

DFSA Annual Supervision Outreach Breakout Group #4 Financial Crime Risks 3 May 2017

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Breakout Group 4 - Agenda

- **Opening Comments**

Lawrence Paramasivam - DFSA

- **OECD Common Reporting Standards**

Jacques Visser - DIFC Authority

- **Financial Crime Thematic Review**

Ali Ba'Alawi - DFSA

- **SAR Update and Common AML Issues**

Catherine Durben and Maryam AlZarooni - DFSA

- **AML Q&A's**

Michael Wong - DFSA



What Are Some Of The Financial Crime Priorities For 2017/2018?

- Risk Based Supervision of Firms and DNFBPs
 - AML Annual Returns
 - Thematic Reviews - Trade Finance and Financial Crime
- Implementation of AML Rule Changes
- FATF Assessment of the UAE



Common Reporting Standards

Jacques Visser
Chief Legal Officer, DFSA Authority

Financial Crime Thematic Review

Ali Baalawi
Senior Manager, Supervision

Objectives of the FC Thematic Review

- To analyse the quality and implementation of the Business AML Risk-Assessment conducted by the Authorised Firms
- To assess the adequacy of the Authorised Firms' systems and controls in implementing effective monitoring and on-going customer due diligence
- To test the adequacy of transaction monitoring and reporting mechanism
- To publish findings report; which may include good and poor practices and issue further guidance to the Authorised Firms

Drivers behind the FC Thematic Review

Annual AML Return, Risk Assessment Findings and Enforcement Actions

Assessment of Business AML Risk

- Areas of improvements include the need for the Firm to tailor their assessments specifically to their business, and obtain buy-in from all areas of the Firm including senior management, compliance and business lines.

Customer Due Diligence (CDD)

- Areas of improvement include the requirement to conduct on-going CDD and transaction monitoring.

Suspicious Activity Reports (SAR)

- Expectation that the number of internal notifications would be significantly higher than the number of external SARs.

Scope of the FC Thematic Review

- 15 Firms: Commercial Banks, Asset Managers, Arrangers and Advisors, Fund Managers, Brokerage etc.

Desk-Based

- Annual AML Returns
- Other supporting documents

On-site

- Discussions with senior management and other staff members
- File reviews

Business AML Risk Assessment

| Good Practices | Poor Practices |
|--|---|
| Detailed Business AML Risk which included assessment of inherent risks, mitigating controls and residual risks | Business AML Risk Assessment not covering activities in the DIFC |
| Involvement of senior management in the assessment | No involvement of senior management in the preparation of the assessment |
| Concluding statement of the overall risk | Covers the licensed activities and/or factors with no analysis of the risks |
| | No adequate assessment and analysis of overall risk |

On-going Customer Due Diligence

Good Practices

Involvement of senior management in the ongoing due diligence

Use of both automatic and manual systems

Register to track adverse findings and actions taken

Documented policy in regards to dormant customers and/or inactive accounts

100% transaction monitoring

Poor Practices

On-going Due Diligence not in line with the firm's policies and/ procedures

Reliance on manual systems
No formal escalation policy in the event of adverse findings

Similar level of due diligence applied to all customers
Lack of policy in regards to periodic reviews

Adoption of a risk-based approach to transaction monitoring

Suspicious Activity Reporting (SAR)

Good Practices

Staff awareness in regards to escalation processes

Clearly identified and documented red flags and typologies in regards commensurate with the business activities

Adequate on-going training
MLRO independence in relation to the investigation and reporting of SAR

Poor Practices

No documented procedures in regards to internal reporting (rejected customers, system to record internal SARs etc.)

