



Guernsey Financial Services Commission

Non-Executive Forum

Presentation by Samantha Sheen

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My name is Samantha Sheen and I am the Head of the Financial Crime & Authorisations Division (FC&A Division).

Introduction

I would like to start my presentation by telling you a little bit about the FC&A Division and its role within the Commission. I will then turn to the Moneyval assessment visit scheduled to take place next year. Next, I will share with you some observations based upon the on-site visits conducted by the Commission over the last 12 months. I will then conclude with brief remarks about the goals and objectives and activities being undertaken by the FC&A Division and those in the pipeline for 2014.

The Financial Crime & Authorisations Division

In November 2012, the Commission launched a team known as the AML/CFT Unit, to whom responsibility for undertaking on-site visits was transferred from each of the supervisory Divisions.

In July 2013, the unit's responsibilities were expanded to include financial crime and related policy activities formerly undertaken by the Policy and International Affairs Division.

Also in July of this year, the AML/CFT Unit was merged with the Authorisations Unit, which was also launched in November 2012, to form the FC&A Division. David McCloskey is the Assistant Director who leads the financial crime team and Manus Carvill is the Assistant Director who heads up the Authorisations team.

Moneyval Assessment

In October, the Commission held an information session for the fiduciary sector, which included an overview of an assessment report prepared by Moneyval following its review of the Cyprus banking sector. Most of you will know that Guernsey became a member of Moneyval, along with Jersey and the Isle of Man, in 2012.

The following findings recorded in that report may be relevant to international finance centres such as the Bailiwick:

1. The first finding was in relation to the Cyprus banks' reliance on introducer arrangements with trust and corporate service providers. The banks appeared to remain in many cases one step removed from the beneficial owner of legal arrangements or legal persons to whom they provided banking services.

Most of the banks had, in all likelihood, not had any face-to-face contact with the beneficial owners of these structures. This suggested a level of dependence that the banks placing on trust or corporate service providers to know and hold customer due diligence about the beneficiaries. This dependence was considered to constitute a high risk characteristic of these relationships. It was determined that the banks should implement the highest standard of customer due diligence, which could include direct contact with the ultimate beneficial owner of administered trust and corporate structures, in a larger number of cases.

This finding suggests that banks may require that more information be provided about the beneficiaries' underlying the trust and corporate structures for whom they are asked to open accounts. In some cases, banks could even go so far as to move away from relying upon introducer arrangements, altogether and require that complete customer due diligence be produced, instead. It is also possible that where introducer arrangements are in place, for example, providers could be looking at more frequent testing as per the Criminal Justice Regulations.

Boards are encouraged to canvass these possible changes with the business which they oversee to verify how readily they would be able to produce the required information and how might they plan for a possible change within industry whereby introducer arrangements might, for some banks, no longer be continued.

2. Politically Exposed Persons (PEPs)

While in most cases the Cyprus banks were able to show that their procedures used to identify source of funds were effective, the measures they used to determine a PEP's source of wealth were not always convincing. Measures used to identify immediate family members and close associates of PEPs needed strengthening. Some of the banks did not have adequate measures in place to identify, in a timely manner, cases where an existing customer became or was subsequently found to be a PEP.

As part of the board's fulfillment of regulation 15 of the Criminal Justice Regulations, we would expect that questions are raised about how the business goes about establishing source of wealth for PEP customers and importantly, how the business goes about monitoring the existing customer base so that it becomes aware, in a timely way, when someone has become a PEP, so that the necessary enhanced monitoring measures can be applied. As non-executive directors, we would encourage you to become familiar with the proportion of PEPs which comprise of the businesses on whose boards you participate.

3. Compliance Monitoring

A number of businesses here in the Bailiwick have systems through which ongoing monitoring is undertaken of its customers base. This allows it to identify, in a timely way, whether new information about a customer would change their risk profile and require a revisit of the risk rating assigned to them. These systems normally operate whereby they will produce a list of "hits". The idea is that the business will then review that list, eliminates any false positives, and then makes further enquiries about those customers and whether their risk rating should be adjusted.

For a number of the Cypriot banks, the number of hits being generated was disproportionate to the number of staff available to sufficiently consider them and then decide how to respond to them. In simple terms, there were too many hits and not enough people to check them.

