

THEMATIC SUPERVISION EMERGING TRENDS CONG/DFSA OUTREACH 30 May 2016

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DNFBPs – Financial Crime Risk

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Guess Who?



DO NOT GUESS WHO YOUR CLIENTS ARE



K_{now} **Y**_{our} **C**_{lient}!

DFSA's Supervisory Strategies for DNFBP

The set of supervisory tools include:

- Desk-Based Review
- Risk-Assessments
- Theme Review
- Outreach Session



Desk-Based Reviews (DBRs)

- Review of the Firm's AML return
- Review of summary of the Firm's business model.
- Review of any communication and visits held by the Firm
- Review any Suspicious Activity Reports submission
- Review sample of the client file



On-sight Visits

- On-site risk assessment will primarily cover discussion with senior management regarding the business model of the DNFBP and discuss the general findings of the client file review



Frequency of On-sight visits

repeated cycle



Number of DNFBP

Type of DNFBP

General findings and observation
of the AML return

Whether or not deficiencies has
been identified on previous risk
assessment

Overall AML risks within the Firm

On-sight Visit Assessment

On-sight visits will focus on assessing whether the DNFBP understands and assesses the AML risks they face and try to mitigate those risks through an action plan.



On-sight Visit Assessment

- Firms will need to demonstrate to us that they have tailored their AML Risk assessment specifically to the Firm's business



On-sight Visit Assessment



On-sight Visit Assessment



- The risks connected to lawyers, accountants and other DNFBP categories like company service providers in the AML field lie basically in the potential misuse of these professions or services that could facilitate in concealing identities of the beneficial owner;

Transactions for the client concerning any of the following activities

- Establishment of companies or other complex legal arrangements (like trusts), where establishment of such corporate vehicles may be used to conceal beneficial owners;



- Buying and selling of real estate;



- Managing of client money, securities or other assets;

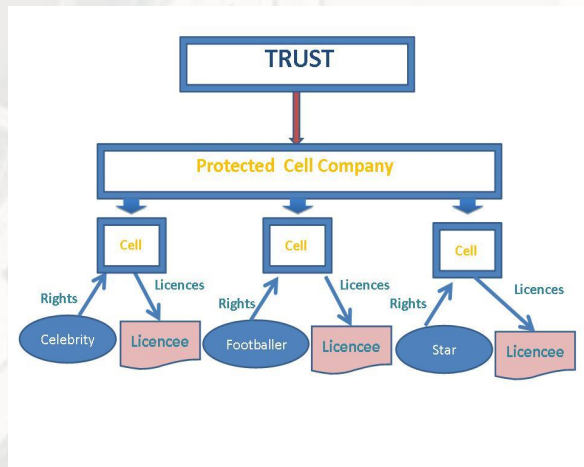
The Risks connected to Lawyers, Accountants and other DNFBP Categories

Our particular concern is the misuse of trust and company services by individuals to convert/conceal their illegal activities.



The Risks connected to Lawyers, Accountants and other DNFBP categories

The ease by which corporate vehicles can be created and dissolved in a fast manner in some jurisdictions.



Beneficial Ownership Information can be hidden through the use of:

1st step



- Complex ownership and control structures;
- Bearer shares;
- Shell companies;
- Formal nominee shareholders and directors;
- Informal nominee shareholders and directors;
- Trusts and other legal arrangements; and
- Use of intermediaries in forming legal persons

High risk/low risk corporate vehicles



Transactions where payments received from unknown third parties

Payments of fees in cash



Unexplained trust structure

A discretionary trust that gives the trustee discretionary power to name the beneficiary and distribute the assets held in trust, and when the trust is set up for the purpose of managing shares in a company, can make it more difficult to determine the beneficiaries of assets managed by the trust.

Customer AML risk assessment

- 1- Purpose and intended nature of the business relationship.
- 2- The Firm must document the nature of the customer, its ownership and control structure and its beneficial ownership. In case of a trust, also analyse the structure and the relationship between a settler and beneficiaries.



Settler



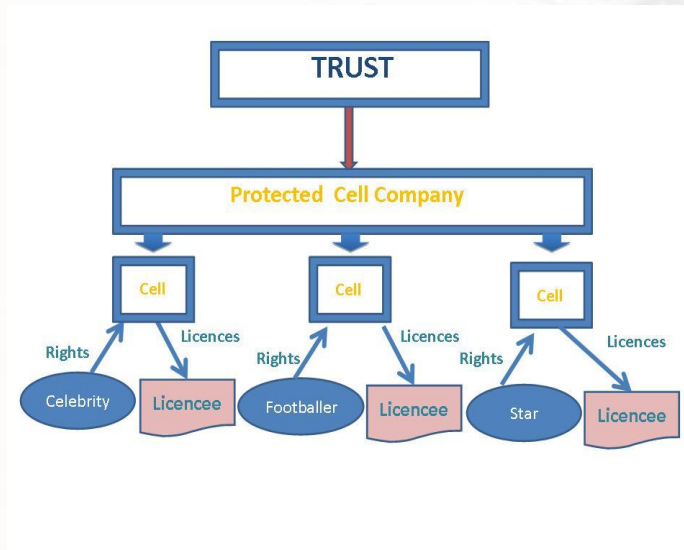
Beneficiary



Persons who are
object of a power

Customer AML Risk Assessment

3- Obtain and verify the rationale for use of trust.



