

Key points made by Fiona Crocker, Director of the Financial Crime Division at presentations on 28 November 2018 on the draft revised Handbook on Countering Financial Crime and Terrorist Financing.

These notes are published to assist firms in their analysis of the main revisions to the AML/CFT framework. The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) (Amendment) Ordinance, 2018 and the Handbook remain the definitive versions.

Update on Last Year's Consultation

The Handbook is in final draft form as the legislation is awaiting approval by the States of Guernsey next month [December 2018].

This version is the product of the feedback from the joint consultation with the Policy & Resources Committee last year to which there was a very high response rate, with 75 responses.

Earlier this year we circulated revised proposals, via the industry associations, on the enhanced measures to be applied to four categories of customer, on the use of intermediary relationships on Collective Investment Schemes ("CISs") and new proposals for declassifying certain types of Politically Exposed Person ("PEP") relationships based upon risk.

Feedback from both engagements has been very carefully considered.

The final draft version has been through internal legal review by General Counsel and the Supervisory Divisions, and external review by UK expert legal counsel.

Format

There is now one Handbook applying to all firms rather than two separate handbooks for financial services businesses and prescribed businesses.

The regime retains a 3-tier approach but the Proceeds of Crime regulations are being replaced by three schedules to the Proceeds of Crime Law ("the PoC Law"), which are supported by rules and guidance issued by the Commission in the Handbook.

The legislation (in particular the new Schedule 3 to the PoC Law) appears in blue boxes and rules appear in red boxes in the Handbook. Everything else in the chapters which isn't in boxes is guidance and explains the Commission's interpretation of the requirements and presents ways of complying with those requirements. A firm may adopt other appropriate and effective measures to those set out in guidance providing that it can show that it achieves the same outcome.

New General Duty to Understand Money Laundering ("ML") and Terrorist Financing ("TF") Risk

There is an increased focus on risk in the revised framework, with a new legal obligation imposing a general duty upon a firm to understand its ML and TF risks and have in place effective policies, procedures and controls to identify, assess, mitigate, manage and review those risks in a way which is consistent with all AML/CFT legislation, the Handbook, and the National Risk Assessment.

It sets an overarching obligation for a firm to apply measures, including a risk-based approach, consistent with the Bailiwick's requirements.

There are changes to the legal provisions to carry out business risk assessments. There will need to be distinct assessments of both the ML risks and the TF risks a firm faces but these assessments can be in the same document.

The risk factors which a firm must consider in its business risk assessments include: the types of customers it has and types of beneficial owners of its customers; the geographic exposure: the types of products and services offered; and the delivery channels used, and these requirements have been lifted up into the PoC Law for consistency with FATF requirements around identifying risk. In practical terms this should present little change to present practice.

The NRA, which is due to be published in 1st quarter 2019, will be covering both ML and FT risks. For an international finance centre the vulnerability, particularly for funding international terrorism, lies within cross-border financial flows and assessments of TF should include consideration of the geographic location of customers and beneficial owners and the origin and destination countries of payments.

The legislation retains the requirement to annually review these assessments but also for a review to occur more frequently when there are changes to the business. Those changes may include development of new products and business practices or the use of new or developing technologies for both new and existing products. Guidance in the revised Handbook explains what "new" means.

The law sets out that as part of these assessments the firm must determine the overall risk to the business, the appropriate level and type of mitigation to be applied, and its risk appetite.

Risk appetite is the type and extent of risk that the business is willing to accept in order to achieve its strategic objectives. There was little industry feedback about the revised requirements to business risk assessments and risk generally, except to propose that this obligation to set a risk appetite should be in legislation rather than rules as initially proposed.

Risk appetite must also now feed into relationship risk assessments. Otherwise the factors underpinning relationship risk assessments, although lifted up into law, remain largely the same, namely that they must include the type of customer, the beneficial owners of the customer, geography etc.

This focus on risks extends beyond the general duty to understand risk and undertake assessments but also within measures for dealing with relationships with PEPs, source of wealth and source of funds ("SOW/SOF") checks on high risk relationships, and enhanced measures for certain types of customers.

Enhanced Measures

Proposed in response to MONEYVAL's recommendation to expand the list of higher risk customers to which enhanced due diligence must be applied. The measures proposed closely mirror Jersey's which were examined during its MONEYVAL evaluation.

