



## FATF'S RESPONSE TO THE PUBLIC CONSULTATION ON THE REVISION OF THE FATF RECOMMENDATIONS

### I. INTRODUCTION

1. In June 2009, the FATF began its review of the FATF Recommendations on anti-money laundering and combating the financing of terrorism (AML/CFT), and has been committed to consultation with the private sector (including representative bodies from the financial sector, DNFBPs and NGOs etc.) throughout the process. This review was undertaken, in part, to address emerging threats that have been identified, but also to reflect on the experiences of members in implementing the Recommendations since they were last revised in 2003. In the course of the review, the FATF has issued two public consultation papers (October 2010 and June 2011)<sup>1</sup>, and organised two private sector consultative forum (PSCF) meetings, in November 2010 and December 2011. In addition, there has been more focused outreach to the private sector, from time to time, on specific technical issues.
2. Feedback was sought by the FATF from the private sector on the following areas:
  - (a) The Risk-Based Approach to AML/CFT
  - (b) Inclusion of Tax Crimes as Predicate Offence for Money Laundering
  - (c) Customer Due-Diligence Measures
  - (d) Transparency of Legal Persons and Legal Arrangements
  - (e) Politically Exposed Persons
  - (f) Enhancing the Transparency of Cross-Border Wire Transfers
  - (g) Targeted Financial Sanctions in the Terrorist Financing and Financing of Proliferation Contexts
  - (h) Third-Party Reliance and Group-Wide Compliance Programmes
  - (i) Data Protection and Privacy
  - (j) International Cooperation
  - (k) The Financial Intelligence Unit
3. More than 140 written responses were received from the public consultations, and each of these was considered by the FATF. On some issues, a variety of views from the private sector were received, and the FATF had to carefully consider the opinions and requirements of different segments of the private sector, while ensuring that the over-arching aim to enhance and clarify the FATF Standards is achieved. While some feedback on the FATF's reaction to the comments received has been provided during the PSCF meetings, this document provides the FATF's formal response to the key themes that emerged from the consultations. The intention also is to hold a further meeting of the PSCF, in the near future, in order to elaborate, where necessary, on the contents of this document.

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<sup>1</sup> [www.fatf-gafi.org/standardsreview](http://www.fatf-gafi.org/standardsreview)

## II. FATF'S RESPONSE TO THE KEY ISSUES ARISING FROM THE PUBLIC CONSULTATIONS

4. Not surprisingly, the consultation process generated a very broad range of opinions on many of the issues, with quite opposite positions being advocated in some cases. This document does not attempt to respond to each and every position taken, but focuses on the more consistent themes that emerged from the comments.

### The Risk-Based Approach (New Recommendation)

5. There was broad support from the private sector on applying a risk-based approach to AML/CFT, in general. The majority of responses were also in favour of a risk-based approach to the supervision of compliance with AML/CFT obligations. Some concerns were expressed that supervisors may not adequately understand or apply the risk-based approach, and that it could be helpful to have additional guidance on compliance risk indicators that supervisors and the private sector may refer to. Requests were also made that the more overt references to the risk-based approach in the Recommendations themselves should not detract from the value of the FATF's sector-specific guidance that had previously been developed in consultation with the private sector; and that the overall approach should be sufficiently flexible for practitioners to be able to use their own judgement when applying a risk-based approach.
6. The effective implementation of the risk-based approach requires both countries and the private sector to work in partnership, to clearly understand the money laundering and terrorist financing risks which affect them, and to adapt their systems to the nature of these risks. The underlying principle, clearly stated in several places in the revised Recommendations, should remain that enhanced measures should be applied where the risks are higher, with the option of applying simplified measures where the risks are lower.
7. The revised Recommendations also make it clear that in applying a risk-based approach, countries and the relevant supervisors should take into consideration the varying characteristics of the financial institutions or designated non-financial business and profession (DNFBPs), and the degree of discretion allowed to them under a risk-based approach. Appropriate information on the risks assessment and the resulting approach to supervision should be communicated to the private sector, so that financial institutions and DNFBPs would have a better appreciation of the flexibility given them to differentiate the extent of their preventive measures, depending on the type and level of risks. The FATF had also taken the opportunity to provide additional guidance in the form of illustrative examples of higher and lower risk factors, and the appropriate measures that might be adopted in certain situations. However, these remain examples and should not be misunderstood to represent part of the mandatory elements of the revised Standards.
8. Regarding sector-specific guidance, the FATF had, in recent years, produced a series of sectoral guidance documents, each of which includes guidance for both public authorities and the private sector in the application of the risk-based approach. Following the adoption of the revised Recommendations, the FATF will, in consultation with the relevant parts of

the private sector, initiate further work to update the guidance documents to reflect the changes in the risk-based approach, and to consider developing additional compliance risk indicators and best practices.

