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Conducting Customer Due Diligence (Part 2)



10th November 2020

Overview of today's session

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- The gathering of information and documentation in understanding and assessing the purpose and intended nature of the business relationship
- What to look for to properly understand and assess the purpose and intended nature of the business relationship
- What is a Customer Risk Assessment
- Key concepts such as source of wealth, source of funds, transaction monitoring and sanctions
- Timing and Extend of CDD
- Look at some recent FIAU Administrative Measures that relate to CDD

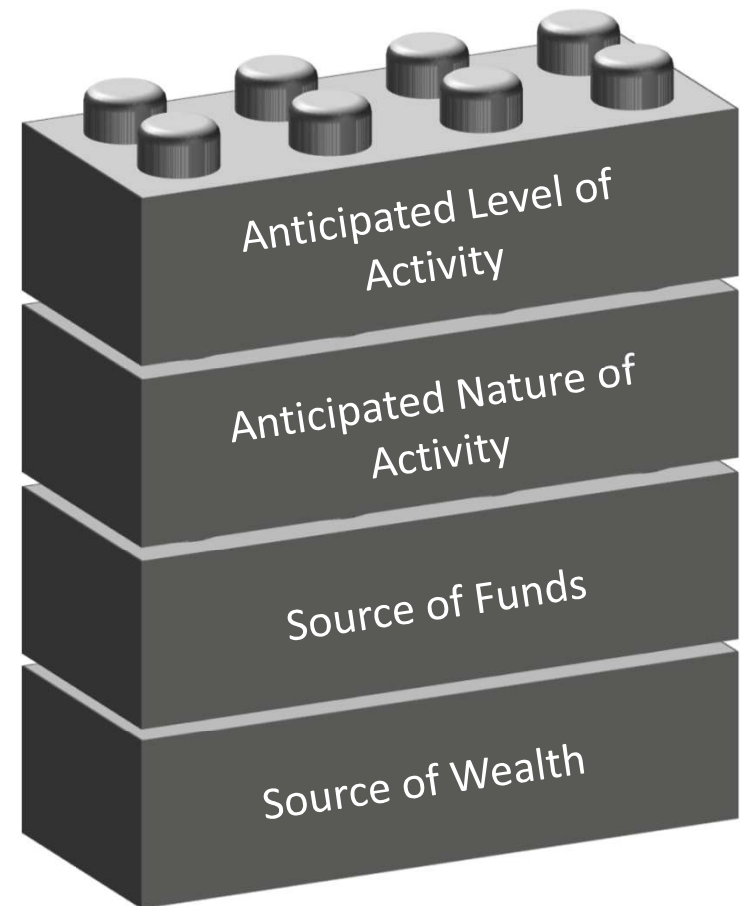
Customer Due Diligence Measures



Purpose & Intended Nature

One of the main CDD obligations is that of **assessing** and **obtaining information** on the purpose and intended nature of the business relationship.

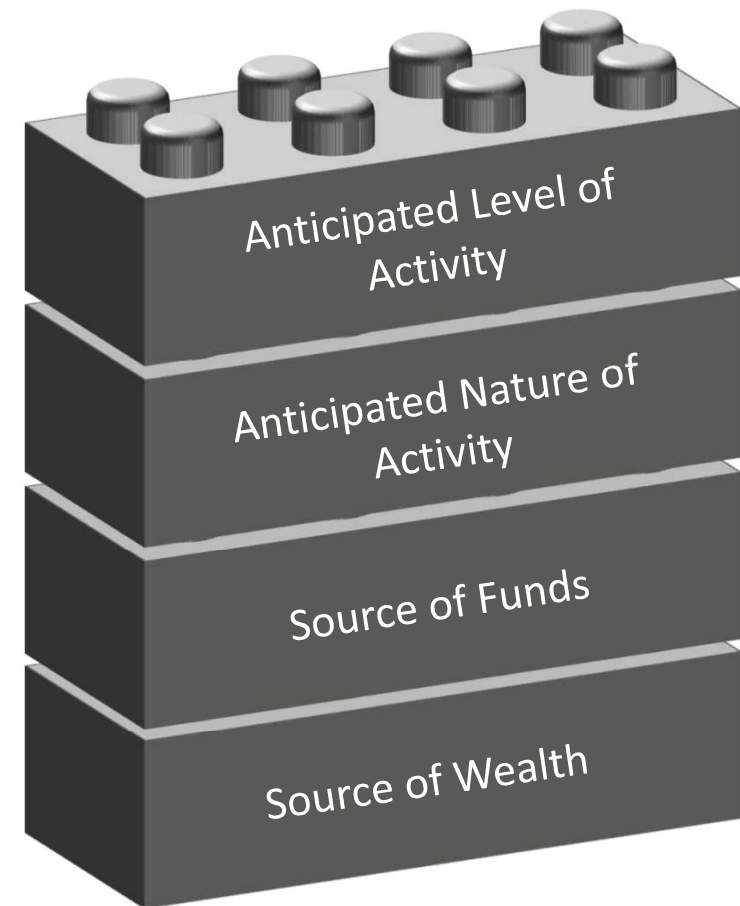
The Subject Person must understand **why** the customer is requesting their services/products and how these services/products are expected to be used in the course of a business relationship



