

ISSA

International Securities Services Association

Financial Crime Compliance

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Welcome



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Welcome to the Q2 2020 ISSA Financial Crime Compliance Bulletin. In this edition, the Financial Crime Compliance (FCC) Working Group will brief you on another topic of great interest to the industry – that of Payment Transparency within the Securities Services Industry.

Additionally, another of our Board Members provides their perspective on ISSA's Financial Crime Compliance Principles (FCCP) and how these have been implemented within their organization.



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Payment Transparency within the Securities Services Industry

ISSA Members have asked ISSA to provide guidance on the application of FATF16 / EU Funds Transfer Regulation («FTR») in the context of securities-related cash movements. This bulletin aims to provide some clarity, while opening a debate, on how cash payments related to securities transactions have to be considered in the context of FATF16 / EU FTR.

The Financial Crime Compliance Working Group

The Financial Crime Compliance Working Group is headed by Clearstream's Mark Gem, Euroclear's Olivier Goffard and Standard Chartered's Yannick Cherel. They are supported by a team of industry experts from many of the world's leading firms: BIL, BNP Paribas, BNY Mellon, Citigroup, Clearstream, Commonwealth Bank of Australia, Credit Suisse, Deutsche Bank, Deutsche Börse, DTCC, Euroclear, HSBC, RBC, SEB, SIX, Standard Chartered, SWIFT and UBS.



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Payment Transparency within the Securities Services Industry

Introduction

The FATF Recommendation 16 sets the payment transparency requirements, i.e. the need to provide full traceability of transfers of funds (in this case, the term «funds» means cash payments). It does this by providing, in certain circumstances depending on the parties to the cash transaction, the identity of the originator and beneficiary of this cash transaction. FATF 16 has been adopted into binding regulations across the world; e.g. in the EU through the EU Funds Transfer Regulations (EU 2015/847). This is a valuable tool in the prevention, detection and investigation of money laundering and terrorist financing.

However, two important questions need to be asked in the context of the Securities Services Industry:

- Are these regulations relevant for securities-related cash movements?
- If so, how – and to what extent – are they relevant?

To answer those questions, ISSA conducted an internal survey with its FCCP working group members. In parallel, ISSA was approached by the SWIFT Payments Market Practice Group (PMPG) - through their dedicated Cross-Border Payments and Reporting Plus (CBPR+) working group - to identify if the Securities Services Industry would require specific fields and/or further rules/definition, in the preparation of the SWIFT Payment and Reporting Instructions migration to ISO 20022, due to take place by the end of 2022.

The internal survey, as well as the follow up discussions which took place at the ISSA FCC Working Group in November 2019, highlighted the following:

- Questions on how to interpret the scope of payment transparency regulations
- Differences between how cash operations and securities operations teams within institutions utilise SWIFT messages
- Differing views on how to operationalise the adherence to the payment transparency requirements in the day-to-day Securities Services operations process

Based on these points, the ISSA FCC Working Group will create a small work stream that will focus on providing clarity on the application of payment transparency requirements in the Securities Services Industry.

Why do we debate this?

1. EU Directive 2007/64/EC

Let us take the example of the Regulation EU 2015/847, which effectively transposes FATF 16 in the EU, EEA and UK and - more precisely - the Article 3 listing scenarios where cash transactions do not fall under the scope of EU FTR. Article 3 refers to the EU Directive 2007/64/EC (i.e. the Payment Services Directive 2) Article 3 (h) & (i) which states the following:

Article 3 EU Directive 2007/64/EC

This Directive shall apply to none of the following...

(h) payment transactions carried out within a payment or securities settlement system between settlement agents, central counterparties, clearing houses and/or central banks and other participants of the system, and payment service providers, without prejudice to Article 28/

(i) payment transactions related to securities asset servicing, including dividends, income or other distributions, or redemption or sale, carried out by persons referred to in point (h) or by investment firms, credit institutions, collective investment undertakings or asset management companies providing investment services and any other entities allowed to have the custody of financial instruments

The provisions of Article 3 (the «Provision») could be perceived by the Securities Services Industry to mean that EU Fund Transfer Regulation - and more broadly the FATF 16 recommendations - is not relevant to «securities-related cash movements». However, when considering Article 3 in more detail, it appears that total exoneration cannot be assumed:

- Article 3(h) only excludes the application of FTR to cash transactions performed in a «securities settlement system»¹ («SSS») as designated by ESMA². In addition, only cash transactions between a member of this SSS and a «Payment Service Provider» as defined by PSD2 are excluded. This already leads us to see that some securities-related instructions processed within an SSS are likely to be subject to the payment transparency requirements of FATF16
- Article 3(i), on the other hand, appears to be broader in scope and covers all institutions allowed to hold financial instruments in custody. In this case, the exemption covers all cash payments related to asset servicing (e.g. dividends, income, redemptions, etc.)

Based on the above review, the ISSA FCC Working Group is of the view that the Provision would not be applicable to:

- Cash payments processed by SSSs recognised by ESMA where one or both parties to the transactions are considered as «Payment Service Providers»; i.e. in the meaning of PSD2 credit institutions, electronic money institutions, payment institutions, the ECB and NCBs (but not, for example, corporate institutions)
- All cash payments processed by entities acting as custodians in the context of servicing securities such as dividends, income or redemption payments

If we therefore exclude from this debate the exemption linked to SSSs - which is only relevant for a minority of ISSA members - and focus on the second exemption, it is important to decide what to do for securities-related transactions that are not linked to the servicing of securities.