Customer AML Risk Assessment

- 4- Customer's country of origin, residence, nationality, place of incorporation or place of business.
- 5- Product, service or transaction.
- 6- Outcome of the business risk assessment.

Customer AML Risk Assessment

Firm's must create a risk matrix that should list a number of factors or characteristics of the client and services which should be classified from normal to high risk.



Low
Simplified



Medium
Standard



High
Enhanced

FATF Typology Report

Highlights key guidance for DNFBPs to follow when conducting due diligence. It also stresses the importance of having adequate due diligence measures for DNFBPs.

<https://panamapapers.icij.org/stairway>

Welcome to the OFFSHORE WATCH

- A famous business man. His agent negotiates a \$7 million sponsorship contract with a global company. Instead of paying \$3 million in taxes on the deal, he wants to hide the money from the tax collector.

Open a bank account in
Switzerland

Create an offshore company

- The bank registers the company ABC Ltd in the British Virgin Islands (BVI). The bank account will be in the name of ABC Ltd, instead of his name.
- To keep his identity secret, he is advised to name a friend or employ a nominee as the shareholder of the company. Or, he could try to keep the company's ownership completely anonymous by using bearer shares.

Pick a nominee shareholder

Register with bearer shares

With bearer shares, his name won't appear anywhere. The shares will be owned by whoever physically holds the physical stock certificate.

- But the British Virgin Islands passes the BVI Companies Act, which outlaws anonymous bearer shares.
- The lawyer advised him to change jurisdiction or choose a nominee shareholder instead.

Pick a nominee

Go to another jurisdiction

Game Over

- He registered the company under a new name, ABC LTD, owned through bearer shares, in Belize.
- But when he tried to open a bank account for this new business, the bank refuses. Bearer shares are a red flag for shady activity, and the bank doesn't want to risk being associated with questionable behaviour.



- The company that supplied the business man with ABC Ltd provided him with a nominee shareholder whose name will appear on the company's public documents.
- But the bank wants to know the identity of the ultimate beneficial owner of the ABC Ltd account for their own records. The bank asks for a passport copy.

Hand over a copy of the
passport

Pick a nominee

Game Over

- The Tax authority now has access to the business man account information and can see that he owes \$2 million in taxes. The businessman is now facing charges of tax evasion.



- His lawyer opens a bank account in his name in Switzerland. The money is deposited directly to his Swiss account. The business man is resident in a country that started a voluntary Tax disclosure program. If he discloses the money that he has been hiding, he will only have to pay the amount he owes, plus a fine.

Tax Authorities

Keep evading taxes

Finally!

- A British citizen in Panama will act as the beneficial owner, also known as natural person nominee, for ABC Ltd. This will cost more than \$15,000 a year, but keeps his tax liability hidden from authorities.

Next

He will go to the tax authorities and admit he has failed to pay \$2 million in taxes over the years. He will pay back that amount, plus a fine.



- Bad decision. A whistleblower will leak his name to the press, and authorities will open an investigation.



Case 2

- A successful business man, made his reputation in real estate and is looking for opportunities for new ventures. He wants to establish a new company.
- He had heard that bribing a head of state could help influence the authorisation process. But how will he go about transferring a large amount of money without leaving a trace?

Use cash

Use an offshore company

Game Over

- It's risky business moving bags of cash, and he could get caught at the border with a suitcase full of bills. He will need to explain this to the authorities.



- He registers the company XYZ LLC in Delaware.
- The head of state (president) informed him that he will be granted the authorisation certificate once the “special payment” is processed. To make sure the terms of the agreement are clear, he asked the business man to sign a document that details the exchange

Accept

Refuse

Game Over

- He obtains the certificate licence but when a group of people learn that he obtained the licence before them, they begin raising concerns with regulators. An investigation is opened and – it's not too difficult for authorities to link him with XYZ LLC.



- The business man convinced the president to forget about the signed document. His “special payment” was accepted with a handshake, and his signature is nowhere near the bribe.
- Now he needs to decide whether he could make the president a shareholder in his company, XYZ LLC. Or you could transfer the money through a series of third-party offshore companies – a process called escrow.

