

**GUERNSEY FINANCIAL SERVICES COMMISSION  
FIDUCIARY SECTOR - AML/CFT FEEDBACK SESSIONS  
9 October 2013**

**Presenters:**

**Samantha J Sheen – Head of the Financial Crime & Authorisations Division**

**David McCloskey – Assistant Director, Financial Crime & Authorisations Division**

**Philip J Marr, Director, Fiduciary Supervision and Policy Division**

On 9 October 2013, the Commission held feedback sessions with representatives from the Bailiwick's fiduciary sector. The sessions covered:

1. Recent Moneyval assessments and how their findings may relate to the Bailiwick's regulated fiduciary sector.
2. Trends identified from on-site visits since November 2012.

The following is a summary of the three presentations made by members of the Commission.

**Moneyval – Membership of the Bailiwick**

In 2012 Guernsey, together with the other Crown Dependencies, joined MONEYVAL. MONEYVAL is part of the Council of Europe. MONEYVAL was established in 1997 and is a FATF-style regional body. MONEYVAL undertakes AML/CFT evaluations of its membership and follows up on how jurisdictions have responded to recommendations made as a result of those evaluations.

To date, the Bailiwick has been evaluated by the International Monetary Fund ("IMF") in relation to its compliance with international AML/CFT standards, which included the Financial Action Task Force ("FATF") recommendations. However, the IMF assessment process does not include a means whereby the Bailiwick can demonstrate and report, on a periodic basis, how it has addressed that evaluation's findings and recommendations. Unlike MONEYVAL, the IMF assessment process does not provide for plenary participation by the Bailiwick in which it would have such an opportunity.

A decision was therefore made that it would be appropriate for the Bailiwick and the other Crown Dependencies to seek membership in MONEYVAL.

## **MONEYVAL – 2014 Evaluation**

MONEYVAL will be conducting an evaluation of the Bailiwick during 2014. MONEYVAL will be assessing the Bailiwick's progress in both addressing the findings of the IMF in its 2010 report, along with the degree to which it has maintained compliance with a number of the other recommendations for which it received a satisfactory rating. The scope of the assessment will cover the Bailiwick's compliance with the FATF recommendations issued in 2003.

### **Moneyval Assessment of the Cyprus Banking Sector**

In 2013, MONEYVAL conducted an assessment of the Cyprus banking sector. MONEYVAL selected 13 of the 41 banks to interview, which included the 7 largest banks operating as at 31 December 2012. The MONEYVAL evaluation team met with banks' compliance staff. Subject to availability, meetings were also convened with senior managers, relationships managers and internal audit. The meetings were quite lengthy, typically 4-5 hours. The interviews consisted of detailed discussions on the AML/CFT policies and procedures of each bank and how they managed risk. At least 60 relevant topics were covered in the course of every interview. The topics covered such areas as:

- Governance Issues – The Role of the Board in determining its ML/FT Policy,
- Customer acceptance,
- Ongoing monitoring,
- Identifying beneficial owners,
- Rejected business,
- Terminated business; and
- Resolution of any disputes between compliance and customer on-boarding.

It wouldn't be appropriate to literally read across the findings of the report prepared by Moneyval of its evaluation of the Cyprus banking sector ("Cyprus Report"), to the Bailiwick's regulated financial sector. There are a number of distinct differences between the regulatory framework of the two jurisdictions, the composition of their financial sectors and the particular circumstances that resulted in Cyprus being evaluated in the first place. One obvious example is in relation to the duration and degree to which the trust and corporate administration sector has been regulated in Cyprus, in comparison to that of the Bailiwick, which has now been regulated for over 10 years by the Commission.

However, despite several notable distinctions, some of the findings and observations made in the Cyprus Report are relevant to international finance centres such as the Bailiwick, as they relate to the detection, forestalling and prevention of financial crime.

The findings that the Commission identified as possibly being relevant for the Bailiwick's trust and corporate service providers were as follows:

A. Reliable Introducer Arrangements

The Cyprus Report records that the evaluators recommended that the highest standard of customer due diligence ("CDD"), which could include direct contact with the ultimate beneficial owner, be applied to introducer relationships involving high risk customers.