2. Defining Asset Servicing

In order to identify securities-related transactions that are not linked to the servicing of securities, it is crucial to answer the question of what Asset Servicing really means. There is, to our knowledge, no recognised definition of this notion. For the sake of this debate, we have used the following split:

- Settlement of securities (i.e. the transfer of a security from one security holder to another) is not to be seen as Asset Servicing
- All events impacting the lifecycle of a security do fall under the notion of Asset Servicing. This includes, amongst others, corporate actions such as dividend and income payments, tax payments

However, since it seems that each firm has a different definition of the meaning of Asset Servicing, we deem it important to come up with a market definition.

3. The Use of SWIFT Message Types

Firstly, ISSA members are of the view that FTR requirements do not apply to cash payments made directly between two financial institutions (FI's). For example: in the context of processing cash transactions linked to the management of their own assets (i.e. treasury transfers or proprietary asset management), the transparency expectation is fulfilled since the unique party to the transaction is the client itself managing its own treasury. For this type of FI to FI payment, the MT 202 message type should be used.

However, where the cash payment is not linked to Asset Servicing or is not an FI to FI payment - but is made by the FI acting on its own account for settlement of securities transactions of its own clients - there is theoretically no reason for those transactions to be excluded from the scope of FATF 16 requirements. In this case, the view is that ideally the MT103 series message type should be used. This should include the fields that record the names and address of the ultimate originator («Payer» and name and address of the recipient of the payment («Payee»). In practice, observations and recent discussions highlight that FIs may continue to use the MT202 for these types of transactions instead of

¹ As defined by the EU Directive 98/26/EC on settlement finality in payment and securities settlement systems

² <https://www.esma.europa.eu/document/designated-payment-and-securities-settlement-systems>

the MT103. Even in cases where the MT103 is used, full originator and payee information may not always be included.

Where the custodian has, in its own system, information showing that its account holder is instructing for the account of underlying clients (which can often be inferred from BO databases, tax certificates...), there are certain questions that arise:

- Does the use of the MT202, as an industry practice, adequately suit the securities business?
- Should the custodian allow the MT202 to be used or should it require the use of the MT202 COV or the MT103 series?
- In the event that the MT103 messages is used, in this context, is the firms' control systems able to distinguish between securities-related cash transfers and actual payments that flow through customer FI accounts?

4. Knowledge of Securities Services

The payment transparency-related regulatory requirements work well for both cash and securities payments. However, from the results of a recent internal survey conducted by ISSA, there is frequently a gap in the nuance of understanding of the SWIFT messages between cash operations teams and securities operations teams. This could be due to the complexity of the types of transaction in the securities services world and/or that cash/ payment transparency knowledge is mainly operated by separate cash units outside of the securities services units.

The ISSA FCC Working Group is of the opinion that this clarity around securities cash related transactions, along with increased knowledge sharing, would be extremely beneficial to the industry. As we will see below, the industry has a unique opportunity to ensure that securities-settlement-related payments are considered in the ongoing reflection around the new SWIFT ISO 20022 standards which are scheduled to be launched by the end of 2022.

FCC Payments Task Force

The ISSA FCC Working Group recognises that securities cash related transactions are specific and need to be adequately considered in the SWIFT message types landscape. Acknowledging that there will be a change in 2022 with the introduction of the ISO 20022 message, and with its aspiration to strengthen the Financial Crimes Control framework within the Securities Services Industry, the ISSA FCC Working Group will be forming a small Task Force. The key objectives of the Payments Task Force will be to:

- Provide principles and guidance on fund transfer scenarios to ISSA Members
- Engage regulators where deemed necessary
- Collaborate with the ISSA SWIFT ISO20022 Working Group in order to be prepared for the ISO 20022 migration

Provided below are examples of a series of fund transfer scenarios which will be discussed by the FCC Payments Task Force:

Securities-related cash transfers

- Treasury («party») transfers
- Custody payments from the agent to the depository
- Income payments from the agent to the depository
- Corporate action transfers from the agent to the depository
- Withholding tax transfers from fiscal agent to authority

Payments – subject to FATF16 compliance

- Repatriation (transfers) from the custodian for the account of the Account Holder's client
- Subscription payments (transfers) from the Account Holder's client to the Custodian
- Broker cover payments for OTC settlements completed FOP, including bulk and net transfers

The ISSA FCCP Working Group welcomes volunteers to join the FCC Payments Task Force, which is led by Yannick Cherel.

FCC Principles Update



Andrew Gray
DTCC

DTCC

DTCC's Group Chief Risk Officer and ISSA Board Member Andrew Gray, explains the importance of the ISSA Financial Crime Compliance Principles (FCCP) to DTCC.

«DTCC has long had a due diligence process that incorporates many of the best practices called for by the FCC Principles. Our Central Securities Depository, The Depository Trust Company (DTC) has its own rigorous sanctions screening program in place and as part of its rules, its over 300 direct Participants, which hold over USD 63 trillion in securities there, are all required to make specific attestations regarding their sanctions screening procedures every 2 years. DTC has mainly domestic participants which are regulated by the same regulators that oversee DTC itself, thus there is a consistent high bar of financial crime compliance and sanctions screening oversight amongst our community.

We played an active role in the ISSA Working Group that drafted the FCC Principles, which focus mainly on cross-border custody relationships, and we have enhanced our processes accordingly, especially as it relates to DTC Participants that are domiciled in cross-border jurisdictions. The broader the ISSA FCC Principles are adopted by Custodians globally, the more vigilant the entire community can be in detecting any efforts to commit financial crime.»