The cause of the problem appeared to be that the banks had failed to recognize that the nature of the business they had taken on which had high risk factors, meant that they would need additional compliance resources in order to ensure that the hits were being properly checked.

Very seriously, this also meant that suspicious activity that might otherwise have been identified by the monitoring system, was being overlooked due to resourcing pressures.

The Cyprus report highlights for boards the importance of ensuring that the development and marketing of new services, products or a change in geographical focus for customers, takes account of the possible corresponding compliance obligations that might also need to be undertaken and the resourcing pressures that might arise.

4. Compliance Arrangements

For some of the Cyprus banks, their compliance function didn't have an effective role in the business take-on process and was not always consulted in the acceptance of high risk customers. In a significant number of banks it

appeared that compliance was only involved in new business decisions where there was a query from a relationship manager.

Boards should be alive to the absence of input from the compliance function, not only in relation to the possible risk rating of new business, but also where there does not appear to be any input about the resources that might be needed to monitor that business and whether current and future compliance capacity can and will be able to do so in an effective manner.

5. Confluence of Risk

It was observed that the combination of a number of the factors I have just summarized meant that in some cases, the confluence of these risks, even if considered low risk in isolation of one another, meant that they could not be effectively mitigated by the customer due diligence measures being applied by the banks.

The combination of, non-face to face relationships with the beneficial owners, combined with reliance upon an introducer arrangement and then added to that a complex legal structure, all suggested that some relationships should have been rated as something other than low risk.

In risk management terms, we refer to this as the confluence of risk factors. This is one of the reasons why businesses are encouraged to look at relationships in the round and not solely at each of their risk characteristics in isolation to one another.

Boards are encouraged to be alive to this and ask the business how they go about managing this type of risk and whether their risk assessment process looks at customer risk in the round.

This report is considered to be of particular relevance because the Bailiwick has been selected for assessment by Moneyval in the autumn of 2014. Communications with Moneyval suggests that this visit will take place in either September or October of next year.

Similar to the International Monetary Fund visit in 2010, a team of assessors comprising of representatives from different Moneyval member jurisdictions will travel to the Bailiwick and undertake a week-long assessment of the regulations, policies, procedures, controls and enforcement activities in relation to money laundering and terrorist financing.

This will, like the 2010 International Monetary Fund visit, include a selection of businesses for the assessors to visit in order to verify whether these measures are understood and being applied.

The Cyprus report may provide us with a glimpse into the types of areas that the Moneyval assessors may focus their attention upon when they visit us next year.

Given the relatively new nature of the 2012 FATF recommendations, it has been agreed with Moneyval that our assessment will be based upon the Bailiwick's compliance with the 40+9 recommendations, which we were assessed against during the 2010 International Monetary Fund Visit.

On-Site Visit Findings

I would now like to turn to the on-site visit findings.

1. Business Risk Assessments

Over the last 12 months, we have seen a variety of business risk assessments and there's clearly some ongoing development in terms of both their complexity and content.

From time to time, we have seen business risk assessments which have appeared to remain static or are based upon some sort of generic template. The contents of the assessment have not changed or been updated to reflect the actual current risks to which the business may be exposed.

Board members are asked to ensure that business risk assessments are periodically reviewed to verify that they continue to be both relevant and up to date. This includes making reference to possible prospective new business development strategies along with new or varied products and services.

As non-executive directors, you play an important role in verifying the relevance of business risk assessments presented to the board. We would encourage you to ask about the information relied upon in completing the assessment and whether the business' procedures require that a review is undertaken when a change to business strategy is undertaken, for example.

2. Relationship Risk Assessments

On the whole, we have found that businesses demonstrate a good understanding of the inherent AML/CFT risks associated with certain prospective customers.

In a small number of instances there has been no record maintained by the business summarizing the basis upon which the given risk rating was assigned.

This has been noted where a senior member of management has a close and on-going relationship with a long standing customer. The problem arises

when that individual leaves the business or is unavailable when a request for information is made by the FIU or the Commission. Most importantly, for you as board members, the lack of record maintained means that you are wholly reliant on anecdotal information.

It is a regulatory requirement that knowledge about relationships and the basis for their risk ratings must be recorded in a manner that is readily retrievable. The compliance function of a business cannot operate in an effective manner if it does not have ready access to this information.