Use Escrow

Give Shares

Game Over

- He obtains the certificate license but when a group of people learn that he obtained the licence before them, they begin raising concerns with regulators. An investigation is opened and – it's not too difficult for authorities to link him with XYZ LLC.



- The law firm handling XYZ LLC's business agrees to help route the money in such a way that it will be nearly impossible to link the "special payment" to the president back to his company.
- The business man is now in the middle of negotiating the technicalities of the cash transfer. However, an associate of his company is arrested on an unrelated matter. The law firm finds out and no longer wants to be associated with him. They send him an email resigning as a registered agent for XYZ LLC.

Will call and negotiate

Take the business elsewhere

- The businessman decided to create a new company called SSA in Panama and found a new registered agent to help.
- The new law firm – needs to check his identity to comply with their “Know Your Client” (KYC) procedures and asks for a passport copy.

Handover passport copy

Refuse



Game Over

- The new registered agent refuses to do business with someone whose identity they can not verify. They will not provide him with any service until they receive a passport copy.



Game Over

- Unfortunately, a few searches on the Internet easily reveal the links between him and his associate. The law firm refuses to do business with him.



Finally!

It worked! The business man promised to pay additional fees, and convinced his registered agent to keep doing business with him. The registered agent helped him with the money transfer, suggested the following steps:

- 1) Turn liquid investments into cash, put the funds in an escrow or third-party account, and then transfer them to an offshore company.
- 2) The law firm is willing to provide a further “very sensitive” service. It will hire a “natural person trustee” – someone who will pretend to be the beneficial owner of a company.

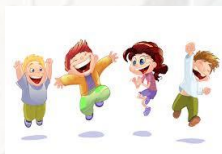
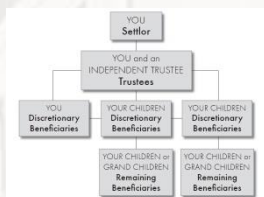
Red Flags



Wire Transfer



Country A



Beneficiaries

Country B



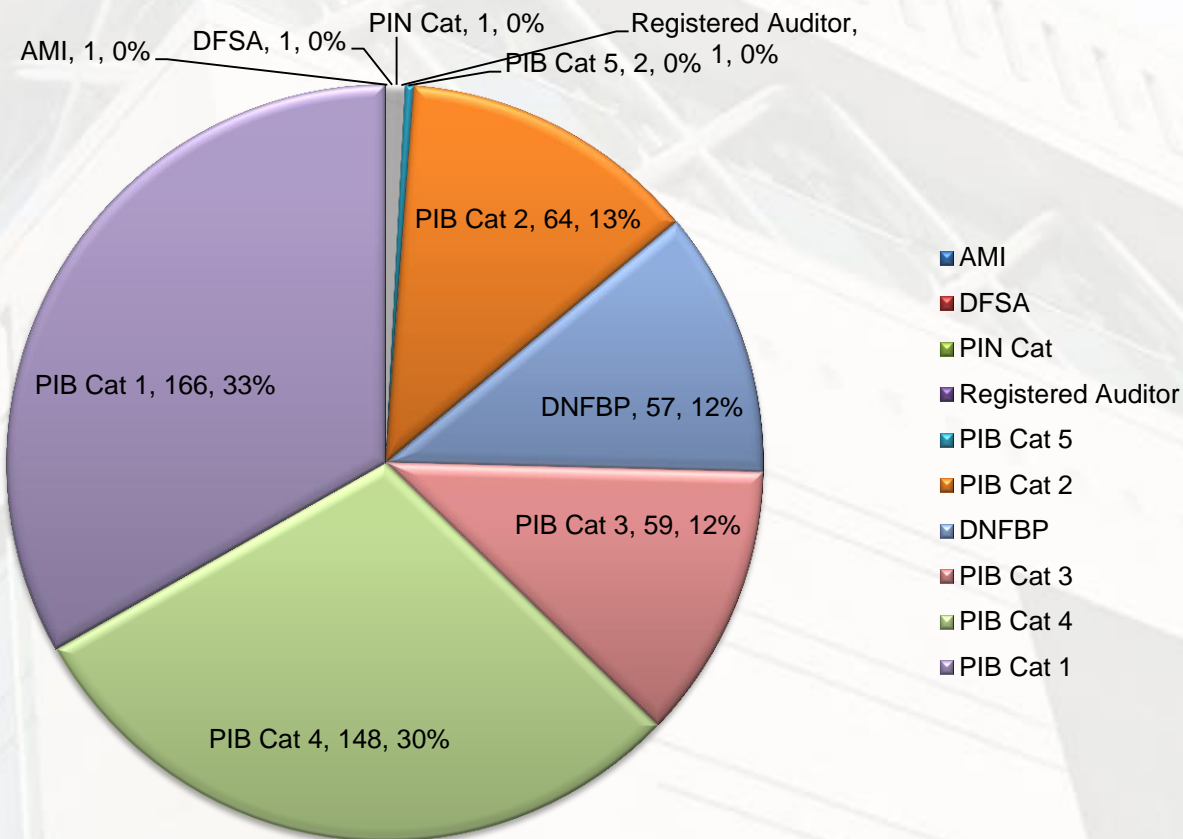
Trustee

Red Flags:

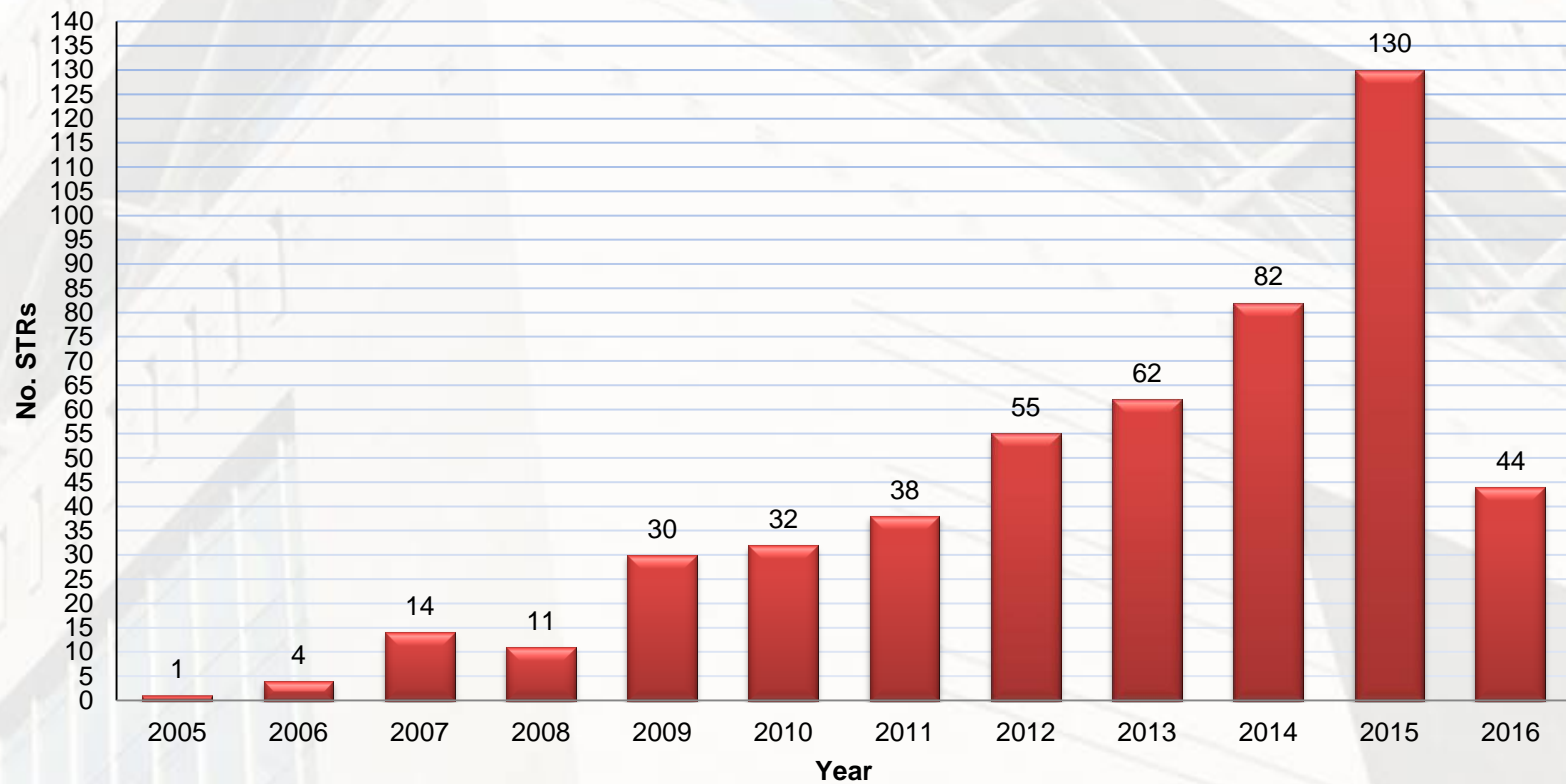
- Client unknown to the Lawyer;
- Country B Risk;
- Source of Funds;
- Type of Service.