Purpose & Intended Nature

Subject persons are required to obtain information and/or documentation on the customer in order to:

- Determine the business rationale behind the service or product being requested vis-à-vis the customer's profile and how the service/product is going to be used.
- Use the acquired information to build the CRA
- Ensure that the customer falls within the subject person's risk appetite
- Determine the appropriate risk mitigating measures
- Undertake ongoing monitoring where applicable to ensure that the actual activity remains in line with the expected activity



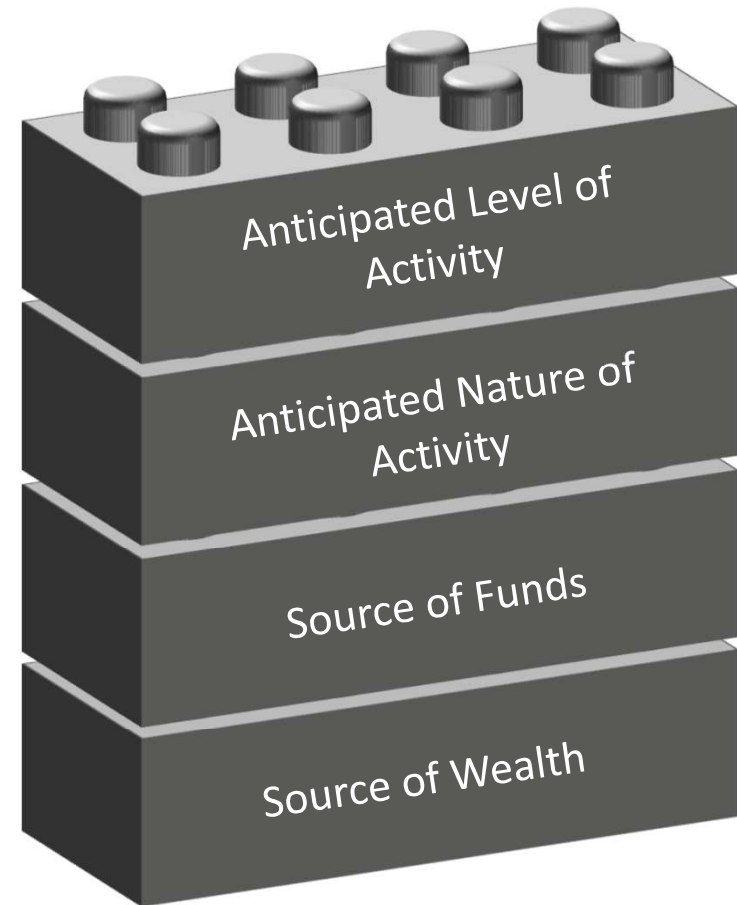
Purpose & Intended Nature

Important to know what to look for when assessing the Purpose and Intended Nature of the Business Relationship:

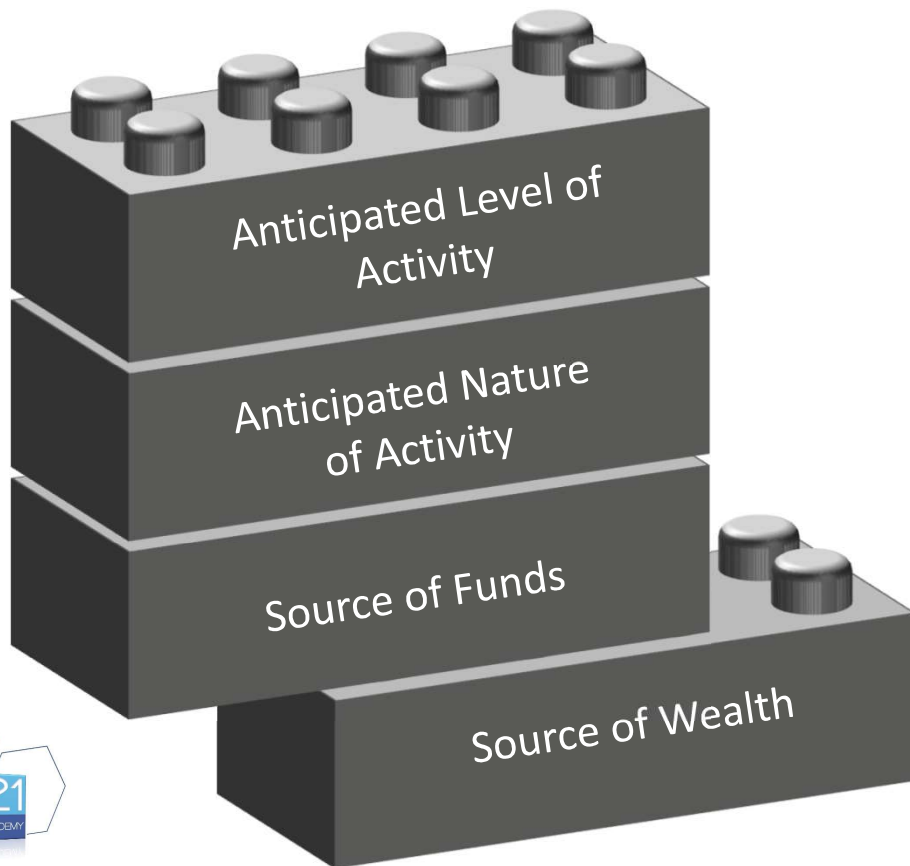
Purpose - the **reason** for which the business relationship is being established