Boards are therefore encouraged to ensure that policies and procedures reflect the importance of maintaining a record of the reasons or rationale relied upon in assigning a given risk rating. This will allow the business to more accurately review and re-assess those relationships should changes occur to the customer's risk characteristics based upon which the original risk rating was given.

3. Source of Funds / Source of Wealth

I previously mentioned source of funds and wealth. You might have noticed that we have published information under the FAQ section of the AML webpage about the Commission's expectations concerning the establishment of a customer's source of funds and wealth.

There have been some instances where a business has relied solely at face value, on the information provided by or on behalf of a customer on an application form about its source of funds and wealth. It is the Commission's expectation that this information is also the subject of independent verification and that verification recorded. We have provided some suggested sources that could be used for this purpose in the FAQ section of our webpage.

4. Governance and Oversight

When undertaking on-site visits, the team looks not only at the nature of any non-compliance, but also at the possible reason or cause giving rise to it. In cases where we have found what appears to be systemic or repeated non-compliance, there are often two identifiable reasons for this.

The first is in relation to resourcing. Compliance functions in some businesses have been reduced or are staffed with individuals with limited compliance experience or knowledge about the financial crime risks specific to that business.

In other cases a member of senior management has assumed responsibility for the role of MLRO or Compliance Officer, with very little work capacity to devote to fulfilling the tasks of the position.

The second cause we see is the level of Board involvement, and in particular, a lack of challenge by its members. It cannot be overemphasized that where the management of financial crime risks is concerned, the tone from the top means everything. If the Board does not appear engaged or place importance upon managing these risks, this will permeate throughout the organization.

Boards are encouraged to regularly ask about compliance resourcing, the controls in place to manage risk and most importantly, to ask why it is that the business believes that its compliance arrangements are appropriate and effective.

5. Training

In the last 12 months, we have seen some excellent examples of quality training being offered and undertaken by businesses.

In some instances, this training has gone beyond AML/CFT matters and included Sanctions and Anti-Bribery and Corruption.

Training material and delivery methods have been reviewed which have included the participation of attendees in scenarios and the use of case studies. The effectiveness of such training methods has made that training more relevant and effective for both Board and staff members of the business.

Businesses are encouraged to consider whether these methods, and in particular case studies specific to their own products and services, might be incorporated into their future training programs.

Goals, Objectives and Future Activities

It has already been a busy year for the team. A detailed review the 2012 FATF Recommendations has been undertaken and we are now looking at our own internal processes.

The FC&A Division has expanded the AML/CFT enquiries program so that the answers to questions sent to us that we feel would be of use to a wider community of businesses, are published on the AML/CFT webpage.

We are currently working towards the development of guidance concerning the application of the Handbook requirements to both personal fiduciary licensees and the legal profession.

In 2014, our on-site visit program will comprise of both assessments of the appropriateness and effectiveness of systems and controls along with more thematic risk-based reviews, such as the reliance upon, and effectiveness of, outsourcing arrangements.

Further education and awareness sessions are planned for the benefit of the registered business sector.

A review of the Handbooks will be undertaken in 2014 with a view to making them more user and web-friendly and appropriate.

Authorisations

The Authorisations team within the FC&A Division is responsible for the processing and due diligence enquiry activities relating to personal questionnaires and personal declarations for all of the supervisory Divisions. The team is also responsible for the processing of certain types of applications and the due diligence enquiries associated with them.

This is a very busy team who performs a crucial service to the Commission. To give you some idea as to the volume of work undertaken by this team, Since November 2012, it has received:

- Personal Questionnaires– 1,030
- Personal Declarations – 2,804
- Average PQ/PDs received per week - 65
- Most PQ/PDs received in one week – 99
- Since May 2013 the team has processed 91 “fast track” fund applications.

This team plays a vital role as part of the Commission’s financial crime function in ensuring that individuals who are not fit and proper, are quickly identified.

Conclusion

Non-executive directors play a crucial role in maintaining the Bailiwick’s strong reputation as an international financial centre which effective controls to mitigate the risk of financial crime. The role of corporate governance oversight is integral to ensuring that firms’ compliance arrangements are and remain appropriate and effective and it is a role which the independent perspective of non-executive directors positively contributes towards.

Should you have any questions or comments regarding either of the Divisions' team or their activities, we would very much appreciate hearing from you.