Inappropriate reliance on booking centers to lodge external SARs
For branches, exclusion from initial investigation on a suspicious activity by the booking centre or head office

Lack of familiarity with the transaction monitoring system

Overall Conclusion

- Deficiencies in regards to the Business AML Risk Assessment
- On-going due diligence and Suspicious Activity Reporting were relatively satisfactory. However, there are still areas for improvement
- Next Steps and potential outcomes – publish findings and issue written guidance

To sum up



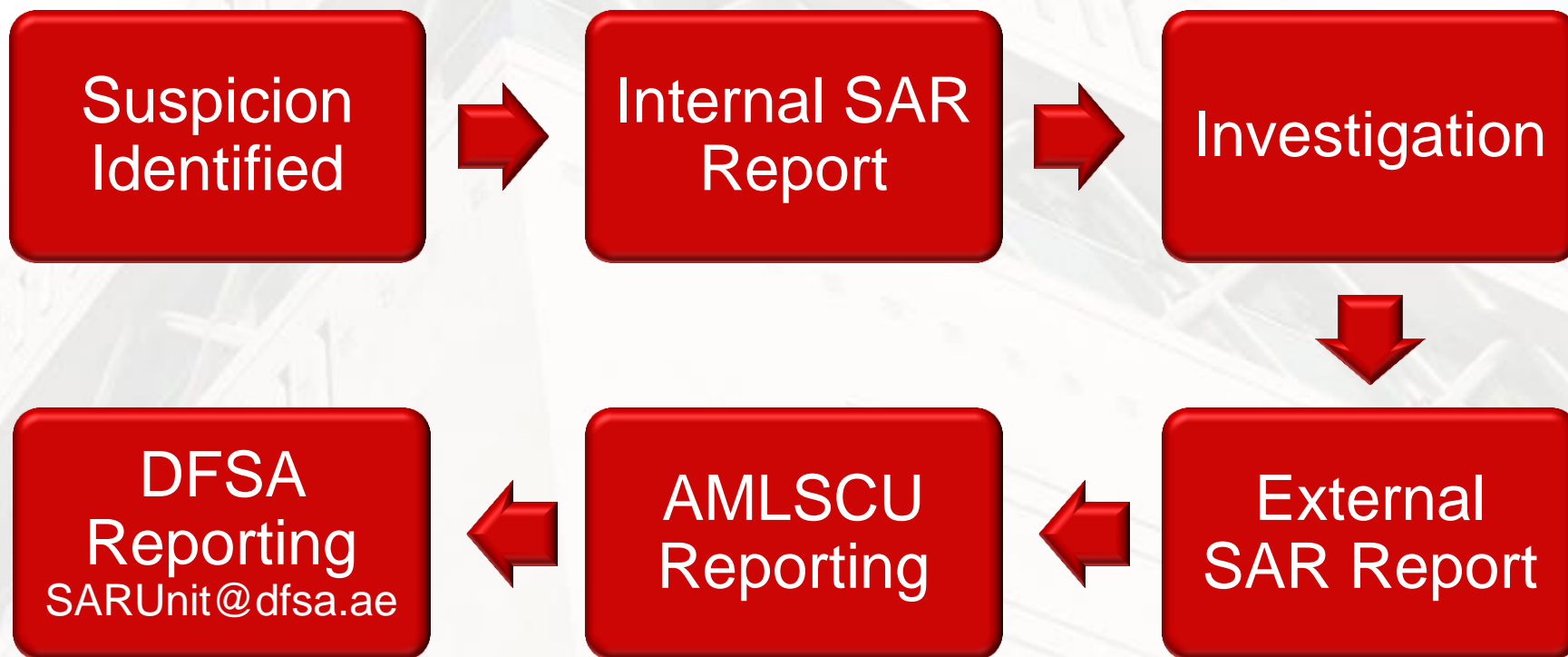
To sum up



SAR Update

Catherine Durben
Manager, Supervision

SAR Process



Review it for completeness



Assess for any further actions resulting from the SAR

SAR Improvement Opportunities



Trade Finance AML risk

- Customs documentation
- Bill of Lading / Verification of Port of Loading



Further to our previous reply, according to the physical carrier, the containers (20x) were loaded on [REDACTED] in load port, Bandar Abbas, Iran (Not Jebel Ali, United Arab Emirates) on [REDACTED]

We have been further advised by Jebel Ali port that there is no record of the containers being loaded from Jebel Ali, UAE.

