



Guernsey Financial
Services Commission

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AML/CFT Cross-Divisional Presentation

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I have two subjects for you this morning. The first is Regulation 10 which covers the acceptance of introduced business. I'd then like to move on to talk about the more general subject of outsourcing because this has raised its head as an issue at a number of on-site visits.

Let's get straight into some feedback around introduced business.

Introduced Business – Rules

There are a number of Rules around introduced business, but I'm going to concentrate on three of them which relate to the obligations on the Financial Services Business ("FSB") to carry out due diligence both on the introducer and the business relationship being introduced.

In respect of an introducer the FSB must:

- satisfy itself that the introducer's risk grading and CDD policies and procedures are appropriate and effective, including enhanced CDD measures.
- establish a testing programme to ensure that each introducer can indeed supply CDD upon request and without delay.

We have seen some examples of good practice in these areas, most notably around annual visits to introducers at which, in addition to talking through any changes to the introducer's business or target markets, the FSB has also taken the opportunity not only to check the introducer's risk grading and CDD policies and procedures, but also to undertake the CDD testing on the spot.

We have also encountered examples of poor testing programmes. These include new introducers not being subject to any testing by the FSB for the first two or three years of the relationship, or existing introducers being tested only once every five years. We have also seen examples of introducers taking months and several chasing letters to supply CDD when tested, but then no action being taken by the FSB to review the desirability of continuing to accept business from the introducer, which is what should be happening in those circumstances

The FSB must also:

- assess each introduced relationship to determine whether information above and beyond the introducer certificate or summary sheet should be obtained.

We have seen many examples of good practice in this regard where FSBs have either asked the introducer for more information or have conducted their own enhanced due diligence such as, for example, commissioning reports from specialist due diligence consultants.

Many FSBs also risk rate the introducers themselves according to, for example, the quality of information provided and the risk profile of the introducer's target market. This risk rating is also used to assess whether more information may be required.

Examples from on-site visits

Let's now have a look at some general observations around introduced business arising from on-site visits.

Confusion over introducer and intermediary

We have seen examples of confusion over "introducer" and "intermediary" terminology.

For intermediary relationships it is only necessary for the FSB to conduct due diligence on the intermediary itself rather than the intermediary's underlying customers. However, intermediary relationships are low risk relationships dealt with in Chapter 6 of the Handbook and they have to meet the tight requirements laid down in section 6.5.1 and 6.5.2 of the Handbook. The majority of business being directed to an FSB is unlikely to meet these tight criteria and will either be introduced business if Regulation 10 is met, or if not, direct business. In either case, the underlying customers must be identified.

So what confusion have we seen? In some cases, the confusion over the terms "introducer" and "intermediary" has been restricted to the interchanging use of this terminology in policies and procedures, including Business Risk Assessments. The nature of the intermediary relationship versus the introducer relationship is very different, as are the risks which each brings to the FSB. It is important therefore that policies, procedures and Business Risk Assessments draw a very clear distinction between these two types of relationship. Where they don't draw a clear distinction, it can lead to introducers being treated as intermediaries and the underlying customers therefore not being identified as they should be. We do see occasional examples of this and in these cases, both the FSB and the Bailiwick are exposed to unknown risks.

High numbers of introducers

Managing a list of introducers effectively requires a considerable amount of resource, given the need to test and review each one. We have encountered instances where lists of introducers have extended to forty or fifty firms such that the FSB no longer has the resources to manage the list effectively. Where this has happened, FSBs have subsequently considered the risk/reward balance presented by each introducer and have used this to manage down the list.

Out of date certificates

We do come across examples of introducer certificates issued since the Handbook came into force in December 2007 that still make reference to the old Guidelines. Certificates issued since December 2007 should make reference to the Handbook.

So, that concludes the feedback I have for you on introduced business.

Outsourcing

I'd like to turn now to the more general subject of outsourcing, which is a fundamental feature of many business models employed in the Crown Dependencies.

Are we outsourcing?