Intended Nature – the **aim** or **plan** (intent) **how** that business relationship will take its course

There is a very **fine line** between the two

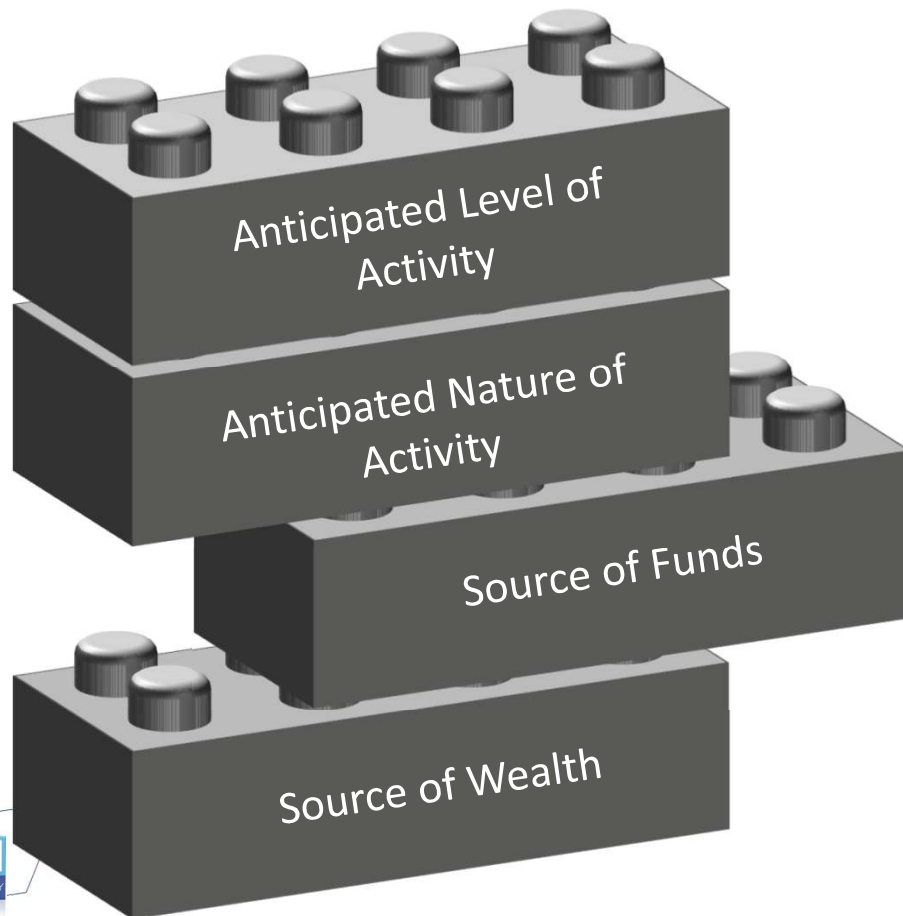


Purpose & Intended Nature Source of Wealth



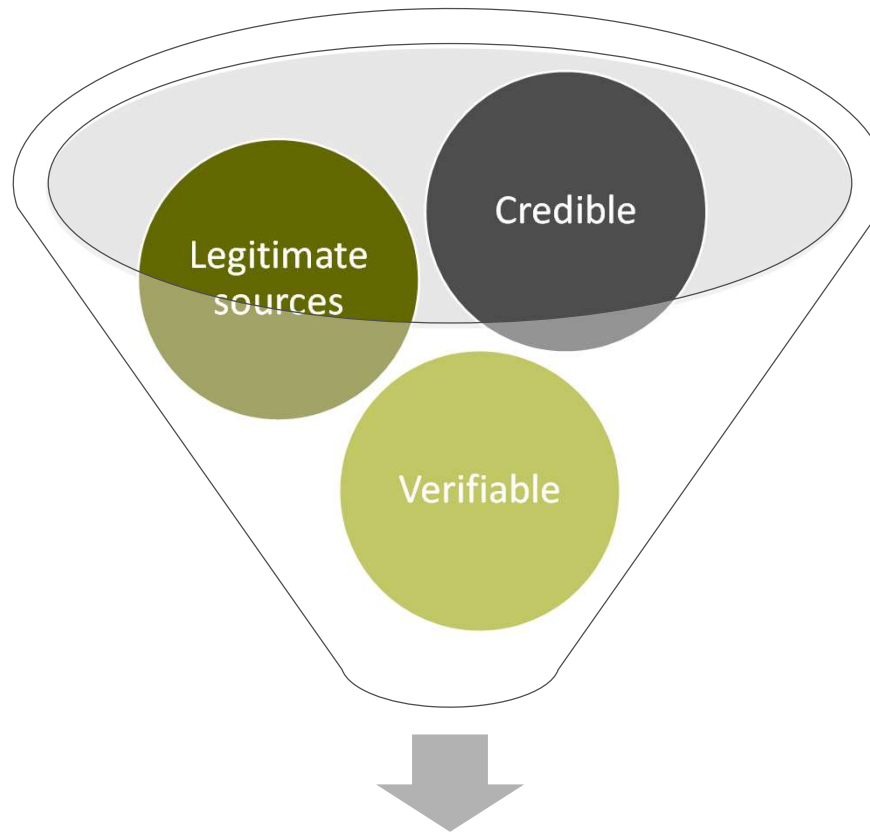
- The economic activity generating the total net worth of the customer.
- Usually identified at the beginning of the business relationship and updated on a need-to-basis.
- Generic SOW descriptions are not enough.
- SOW may in itself be a high-risk indicator e.g. SOW derived from a high-risk industry.
- Verification and corroboration required in higher risk scenarios.
- Verification and extent of corroboration to be determined on a risk-based approach.