There are two aspects to this recommendation that are relevant for Bailiwick trust and corporate service providers. First, it suggests that trust and corporate service providers can expect that private banks could possibly ask for more information about the settlors, beneficial owners and directors, in place of simply accepting an introducer certificate, where the bank has classified the relationship as high risk. It is even possible that in some cases, banks may move away from relying up introducer arrangements all together.

Second, trust and corporate service providers may be subject to further scrutiny by international evaluators such as MONEYVAL in order to verify that the providers not only know who their customers are, but have performed enhanced CDD where the customer's overall risk profile could be characterised as high risk.

B. Politically Exposed Persons ("PEPs")

The Cyprus Report records that some of the banks had ineffective measures in place to establish a PEP customer's source of wealth. Ineffective measures were also noted in relation to banks' ability to identify when any of their existing customers subsequently became PEPs. This latter finding was of particular concern to the evaluators where it appeared that reliance was being placed on a third party introducer to have performed the requisite CDD. This concern was escalated further where reliance was extended relying on the introducer to spot whether a customer had become a PEP and notify the bank accordingly.

C. Monitoring

The Cyprus Report records that a number of the banks reviewed used automated systems for monitoring purposes. These systems generate an alert, to indicate a possible discrepancy in the expected account activity of a particular customer. The MONEYVAL evaluation team found that the alerts generated by these monitoring systems on high risk accounts appeared to be disproportionate to the number of staff available to manage them. Or, in simple terms, there were too many alerts and not enough people to check them.

There could be a number of explanations for this. It is possible that rather than designing a monitoring system, taking account of the business, considering its size, complexity and nature of its business, some of the banks were applying the same standard of monitoring to all customers, regardless of the risk they posed. Alternatively, the banks may have failed to consider, as part of their business risk assessments, the amount of resources that would need to be expended in order to undertake enhanced due diligence, given the overall proportion of high risk customer that made up their customer base.

In either case, the resulting risk is obvious – by becoming overwhelmed by the sheer number of alerts, staff may eventually decide this to be a pointless task and alerts which indicate serious AML/CFT concerns are overlooked.

#### D. Compliance Arrangements

The next finding was in relation to the banks' compliance arrangements concerning new business take-on. The MONEYVAL evaluators found that the banks' compliance functions did not have an effective role in the business take-on process, particularly where high risk customers were being considered. The important message here is the role that the compliance function can play in the business take-on process. It is far easier to identify and refuse a prospective business relationship than it is to try and exit a trust arrangement, for example, after it has been established. The Cyprus Report also records the observation that it would be valuable, for risk management purposes, if banks were to record rejected business more systematically together with the reason for doing so.

### **Messages from the Cyprus Report**

You might recall that prior to the IMF visit in 2010, the Commission issued a set of instructions requiring that a number of actions be undertaken following on from the introduction of the Regulations and Handbooks in 2007 and 2008. At the moment the Commission does not propose to issue similar Instructions prior to the MONEYVAL assessment, but would suggest that trust and corporate service providers:

1. Review their compliance arrangements to ensure that the areas mentioned above are effectively and appropriately dealt with by the business' compliance arrangements.
2. Revisit the Instructions issued by the Commission in 2009 and ensure that the business can demonstrate its compliance with their requirements.
3. Advise the business' Board, Governance Committee and compliance teams of the forthcoming Moneyval assessment in 2014.
4. Take a moment to review the comments made in the Cyprus Report and consider whether the risks identified in that report might also apply to the business. Consider how the business' current compliance arrangements mitigate those risks.

### **On-site Visit Feedback**

The FC&A Division has undertaken a number of on-site visits since November 2012. Some of the more notable observations identified from those visits are summarized below.

#### Business Risk Assessments (“BRAs”)

The on-site visit teams have seen a variety of BRAs and there’s clearly ongoing development in their complexity and content. One observation is that the on-site visit teams have seen BRAs that appear to remain static or use a template style model - neither of which reflects the current risks of the business. Businesses should take steps to ensure that their BRA continues to be appropriate and effective to manage not only its current risks but also any emerging risks.