The Commission's initial proposals sought to draw a very clear distinction between relationships assessed as high risk and relationships with a customer where higher risk factors were present because the customer: i) was a non-resident; ii) was seeking private banking services; iii) was a personal asset holding vehicle; or iv) had nominee shareholders ("qualifying customers") but which may not necessarily be high risk. We had also proposed that certain specific measures should be applied.

Whilst the feedback we had last summer indicated that a number of firms were already applying the measures which were proposed, concern was expressed that it appeared that a 4th tier of CDD had been created and the proposed measures were prescriptive rather than risk based.

We shared the revised proposals which will apply with you last March. Now under the legislation firms will have to carry out enhanced measures in relation to qualifying customers.

In the PoC Law enhanced measures means taking appropriate and adequate measures to manage and mitigate the specific risks associated with these types of customer. This means that the measure must be specific to the particular higher risk factor(s) present rather than the law or a rule specifying what the measure must be.

The application of enhanced measures is mandatory but the decision on the type of measures to apply and the extent to which they are applied is a decision to be made by a firm based upon its assessment of the risk. Therefore it is more risk-based.

The Handbook gives guidance on the risk that these four types of customer could pose and the mitigating enhanced measures which could be applied. A firm could determine that some other measure would be more appropriate to manage and mitigate the specific risk.

The extent that enhanced measures are applied will also depend upon risk as a non-resident customer from an Appendix C country is likely to be less risky than a non-resident customer from a jurisdiction identified by credible source as having higher levels of bribery and corruption.

The consultation version included customers with bearer shares but there was strong feedback that where bearer shares existed within a relationship, that relationship should be high risk and subject to mandatory enhanced customer due diligence which was proposed in the revisions to this section circulated to industry in March.

Misconceptions about enhanced measures:

- Whilst firms must have regard to the cumulative effect that more than one higher risk factor might have on the assessment of risk, it is still perfectly feasible to have a customer to whom enhanced measures must be applied but which does not necessarily make it a high risk relationship.

We have sought to illustrate through charts how enhanced measures applies across the risk spectrum.

- Enhanced measures must be applied to a qualifying customer where the relationship is high risk in addition to Enhanced Customer Due Diligence ("ECDD"). However there

may be occasions where measures applied under ECDD could also satisfy the requirement to apply enhanced measures.

For example, ECDD must be applied to a foreign PEP as a mandatory high risk relationship. So too must enhanced measures because the PEP is a non-resident customer. As part of ECDD a firm must undertake reasonable measures to establish and understand SOW/SOF. Those SOW/SOF checks could also satisfy the requirement to apply enhanced measures if they address the risk presented by the PEP being non-resident.

- Enhanced measures are specific in their application, and apply to the customer of the firm and not to the beneficial owner in accordance with the recommendation made by MONEYVAL. This means that for certain types of relationships where there may be more than one Bailiwick firm involved, the enhanced measures to be applied by each firm, could be different.

Politically Exposed Persons

Domestic and international organisation (“IO”) PEPs – A firm will have to ensure that its mechanisms for identifying foreign PEPs now capture IO PEPs and domestic PEPs. A firm will now need to identify if new, or any of their existing, customers are or have been domestic PEPs or IO PEPs. International organisations are institutions formed by political agreement by countries, such as the UN, IMF, and NATO.

There were suggestions to include international sporting federations. This would be over what the FATF standards require but it does not prevent a firm determining that the risks are such that it would be appropriate to treat the relationship as high risk and apply ECDD.

In response to feedback to assist in identifying domestic PEPs, the Commission has drawn up a list of posts which it considers qualify the holder as a domestic PEP - Appendix E. The Commission has sought to strike a balance between risk and proportionality in its compilation.

There is no mandatory application of ECDD to domestic or IO PEPs. Their role and responsibilities must be factored into the relationship risk assessments, but the determination of whether a domestic PEP or IO PEP is high risk is a firm’s decision. Appendix E is intended to assist in identifying a domestic PEP and should not be interpreted as setting any expectation that those post-holders should be subject to ECDD.

The FATF’s guidance on PEPS proposes that the handling of a client who is no longer entrusted with a prominent public function should be based on an assessment of risk and not on prescribed time limits.