Correspondent Banking AML risk

- Lack of clarity or response from beneficiary bank on queries

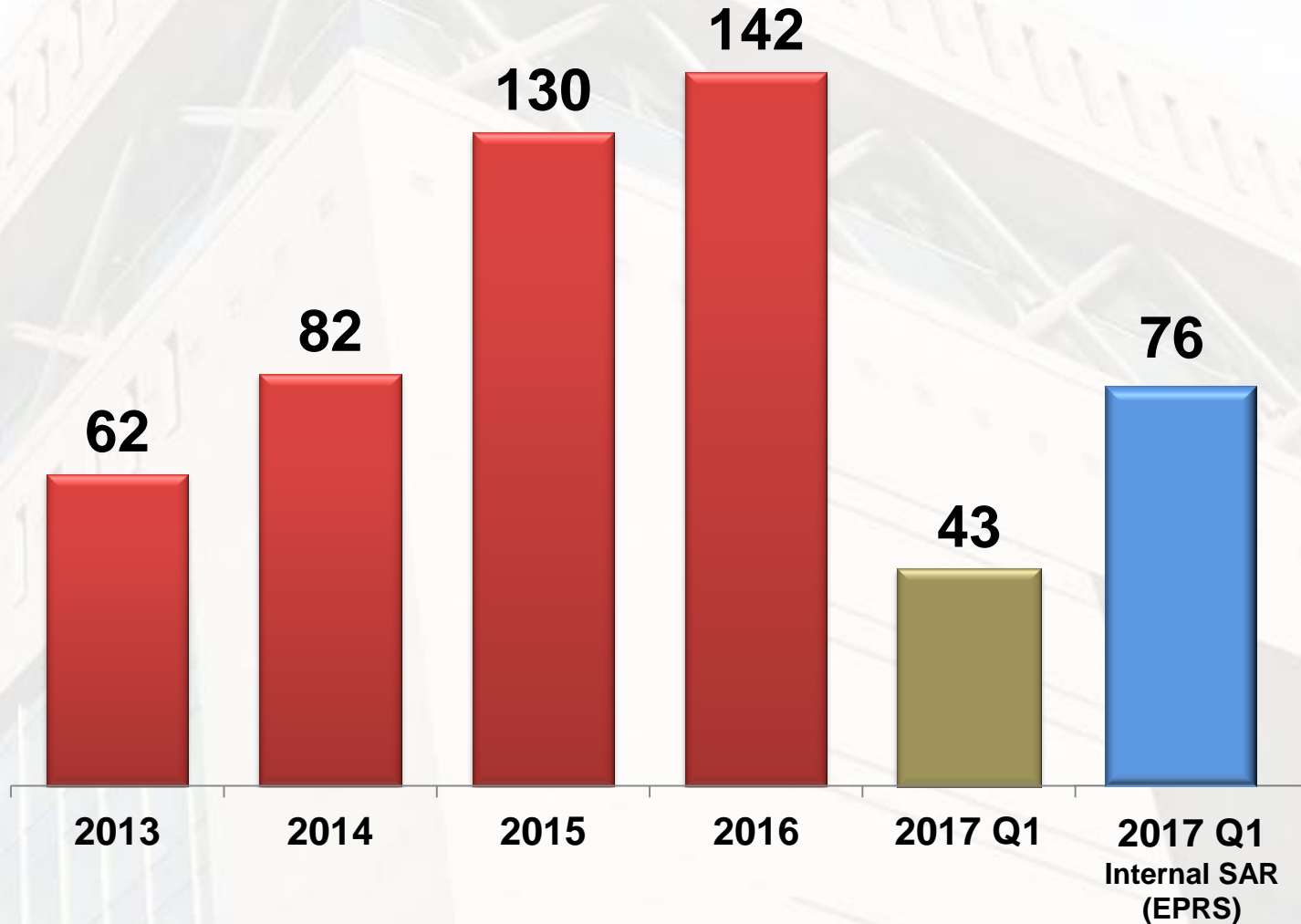


We acknowledge that we have been seeing activities within the portfolio of [REDACTED] that is not within our risk appetite and which we deem suspicious and result in filings.

We are currently scheduling a high level on site visit with the Bank to discuss our concerns and also hear from them on how they manage their clients' risks.

We will continue monitoring the transactions flowing in their account as per our regulatory duties and determine a new course of action if warranted.