It is important for businesses to be alive to the fact that as their business development activities change, so too may the nature or type of money laundering and terrorist financing risks to which they are potentially exposed. This may, in turn, mean that the controls a business has developed to manage the risks identified in its BRA may no longer be appropriate and effective to manage new money laundering or terrorist financing risks that, for example, a new product or service may present.

#### Source of Funds / Source of Wealth

Businesses might have noticed that the Commission has published information about its expectations regarding the requirement that the source of funds and wealth be established as part of enhanced due diligence. The on-site visit teams have seen instances where a business has relied at face value on the information provided by a high risk classified customer on an application form. It is the Commission’s expectation that steps are taken to verify any information provided by such customers, in order to independently confirm the veracity of the information provided. This requirement will allow a business to determine, first whether the proceeds are in fact generated from the source identified, and also whether based on that information, it wishes to undertake further enquiries, or even decide not to establish or continue that business relationship.

#### Introducer Arrangements

The on-site visit teams have noted in some limited instances that the status of an underlying customer of an introducer arrangement has changed, but steps have not been taken by the introducer to notify the certificate holder. Whilst the Handbook does not expressly compel this, it is good practice and to the benefit of the Bailiwick as a whole to notify certificate holders when changes happen. We note the FCA’s recently published final notice on Guarantee Trust Bank as a reference, in this regard.

## Training

The onsite visit teams have seen some quality training presentations which have gone beyond money laundering and terrorist financing risks, and included training on sanctions and anti-bribery and corruption. They have also seen training material and delivery which has included participation by the attendees in scenarios and the use of current case studies.

## Customer Application Forms

Please don't forget to update customer application and other data collection forms. Businesses often place a lot of effort and focus upon the development and maintenance of policies and procedures - but the onsite visit teams have seen at times that the business has forgotten to also consider the forms which it uses. In some limited instances, this has resulted in the inadvertent failure to collect identification data such as the former name of the customer.

## Visit Questionnaire

An unexpected observation is the use of our onsite visit questionnaire. As part of an onsite visit the FC&A Division issues a questionnaire, which assists the team in its pre-visit analysis and understanding of the business. Although it was never the intended purpose we have seen the questionnaire used to undertake an annual assessment by boards and governance forums of a business' compliance arrangements. I would just be mindful that the questionnaire is subject to change.

## **Philip Marr**

### **Director, Fiduciary Supervisory and Policy Division**

Just a few thoughts from me to reinforce what Dave McCloskey has already said today.

Essentially I want to concentrate on two things; firstly how useful the Cyprus Report is and its relevance to the Bailiwick looking forward to 2014? Another way of looking at that is to ask: to what extent is the Cyprus Report the result of a special case and therefore not quite as relevant as it might seem to the activities of the regulated fiduciary sector here in the Bailiwick. Secondly I will briefly say a few words on my interpretation of some of the findings of recent AML/CFT on-site visits that apply to the Bailiwick's fiduciary sector.

The Cyprus Report states from the outset that the evaluation was a very different one than has been done on other jurisdictions because it has a special focus on the effectiveness of the AML/CFT compliance arrangements of the Cyprus banking sector. I think it is worth

remembering the circumstances at the time - in the early part of 2013 - which formed the context for this evaluation.

You may recall that the Eurozone crisis was at its height and there were major concerns about the Cyprus bail-out, how much resource would be made available to re-capitalize the banks and what economic measures would have to accompany those; and you will also recall that the Cyprus bail out came not that long after the bail-out of Greece.

It is also arguable that Cyprus was handled very severely (including 'haircuts' on deposits) because it was a relatively small member state and the problems were not so as intractable as they might have been if we had been talking about a larger jurisdiction.

A key element to the bail-out was that Germany was driving the nature of the support that could be offered and were opposed to a financial bail-out where one of its key industries was based on what was perceived as comprising of a large percentage of high risk customers seeking to evade tax. There were particular concerns given the long-established double taxation treaties which Cyprus has with Russia and Ukraine.