Suspicious Activity Reports

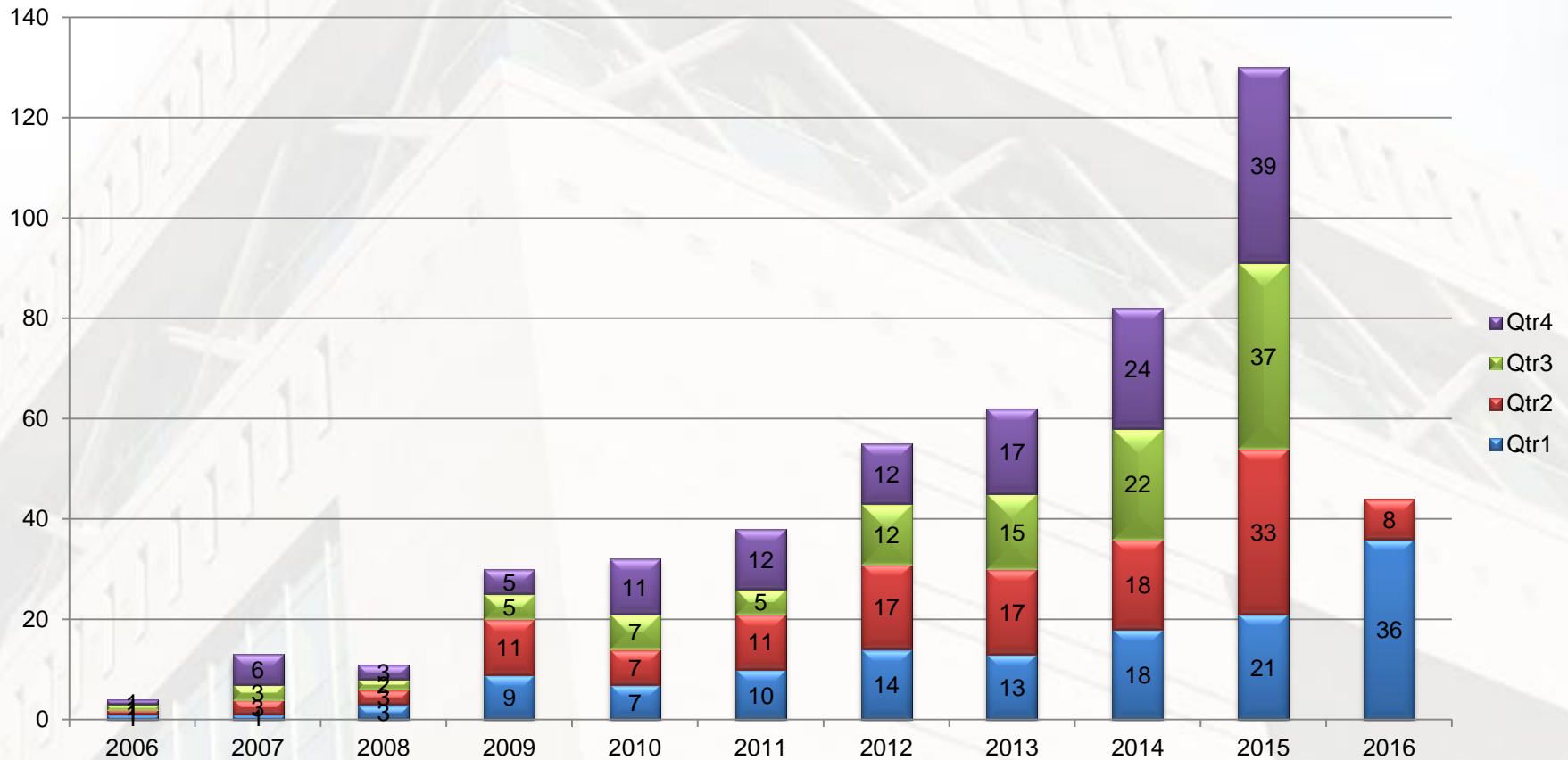
Suspicious Activity Reports (SARs): 2005-2016



