations.

FLA has on a number of occasions raised the issue with HM Treasury concerning the position of third party agents in relation to the Third Money Laundering Directive.

Finance houses use agents such as motor dealers and high street retailers to perform customer due diligence and collect Know Your Customer (KYC) evidence on their behalf as the latter have contact with the customer at the point of sale. Our interpretation is that under article 19 of the Commission's proposal such firms would

be excluded from acting as agent as they are not within the scope of the Directive as defined by article 2.

We, together with our European colleagues, put forward an amendment to the European Parliament. This was diluted by the lead Civil Liberties Committee, so that a point of clarification is made in the recitals.

In informal discussions, at the time when the Directive was under discussion, UKREP informed FLA that HM Treasury would not interpret the Directive as preventing agents undertaking customer verification, and we have since received oral assurances from HM Treasury. To give our members peace of mind, we would derive much comfort from a written assurance and explicit inclusion in the text of the Regulations that confirms this as HM Treasury's position. Without this certainty, the fundamentals of point of sale finance are put at risk.

Chapter 6 - Equivalence and subsidiaries in third countries

Equivalence: Do you believe that the provisions should be kept at a high level allowing someone in the regulated sector to make a decision on equivalence taking into account the equivalence lists produced by the UK (and any other lists in a cross-border transaction), or that the Regulations should require firms to only treat those countries as equivalent that appear on the UK's lists?

What types of information would be helpful for industry, in order for them to be confident that another jurisdiction could be classified as equivalent?

FLA Response: In keeping with a risk-based approach to developing anti-money laundering policy, FLA believes that the Government should transpose directly and at a high level the requirements of the Directive into the Regulations and that the Regulations should allow regulated sector firms to decide whether a country is equivalent, taking into account any lists produced by the UK Government.

Industry guidance and Government and Commission issued advisory notes, based on FATF Non-Cooperative Countries or Territories list should continue to be issued to assist firms in assessing equivalence of overseas anti-money laundering / counter-terrorism finance (AML/CTF) regimes.

Chapter 7 - Reporting obligations

Consent: Have circumstances arisen where the regulated sector has concluded that refraining from carrying out a transaction is "likely to frustrate efforts to pursue the beneficiaries of a suspected money laundering or terrorist financing operation?" Do you think that the UK needs to take further action to give effect to Article 24.2? If so, what measures should be taken?

FLA Response: No comments

Protection of employees: Do you think that the UK needs to take further action to ensure effective implementation of Article 27? If you think that the Government should, what action should be taken and what are the benefits of doing so. If you think that the Government should not, what are the concerns with doing so?

FLA Response: No comments

Tipping off: Do you think that Article 28 requires amendment to section 333(3) or section 342(4) of the Proceeds of Crime Act 2002 (defences for professional legal advisers for tipping off offences).

Do you think that the UK needs to take further action to give effect to Article 28.1? If so, what measures should be taken?

FLA Response: No comments

Chapter 8 - Record keeping, internal procedures and training

Record keeping: The Government would welcome your comments on whether the Regulations should either offer an open choice of whether copies or references should be kept as records, or explicitly require that when documentation is taken, copies should be kept unless it is not practicable to do so in which case the references of the evidence required will be sufficient. In providing your response the Government would welcome any information on the relative costs of the two options.

FLA Response: The Third Money Laundering Directive requires that a copy of the evidence required to satisfy customer due diligence requirements or references of the evidence required and evidence and records of transactions carried out as part of the business relationship be kept for five years from when either the business relationship or the transaction ends. We would suggest that the Government transposes the requirements of the Directive literally in this regard, providing a clear choice for firms who are using documents to verify ID over whether to keep copies of those documents or the references of the evidence that was required.

While it may be practical for some firms to keep copies of the documents, and while there are certainly some advantages, from an evidential perspective, in doing so, we believe that such a requirement would impose costly and impractical burdens on many firms. On these grounds we would encourage the Government to avoid exceeding the requirements of the Directive in this area.

Chapter 9 - Requirements of government and its agencies

No consultation questions.

Chapter 10 - Monitoring and supervision

Model of supervision: Do you agree with the suggested model of supervision?

