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## **Project against Economic Crime (PECK)**

# **Explanatory meetings on Questionnaires for the anti-money laundering/combating the financing of terrorism (AML/CFT) and anti-corruption (AC) components**

***11 – 12 July 2012***

## **Module 16**

### **Risk, Customer Due Diligence, PEPs, Secrecy, Reporting, Protection and Shell Banks**

***Sections 3.1 to 3.4, Sections 3.6 to 3.8***

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CoE Expert***

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### Section 3.1

# Risk of Money Laundering or Terrorist Financing

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### **Risk – who are the national players?**

- **National policy-makers (for systemic risk issues)**
- **Law enforcement (for national typologies)**
- **Regulators (for approach to risk in supervisory procedures)**
- **Financial institutions (for approach to managing risk in their business)**

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### Overview of Risk

- Risk is a complex area for several reasons:
  - Issues have potential impact across a large number of the FATF Recommendations
  - Risk assessment is an art not a science
  - Risk factors will vary from jurisdiction to jurisdiction
  - Many jurisdictions have a limited experience of a risk-based approach
  - We must ensure that we are talking the same language

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### Risk Treatment in the FATF Recommendations

- **FATF Recommendations contain multiple references to ML/FT risk and risk management**
- **Key elements that we need to identify are:**
  - **coverage within definition of financial institutions**
  - **application of CDD measures**
  - **scope of supervision by competent authorities**

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### Response to Risk

- **Response to risk works both ways:**
  - reduced measures where risk is proven to be low
  - increased measures where risk is perceived to be high
- **It is not mandatory to apply a risk-based approach, except when dealing with high or specifically identified risks:**
  - Jurisdictions cannot be criticised for adopting strictly rules-based approach

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### Systemic Risk

- In the case of financial institutions, there is some scope to limit or not apply standards:
  - to a particular financial activity or type of institution “in strictly limited and justified circumstances, and based on a proven low risk of money laundering...”
  - to entities “when a financial activity is carried out by a person or entity on an occasional or very limited basis...such that there is little risk of money laundering...”

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### **FATF has produced extensive guidance on application of RBA**

- **Type of Guidance:**
  - Sector-specific documents on FATF website
  - Produced in cooperation with the private sector
- **Guidance does not constitute change to the Standard, but should help for informed discussions and application.**
- **Guidance Documents structured to address:**
  - Purpose of risk-based approach
  - Guidance for public authorities - Some high level principles and key implementation issues
  - Guidance for private sector – Key risk categories, application of RBA and internal controls



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### Questions for discussion – Sec 3.1 (Risk)

- Has a decision been taken not to apply certain required AML/CFT measures to a particular financial sector based on an analysis of ML and TF risks?
- If so, what is the outcome? - Under what basis?
- Has a decision been taken to apply a risk based approach for CDD by the financial sector?
- Is a risk based approach applied for supervisory purposes?

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### **Section 3.2 – Recommendation 5**

### **Customer Due Diligence**

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# Key Features and Objectives of Recommendation 5

- Recommendation 5 is a particularly complex area
- Large number of detailed points: 18 EC
- Criteria have to be applied to all 13 financial activities, as applicable
- CDD is an area where the risk-sensitive approach may be widely used in certain jurisdictions
- Recommendation 5 sets the triggers for other important Recommendations, and in particular for reporting purposes

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### Key players for Recommendation 5

- **Policy-makers (for overview of regulatory framework)**
- **Financial services regulators (for details of objectives, structures, resources and procedures)**
- **Private sector institutions (for their perception of regulatory requirements and procedures and implementation issues)**
- **Professional associations (for industry-wide perspective)**

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### What is Customer Due Diligence (CDD)?