Licensees have differing views on whether a function carried out on their behalf by somewhere else in their group really is outsourcing. The Handbook makes it clear that if the function is not being done by the FSB itself, it is outsourcing, regardless of who the service provider is. The Handbook also makes it clear that responsibility for compliance with the Regulations remains with the FSB, not the service provider.

Outsourcing, and outsourcing to somewhere else in the group in particular, has raised its head as an issue during some on-site visits. I wanted to take the opportunity today to share with you why it's been an issue, and to highlight some areas which can easily be overlooked in outsourcing arrangements but which can lead to non-compliance with the Handbook.

An outsourcing too far?

What do I mean by outsourcing too far?

Let me illustrate it with an example of a licensee that outsourced its client take-on, risk assessment and ongoing monitoring process to somewhere else within its group, such that its new and existing customer relationships were risk assessed and signed off by the group service provider. There were two major problems with this arrangement that made it an outsourcing too far. The first was that the service provider was assessing and signing off on risk to which the Guernsey licensee was exposed. An FSB must do this itself in order to remain compliant with Regulation 3, but in any case it makes no sense for someone else to be accepting risk on your behalf. The second problem was that the licensee had no arrangements in place to assure itself that the work being done by the group service-provider was compliant with the Regulations and Handbook. In failing to gain and maintain that assurance, the licensee itself was non-compliant with the corporate governance requirements of Regulation 15.

The moral of this particular story is that the risk assessment and corporate governance obligations contained in Regulations 3 and 15 simply cannot be outsourced.

Relax - it's intra-group

Many licensees regard intra-group outsourcing as inherently less risky than third party outsourcing. One of the ways that this manifests itself is in documentation such as Service

Level Agreements for example, which tend to place far less stringent obligations on an intra-group service provider than a third party provider.

Let me illustrate this with another example of a licensee that outsourced a crucial part of its monitoring programme to somewhere else within its group. A Service Level Agreement was in place, but it was intra-group and the obligations on the service provider, particularly around reporting, were not rigorous. There was then a partial breakdown of the service which went unnoticed for several months by the group service provider. Because the Guernsey licensee wasn't receiving data on the quality or level of service provided, it had no means to spot for itself that something was wrong with its monitoring programme. That breakdown in service had the potential to render the Guernsey licensee non-compliant with the Handbook and Regulations.

The first moral of this story is that intra-group outsourcing is not inherently less risky than third party outsourcing, but it is often treated as such by the lesser obligations imposed on group service providers. The second moral of this story is that if the quality of service drops or is interrupted, you need to know and you need to know quickly.

Differences in AML/CFT standards

Differences in AML/CFT standards between Guernsey and the jurisdiction in which the service provider is located are often overlooked in outsourcing arrangements. For example, Guernsey is one of the very few places in the world to apply AML/CFT rules to general insurance. Service providers need to be working to Guernsey standards.

“Global” policies and procedures

Following on from the above point, beware the use of “global” policies and procedures which invariably do not reflect the Guernsey business or Guernsey Handbook requirements. For example, Guernsey, Jersey and Isle of Man requirements can be lumped together and although they have substantially converged, there are differences between the regimes. The global policies problem also arose in the example I gave earlier of outsourcing too far. The group service provider was risk assessing and taking on Guernsey clients using global policies which did not reflect the Guernsey requirements. As a result, customers who should have been flagged as High Risk were taken on as Standard Risk. The net effect was a pocket of risk in the Guernsey licensee's business that was not fully understood and of which the licensee was unaware.

I hope that this has given you an indication of why outsourcing has been an issue at some on-site visits, and I hope that I have also provided you with food for thought if you are an outsourcer.

Useful reading

Two useful documents

I'd like to finish the outsourcing theme by pointing out a couple of documents on our website that may be helpful to you. Don't be put off by the banking sector label; the principles within them are generic and can apply to any outsourcing. You will find these

both in the “Banking” section of our website, the first in “Legislation and Guidance” and the second in “Thematics”.

That brings us to the end of this morning’s presentation and we hope that it has been helpful in providing you with some feedback from our on-site visits over the past year. On behalf of the panel thank you for listening.