



CHAIRMAN'S COMMENTS

Dear Colleagues,

As our Association moves into its third year since inception, I feel it is appropriate to use my newsletter comments to provide a short summation of our progress.

Having recently reviewed the lofty goals that we set ourselves back in early 2012, the progress that we have made in reaching these objectives is remarkable.

Without doubt, the most important target we set was to become 'established' as a representative body for non-cash based authorised payment institutions. When defining 'established' the first Executive Committee reached the conclusion that this meant being firstly engaged with key regulators of our members, secondly continual discussion with all banking providers and lastly providing a growing membership with regulatory updates and guidance. So what evidence is there that our Association has reached the 'established' stage?

We achieved in our first year recognition and engagement with all key regulators, specifically the FCA, FOS, HMRC and HM Treasury. This engagement has progressed and continues into our third year with Executive Committee members having regular meetings with their regulatory contacts. The Association continues to discuss relevant issues within the industry with the main banking providers. Lastly we continue to provide regular updates to our growing membership on industry developments. Most notably this year we provided our feedback to members on the European Commission consultation on FX financial instruments, where we also submitted a consultation paper.

Of the other significant achievements reached this year I would like to highlight the formation of the fraud alert system. The Executive Committee in the early part of 2014 highlighted the increased instances of external fraud. Specifically the Committee was worried about the rise in third party fraudulent activity. In response we decided to setup a fraud identification system whereby all members committed to notifying of any fraudulent activity where reporting restrictions permitted. This relatively simple process has grown in success and has alerted all members to organised criminal gangs who targeted our industry for fraudulent purposes.

Financially the Association remains in a strong position, which allows us to keep both full and associate member fees at a constant level. The financial solidity of AFEP is almost solely down to the support of member firms who provide us with facilities to host both the monthly Committee meetings and quarterly member meetings. I would like to take this opportunity to formally thank all those members who have provided their offices in the past twelve months.

Whilst it is enjoyable to discuss all the strengths of our Association, it is more important to recognise our weaknesses and focus our attention on addressing these over the course of the next year.

We would accept that as an Association our response to members on key events, such as European pronouncements on the regulatory scope of FX Forwards, should improve. Clearly our response times are mitigated by not having a full time administrative staff or Executive Committee. However we have committed to



monitor our responses both in terms of time and useful guidance. Being financially strong gives the Association the option of bringing in more resources if necessary.

Another area of improvement on the agenda is providing industry best practice to all members. We all recognise that our industry has faced significant challenges over the past years, which looks set to continue. Whilst we cannot control external pressures our membership can only continue to 'raise the bar' in terms of industry compliance standards. Having recognised this the Committee will be working towards providing industry best practice guides for members over the next year.

Before signing off I would like to confirm some Executive Committee appointments for the upcoming year. Both Laura Hanna and Millie Richardson are joining the Executive Committee after having been on the sub-Committee, their positions on the sub-Committee are replaced by Mike Southgate to whom we extend a warm welcome. Furthermore, Michael McGowan has stepped down from the Committee after having served two years. I would like to thank Michael for all of his time and commitment to the Association.

Finally I would also thank all members for their continued support of the Association and remind everyone that any recommendations or comments are very much welcomed.

Jamie Cooke
Chairman

Fourth EU Anti Money Laundering Directive: Jamie Cooke

As the implementation of the Fourth EU Anti Money Laundering Directive draws ever closer, expectations are that it will be transposed into UK legislation late in 2015 or early in 2016, and this gives time for Payment Institutions to determine whether their current systems are fit for purpose and suitable to use as building blocks to meet the new requirements. Whilst the expected changes may not be earth shattering there is certainly the premise that the requirements will tighten obligations on firms under existing rules and will also place an emphasis on the adoption of sanctions being levied for systemic breaches.

The Risk Based Approach

At a firm level there will be more of an emphasis placed on the 'risk based' approach that is adopted at the client acceptance stage, and as such then it is important that the risk assessment is accurate and robust, as this will determine the type of due diligence that needs to be undertaken on the client. This should allow a focus of resources towards higher risk clients, taking into account, but not limited to, for example jurisdiction, industry sector, or where the size and nature of the transaction poses a higher risk. A positive outcome of the increased focus on an adequate and properly adopted risk rating system is that it can save resource and staff time by ensuring resource is not focused on low risk clients.

