The Banker MASTERCLASS

Complying with the EU Funds Transfer Regulation 2015

Regulators are increasingly aligning their efforts to combat money laundering and terrorist financing internationally. Looming on the horizon for banks in Europe – and beyond – is the EU Funds Transfer Regulation 2015, due to come into effect in June this year.

Stefan Fruschki, head of regulatory management, institutional cash management at Deutsche Bank

The United Nations Office on Drugs and Crime estimates the amount of money laundered globally in one year is 2-5% of global GDP, approximately between $800bn-$2,000bn. Exact figures on money laundering and terrorist financing are difficult to determine, as the transactions are illicit.

In the frontline of the fight against financial crime, financial institutions (FIs) are facing a wave of international, regional and local measures designed to increase transparency and traceability of payment transactions. FIs play a key role in this evolving, increasingly complex regulatory landscape.

"Money laundering and terrorist financing are a threat not only to the integrity of the financial system but to society in its entirety," says Stefan Fruschki, head of regulatory management, institutional cash management at Deutsche Bank. "As these activities are often carried out in an international context, regulators are highly aware that they can't fight these activities on an isolated, national basis."

THE HARMONISATION CHALLENGE

One global initiative to align national anti-money laundering and anti-terrorist financing measures began in 1989 with the establishment of the Financial Action Task Force (FATF), an intergovernmental body. FATF sets standards and promotes the implementation of regulatory and operational measures to combat money laundering and terrorist financing.

FATF's standards have served as the basis for subsequent regulation in Europe such as the Funds Transfer Regulation 2015 (FTR 2015), as well as the Fourth – and now Fifth – Anti-Money Laundering Directive (AMLD). FATF's recommendations are non-binding, so while they are taken under consideration by national legislators, some deviation in implementation does occur when transposing into local law. This is something FIs need to understand, says Mr Fruschki, as they must comply with the applicable local laws and regulations, even where local rules deviate from the FATF recommendations.

For example, pursuant to the FATF recommendation 16 on wire transfers, intermediary payment service providers (PSPs) may switch payment transactions into payment schemes that have technical limitations, although certain information may be lost or not transmitted as a result. However, FTR 2015 does not contain such an exemption. "This may have a significant impact on how and when an intermediary PSP in Europe may switch payment transactions into the local payment schemes," he adds.

FTR 2015 repeals the previous FTR 2006 and is "more an evolution than a revolution", according to Mr Fruschki. The 2015 regulation does not change the existing principles, but instead updates and extends the previous requirements. It does introduce a number of additional requirements, such as transmission of information on the payee and the requirement for intermediary PSPs to implement effective measures to detect missing information. However, he stresses the importance of examining in depth the details of the new regulation, as FTR 2015 goes beyond these obvious changes.

SCOPE OF FTR 2015 – NOT JUST EUROPE

Like many regulatory initiatives rolled out during the past decade, FTR 2015 is regional in scope but has a global impact. The regulation applies to transfer of funds in any currency that are either sent or received by a PSP established in the European Economic Area (EEA), which includes EU member states plus Iceland, Liechtenstein and Norway.

For FTR 2015 to apply, just one of the parties to the transaction needs to be based in the region. If a PSP receives a payment from outside the EEA, it must check whether certain information is transmitted with that transaction. Should that information be

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missing, the PSP established in the EEA must decide whether to execute, suspend or reject the payment, and may also have to send a request for information to the non-EEA-based PSP.

Mr Fruschki says, "While non-EEA-based PSPs cannot directly breach FTR 2015 requirements as such, they are still affected. We'd recommend that such PSPs check whether their local law allows them to transmit the information required by FTR 2015 into the EEA. This will ensure that there are no disruptions to the payment flow."

While the FTR 2015 applies to transfers of funds – defined as transactions carried out by electronic means on behalf of a payer through a PSP to make funds available to a payee through a PSP – it does not cover certain payment transactions related to services such as those defined in the negative scope in the Payment Services Directive I. In addition, payment transactions carried out using certain technologies and involving certain parties or made for specific purposes are out of scope.