### Inclusion of Tax Crimes as a Predicate Offence for Money Laundering (New)

9. The responses received from the private sector on the inclusion of tax crimes as predicate offences were mixed, with a number of financial representative bodies supporting the proposal in general, while many representative bodies, including DNFBPs' representative bodies, indicating concerns or rejecting the proposal. The concerns relate in particular to: (i) the scope of tax crimes, with a strong preference indicated that only serious tax crimes should be included; (ii) the lack in expertise and the inherent difficulty for the private sector in detecting tax crimes; and (iii) the need for a level playing field.
10. The FATF had considered these concerns and the need to address the growing threat over the laundering of tax crimes. The change is thus calibrated to focus on the inclusion of serious tax crimes, and is similar to the approach that the FATF has taken consistently in defining the minimum range of predicate offences for money laundering as being serious offences. Countries would, therefore, have some flexibility with respect to the precise offences to be included in relation to its own circumstances.

### Customer Due-Diligence (CDD) Measures (New Recommendation 10)

11. The private sector was consulted on various aspects of the CDD measures, including proposals to further clarify the steps necessary to identify and verify the ultimate beneficial owner. A number of issues were tabled by respondents, relating to: (i) the challenges faced in establishing who are the beneficial owners, and the possibility of introducing a threshold in defining beneficial ownership; (ii) the cost and burden of conducting CDD measures, and the possibility of exemptions from identifying the beneficial owner, unless there are identified money laundering and terrorist financing risks; (iii) requests for assistance from the public sector to help the private sector identify and verify beneficial owners of legal persons and legal arrangements; and (iv) the specific circumstances of the life insurance industry when dealing with beneficiaries of life insurance policies. The FATF is fully aware of the challenges faced by financial institutions and DNFBPs in fulfilling the obligations with respect to identifying beneficial owners, and this has been a particular challenge identified during the recent round of mutual evaluations conducted on FATF members. Therefore, considerable attention has been given during the revision to try to address some of the concerns.
12. **Clarification of measures to identify and verify beneficial owners:** In recognising that it may not always be possible to identify the natural person who is the ultimate beneficial owner when dealing with legal persons or legal arrangements (e.g. when there is a diversified ownership structure), a step-by-step process on the appropriate CDD measures has been adopted in the revised Recommendation. When dealing with a customer which is a legal person, a financial institution should first try to identify the natural persons who ultimately have a controlling ownership interest; but if there is doubt over whether such

- persons hold the beneficial ownership, or when no such natural persons can be identified, the financial institution should aim to identify if there are other natural persons that may exercise control over the customer through means other than shareholding. If these measures fail to identify a natural person exercising such controls, the financial institution should then take reasonable steps to identify the natural person holding a senior management position.
13. The FATF has also considered the private sector's concern over the concept of identifying and verifying the "mind and management" of a legal person, and has removed the reference, using instead the more familiar concept of "senior management". To assist in the effective implementation of these requirements, the FATF will be considering the possible need for additional guidance on the measures for the identification and verification of beneficial owners, and will consult the private sector accordingly, in due course.
  14. The private sector proposal for applying a numerical threshold when determining controlling ownership of a legal person has been considered. The revised Recommendations now recognise that such an approach may be reasonable in some cases, and it will be the responsibility of individual countries to determine and justify what would be the appropriate thresholds if they choose to adopt this approach.
  15. **Cost and burden of compliance and the benefits of a risk-based approach:** The FATF recognises the cost borne by the private sector in implementing the CDD requirements, as well as the potential challenges that they can incur when dealing with customers, but the FATF remains resolute in its opinion that robust CDD measures are fundamental to an effective AML/CFT regime. Also it is in the interest of financial institutions and DNFBPs themselves to minimise the risks to their reputation from their association with money-laundering and terrorist financing. The FATF also believes that the implementation of an appropriate risk-based approach will allow the private sector to better allocate resources according to the risks associated with the transactions and business relationships, and apply reasonable measures commensurate with the risks. A key component for an institution in understanding its risks is to know who it is dealing with. It is thus entirely appropriate that institutions should identify and verify both the customer and the beneficial owner. Nonetheless, under the risk-based approach, the scope and depth of those measures may vary, and it may even be possible for there to be exemptions from the requirement to identify and verify the beneficial owner in strictly limited and defined circumstances, when there is proven low risk of money laundering or terrorist financing. When properly applied, the risk-based approach will assist the private sector to focus its resources and reduce the burden of compliance.
  16. **Access to greater information on the ownership of legal persons and legal arrangements:** Some respondents proposed that, if financial institutions are being required to establish beneficial ownership, the public sector should assist by facilitating access to much more information on who owns or controls such legal structures. The FATF has given further considerable thought to measures to improve the transparency of legal person and legal arrangements, primarily for investigative purposes (the revised Recommendations 24 and 25, including the Interpretative Notes), and believes that the