Purpose & Intended Nature Source of Funds



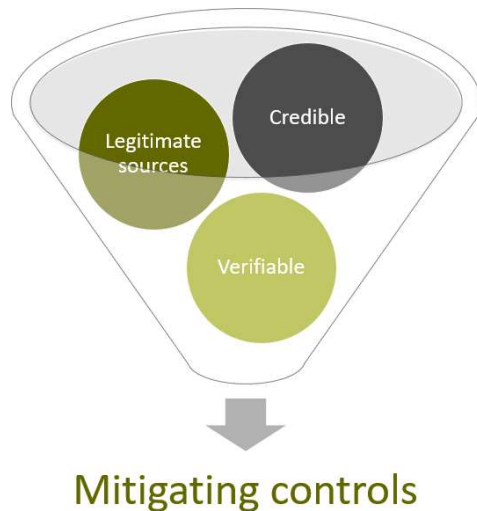
- The source of the particular funds which are the subject of, or which will be utilized in a transaction.
- Identification and (at times) corroboration of SOF throughout the relationship
- Needed to preserve that audit trail and make sure that the BO of the funds is always identified.
- Goes beyond the identification of the source of transfer
- Different SOF present different risks.
- Verification and corroboration on a risk-based approach.

Source of Wealth and Source of Funds



Mitigating controls

Source of Wealth and Source of Funds



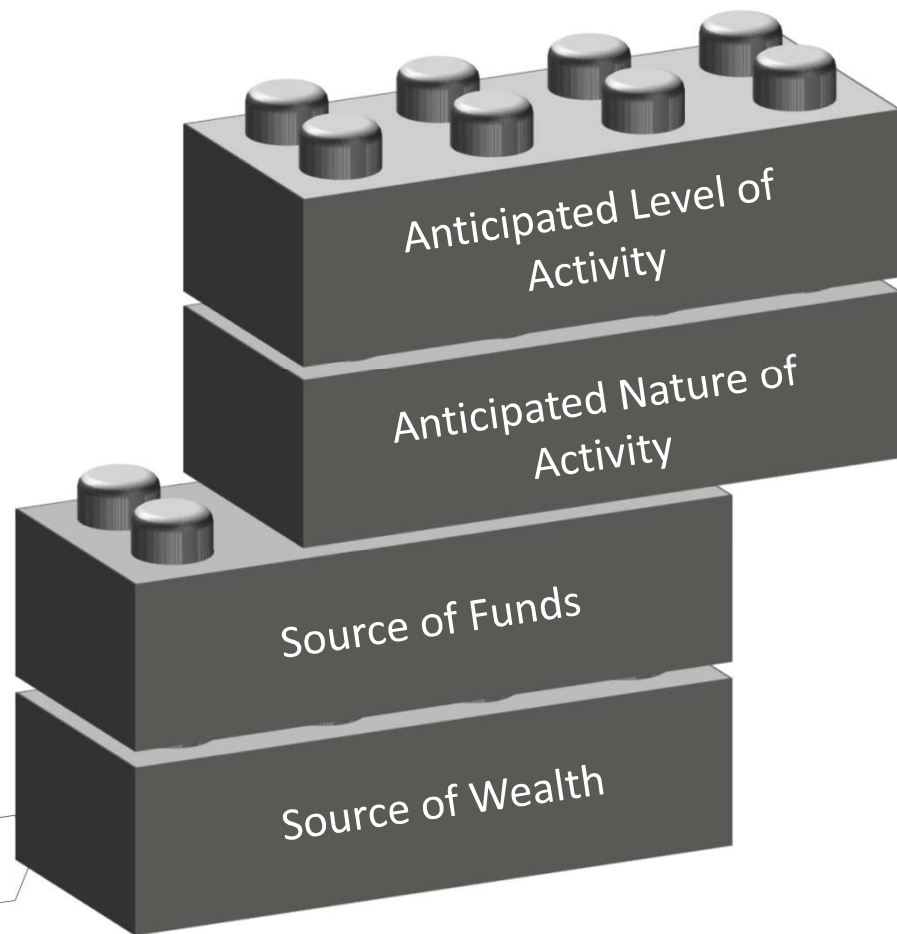
SOW / SOF vis-à-vis Business Relationships and Occasional Transactions

- Establishing the SoW is a **requirement** in the case of a **business relationship**
- Establishing the SoF is a **requirement** in the case of a **business relationship**, when and where this is **necessary**
- Establishing the SoW & SoF may also be required in the context of an occasional transaction



The most **effective mitigating measures** is likely to be that of querying on the SOW / SOF – obtaining information on how the funds have been acquired + concluding whether this makes sense considering the customer's SOW.