Number of SARs 5 Year Trend



Most Common SARs by Typology 2013 - 2017

Adverse Media



Account Activity
inconsistent with
customer profile



Fraud



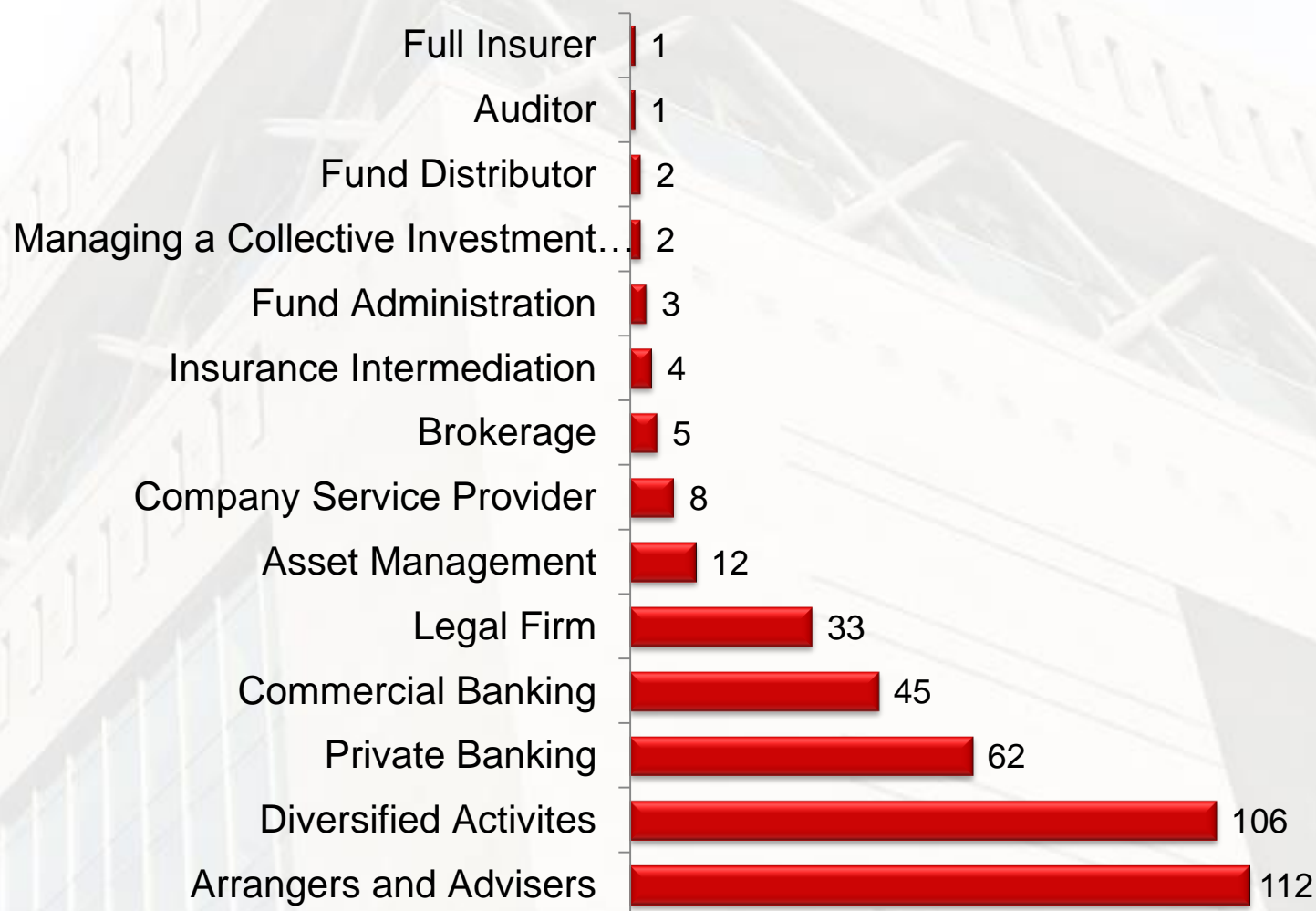
Suspicious Customer
Behaviour



Suspicious Source of
Funds



SARs by Firm Type 2013 - 2017



Financial Crime Thematic Review

Maryam Al Zarooni
Manager, Supervision

Common AML Issues

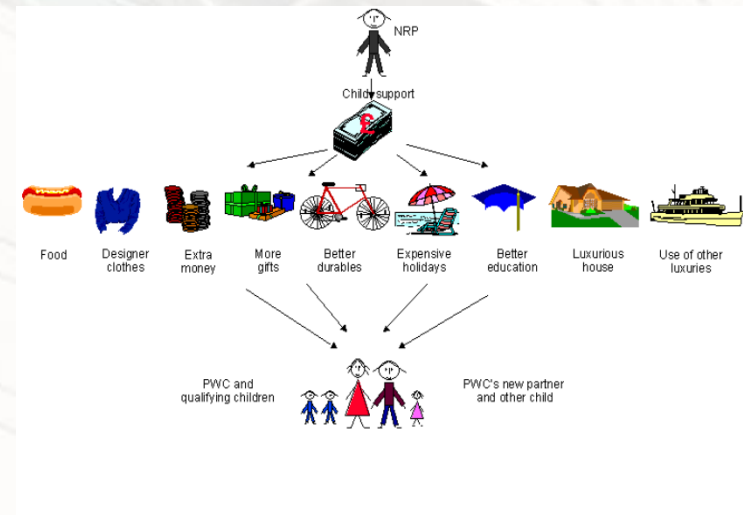
Enhancement
in AML
Framework

Initial and
ongoing
customer due
diligence

Verifying the
high risk
client's source
of wealth and
funds

Common AML Issues

Lack of knowledge and understanding of when and how to establish a client's source of wealth and source of funds, with some Firms failing to distinguish between the two.



Initial and On-going Customer Due Diligence

We have seen some Firms relying on Relationship Managers to carry enhanced due diligence review on clients with no oversight by compliance to identify any deficiencies and take appropriate action.

Common AML Issues on Enhanced Due Diligence

Firms relying heavily on world check screening and using it as a **standalone** exercise when carrying enhanced due diligence on their **high risk customers**.



EDD - High Risk Customer

For high risk customers, Firms must undertake a greater degree of due diligence throughout the customer relationship and should understand the nature of the customer's business and consider whether it is consistent and reasonable.



Documentation Issue

We have also visited Firms that failed to record adverse information related to high risk client's, and some Firms that failed to document the rationale for dismissing any adverse matches



Adverse Match

**HIGH
RISK**

Enhanced Due Diligence for PEPs

We also found weaknesses in Firms of all sizes when they should be establishing and verifying high risk clients' sources of wealth and funds including PEPs.



Inadequate verifications



Additional Guidance

Identifying beneficial ownership



**Documenting the understanding
and verification of source of
wealth and source of funds**

**Enhancing the definition of a
PEPs, to ensure the inclusion