- **CDD is more than simple customer identification i.e. more than taking the name of the customer. CDD is:**
  - a) Identifying the customer & verifying customer's identity from independent sources**
  - b) Identifying and verifying beneficial ownership and control**
  - c) Establishing intended purpose and nature of the business relationship**
  - d) Conducting ongoing due diligence and scrutiny of the relationship and transactions & keep records up to date**

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### Core Identification Measures

**General principle is to establish customer's identity using reliable, independent source documents, data or information (which will vary from jurisdiction-to-jurisdiction) (EC.5.3)– hence anonymous accounts not allowed (EC5.1)**

- **For natural persons, typically obtain**
  - **Name, date of birth and nationality**
  - **Address and other contact details**
- **For legal persons or arrangements, obtain**
  - **Proof of incorporation/creation**
  - **Identity of signatories, directors, trustees**
  - **Legal authority of signatories to act**

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### When is CDD required?

- **Establishing business relationships**
- **Occasional single or series of transactions of €15,000 and over**
- **Occasional wire transfers of €1,000 and over**
- **There is suspicion of ML or FT irrespective of any thresholds**
- **There are doubts on veracity of customer identification data obtained**

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### Required CDD measures (1/2)

- **Customer - whether permanent or occasional, natural or legal person - and verify information**
- **For legal persons ensure authorisation of person acting on behalf of and identify and verify information**
- **For legal persons verify legal status**
- **For legal persons identify and verify beneficial owner**
- **For all customers determine whether customer is acting on behalf of another – identify and verify both**



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### Required CDD measures (2/2)

- For legal persons understand ownership and control structure
- For legal persons identify mind and management
- Understand purpose and intended nature of business relationship
- Conduct ongoing due diligence of relationship through scrutiny of transactions and updating data obtained under the CDD process

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### Beneficial Ownership (1/2)

- **Financial institutions should identify and take reasonable steps to verify the beneficial owner**
- **Beneficial owner refers to the natural person(s) who ultimately owns or controls the customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate, effective control over a legal person or arrangement**

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### Beneficial Ownership (2/2)

- **Two primary scenarios**
  - **Individuals behind legal persons (concepts of ultimate ownership/control and “mind and management”)**
  - **Person on whose behalf account is held or transaction conducted (but who is not the declared account holder customer)**
- **It is not necessary to establish beneficial ownership of listed public companies that are subject to regulatory disclosure requirements (i.e. stock exchange)**

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### Risk in Recommendation 5

- Financial institutions shall apply enhanced due diligence for higher risk categories of customers, business relationships or transactions
- Jurisdictions may allow financial institutions to apply reduced or simplified due diligence where there are low risk of money laundering or financing of terrorism – but not when there is suspicion
- Competent authorities shall produce guidance for financial institutions where simplified due diligence is allowed

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### Timing of Verification

- **Basic rule – Verify identity before or during establishment of relationship or undertaking a transaction**
- **Exception – Delayed verification permissible when essential not to interrupt business, but only when:**
  - **ML risk is controlled through specific, applied measures**
  - **Verification takes place as soon as possible – 6 months is too long**

***See Methodology examples***

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### Failure to complete CDD

- Where CDD cannot be satisfactorily completed account should not be opened, business relationship not established and consider filing a suspicious transaction report
- Where business has been established and CDD cannot be completed relationship to be stopped and consider filing suspicious transaction report

**CDD measures to be applied to all existing customer on basis of materiality – in all instances where there is anonymity.**

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### Common Problems (1/2)

- **Inadequate risk assessments leading to exemptions or simplifications where there is no proven low risk**
- **CDD requirements not contained in law or regulation**
  - **EC 5.1-5.3, 5.5, 5.7 (*asterisked*) or “Requirement” does not constitute other enforceable means (OEM)**
- **Scope problem**
- **ID Documents not sufficiently reliable**
- **Obligations do not cover all CDD situations – EC 5.2**

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### Common Problems (2/2)

- **Beneficial ownership not covered**
- **Lack of obligations to understand the purpose of relationship and to undertake ongoing CDD**
- **Low risk – provides for complete exemption, rather than reduction in measures, or is too broad in scope**
- **High risk – no obligation for enhanced CDD**
- **No/inadequate measures for existing customers.**



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### Questions for discussion – Sec 3.2 Rec 5 (CDD)

- Are there any laws allowing for anonymous business relationships, account opening and transactions?
- When is identification of customer to be applied?
- How is beneficial ownership defined? Is there an obligation to identify the beneficial owner in all cases?
- Can financial institutions apply CDD on a risk sensitivity basis? – Any guidance from the authorities?
- How does the financial sector industry react to the CDD obligations?