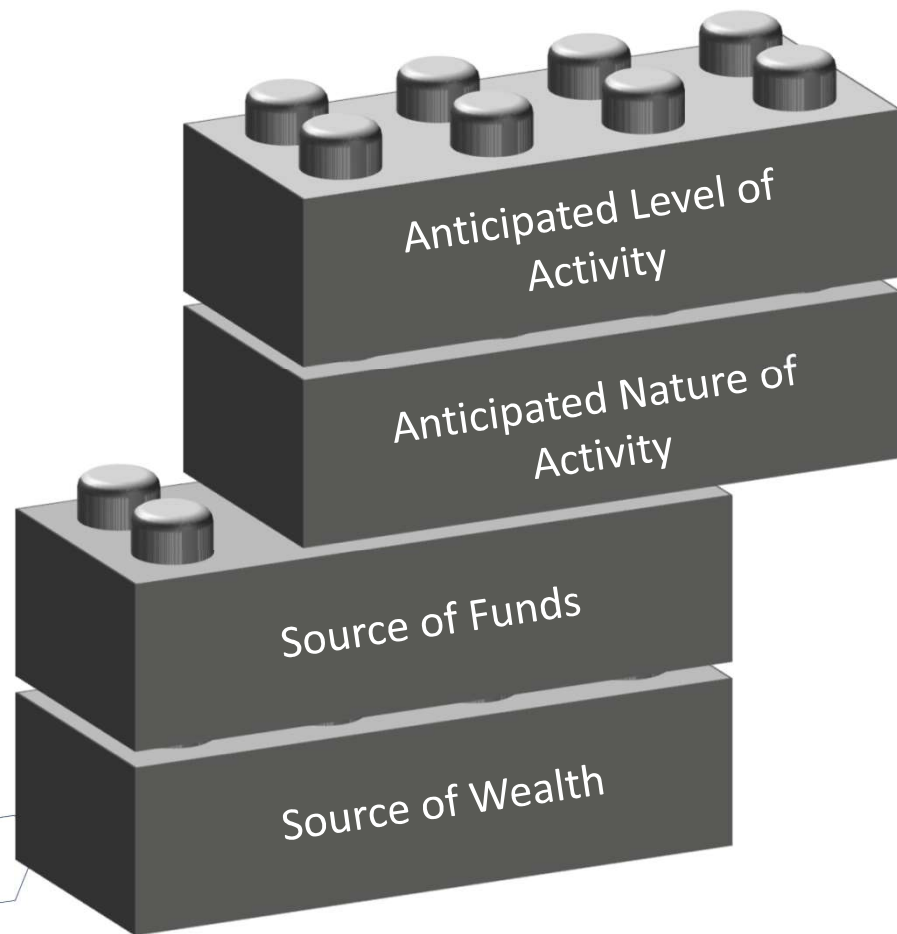
Purpose & Intended Nature Anticipated Nature & Level of Activity



- A Subject Person must obtain a clear indication of both the nature and level of activity at the start of the business relationship.
- This information will form the set of parameters of activity and transaction that are to be considered as 'normal' for a client.
- Activity falling out of the 'normal' parameters should trigger a review by the Subject Person.

Purpose & Intended Nature

Anticipated Nature & Level of Activity



HOW is the business relationship expected to develop

One is expected to understand:

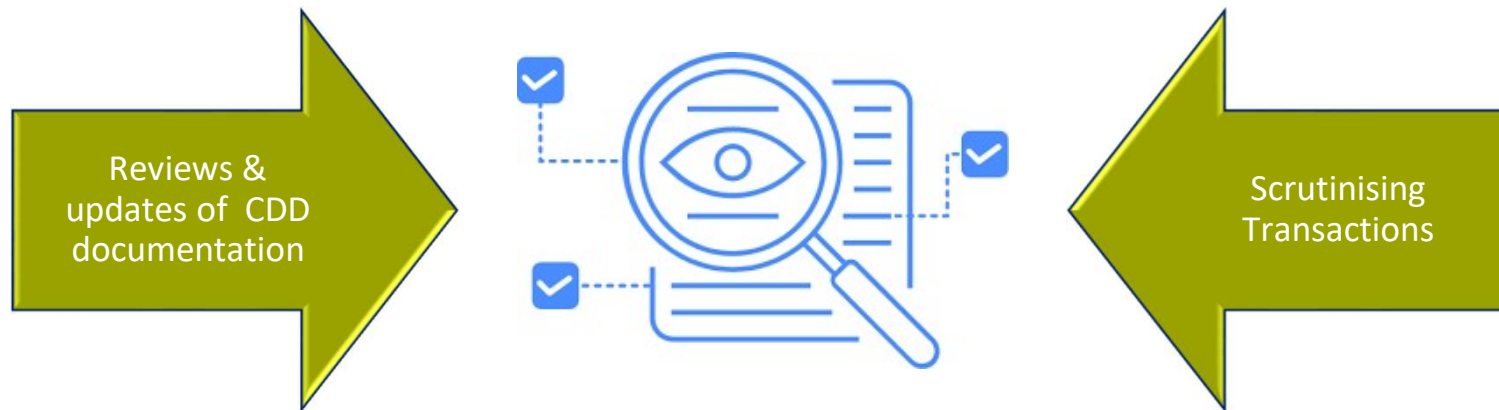
- Type of transactions (e.g. Inward, outward)
- Level of activity (e.g. Frequent, sporadic)
- Amounts involved (e.g. Large transactions, smaller transactions)
- Jurisdictional links
- Other relevant information such as projected turnovers