Perhaps one of the most significant updates will be the removal of certain circumstances that are considered appropriate to apply simplified due diligence. The Directive proposes to remove regulated financial institutions, listed companies and domestic public authorities from the categories of clients that are regarded as posing a lower risk.

It is proposed that the 'risk based' approach should also be adopted at a national and Europe wide basis to provide greater guidance to regulated firms on the local and continental financial crime risks. The Directive



requires a risk assessment at national level to help each country identify and understand the risks they face, and hopefully allow processes to be put in place at a governmental level to allow for adequate supervision to review and mitigate the risks that are identified, again adopting an approach that allows regulators to concentrate resource on the higher risk areas.

Identifying Ultimate Beneficial Owners (UBO's)

Currently the rules focus on UBO's that own or control 25% or more of the business, or where this is not the case then a dominant shareholder who directs the activities of the entity. Going forward however the rules have been adjusted to allow a firm to meet their obligations if it identifies a senior manager where there is neither an ultimate beneficial owner nor a controller prevalent.

The UK has also chosen to adopt the proposals on greater transparency and has indicated that they will establish a register of UBO's and also one of beneficiaries of trusts (which will include its territories such as British Virgin Islands) and which are to be available to the public.

Clearly both registers will give rise to privacy concerns and potentially have data protection issues, however the positive will be that it should make the identification process for 'Know Your Client' much less of a burden.

Change to the definition of 'Politically Exposed Persons'

One of the vagaries in the UK adoption of the EU Third Money Laundering Directive was that it did not include UK based persons within the definition of a PEP, which was at odds with the approach taken by most other Member States.

The new Directive has widened the definition of PEP to include both domestic and foreign individuals who have held a prominent public position and also extended the period they have held the position from 'the previous 12 months to 18 months'.

Tax crimes become a predicate offence

The Directive states that tax crimes will become a predicate offence in future, while this addition will have limited impact in the UK as tax crimes have long been predicate offences it is a further attempt to harmonise the approach adopted across all EEA Member States.

Sanctions

A significant change is the introduction of minimum sanctions that a Member State should ensure are to be levied for systemic breaches of key elements such as client due diligence, record keeping, internal controls and for suspicious activity reporting. Further it widens the obligation to ensure the penalties can apply to an individual who under national law was responsible for such breaches. Some examples of these minimum sanctions are the publication of reprimand, removal of registration, and administrative sanctions of up to 10% of annual turnover with a €5million cap.

Information of fund transfers

The proposed Regulation on wire transfers will increase the level of information required for payments by extending the identification obligation from payers to payees. Furthermore it introduces the requirements on Payment Institutions to verify the identity of any beneficiary of a payment that originates outside of the EU for amounts in excess of EUR1,000.

The draft Regulation clarifies that credit and debit cards, mobile phones and other electronic devices will be covered if they are used to transfer funds.

Summary

The impact of the Fourth Directive on UK regulated firms is not likely to be substantial as most of the amendments in these legislative proposals have already been implemented into the UK regime such as tax crimes being a predicate offence.

However some of the amendments will require Payment Institutions attention such as the revised approach to simplified due diligence. Any firms whose procedures are based solely on the categorisation of the client and not other factors will need to revise their procedures in light of the proposed amendments to simplified due diligence.

It is encouraging to see that greater focus has been placed on national countries to provide more guidance to regulated firms on key risks. It seems reasonable that this proposal will improve the 'risk based' approach taken by regulated firms and drive up the regulated sectors standard.

The move to greater transparency of ultimate beneficial owners and national public registers would be welcomed by the regulated sector. Not only would this provide greater transparency it also would reduce the costs associated with identifying beneficial ownership. It is however important to note that this Directive is at consultation stage and a controversial proposal such as a public register of beneficial ownership will be met with resistance.

FATCA Update: Francesca Maritan

Do you have custodial accounts?

HMRC have confirmed they would not consider transactions that involve a client's money passing into and then out of a firm's control in anticipation or settlement of fees, or charges for a transaction, to constitute a custodial account. However, that rationale would not extend to circumstances where a client maintains a permanent account balance or where funds are held on behalf of a client for longer than a transitory period.