revisions will go some way in improving the availability of information to financial institutions and DNFBPs, while balancing legitimate rights to privacy. These new measures are described in the next section of this document.

17. **CDD measures for life insurance:** Feedback was also received from the private sector, and specifically, the life insurance sector, that there should be a clear distinction between a beneficiary of a life insurance policy and the beneficial owner, and that verification of beneficiaries may not always be possible at the beginning of the business relationship. These views were accepted by the FATF, and the revisions seek to clarify the CDD measures required, and to stress that verification of the beneficiaries need only occur at the time of the payout. Reasonable measures should be taken to identify and verify the beneficial owner of the beneficiary (including whether the beneficial owner is a politically exposed person) at that time.

#### Transparency of Legal Persons and Legal Arrangements (New Recommendations 24 and 25)

18. The FATF has given considerable attention to the question of how to improve the transparency of legal persons and legal arrangements (and in particular, trusts arrangements); primarily in relation to assisting the investigation of money laundering and terrorist financing, but also with respect to what additional information might be made available to the financial sector.
19. **Transparency of Legal Persons:** The revised Recommendation requires companies to maintain basic information relating to the company, its directors and shareholders. Countries have a range of options to determine how additional information relating to beneficial ownership is maintained, and these are not focused primarily on the use of financial institutions as a substitute registry for beneficial ownership information, which was a concern expressed by several contributors to the consultation process. The options include the use of various existing sources, including information held by other competent authorities, the company itself, the private sector or available information on listed companies. In addition, the new requirements for nominee directors and shareholders to disclose their status to the company registry, or be licensed, will go some way towards reducing the risks in relation to camouflaging the ownership.
20. **Transparency of Legal Arrangements:** Specific feedback was received from the private sector on legal arrangements relating to: (i) concerns over the use of trust registries and the rationale for requiring the same level of transparency for a trust arrangement as for legal persons; (ii) a proposal to include “protectors, enforcers and the like” within the class of “beneficial owners”; and (iii) focusing the obligations on trustees to be consistent with common practice and legal obligations.
21. The FATF considered and accepted these proposals. The revised Recommendation allows countries to determine if a trust registry should be required, and focuses on the obligations of a trustee. As such, trustees now have to obtain and maintain adequate and accurate beneficial ownership information, including information on the identity of the settler, the trustee(s), and the protector (if any), as well as disclose their status as trustees when entering into a relationship with a financial institution or DNFBP.