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### **Section 3.3 – Recommendation 6**

### **Politically Exposed Persons**

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### Scope of Recommendation 6

- **Rec 6 addresses risks posed by certain types of customers or counterparts that require enhanced procedures and scrutiny.**
- **Generally, the target measures are in addition to Rec 5 requirements, not a substitute**
- **Non-compliance with Rec 5 principles would impact compliance with Rec 6**
- **Financial Institutions must be required specifically to address these issues: reliance simply on general risk-based approach is not adequate**

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### Key Features and Obligations of Recommendation 6

- **Main goal of Rec 6: to fight against the laundering of the proceeds of corruption related offences**
- **Rec 6 aims to make sure that FIs apply enhanced measures and scrutiny over the specific category of PEPs**
- **PEPs defined as persons who have been entrusted with prominent public functions in a *foreign* country (but jurisdictions encouraged to include domestic PEPs)**
- **In addition to normal due diligence required by Rec 5, FIs must take several additional initiatives**

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### Additional measures for PEPs

- **Appropriate risk management systems to identify a PEP**
- **Obtain senior management approval for establishing relationship**
- **Reasonable measures to identify source of wealth and source of funds**
- **Conduct enhance ongoing monitoring of the business relationship**

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### Some identified deficiencies (1/2)

- **PEPs are broadly defined and hence not all relevant PEPs are captured by FIs**
- **Enhanced procedures may also extend to members of the immediate family of such persons (issue rarely addressed in laws/regulation and difficult to assess in practice)**

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### Some identified deficiencies (2/2)

- **Some additional obligations for FIs are considered difficult to comply with:**
  - establishing source of wealth,
  - identifying origin of funds,
  - lack of definition of “enhanced ongoing monitoring of a relationship with a PEP”,
  - PEPs behind legal entities...

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### Questions for discussion – Sec 3.3 Rec 6 (PEPs)

- How are PEPs defined in the laws or regulations? Close associates and family included?
- Are there legal obligations for identifying and monitoring PEPs by Financial Institutions? – Domestic? Foreign? Both?
- Do the legal obligations, if any, apply to identifying beneficial owner PEP status? – See Rec 5 re BO
- What are the main problems encountered by the Financial Institutions in complying with PEP requirements?



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### **Section 3.4 - Recommendation 4**

#### **Secrecy Laws**

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# Key Features and Obligations of Recommendation 4

- **Financial Institutions secrecy does not inhibit the implementation of FATF Recommendations in particular in:**
  - **ability of competent authorities to access information for AML/CFT purposes;**
  - **sharing of information between competent authorities on a domestic and international level**
  - **sharing of information between financial institutions where this is required under the FATF Recommendations**

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### Gateways

- **Overriding provisions in AML/CFT Law lifting secrecy obligations imposed by other laws for AML/CFT purposes**
- **Specific gateways in particular financial and other laws lifting secrecy obligations imposed by that law on Financial Institutions**

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### Questions for discussion – Sec 3.4 Rec 4 (Secrecy)

- Do secrecy laws inhibit financial institutions and the authorities from access to and sharing of information?
- Do secrecy laws cover sharing of information by the authorities with the foreign counterparts?
- What gateways are in place for lifting bank or professional secrecy?