This information is beneficial to conduct a comprehensive CRA and equally important to be in a position to carry out proper and meaningful monitoring of the business relationship

Customer Due Diligence Measures



Ongoing Monitoring



Ongoing Monitoring

Reviews and updates to CDD documentation

PERIODICAL to existing customers on a risk-based approach


- Documents must be kept up to date
- Information must remain relevant, accurate, sufficient
- Does not imply re-verification of identity

TRIGGER EVENT - Circumstances of an existing customer have changed. E.g.

- Identity of the customer's BO has changed
- Change in the purpose or intended nature of the relationship
- Transactions not consistent with customer's previous transactions

Necessary to determine whether the initial risk assessment remains valid or whether the assessment and relative mitigating measures need to be altered.

Ongoing Monitoring Scrutiny of Transactions

- 
- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
 - Identify suspicious activity; and
 - Determine whether the initial risk assessment is still valid.

Ongoing Monitoring Scrutiny of Transactions



- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
- Identify suspicious activity; and
- Determine whether the initial risk assessment is still valid.

Two types of Transaction Monitoring

Real-Time monitoring

- Focus on activity & transactions when information or instructions are received from customers, before or as an instruction is processed
- More effective at reducing exposure to risk
- Suitable for face-to-face scenarios
- Non-face-to-face where transactions are not executed immediately
- Requires awareness of relevant trigger events and red flags
- Requires understanding of the expected behaviour/use of the relationship
- EDD measure for high-risk customers and transactions
- Best combined with post-transaction monitoring to detect patterns

Ongoing Monitoring Scrutiny of Transactions



- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
- Identify suspicious activity; and
- Determine whether the initial risk assessment is still valid.

Two types of Transaction Monitoring

Post-Event Monitoring

- May involve end-of-day, weekly, etc. reviews of customer activity and transactions
- More effective at identifying patterns of unusual customer activity/transactions
- Not all relationships/services permit real-time monitoring and flagging of transactions
- Must still file STR, even after the event

Ongoing Monitoring Scrutiny of Transactions



- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
- Identify suspicious activity; and
- Determine whether the initial risk assessment is still valid.

Transaction monitoring framework Key elements:

- Profiling & Peer Analysis (segmentation)
- Rules based parameters (scenarios)
- Data Collection & filtering systems (systems and challenges)
- CDD
- Escalation processes
- Review, management information and key performance indicators

Ongoing Monitoring Scrutiny of Transactions



- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
- Identify suspicious activity; and
- Determine whether the initial risk assessment is still valid.

Two types of Transaction monitoring methods:

- Manual
- Automated

Considerations:

- Depends on size of SP, number of clients and transactions, level of risk
- System must yield the desired results, including relevant alerts within adequate timeframes
- Large transactions are better monitored through automated systems
- If the SP uses an automated system, does the system generate reports showing reasons, rules and parameters? Can system be easily adapted to cater for changes? Can the system learn from previous false positive? (fine-tuning)

Ongoing Monitoring Scrutiny of Transactions



- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
- **Identify suspicious activity;** and
- Determine whether the initial risk assessment is still valid.

Different sources of identification

- Front-liners
- Transaction Monitoring systems
- Negative news articles
- Law Enforcement Enquires

All suspicious activity should be escalated to the MLRO and the MLRO team.

Ongoing Monitoring Scrutiny of Transactions



- Identify transactions that are inconsistent with the Subject Person's knowledge of the customer and the customer's business and risk profile;
- Identify suspicious activity; and
- Determine whether the initial risk assessment is still valid.

The CRA is a live document.

If the initial CRA is not valid:

- Are additional CDD measures required?
- Does the customer still fall within the Subject Person's risk appetite?

Screening

Purpose of screening

- PEP status
- Freezing Orders
- Adverse Media
- Sanctions

Two types of screening

- Name screening
- Payment screening





"John Smith" Laundering or Fraud or Corruption



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Materially
Adverse
News
Be Specific!



Analysing and Documenting Adverse News

- Review the article and consider if it matches your client's age, location and other circumstances
- Consider what the article is actually highlighting about your customer (e.g. investigation vs conviction)
- Consider the source and date of publication
- Looking at the customer in light of the additional information, is there anything that would now be considered suspicious?



*Always document findings
and conclusions!*

Sanctions

- The restrictive measures imposed by governments and multinational bodies, which seek to alter the behaviour and decisions of other governments or non-state bodies.
- Sanctions are often intended to deter a range of activities, e.g. terrorism, terrorist financing, proliferation finance, human rights violation.
- Type of sanction and target entity differs according to the behaviour the sanction is seeking to curb.
- Malta is legally bound by the UN, EU and national sanctions issued under the National Interest (Enabling Powers) Act, BUT caution still needs to be exercised in relation to sanctions issued by other states, particularly the sanctions issued by OFAC.