of International PEPs**



Common Issues Identified for PEPs

1-There was no explanation for why low ratings were assigned to certain PEPs.

2-Firm uses a very narrow definition of PEP and generally, only applies the designation to members of the royal family.



Enhanced Due Diligence for PEPs

Senior management should be provided with all relevant information before approving PEP relationships to ensure they understand the nature of, and the risks posed by, the relationship they are approving.

Source of Wealth and fund



Potential



Adverse Information and Red Flags



EDD - Verifying the clients source of wealth and funds

Firms recorded some narrative with respect to the clients source of wealth and funds. However, there was no supporting documents to evidence the verification of the source of wealth and source of funds



No Documentary Evidence

Writing the rationale to Written Tasks, type 1 can be challenging for students. A frequent lament of Written Task examiners was that students were simply too 'wordy'; at times, students would write a rationale which was appreciably longer than the Written Task which it accompanied. In part, it is this experience that motivates the decision to delimit the rationale in the Language and Literature course to a maximum of 300 words.

Teachers should really encourage their students to aim for the upper word limit of 300 words. This word limit, however, must not be exceeded; if it is, one mark is deducted from the student. If students write less than 200 words, *no* marks are automatically deducted. However, in this case, it is unlikely that students will achieve the maximum of 2 marks available for the rationale that shows 'a clear explanation and understanding of the aspects being investigated'.

The point made above about word length is so important that it is worth repeating: *Teachers should really encourage their students to aim for the upper word limit of 300 words.* Beyond this, of course, the words need to be well chosen and the rationale should be clear and concise. But what should the student include?