In order to gain greater transparency around the customer base and overall AML/CFT measures being taken by the banks to mitigate those risks, additional measures were sought before further financial assistance was to be offered.

In addition to the background circumstances, there are other differences. One key difference between Cyprus and the Bailiwick is that the Cypriots don't yet regulate trust and corporate service providers. Although a legal framework had been introduced in Cyprus, it had not yet been implemented at the time the MONEYVAL assessors arrived. So, the Cyprus banking regulator had not yet put in place the resources and the infrastructure for the supervision of what Cyprus refers to as ASPs – Administrative Service Providers. In the Bailiwick, trust and corporate service providers have been regulated for quite some time and indeed are ten years ahead of Cyprus in that area.

All that said, by way of treating Cyprus as a special case, there are nevertheless some similarities which make it a necessary read which can shed light on why the Cyprus Report is relevant for the Bailiwick's fiduciary sector, given that the Bailiwick is facing an evaluation next year.

#### Characterization of Fiduciary Business

First, the MONEYVAL evaluators regarded fiduciary businesses as inherently high risk. This is not entirely surprising as most of the methodology underlying the FATF recommendations is based on that premise, as well. One element which is repeated in the Cyprus Report is that it was a combination of a number of factors, what the Commission has also referred to as a

confluence of risk factors, which led to the riskiness being compounded: essentially the combination of introduced business plus complex structures plus the use of nominee accounts.

### Reliable Introducer Arrangements

Second, the MONEYVAL evaluators regarded reliance upon introducers as also inherently high risk. Introduced business forms an important part of the Cypriot banking sector and features widely in the Cyprus Report. Since there is introduced business in the Bailiwick, we can be pretty confident the MONEYVAL evaluators will look at how these arrangements are dealt with.

What I would say is we don't have are the chains of introducers which were a feature of Cyprus' banking sector, with one introducer passing business on to another introducer and so on. Clearly in this context you, the fiduciary sector, are the introducers of business to the banking sector in the Bailiwick. However, there are disciplines around that and there are mechanisms by which the banks sample and check the quality of the business that is being introduced to them and the compliance arrangements of those fiduciary businesses who act as introducers. So we will have to make sure that the MONEYVAL evaluators are made aware of the differences in approach and regulatory requirements here in the Bailiwick as compared to Cyprus.

### Ultimate Beneficial Ownership

'Know your customer' and ultimate beneficial owner considerations tend to feature less strongly in the Bailiwick because trust and corporate service providers generally have more direct contact with the customer. However the MONEYVAL evaluators' criticism that the ASPs in Cyprus were not very good at determining source of wealth may well also apply in the Bailiwick and so we should bear that in mind for next year.

### Politically Exposed Persons ("PEPs")

The MONEYVAL evaluators flagged the number of PEPs and high risk business in Cyprus and commented on the lack of on-going monitoring of some of these relationships. That comment may well also apply to the Bailiwick's fiduciary sector because it is a question of the resources allocated to on-going monitoring.

### Onsite Visit Findings

Just a few points on the on-site findings generally. I think one of the areas where the fiduciary sector can raise its game is by being smarter or more focused in determining its risk appetite. That should be able to be dealt with as part of Corporate Governance where the board makes a risk appetite statement or determines what we might call a risk appetite framework i.e. the



tolerances by which it will take on high risk business but also setting the boundary beyond which it won't go. The obverse of having a risk appetite framework is that, if you don't have one, it rather looks like you will take any business on that turns up and that is not a good position and it will be helpful to get smarter in that area.

On resourcing generally it has seemed to me in digesting some of FC&A Division's onsite visit findings during this year that there could have been a lot fewer breaches of the rules in the Handbook or comments about "could do better" if the compliance function in the fiduciary business had been better resourced. I am convinced that, if more businesses had a stronger compliance function and in some cases that may just be about additional bodies to actually cover the various elements of monitoring, then we would not have seen so many breaches and "could do better" performance. To be fair, that might beg the bigger question as to whether there is a large enough pool of qualified compliance staff in the Bailiwick and that is not an easy question to answer but we can all make a start by investing in the future by bringing on some of the better younger staff and giving more staff an understanding of compliance issues.