Sanction Screening Obligations

Subject persons are required to:

- Be able to **detect** whether a customer or a transaction is subject to any sanctions;
- **Freeze** the funds, financial assets or economic resources owned or controlled, directly or indirectly, by designated persons or entities;
- **Prevent** funds, financial assets or economic resources **from being made available to or for the benefit of** designated persons or entities;
- **Report** – In Malta, the competent authority for sanctions implementation is the **Sanctions Monitoring Board**.



Timing of CDD

Timing of CDD

CDD must generally be applied when:

- **BEFORE** establishing a business relationship;
 - **BEFORE** carrying out an occasional transaction;
 - When there is a **suspicion of ML or FT** (no threshold/derogation applies);
 - There are **doubts as to the veracity or adequacy** of previously obtained customer identification data.
-
- **Periodical** - At appropriate times to existing customers on a risk-based approach.
 - **Trigger event** - the circumstances of an existing customer and the relative risk assessment have changed.

Determining the Extent of CDD

Determining the Extent of Due Diligence The Risk-based Approach

*“Subject persons must **IDENTIFY** and **ASSESS** the ML/FT risks they are exposed to, and **VARY** and **ADAPT** the said measures, policies, controls and procedures in a way that ensures that resources are applied where most needed i.e. where subject persons determines that it is exposed to a higher than normal risk of ML/FT”*



FIAU Implementing Procedures (Part I)

Identify and Assess the Risk

The Customer Risk Assessment



Customer Risk

- Business and Professional Activity
- Reputation
- Nature and Behaviour
- PEP links
- Sanctions



Products/Services/Transaction

- Transparency
- Complexity
- Value and Size
- Economic rationale (or lack thereof)



Geography

- Residency
- Nationality
- Main place of business
- Business connections
- Other relevant jurisdictional links



Channels

- Face-to-face OR Non-face-to-face
- Use of and type of Intermediaries
- Introducers



Other Factors

- Depends on the type of subject person. Some examples include:
- Length of the Relationship
- Wagering

Extent of Due Diligence



Extent of Due Diligence

Necessary Information/documentation – **nothing more** and **nothing less** than what is **required** to understand the purpose and intended nature of business relationship / compile a Customer Risk Profile, i.e. in line with the **RBA**

One should always seek to collect necessary information, refraining from requesting **disproportionate, excessive** or **irrelevant** information:

- Disproportionate / Excessive: anything that is **too intrusive**, when other less intrusive information that fulfils same purpose can be requested
- Irrelevant: anything that **does not add value** to the profile, **does not serve** to mitigate risks, or **does not provide** any reassurance relevant to ML/FT risks.

Simplified Due Diligence

SDD may be applied within the following two categories:

- In relation to **activities or services that are determined by the FIAU** to represent low risk of ML/FT, having taken into consideration the findings of the National Risk Assessment:
 - **Customers carrying out Relevant Financial Business**
 - **Listed Companies and their wholly owned subsidiaries**
 - **Public Sector Bodies**
- When, on the basis of a risk assessment carried out, it is determined that an occasional transaction or business relationship represents low risk.



Simplified Due Diligence

What changes?

- TIMING OF THE CDD e.g. postponement of verification until a pre-determined threshold is reached.
- THE QUANTITY OF INFORMATION AND/OR DOCUMENTATION e.g. obtain less information on the source of wealth or funds.
- THE QUALITY OF INFORMATION AND/OR DOCUMENTATION e.g. obtain information directly from customer rather than from independent source.
- THE FREQUENCY and INTENSITY OF ONGOING MONITORING.

Simplified Due Diligence

Not an exemption

In applying SDD, one must ensure that:

- The variation does not result in an exemption from CDD measures;
- Threshold or trigger event is set at a reasonably low level;
- Systems are in place to detect when thresholds are reached and to prevent bypassing of restrictions/limitations;
- One does not vary, defer or delay CDD measures that **CANNOT** be varied, delayed or deferred.



Simplified Due Diligence

Not an exemption



SDD **cannot** be applied when:

- there is knowledge or suspicion of ML/FT;
- when EDD is mandatory; or
- when there is a substantial change in circumstances.

As a **minimum**, customers must ALWAYS be identified, and sufficient degree of ongoing monitoring must be applied.

Enhanced Due Diligence

EDD must be applied when the:

- Activities/services are determined by the FIAU to represent a high risk of ML/FT when taking into consideration the findings of the National Risk Assessment.
- When, based on the CRA, activities/relationships are deemed as higher risk.
- Customer is established in a Non-reputable Jurisdiction.
- When prescribed by law. These are:
 - a) Politically Exposed Persons;
 - b) Correspondent Banking Relationships;
 - c) Complex and Unusually Large Transactions



EDD measures delineated in the law/regulations.

Enhanced Due Diligence

When the SP determines high risk, EDD to be applied varies according to the nature of risk.