Firms were asked in the consultation if there were circumstance based upon risk when a risk-based approach might be appropriate for relationships with former PEPs. Some very good examples were provided of relationships with former PEPs whereby it was clear that the risks were other than high. Together with input from the Commission, Law Enforcement and the Law Officers on the authorities’ experience regarding PEPs, these examples contributed to the development of risk-based means by which certain type of PEPs could be declassified at specified periods after they had ceased to hold political office.

The measures are broadly the same as those circulated last March with periods of 5 years from cessation of public office for all domestic PEPs, and 7 years for foreign and IO PEPs excluding heads of state/organisation and those with power to direct spending of significant sums and their immediate family members and close associates.

The Commission has not quantified within the Handbook what would be “significant” sums as this will vary from jurisdiction to jurisdiction, but there is guidance on what factors could be considered when determining if the former PEP had authority or influence over the spending of significant sums.

It will be important to document how those decisions were made, including the elements that were taken into account about the individual’s former political role and responsibilities when making the decision to declassify.

Firms will still have to identify if an individual formerly held a prominent public function across all 3 types of PEP regardless of how long ago public office was held.

If a domestic PEP or qualifying IO PEP ceases to hold political office within the 5/7 year period, nothing changes and firms will need to factor their political status into their risk assessments to determine whether they should treat them as high risk. A qualifying foreign PEP ceasing office within the 7 year period must remain subject to ECDD.

Where an individual has ceased to hold a public posts outside of these 5/7 year periods, the firm must consider whether the criteria in the PoC Law are met as part of deciding whether the PEP can be declassified.

The Handbook contains guidance to clarify that for certain types of relationships there may be a PEP present but because the individual is not the customer or beneficial owner, and the relationship does not involve handling personal assets or funds of the PEP, then the individual’s presence does not automatically make this a mandatory high risk relationship (see Section 8.5.2 of the Handbook).

Relevant Connection with High Risk Countries

The current test for a geographic connection with a jurisdiction identified as having AML/CFT deficiencies is “established or situated”. The PoC Law now defines what a relevant connection to a jurisdiction associated with funding terrorism or identified by the FATF as AML/CFT deficient is.

Establishing and Understanding SOF/SOW

There is now an obligation in the legislation for firms to “understand”, as well as to take “reasonable measures to establish”, the SOF and SOW of the customer.

The Handbook defines that “reasonable measures” should be commensurate with risk. Clearly the extent to which SOW/SOF measures are applied will vary between a high risk relationship with one high risk factor to that of a high risk relationship with multiple high risk factors.

The legislation requires SOF/SOW checks for the customer, and on the beneficial owner but only where the beneficial owner is a PEP, which is consistent with the FATF standards.

This means that for all high risk relationships, other than where the beneficial owner is a PEP, SOF and SOW enquiries focus on the customer which continues to include establishing the economic activity which generated the funds in the relationship.

Beneficial Ownership

The consultation version pre-dated the issue of the Beneficial Ownership (Definition) Regulations for the Beneficial Ownership Law, but which would be carried across into the Proceeds of Crime framework.

The definition has been taken across so both laws apply identical measures regarding the same three step approach to identifying beneficial owners, both apply the same ownership threshold of more than 25% and both use the same list of recognised stock exchanges for exempting listed companies.

As the Beneficial Ownership Law applies only to Guernsey corporate vehicles, the beneficial ownership definition in the Proceeds of Crime framework had to be developed to ensure that all legal persons and legal arrangements were covered.

Key to identifying beneficial ownership is a three-step test which requires a firm to look first at control through ownership, and if no individual or individuals can be identified as the beneficial owner/s to then move to step 2 to establish if there are individuals who exercise control through means other than ownership which may come about through family, employment or contractual relationships. A firm must be alert to the possibility that a beneficial owner could be identified in both steps 1 and 2. Step 3 is the back-stop, only where no individuals can be identified in Steps 1 and 2 and it would then be appropriate to identify the senior managing official of the legal person as the beneficial owner.

There are exemptions from identifying the beneficial ownership of certain types of legal vehicles, which are described as transparent legal persons, as their beneficial ownership is already disclosed. These are companies listed on a recognised exchange, States of Guernsey owned companies and GFSC regulated firms.

This means that there is an exemption from identifying and verifying the identity of the beneficial ownership of a Guernsey TCSP, for example acting as trustee of XYZ Trust, but the beneficial owners of all other corporate trustees, including Jersey regulated TCSPs, acting as a trustee of a trust must be identified and verified.