### Politically Exposed Persons (PEPs) (New Recommendation 12)

22. The revisions to the Recommendation are intended to strengthen current standards, particularly in relation to increased international concerns on corruption. Case studies and research released by various international bodies, including the FATF, confirm continued instances of serious abuse by PEPs, their family members and close associates, particularly in cross-border scenarios. In view of the growing concerns, it is important that the PEP requirements be expanded to cover domestic PEPs and persons who are or have been entrusted with a prominent function by an international organisation by adopting a risk-based approach for these groups. The approach for foreign PEPs will, however, not be changed, as the risks are still most significant in a cross-border context.
23. The feedback received from some elements of the private sector indicated concern for the move to strengthen the requirements on PEPs, their family members and close associates. Suggestions were made by some respondents that a risk-based approach could also be applied to foreign PEPs, as is now proposed for dealing with domestic PEPs. There were also proposals that the FATF should provide definitions for “family members” and “close associates” of PEPs, and for national authorities to consider issuing a public listing of PEPs.
24. Consideration was given to the request for national authorities to issue a public list of PEPs. There were concerns that this would reduce the attention paid by institutions to identifying and assessing the risks in dealing with PEPs, and might increase the adoption of a tick-box approach. Moreover, such lists could quickly become out of date, and would not be able to adequately take into account the additional information that institutions should obtain through their CDD measures.
25. In considering the issue of defining family members and close associates, the FATF noted that the definition of a family member and close associate of PEPs could differ substantially with the culture and risks in a country, and that any useful definition has to be sufficiently broad and flexible for countries, financial institutions and DNFBPs to adapt to the appropriate local circumstances, and the precise nature of the business relationships. The decision was taken, therefore, not to define these terms as part of the revised Recommendations.
26. In order to facilitate the private sector efforts in implementing the PEP requirements, the FATF is intending to develop further guidance on the issue, and this would include guidance on how to identify a PEP, his/her family members and close associates.

### Enhancing the Transparency of Cross-Border Wire Transfers (New Recommendation 16)

27. The FATF has considered the feedback received from the private sector, and has accepted most of the proposals and amended the text of the former SR.VII/INSR.VII on a number of issues.
28. **Terminology and Definitions:** The FATF has retained the existing terminology, in line with the unanimous request from the private sector not to change the terminology which is currently used in the FATF Recommendations. The private sector had indicated that the existing terminology represent well-known concepts in the financial sector, and are also

- used in other relevant international instruments such as “Due diligence and transparency regarding cover payment messages related to cross border wire transfers” by the Basel Committee on Banking Supervision (May 2009). Consequently, the new FATF standard on wire transfers (R.16) uses the terms beneficiary, beneficiary financial institution, wire transfers.
29. The FATF has taken steps to respond to the private sector’s concern that using the term “full” was very confusing because, colloquially, it may be interpreted by different parties as meaning different things, and implies that very comprehensive information must be collected. In the interests of providing further clarity on this issue, the FATF has replaced the term “full” with the term “required”, and added two explanatory footnotes which explain what constitutes required originator and beneficiary information. The FATF has also amended the text in response to the request for clarification that, in the context of gathering originator information, the originator’s address, national identity number, customer identification number, and date and place of birth are alternatives (i.e., only one of these pieces of information is required). To address this concern, the word “or” has been inserted between each of these alternatives.
30. Changes were also made to the definitions of unique transaction reference number and domestic wire transfers to clarify that a message/messaging system does not act “to effect” a wire transfer, in line with a drafting suggestion made by SWIFT.
31. **Exemptions:** The private sector also requested that the current exemption for message payment systems (which exists in relation to the processing of wire transfers, as set out in a footnote to the definition of financial institutions) be extended to the application of other FATF Recommendations, and that clearing networks be excluded from the definition of money or value transfer service providers. However, it is important to note that these issues are integrally linked to the FATF’s ongoing work on new payment methods. For now, the FATF has decided that these suggestions will be considered, as appropriate, at a later date, given the ongoing work. The FATF will, in further consultation with the private sector, review the suggestions in the context of its work on new payment methods.
32. **Other Clarifications:** The private sector also asked that the terms “accurate and meaningful” be revisited to take into account operational reality, and to avoid potential misunderstanding. Participants of the PSCF in December 2011 were invited to submit specific comments and proposals on this issue. The FATF has taken this concern into account and the term “meaningful” is no longer used in the FATF Recommendations.

### Targeted Financial Sanctions in the Terrorist Financing and Financing of Proliferation Contexts (New Recommendations 6 and 7)

33. In general, the private sector was supportive of the proposed changes to the FATF Standards relating to targeted financial sanctions. Most of the comments and feedback focused on the importance of using consistent terms throughout the Recommendations on targeted financial sanctions. The FATF has addressed this concern by amending the text to ensure that consistent terms are used throughout the relevant Recommendations when referring to identical concepts.