The study guide says that a rationale *must* (my emphasis) explain the following:

- how the content of the task is linked to a particular part of the course



EDD - Verifying the clients source of wealth and funds

In the contrary, we have seen instances of Firms attaching supporting documentation in the client file without clearly indicating its rationale and assessment of the information.

3/1/04 DEMO Construction Co., Inc. Page 1
INCOME STATEMENT
March 2004

| Completed Job Basis | This Year----- | | Prior Year----- | |
|---|------------------|-------------------|------------------|------------------|
| | Month | Year-to-Date | Month | Year-to-Date |
| INCOME | | | | |
| Interest Income | 485.12 | 1,943.60 | 45.67 | 246.77 |
| Discounts Earned | 75.00 | 75.00 | | |
| Closed Job Revenue | 24,362.00 | 131,964.69 | 21,890.00 | 39,578.00 |
| TOTAL INCOME | 24,945.12 | 133,986.29 | 21,935.67 | 39,824.77 |
| COST OF CONSTRUCTION | | | | |
| Closed Job Labor | 4,819.56 | 18,234.27 | 3,266.50 | 4,838.50 |
| Closed Job Material | 4,244.45 | 24,024.77 | 3,623.25 | 5,739.05 |
| Closed Job SubContract | 5,180.25 | 40,820.75 | 8,710.50 | 11,702.80 |
| Closed Job Miscellaneous | 3,382.74 | 10,825.95 | 488.75 | 503.65 |
| Closed Job Burden | | 5,145.13 | 910.00 | 1,286.00 |
| TOTAL COST OF CONSTRUCTION | 17,642.00 | 100,010.88 | 17,000.00 | 24,100.00 |
| Gross Profit | 7,303.12 | 31,975.41 | 4,935.67 | 15,704.77 |
| GENERAL & ADMINISTRATIVE | | | | |
| Contributions | | 150.00 | | 56.25 |
| Dues & Subscriptions | | | | 45.00 |
| Estimating Expense | | | | 503.00 |
| Insurance - General | 281.80 | 844.00 | 281.00 | 550.00 |
| Insurance - Medical | 35.00 | 35.00 | 158.00 | 315.00 |
| Office Expense | | 222.25 | | 17.00 |
| PRR Taxes & Ins | 694.47 | 911.11 | 1,144.85 | 1,746.55 |
| Rent | 1,800.00 | 5,000.00 | 2,000.00 | 4,000.00 |
| Salaries - Office | 1,440.00 | 4,440.00 | 800.00 | 3,000.00 |
| Telephone | | 25.89 | | 112.50 |
| Utilities | | 128.25 | | 665.00 |
| TOTAL GENERAL & ADMINISTRATIVE | 4,250.99 | 11,667.52 | 4,384.35 | 11,993.31 |
| Operating Profit | 3,052.13 | 20,107.89 | 551.32 | 4,041.46 |
| Net Income Before Taxes | 3,052.13 | 20,107.89 | 551.32 | 4,041.46 |
| Net Income | 3,052.13 | 20,107.89 | 551.32 | 4,041.46 |



Rationale



EDD - Verifying the clients source of wealth and funds

Relationship Managers seem to have in-depth knowledge, but the written documentation was lacking detail and assessment of the verification of source of wealth and fund.

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EDD - Verifying the clients source of wealth and funds

Firms that place too much reliance on clients' own explanations and considering only at face value. Firms should perform independent measures to verify clients source of wealth and funds.



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Wealth

Teachers should really encourage the student to write a rationale that is clear and concise. This word limit, however, must not be exceeded; if it is, one mark is deducted from the student. If students write less than 200 words, no marks are automatically deducted. However, in this case, it is unlikely that students will achieve the maximum of 2 marks available for the rationale that shows 'a clear explanation and understanding of the aspects being investigated'.