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# **Section 3.6**

## **Recommendation 13 and SR IV**

### **Suspicious Transaction Reporting**

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### Key Players involved

- **FIU - Reporting obligations and processes, guidance and levels of reporting across and within sectors.**
- **Supervisors/regulators of reporting entities - nature/scope of the obligation, guidance and levels of compliance with STR-related obligations etc.**
- **Range of reporting entities (banks and other FIs) - understanding of obligations and experience in complying with requirements, quality of guidance and feedback.**

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### Key Features and Obligations of Rec. 13 and SR IV

- **Need explicit, direct obligation to report for both ML and TF as defined by the FATF (this must be in law or regulation).**
- **Reporting must relate at least to all Rec 1 predicate offences as defined by the FATF.**
- **Must also apply to attempted transactions.**
- **No threshold – must be obligation to report ALL suspicious transactions, including attempted transactions, regardless of amount.**

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### Typical deficiencies

- Only some Financial Institutions covered.
- Deficiencies in ML offence / TF offence / range of predicates limit reporting requirement.
- Cannot simply rely on TF being a predicate offence for ML.
- Not required by law or regulation (reporting obligation in OEM or guidance only).
- Attempted transactions not covered.
- Lack of effective implementation:
  - Low number of STRs.
  - Uneven reporting with and across sectors.
  - Poor quality STRs.



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### Questions for discussion – Sec 3.1 Rec 13 SR IV (STRs)

- Are financial institutions required to report suspicious transactions and/or activities?
- Under what circumstances should they report? Is this related to all predicate offences?
- Are they required to report attempted transactions?
- Is there a threshold for reporting?
- Are FIs required to report when the suspicion involves tax matters?

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### Section 3.7 – Recommendation 14

### Protection and Tipping-off

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### Key Features and Objective of Recommendation 14

- **Legal protection of Financial Institutions, their directors, officers and employees from both criminal and civil liability for breach of confidentiality if they report their suspicion**
- **Prohibition for Financial Institutions, their directors, officers and employees (permanent or temporary) from disclosing that an STR or related information is being reported or provided to the relevant authorities (FIU) – “*tipping off*”**

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### Questions for discussion – Sec 3.7 Rec 14 (Protection & Tipping off)

- If FIs, directors, officers and employees are protected for *bona fide* reporting does this protection cover both criminal and civil liability? Is the protection specific to AML/CFT matters or generic?
- Are there legal provisions against “tipping off”? Gateways?
- Do these include instances where disclosure relates to an ongoing investigation?
- Are the names and other details of officers filing an STR kept confidential by the FIU? Legal requirement?

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### **Section 3.8 – Recommendation 18**

#### **Shell Banks**

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### What is a Shell Bank?

**“ A bank that has no physical presence in the jurisdiction in which it is incorporated and licensed, and which is not affiliated with a regulated financial services group that is subject to effective consolidated supervision”**

***Physical presence means meaningful mind and management located within the jurisdiction. The existence simply of a local agent or low level staff does not constitute physical presence***

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### Key Features and Objectives of Recommendation 18

- Jurisdictions should not approve the establishment or accept the continued operation of shell banks.
- FIs should not be permitted to enter into, or continue, correspondent banking relationships with shell banks.
- FIs should be required to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

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### What should the authorities do? (1/2)

#### Guidance from supervisors encouraging FIs:

- to pay special attention to ensure no business relationships with shell banks, and
- to adopt measures that will ensure that they do not enter into correspondent banking relationships with shell banks via a respondent bank.



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### What should the authorities do? (2/2)

#### Supervisors should:

- Review correspondent account files and look for evidence that the bank has conducted enhanced due diligence in managing ML/TF risks associated with correspondent banking;
- look for evidence that the bank has requested information and documentation from respondent banks and verifies that the respondent is a regulated bank, is not a shell bank and does not deal directly or indirectly with shell banks.

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### Questions for discussion – Sec 3.8 Rec 18 (Shell Banks)

- Is the concept of shell banks prohibited by law?
- What mechanisms do the authorities have to ensure they do not licence a shell bank?
- What rules or regulations are in place guiding banks not to enter into business relationships with shell banks or banks that allow their accounts to be used by shell banks?
- What tools or mechanisms are applied by the supervisor to ensure that banks comply?