Deposits accrued on accounts may fall into the category of a 'custodial account' under FATCA. Where balances are held on account, the flow of money is not transitory. It is immaterial that funds received into accounts are not classed as client money, according to the FCA's interpretation of the Payment Services Regulations, until the foreign exchange contract is booked. Because there exists a contractual obligation to repay this money to the client this meets HMRC's issued guidance in the IGA '[custodial accounts will include] arrangements pursuant to which an obligation exists to return cash or assets to another'

When is a financial account a reportable account?

A reportable financial account is one that is held by either:

- US citizen or resident in the US for tax purposes.
- Specified US persons (a corporation, partnership or trust organised in the U.S. or a U.S. state; that is not traded on an established securities market, or a U.S. government or agency)
- Passive Non-financial Foreign entity with one or more Controlling Persons who are citizens or residents of the US.

What are Non-Financial Foreign Entities (NFFE's)

All entities are NFFEs except:



- financial institutions
- US persons
- Exempt beneficial owners
- Excepted Non-Financial Foreign Entities

What are Excepted entities?

These include (but are not limited to):

- Any publicly traded corporation and its corporate affiliates
- Any entity organized in a US territory
- Foreign Central Bank
- Foreign Government or agency
- International Organizations
- Governments of US territories

What is an active NFFE?

If less than 50 % of the entities gross income for the preceding calendar year or other appropriate reporting period is passive income and less than 50 per cent of the assets held during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income.

Are Active and exempted NFFE's exempt from FATCA requirements?

Yes

What is a passive NFFE?

A passive NFFE is any other NFFE other than an active or exempted NFFE. As outlined above, with these entities it is required to identify any controlling person that is a US person for tax purposes. (i.e. Have =>25% of the beneficial ownership in the entity.)

How can you review pre-existing accounts (Opened before 1st July 2014) for reportable accounts?

As required under the Act, a snap shot can be taken of reportable accounts on the 30th June 2014. This can form the basis for determining whether any accounts will be reportable. The accounts can then be reviewed against:

Threshold exemptions: If you elect to apply thresholds to the accounts, determine whether accounts are in scope for individual and entity accounts.

US Indicia: If information held on the account suggests that there is a US Specified person on the account or one or more Controlling Persons who are citizens or residents of the US, the account will be reportable, unless: The individual or corporate entity who are able to confirm (by means of self- certification) their non US status for tax purposes are thus exempt.

What constitutes self-certification for reportable accounts?

Individual/personal accounts

Guidance suggests that self-certification is when 'the individual is asked to select the appropriate country or countries in which they are tax resident and whether they are a US citizen.'

Entity accounts

Guidance suggests that self-certification can be achieved in the same way as described for new individual accounts

What due diligence is required for new accounts (Opened after the 1st July 2014)?

Determine how to request information regarding a client's citizenship and tax residency. Update registration processes accordingly. Determine how information will be stored and extracted for reporting processes.

Passive Income

The term "passive income" is -

1. Dividends;
2. Interest;
3. Interest with respect to a pool of insurance contracts;
4. Rents and royalties, except those for conduct of the business;
5. Annuities;
6. Gains over losses from transactions (incl futures, forwards, etc) in any commodities, except
 - (i) hedging transaction by a controlled foreign corporation; or
 - (ii) active business gains or losses from the sale of commodities,
7. The excess of foreign currency gains over foreign currency losses;
8. Net income from "notional principle contracts" (NB: in the UK this would normally be a swap);
9. Amounts received under cash value insurance contracts; or
10. Amounts earned by an insurance company in connection with its reserves for insurance and annuity contracts.

However, the following amounts are excluded from any calculation of Passive Income

1. Income from interest, dividends, rents, or royalties that is from a related person. A person is a related person with respect to the NFFE if they are an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the NFFE, or controlled by the same person or persons which control the NFFE.
2. An NFFE that regularly acts as a dealer in property (item 6 above), forward contracts, option contracts, or similar financial instruments
 - (i) Income or gain (other than any dividends or interest) from any transaction entered into in the ordinary course of such dealer's trade or business as such a dealer; and
 - (ii) If dealer in securities, any income from any transaction entered into in the ordinary course of such trade or business as a dealer in securities.

Next Member Meeting

Thursday 5th December

Venue: TBC

Time: We will start at 5.00pm.

Programme: Peter Foley, Head of AML Investigations at Barclays, who will take us through 'Money Laundering - more than just disguise'

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