The names of directors of companies must be verified but the identity of directors who do not represent the company in the relationship with the firm and/or who do not fall within any of the three beneficial ownership steps will not have to be verified.

The Handbook also clarifies that:

- online bank statements and utility bills are acceptable for verifying address, providing the firm is satisfied that they are genuine documents which have not been tampered with;

- that soft copy versions of certified copy documents are acceptable providing they come from the certifier and the firm is satisfied that receipt poses no increased risk, for example of identity fraud; and
- that there is no prescribed wording for certifications of copy identification data, but the firm must be satisfied that the underlying purpose of certification has been met and the information must convey that the certifier has seen the original documents and met the person subject to the certification.

The section on CDD Utilities which was in the consultation version has been removed to keep the Handbook technology neutral. However, CDD Utilities may be used and qualify as independent data sources for verifying customers' identity. There is a specific section in Chapter 5 of the Handbook discussing how independent data sources can be used.

Collective Investment Schemes

Every Guernsey authorised and registered CIS will have to nominate a firm licensed under the Protection of Investors Law to be responsible for the application of CDD measures to investors

Intermediary Relationships

Firms were asked during the consultation if certain intermediary relationships where simplified customer due diligence can be applied remained relevant and in use. Feedback indicated that some were and these relationships have been re-instated.

In respect of the use of intermediaries on CISs, MONEYVAL had proposed that they should not be available where a CIS has a very limited number of investors because of the risk that the identity of the beneficial owners may not be known.

It was initially proposed that fund administrators should have a means to require intermediaries to provide underlying investor information. After discussion with the fund sector about the use of intermediaries on CISs and the provision of information and statistics to the Commission on the use of intermediaries across all Guernsey funds, the existing provisions have been retained. There are specific requirements in the POI Law regarding control over the investment management of a CIS and there must now be an assessment of the risk of a CIS with a very limited number of investors becoming a personal asset holding vehicle with undisclosed beneficial owners. Where this risk is anything other than low, the intermediary provisions must not be applied.

The Commission will be confirming with the fund sector the provision of statistics on the use of intermediaries within Guernsey CISs on an on-going basis, commencing in 2019.

Compliance Arrangements

The legislation introduces a new post of Money Laundering Compliance Officer ("MLCO") which may be held by the Money Laundering Reporting Officer ("MLRO").

The criteria for both roles are largely the same but a key difference now is that, should a firm chose to appoint a person other than its MLRO, this can be a person resident in the UK, Jersey or the Isle of Man, as well as Guernsey, providing that the remaining criteria are met. This

change was made in response to feedback that for some firms there is already a manager fulfilling this role across Channel Islands or Crown Dependency groups. The Commission considered it appropriate to enable a firm to draw upon a wider pool of compliance personnel.

In the consultation version the Commission had proposed that the MLCO should be independent from client facing and/or business development roles. As feedback indicated that this would pose a challenge for very small firms as staff may have more than one role, we have removed that provision and will now require that any conflicting duties that the individual fulfilling the MLCO role may have must be identified, documented and managed.

For sole traders such as personal fiduciary licensees, or an individual registered in his/her own name under the PB Regulations, the PoC Law does not require the individual to appoint an MLCO or a Nominated Officer. The obligations for compliance and to report suspicion fall upon the individual.

There is no requirement to notify the Commission of the identity of the Nominated Officer, unless the Nominated Officer takes on the MLRO role on an extended basis. The obligation to inform the FIS remains unchanged.

There are now grandfathering provisions for those appointed to MLRO and Nominated Officer positions prior to 31 March 2019, therefore the only appointment which the Commission must be notified of is MLCO.

The Handbook is in draft final form to enable any technical faults preventing or hindering compliance to be identified before the Commission formally makes the rules which must be before 31 March. If issues are identified these should be raised with the Commission as soon as possible and ideally by the start of January to give sufficient time to make appropriate revisions.

Supervisory Data

The Financial Crime Division intends to discuss with industry next year extending the data collected in the Financial Crime Risk Return to include, amongst other things, more information on PEP relationships.

Workshops

Technical workshops are being arranged for Q1 2019 to discuss in more detail some of the key changes to the AML/CFT framework and what they mean in practice for firms. As firms work through the Handbook, if there are areas which they would like to see covered in these Workshops, please could they let us know by e-mail to: Handbook@gfsc.gg.