The regulation also does not apply to clients. "The FTR 2015 does not impose any obligations or responsibilities on customers, whether this is private or corporate customers," explains Mr Fruschki. "It is the PSPs that must comply with the law and ensure that requirements are met. Depending on the interpretation and implementation of the requirements, however, their clients may be indirectly affected as well."

REQUIREMENTS

There are three main complexes of requirements imposed by FTR 2015 (not all of them new): information transmission requirements; verification and detection requirements; and those for the handling of insufficient information. Depending on the scenario, information on the payer (name, address, account number) and the payee (name, account number) must be transmitted and retained with a transfer of funds in the designated payment message type fields. "The PSP of the payer must not only ensure that the required information is transmitted, but it must also verify that the information on the payer is accurate," says Mr Fruschki.

He adds: "The requirement for the information to be retained with the transfer poses a problem if a PSP wants to switch the transaction into a technically limited payment system that does not allow transmission of this information."

Should the intermediary or payee's PSP determine that required information is missing, it must decide whether to execute, suspend or reject the payment. Depending on the decision, a request for information must be sent to the payer's PSP. Finally, if a PSP repeatedly fails to transmit sufficient information, the PSP must decide whether additional steps are required. These additional steps start with the issuance of warnings and, in extreme cases, could ultimately result in the termination of the business relationship.

IMPLEMENTATION HURDLES

A number of obstacles to implementation remain, according to Mr Fruschki. "Because FTR itself is not always sufficiently clear, there are some requirements that could be interpreted differently. For example, FTR requires PSPs in certain scenarios to detect whether transactions are linked, but it doesn't provide any guidance on which scenarios would qualify. Also, there is no definition of what constitutes a 'repeated failure' or how and when a PSP must report them – including if and when additional steps in relation to the other PSP must be taken," he explains.

There is also a need for further clarity if a "name-number-check" will be required in certain scenarios and what requirements apply at what process step when executing SEPA direct debits.

The European Supervisory Authorities (ESAs) are tasked with issuing regulatory guidelines for FTR 2015 by June 26, 2017. In the consultation phase, following the issuance of draft guidelines, these and other outstanding issues can be clarified. "It is key, in this context, to understand that the FTR puts in place a comprehensive framework. However, the effectiveness of that framework depends on all stakeholders involved having the same interpretation – not just the PSPs, but also local regulators," says Mr Fruschki. "We therefore need crystal clear guidelines that leave as little room for interpretation as possible."

At the FI level, ease of implementation will depend on the service, product offering and complexity of individual banks. Affected institutions should not underestimate FTR 2015 and should seek to gain an understanding of the requirements, Mr Fruschki says. "Some FIs will not be significantly affected, but there are others for which FTR will require serious implementation efforts. Implementation efforts and projects should not be treated as simple IT, compliance or payments exercises. To ensure end-to-end compliance the PSP of the payer when executing a payment transaction must understand the background of that payment transaction to correctly identify the payer and the payee.

He adds, "In case of complex products and sophisticated structures involving several parties and potentially multiple transactions this is not necessarily straightforward. Therefore, a multitude of stakeholders both from front- and back-end must be involved."

IMPROVING INDUSTRY TRANSPARENCY

The level of disruption related to FTR 2015 will depend on whether the industry gains a common understanding of the regulatory requirements. This will become clearer when the ESAs' guidelines are finalised in June.

Mr Fruschki characterises FTR 2015 as an evolution in the regulatory environment and does not believe it poses a threat of radical disruption for FIs. "On day one there likely will not be any big disturbances. But what happens subsequently will depend on whether PSPs interpret the requirements differently. When a PSP considers information missing, it must act and challenge the sending PSP – which might have a different understanding of the requirements of that particular scenario. In addition, local authorities might interpret FTR 2015 differently, which would lead to a fragmented landscape."

He emphasises the big picture: the purpose of the FTR is to create transparency and full traceability of transactions to prevent, detect and investigate money laundering and terrorist financing activities. "This is an issue of importance not only to FIs and regulators but to society as a whole," he says. "FTR clearly is the right thing to do, which is the reason that we as an industry must get it right."

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