



Guernsey Financial  
Services Commission

## **Industry Seminar – 20 October 2011**

### **AML/CFT Cross-Divisional Presentation**

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Good morning

Many of you will have seen this expression, or something similar, before:  
Knowing your client = CDD + Monitoring

My colleague Nic Cleveland will discuss monitoring with you shortly, but first I will present the Commission's findings in respect of Customer Due Diligence, and more particularly Regulations 4 to 7.

Regulation 4 introduces CDD. It requires that, when establishing a business relationship or carrying out an occasional transaction, a business must identify the customer and verify that identity.

Most licensees have understood the need to identify and verify their customers. This is particularly true of new customers, but the Commission has noted instances of long established customers who have not been properly identified and verified. This is, of course, a breach of Instruction 6.

Instruction 6 was issued in November 2009. It required the board to satisfy itself that CDD information appropriate to the assessed risk is held in respect of all business relationships. This was to be completed by 31 March 2010.

It is now 18 months since that deadline but from time to time the Commission still finds licensees who either have not carried out a risk assessment of all their customers, or who have not obtained the CDD appropriate for the assessed risk.

A number of licensees have commented that they have difficulties either contacting their customers or persuading them to provide the necessary CDD. Upon occasion they have been trying to obtain the CDD since the time the Instruction was issued.

Some licensees have used the onsite visit as a trigger to review all the outstanding relationships. The inability to identify and verify a customer adequately should be an indication that the relationship requires attention now, not when the Commission visits next. More importantly, Instruction 6 required that the CDD necessary for the assessed risk of that customer be obtained by 31 March 2010.

Regulation 5 requires that enhanced CDD should be carried out for certain types of relationships.

The Handbook lists examples of indicators which can be used when determining whether a risk should be treated as high.

Rule 63 states that a licensee must ensure that where “in a particular customer/product/service/delivery channel combination, any one aspect of the business relationship or occasional transaction is considered to carry a high risk of money laundering or terrorist financing, the overall risk of the business relationship or occasional transaction is treated as high risk.”

This rule is straightforward: once any one aspect of a business relationship has been identified as being high risk, the relationship must be treated as high risk.

The Commission has seen a number of instances where a relationship with a high risk element has been treated as low risk overall. The reasons for doing this have included:

- one of the directors knows the client personally and doesn't consider him a high risk
- lots of low risk indicators negate one high risk indicator
- the business has mitigated the risk

There is no way around having a high risk indicator. A business can, and should, mitigate the risk. But that relationship must be classed as high risk.

Where there is more than one alternative for a risk indicator, businesses should avoid the temptation to choose the lowest one. We have seen examples of customers with links to more than one country who have been assessed as low despite having strong links to a high risk country. This exposes the business to the risk presented by a high risk customer without the protection of the additional controls that would have been applied had the risk been assessed correctly.

The regulation also requires that a business must, where appropriate, take reasonable measures to establish the source of a customer's funds and wealth. This is an area which often causes disagreement with the Commission.

Rule 163 requires that the business must consider the risk implications of both the source of funds and wealth, and the geographical sphere of the activities that have generated the funds and wealth. During on-sites the Commission has noted examples of:

- little effort to establish the source of funds or wealth
- the measures to establish the source of funds or wealth have not been sufficiently independent.
- supporting documents have been obtained but the risk implications have not then been considered.

We appreciate that verifying the source of funds or wealth is not an exact science but, as a minimum, the risk implications of the geographic source and the activities undertaken should be documented. This should be supported by an explanation of why the documentation and explanations received are considered adequate.

Rule 169 requires that businesses must give special attention to those countries that do not or insufficiently apply the FATF Recommendations, and those countries which are closely associated with criminal and terrorist activity. Businesses are usually aware of the Commission's Instructions and Business from Sensitive Source Notices, but the rule goes beyond just the territories listed in those publications. The Handbook also requires that businesses must consider other sources, for example the IMF and Transparency International. The Commission would prefer to see more evidence that businesses have considered these risks when investigating the source of funds.

Some businesses employ third parties to carry out the research for their enhanced CDD. When a business takes this approach because it does not have the skills or resources in-house, the Commission would support that decision. However, it does not remove the responsibility from the licensee for completion of the enhanced CDD. The Commission has seen instances of third party reports which identify issues only for the reports to be filed without action. The guidance in the Handbook makes it clear that **understanding** the customer's source of funds and wealth are important aspects of CDD. The licensee's procedures should ensure that the source of funds and wealth are established **and** understood.

This brings me to the use of third party databases. Sometimes, when the Commission asks about enhanced CDD the response is simply "Worldcheck". Worldcheck, like all similar databases, can be a useful tool for the business, but like all tools it must be used in the right way. The Commission has seen examples of checks where the search parameters used are so vague as to be meaningless, or the name is so common that the licensee does not check the details of all the hits, because it would take too long.

In those circumstances it is not acceptable to say "we Worldchecked them" and put the file away. CDD is not a case of Worldcheck or nothing. If Worldcheck doesn't provide you with sufficient information to satisfy the assessed risk of the customer, then an alternative approach must be adopted.

In certain circumstances, when a business has assessed a relationship as low risk it may apply reduced or simplified CDD.

Within general insurance there are certain circumstances when a broker licensed under the Insurance Managers and Insurance Intermediaries law does not have to verify the identity of its customers at inception.

When a broker assesses a general insurance customer or product as low risk it does not have to carry out verification until a payment is made. In certain circumstances the broker does not have to verify the identity at the payment stage either. The broker is, however, in all other respects captured by the AML/CFT legislation.

The option not to verify operates in very specific circumstances, but this is not always reflected in procedure manuals. It is important that the manual states clearly what those circumstances are so that staff do not inadvertently fail to verify a normal or high risk customer.

Identification and verification of the identity of any customer must, subject to certain exceptions, be carried out before or during the course of establishing a business relationship.

The exceptions are that it may be completed following the establishment of a business relationship provided that:

- it is completed as soon as reasonably practicable thereafter,
- the need to do so is essential not to interrupt the normal conduct of business, and
- appropriate and effective policies, procedures and controls are in place which operate so as to manage the risk.

Rules 117, 122 and 127 lay out the rules for identifying beneficiaries for trusts and life policies. They all require that verification of the identity of beneficiaries and persons known to be likely to benefit must, where possible, be undertaken before or during the course of establishing a business relationship. Where it is not possible to do so, the reasons must be documented and verification must take place prior to any distribution.

There are many legitimate reasons why a beneficiary is not identified or verified at inception. But in those circumstances the Handbook requires the business to:

- demonstrate and document why it was not possible to identify and verify the beneficiary when establishing the relationship
- ensure that identification and verification is completed as soon as reasonably practicable after the business relationship is established,
- demonstrate and document the need to do so is essential not to interrupt the normal conduct of business, and
- to have appropriate and effective policies, procedures and controls in place to manage the risk.

A number of licensees are not identifying and verifying beneficiaries until payments are made on the assumption that the rules give them an “opt out” clause. But in order to do this, the business must also meet the other conditions laid out in the regulation and the rules. In particular, the licensee must demonstrate and document the decision making processes and have appropriate and effective procedures and controls.

With such a large area to cover I can touch on only some of the CDD issues arising out of on-sites. Inevitably, I have addressed the bad practices and I would emphasise that this does not reflect the considerable amount of good work being done by many licensees.

Thank you for your time. I will now pass you to my colleague Nic Cleveland of the Fiduciary Division who will be discussing Monitoring, Training and Screening.