34. The private sector also requested that the Recommendations on targeted financial sanctions be more explicit in taking human rights into account, particularly in relation to the UNSCRs on proliferation. In response to this concern, the FATF has included references to the Focal point for delisting established pursuant to S/RES/1730(2006) (relating to proliferation-related targeted financial sanctions) and the United Nations Office of the Ombudsperson pursuant to S/RES/1904(2009) (relating to terrorism financing-related targeted financial sanctions).
35. The private sector had also requested that the competent authorities should be required to communicate information about delistings, and authorisations to access frozen funds/assets. The FATF has amended the text of both Recommendations 6 and 7 to take these concerns into account.
36. There were requests for additional guidance on how best to implement targeted financial sanctions. Following the adoption of the revised Standards, the FATF will consider whether the current Best Practices Paper on the former Special Recommendation III (Targeted Financial Sanctions for Terrorist Financing) and best practices relating to some of the specific implementation concerns raised by the private sector during the consultation process would be updated.

### **Third Party Reliance and Group-Wide Compliance Programmes (New Recommendations 17 to 19)**

37. Arising from the first public consultations, the private sector asked for additional flexibility and clarity with regard to the scope of reliance on CDD undertaken by third parties. As a consequence, amendments have been made to the relevant Recommendation to clarify the distinction between an outsourcing and agency relationship, to allow for more flexible intra-group reliance, and for the level of country risk to be mitigated (i.e. no longer limiting eligible third parties to those based in countries that adequately comply with FATF standards), if the third party is part of the same financial group which applies group-wide AML/CFT measures. DNFBPs may also apply third party reliance, so long as the stated conditions are fulfilled.
38. Several respondents to the consultation were concerned that the value of third-party reliance was negated by the requirement that the institution that relied on the third-party CDD procedures still had ultimate responsibility for the proper application of the measures. The FATF still considers that the ultimate accountability of the institution taking on the business is an essential component of an effective CDD process, and has, therefore, not modified this requirement.
39. The FATF has noted the widespread support for the principle of group-wide compliance programmes and the principle of information-sharing within the financial group for the purpose of global risk management. To further streamline the obligations, the revised Standards have merged the former Recommendations on “Internal Controls” (formerly R.15) and “Foreign Branches and Subsidiaries” (formerly R.22) into a single new Recommendation (R.18) which require the implementation of group-wide compliance programme to the group’s foreign branches and subsidiaries.

### Data Protection and Privacy

40. The FATF considered the concerns raised by the private sector that data protection and privacy laws in some countries could limit intra-group cooperation and reliance, and that financial institutions and DNFBPs should not be obliged by the rules of one regulator to breach the rules of another.
41. This is a complex area in which the FATF is not able to act unilaterally, and the FATF recognises that it will have to work closely with other relevant international bodies. The FATF is considering a coordinated process to further examine the issue. Nonetheless, in order to facilitate the effective implementation by the private sector on the FATF Recommendations, the revised Standards also seek to promote cooperation between relevant authorities both domestically and internationally. Supervisors should also work with their counterparts to facilitate intra-group cooperation and exchange of information by the private sector.

### International Cooperation (New Recommendations 36 to 40)

42. There was general support from respondents for strengthened international cooperation, although some private sector entities stressed the need to have safeguards in place to ensure a sound legal basis for information exchange. In expanding the scope of international cooperation, the FATF is mindful of the need to balance the need to ensure the confidentiality of information with the ability for authorities to cooperate to the widest extent possible. The revised Recommendations thus require international cooperation to take place under appropriate conditions and an assurance of confidentiality. Further, cooperating authorities would be able to refuse such international cooperation if there are serious and valid concerns over the ability of the requesting party to protect the confidentiality of information.

### The Financial Intelligence Unit and Feedback (New Recommendation 29)

43. The FATF noted the strong support for competent authorities, including the FIU and law enforcement authorities, to provide timely and useful feedback and typologies. These issues are covered within existing FATF Recommendations, and reinforced through the risk-based approach, where countries and competent authorities are required to provide appropriate information on the results of their risk assessments on money laundering and terrorist financing. This is also an area in which the FATF would like to further engage the private sector, including discussing how it could produce guidance to enhance the feedback mechanisms and other more useful and relevant typologies.

## III. CONTINUED ENGAGEMENT OF THE PRIVATE SECTOR

44. The FATF is committed to continuing its engagement with the private sector, and looks forward to working closely with the members of the private sector consultative forum and other interested parties. This could include future work on updating the relevant guidance to the respective sectors, and other areas of mutual interest.