Additional measures could include:

- obtain additional information or evidence to establish the identity;
- take additional measures to verify the documents supplied, or require certification of such documents;
- ensure the first payment is made through a bank account in the name of the customer;
- establish and document the source of wealth and source of funds;
- carry out more scrutiny of the business relationship and be satisfied that it is consistent with the stated purpose; and
- delve deeper into the history, ownership, and financial situation of the parties to the transaction.



Failure to complete CDD

In the event of failure to complete the required CDD measures a Subject Person **must**:

- Abstain from establishing a business relationship or carry out an occasional transaction;
- Terminate a business relationship;
- Abstain from carrying out any transaction through the customer account.

Unless there are grounds giving rise to a suspicion of ML/FT and doing so may frustrate analysis or investigation by the FIAU.



Carry on with business and immediately inform the FIAU

Recent FIAU Administrative Measures

Recent FIAU Administrative Measures

RELEVANT ACTIVITY CARRIED OUT:

Investment Services

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:

Administrative Penalty of EUR35,109 and a Remediation Directive

SOME OF THE REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURES:

Regulation 5 of the PMLFTR: The Company conducts two distinct CRAs which take into consideration different risk criteria, this depends on whether the customer is on-boarded by the Maltese licensed company or through its EU Branch.

Regulation 7(1)(a) of the PMLFTR: None of the documentation pertaining to natural persons boarded face-to-face were duly certified.

Regulation 7(1)(c) of the PMLFTR: The Company either held no or insufficient information pertaining to the purpose and intended nature of the business relationship. Furthermore, they held insufficient information on the employment/occupation of the customer as the descriptions obtained were generic.

Recent FIAU Administrative Measures

RELEVANT ACTIVITY CARRIED OUT:

Company Service Provider

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:

Administrative Penalty of EUR57,845 and a Remediation Directive

SOME OF THE REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURES:

Regulation 5 of the PMLFTR, Regulation 5(5)(a)(ii) of the PMLFTR: The Company failed to:

- have adequate CRA procedures in place;
- effectively risk assess customers by considering all the information it had available;
- carry out a CRA for two files;
- understand the reasoning behind an assigned rating in a file;
- assign a rating which adequately reflected the risk posed by the client in one file;
- carry out a CRA prior to entering into a business relationship with prospective customers; and
- reassess a high risk file once serious concerns arose linking it with crimes of a ML/FT nature.

Recent FIAU Administrative Measures

RELEVANT ACTIVITY CARRIED OUT:

Advocate, Company Service Provider - Individual

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:

Administrative Penalty of EUR22,062 and a Remediation Directive

SOME OF THE REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURES:

Regulation 7(1)(c) of the PMLFTR:

- For a particular file, no information was available to the SP in order for it to build a comprehensive customer business and risk profile on its customers. The fact that the SP accepted a liquidator position for a number of companies that opted for a voluntary winding up, did not discharge from the obligation to obtain information on the corporate customer's set up.
- In another instance the Subject Person acted as a company secretary and director for a company, however no information was found on file or provided during the course of the examination in relation to the purpose and intended nature of the relationship, including information regarding the purpose of the company.

Recent FIAU Administrative Measures

RELEVANT ACTIVITY CARRIED OUT:

Credit Institution

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:

Administrative Penalty of EUR340,058 and Follow-Up Directive

SOME OF THE REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURES:

Regulation 5(5)(a)(ii) of the PMLFTR: Although the Bank did have CRA procedures in place, the measures and methodology reflected within these procedures were not rigorous and comprehensive enough.

Regulation 11(1)(b) of the PMLFTR: The required EDD measures were either not carried out or deemed to be inadequate (the information gathered by the Bank deemed as inappropriate in order to mitigate the risks emanating from the business relationship). In one particular case, whilst the Bank had increased one of its customer's risk rating to high throughout the course of the business relationship in view of a change in circumstances and also exercised strict monitoring, the evidence held does not verify the provenance of the funds and therefore even the close monitoring carried out was rendered ineffective.

Recent FIAU Administrative Measures

RELEVANT ACTIVITY CARRIED OUT:

Remote Gaming Operator

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:

Administrative Penalty of €58,757

SOME OF THE REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURES:Regulation 5(5)(a)(ii) of the PMLFTR:

The Company was found to have no documented CRA procedures in place and its AML Policies and Procedures offered no explanation as to how the CRA was conducted in practice.

The Company was not obtaining the necessary information to establish the customer's source of wealth and the expected level of activity.

Although a general reference was made to the circumstances that would require the carrying of EDD measures, such procedures were generic and noncomprehensive. Most of the EDD measures employed by the Company focused on obtaining verification documents or validating the customer's residential address, thereby failing to identify and address the risks emanating from each set of circumstances.

Concluding Points

CDD – Concluding Points



DO NOT BE 'AFRAID'
TO ASK THE
UNCOMFORTABLE
QUESTIONS



TAKE THE TIME TO
DIG DEEPER



USE THE CDD
INFORMATION
OBTAINED!



DOCUMENTATION IS
KEY - THE
REGULATOR WILL
ASSUME THAT
UNRECORDED INFO
DOES NOT EXIST

Questions?

Thank you



Alison Vella
AML/CFT Consultant

M (+356) 9946 0573
E alison.vella@komply.com.mt





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