FLA Response: The requirement of the Directive to introduce effective monitoring for compliance with anti-money laundering controls will create a significant new regulatory burden for those financial institutions falling within scope of the Directive who are not currently regulated for their activities by OFT, FSA or HMRC. We do however derive comfort from HM Treasury's assurances that these will not be excessive and do not constitute the thin end of any wedge.

We have previously suggested to HMT that this small category of firms might more appropriately be self-regulated in respect of money-laundering compliance, by professional or industry bodies applying the JMLSG Guidance. We do, however, acknowledge that the Directive specifically prohibits such an arrangement in the case of financial institutions.

FLA believes that the monitoring requirements of the Directive in respect of financial institutions should be met in a proportionate manner that is consistent with the recommendations of the Hampton Review. We agree that any new regime will need to be self-funding and that the level of fees should be linked directly to the cost of supervision. We feel strongly that monitoring under the new regime should be in line with any existing monitoring policy for money laundering currently carried out by the proposed-competent authorities.

Regulators should be encouraged to take a risk-based approach to ensure that supervision does not exceed the objectives of the Directive and does not deliver unnecessary and over-burdensome regulation. Clearly the interests of fair competition require as consistent approach amongst the various regulators.

Annex 1 financial institutions: Do you agree with the Government's proposals as to who should take on monitoring of these institutions?

FLA Response: We continue to believe strongly that truly effective regulation of the financial services industry can only be achieved through the creation of a single regulator. We therefore deplore the Government's decision not to consult on the "Hampton footnote". Pragmatism however suggests that early reconsideration is unlikely. This continues to present challenges for those firms who are licensed by OFT and regulated by FSA for other activities. This is likely to be compounded, rather than eased by a regime where OFT will be supervising some licensed firms for money laundering, while others (those already regulated by FSA) will continue to be supervised by FSA.

Many of our members are already regulated by FSA for their activities and will therefore already be supervised by FSA for money laundering purposes. Wholly owned subsidiaries of these regulated firms, maybe un-regulated in their own right, are usually subject to group policies, and hence FSA regulation in respect of money laundering. In the interests of consistency we would argue that these firms should be identified and explicitly subject to the existing FSA regime.

Many if not most asset finance (leasing and hire purchase) firms have consumer credit licences, whether part of banking groups or not. It is wholly anomalous that those in banking groups will be regulated by FSA and non-banks by OFT, given the identical nature of their business. Those currently unregulated altogether are to go to FSA and we believe there is a strong argument for having a single regulator for asset finance. We understand that a similar position arises in the Factoring and Invoice Discounting sector. We believe that the same solutions should be adopted in these areas.

The same consideration also applies to consumer credit businesses. None of these are however unregulated and a straight split between banks and non-banks is proposed. We see this as an undesirable distortion to competition and a further hint of two tier regulation.

We note the Chancellor's intention to set up a forum of AML/CTF regulators. Whilst this should help to iron out anomalies, we would like to explore with HM Treasury this very uncomfortable area of the proposals to see whether a more satisfactory outcome can be reached.

There remain a number of firms which are currently unregulated. We are in touch with HM Treasury and FSA to help ascertain their nature and extent. HM Treasury propose that they should be regulated by FSA. Although this could impose burdensome and intrusive principles-based regulatory requirements on firms with no history under FSMA 2000 and no experience of interpreting FSA rules and guidance, on balance it makes sense to do so. It is worth noting that FLA member firms are currently strongly recommended to follow the relevant parts of the JMLSG guidance.

The anomalous regime set out in the consultation report flows from defects in the underlying regulation; we pointed out at the drafting stage that FSMA should have established a single authority for money laundering in the financial services sector, not based on the authorisation regime. We hope that HM Treasury will nevertheless try to achieve consistency and proportionality across the board.

Chapter 11 - Penalties and status of industry guidance

No consultation questions

3. CONCLUSION

We would like to convene a meeting at the earliest opportunity to discuss the key issues we have raised, principally around the definition of "financial leasing" and the competent supervisory authority for FLA members.

4. FLA CONTACT DETAILS

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20 October 2006

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