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Fund

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EDD - Verifying the clients source of wealth and funds

Examples of Source of wealth

Inheritance

Information you could look for

- Name of deceased
- Date of death
- Relationship to client
- Date received
- Total amount
- Solicitor's details

Examples of requested documents

- (copy of the Will) clearly showing the amount of inheritance
- Signed letter from a licensed solicitor

EDD - Verifying the clients source of wealth and funds

Examples of Source of wealth

Company profits

Information you could look for

- Name and address of company
- Nature of company
- Amount of annual profit

Examples of requested documents

- Copy of latest audited company accounts
- Documentary evidence of the nature of business activity e.g. a letter from a regulated accountant

EDD - Verifying the clients source of wealth and funds

Examples of Source of wealth

Dividend payment

Information you could look for

- Date of receipt of dividend
- Total amount received
- Name of company paying dividend
- Length of time the shares have been held in the company

Examples of requested documents

- Dividend contract note or equivalent, clearly showing the dividend details, customer's name and entitlement

EDD - Verifying the clients source of wealth and funds

Examples of Source of wealth

Retirement income

Information you could look for

- Retirement date
- Details of previous profession/ occupation
- Name and address of last (final) employer
- Details of pension income source

Examples of requested documents

- Pension statement clearly showing name of provider, name of customer, amount and frequency of income
- Letter from a regulated accountant clearly showing name of customer, date(s) and amount of retirement income received.

EDD - Verifying the clients source of wealth and funds

Examples of Source of wealth

Sale of property

Information you could look for

- Address of property sold
- Date of sale
- Total sale amount

Examples of requested documents

- Letter from a regulated accountant, stating property address, date of sale
- Name of purchaser
- Copy of sale contract

EDD - Verifying the clients source of wealth and funds

Examples of Source of wealth

- **Trust**

Information you could look for

- Identify the individuals who are the settlor(s).

Examples of requested documents

- Trust deed.
- company website, annual reports, and financials.

Financial Crime risks remains a high priority given the continued regulatory focus of such risks across the industry and the considerable reputational impact of a financial crime event. Addressing such risks requires an effective AML framework.



AML Q&A

Michael Wong
Associate Director, Supervision

Annual AML return

What are the AML Return reporting obligations for a Firm with a financial year ending 31-Mar-17?

AML Rule 14.5.2 states two AML Return reporting periods:

- For financial year ending 2016, AML Return to be completed within four months of financial year end; and
- for period 01-Aug-16 to 31-Jul-17, AML Return to be completed and submitted on or before 30-Sep-17.

In accordance with this rule the only applicable reporting period for a Firm with a financial year ending 31-Mar-17 is for period 01-Aug-16 to 31-Jul-17, which would result in a 4 month gap from 01-Apr-16 to 31-Jul-16 in AML reporting. Please confirm.

Annual AML Return

The definition of “customer” in the AML Module includes a Person for whom the Firm has established a business relationship. Accordingly, within the AML Return, must the Firm report on all customers, which would include, inter alia, Clients and other business relationships such as business partners?

AML – 5% Threshold

Article 4 of Cabinet Resolution 38 of 2014

The Federal AML Cabinet Resolutions is itself is open to interpretation as to whether the expectation is to identify the 5% beneficial owners or the 5% immediate shareholders of a legal person. It would appear that the DFSA have interpreted the Federal Law as applying the 5% threshold to immediate shareholders only. Keeping in mind that Firms are obliged to take a risk based approach with regards to the identification and verification of beneficial ownership

Please confirm that the mandatory threshold of 5% applies only to the identification and address of immediate shareholders and not beneficial owners.

AMLSCU Biannual Reporting

AML 14.5.1 guidance states Firms should be aware of their obligation under Cabinet Resolution No.38 of 2014 to prepare AML reports and copy them to the AMLSCU.

Does the DFSA have any insight as to whether there is a prescribed form or what form the reports might take?

AMLSCU training programmes

AML 12.1.1 guidance states Firms should be aware of their duty under Cabinet Resolution No. 38 of 2014 to establish and provide AML training programmes in coordination with the AMLSCU.

Does the DFSA have any insight as to what “coordination” is required with the AMLSCU and what form this might take?

SAR Online Reporting

Within the DFSA letter dated 03-Mar-16 which provides guidance to complete the DFSA's Annual AML Return, section J1, Element 2b asks: Has the Firm obtained access to the AMLSCU's SAR online reporting platform? Does the DFSA have any insight as to whether DFSA Firms are able to access this platform?

Certified Copies

Please can you clarify the requirements for obtaining certified copies of documents? Does the DFSA permit a risk based approach to certification of documents as it is often difficult to obtain certification due to a lack of eligible certifiers.



Thank You