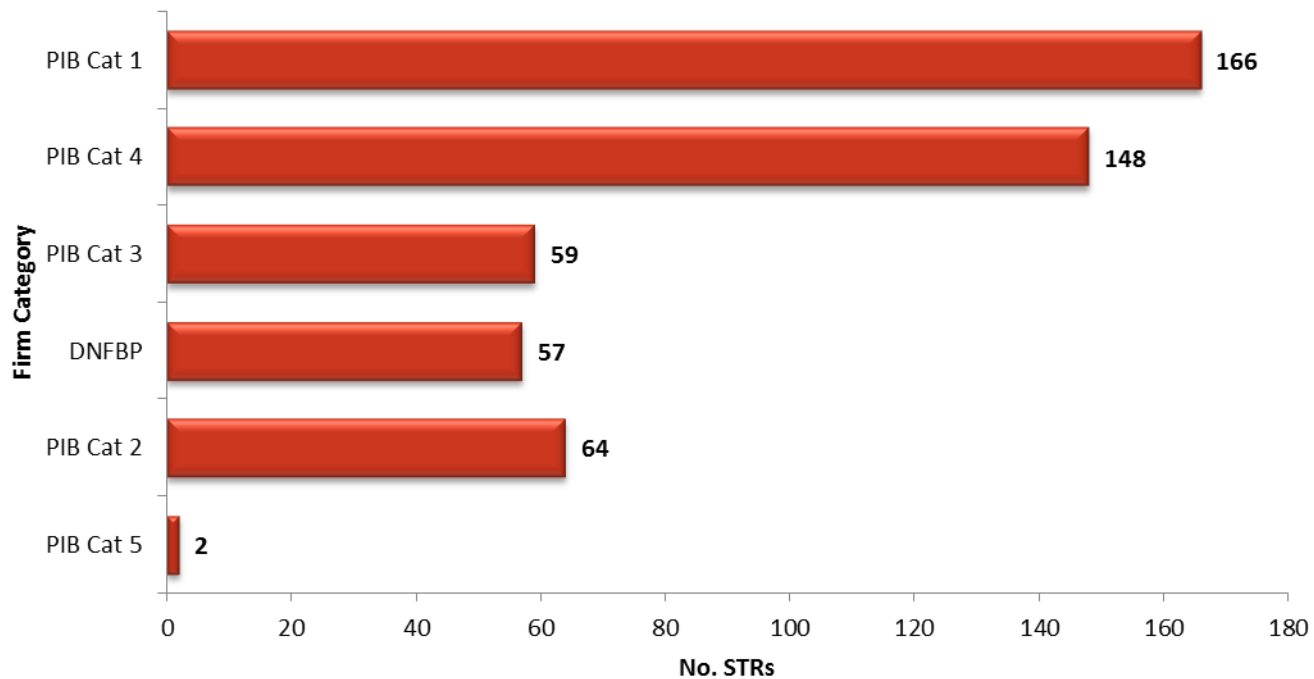
SAR by Year



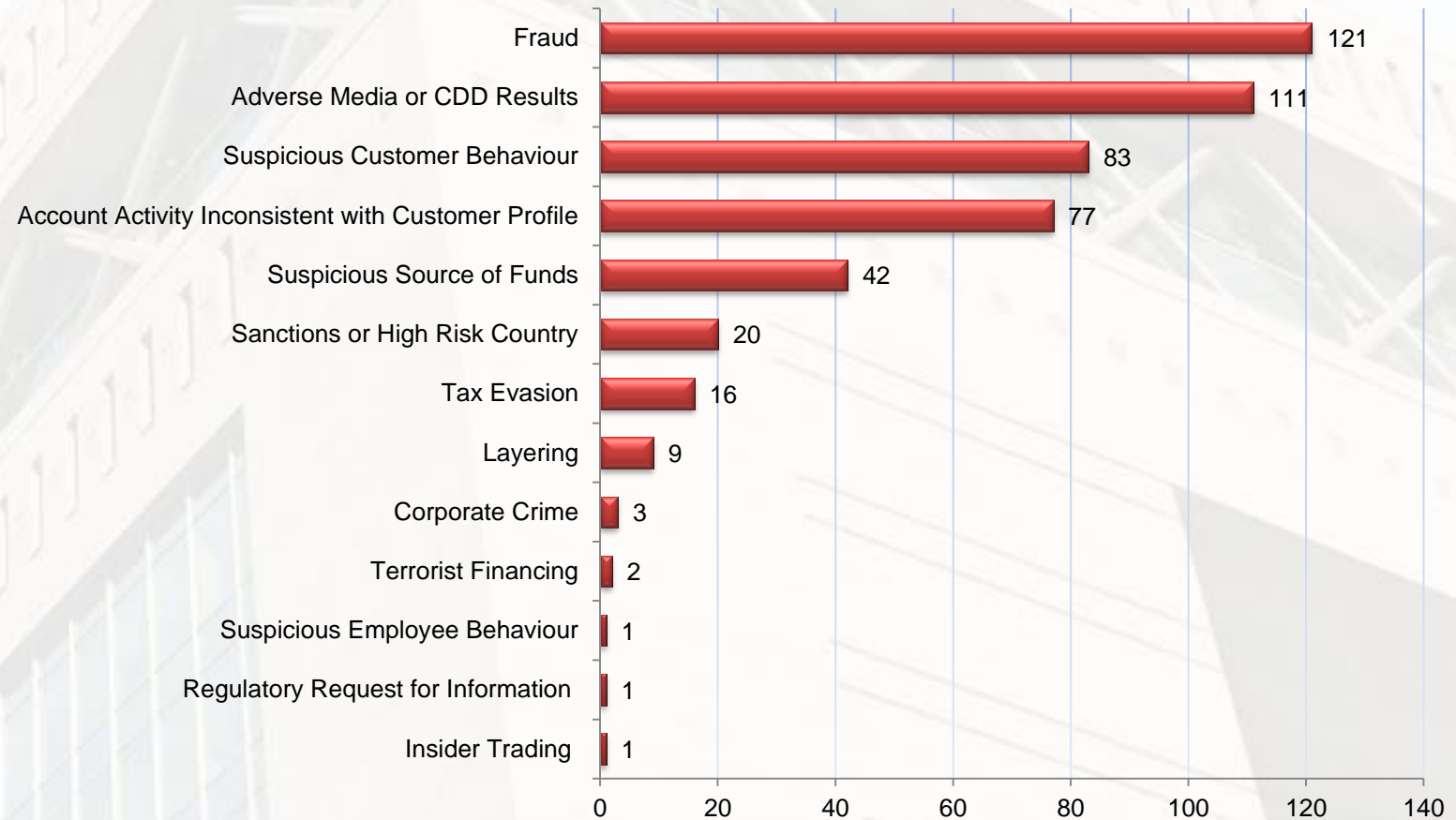
SAR by Quarter



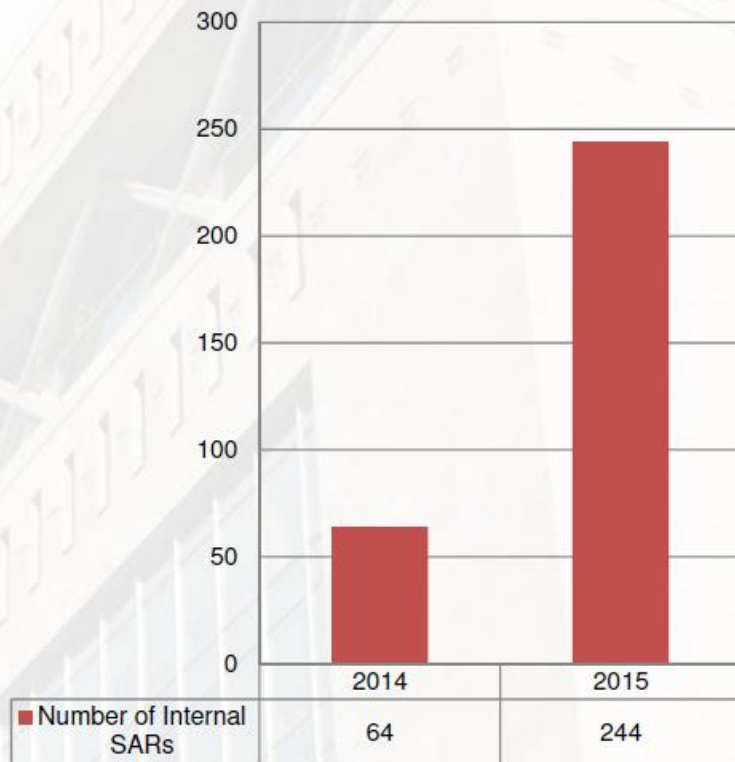
STRs by Firm Category 2005 - 2015



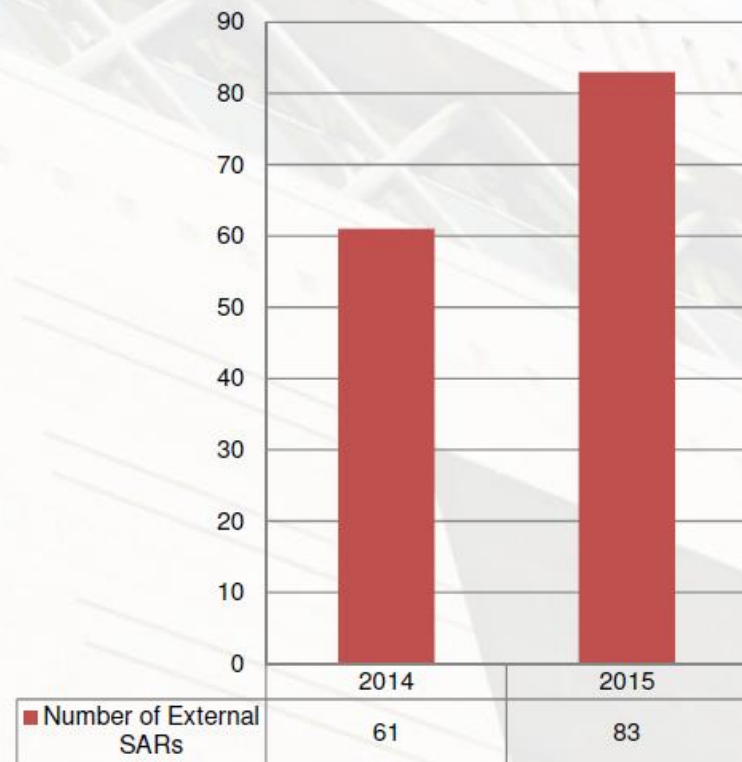
SARs: 2005-2016



Internal SARs

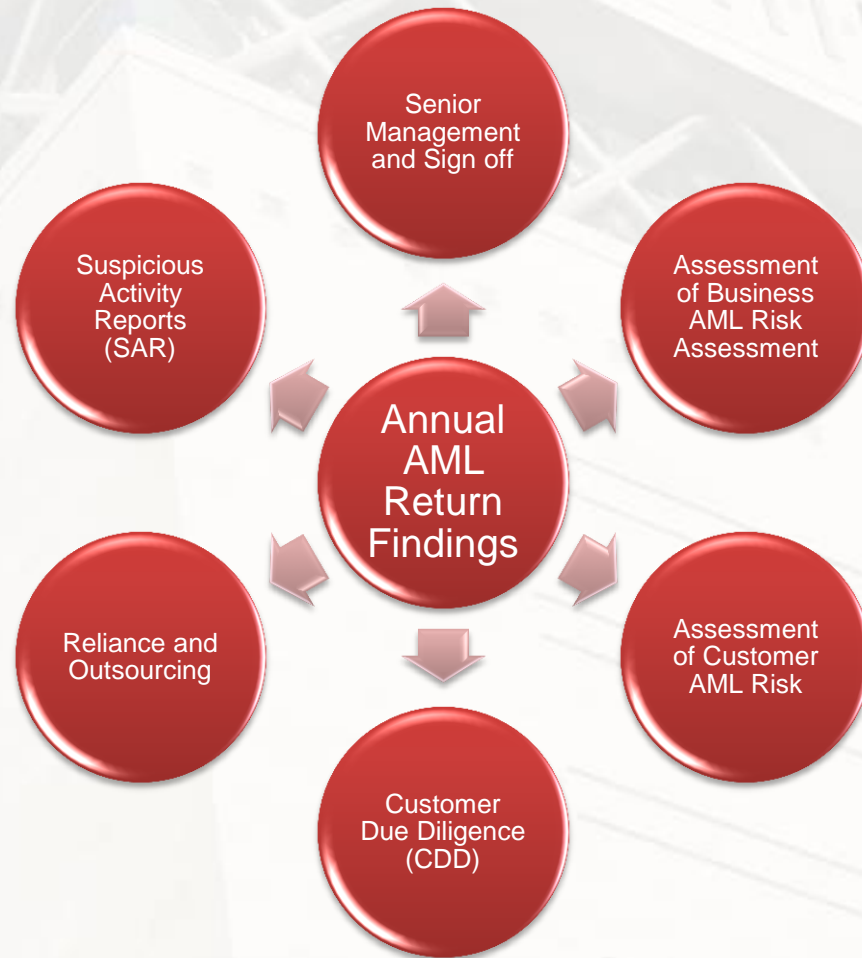


External SARs



Financial Crime Thematic Review

Background



Background

Suspicious Activity Report (SAR)

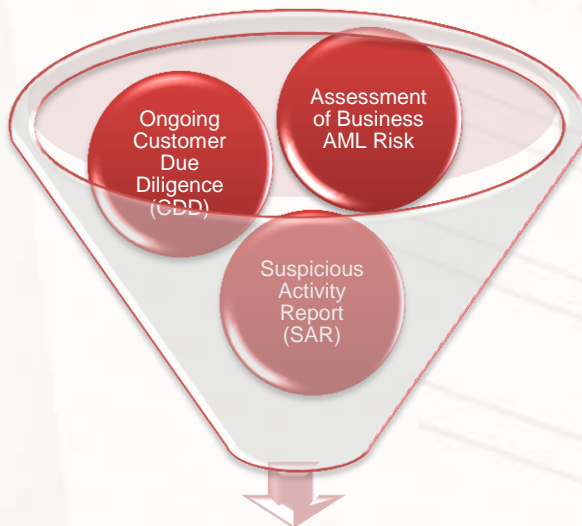
- 244 internal notification relating to suspicious activities, and 83 external SARs were lodged by Firms based on 2015 returns.
- The trigger for submitting an internal notification should be as expansive as possible with the MLRO then acting as a second stage and ultimately deciding if an external SAR should be lodged. Accordingly, the DFSA expected that the number of internal notification would be significantly higher than the number of external SARs.

Customer Due Diligence (CDD)

- Most Firms were able to document and evidence the CDD processes undertaken when on-boarding new customers and such steps were generally well articulated and clear.
- Areas of improvement include the requirement to conduct ongoing CDD such as transaction monitoring.
- Many Firms appeared to rely on the fact that transactions were booked overseas to not monitor transactions in the DIFC.

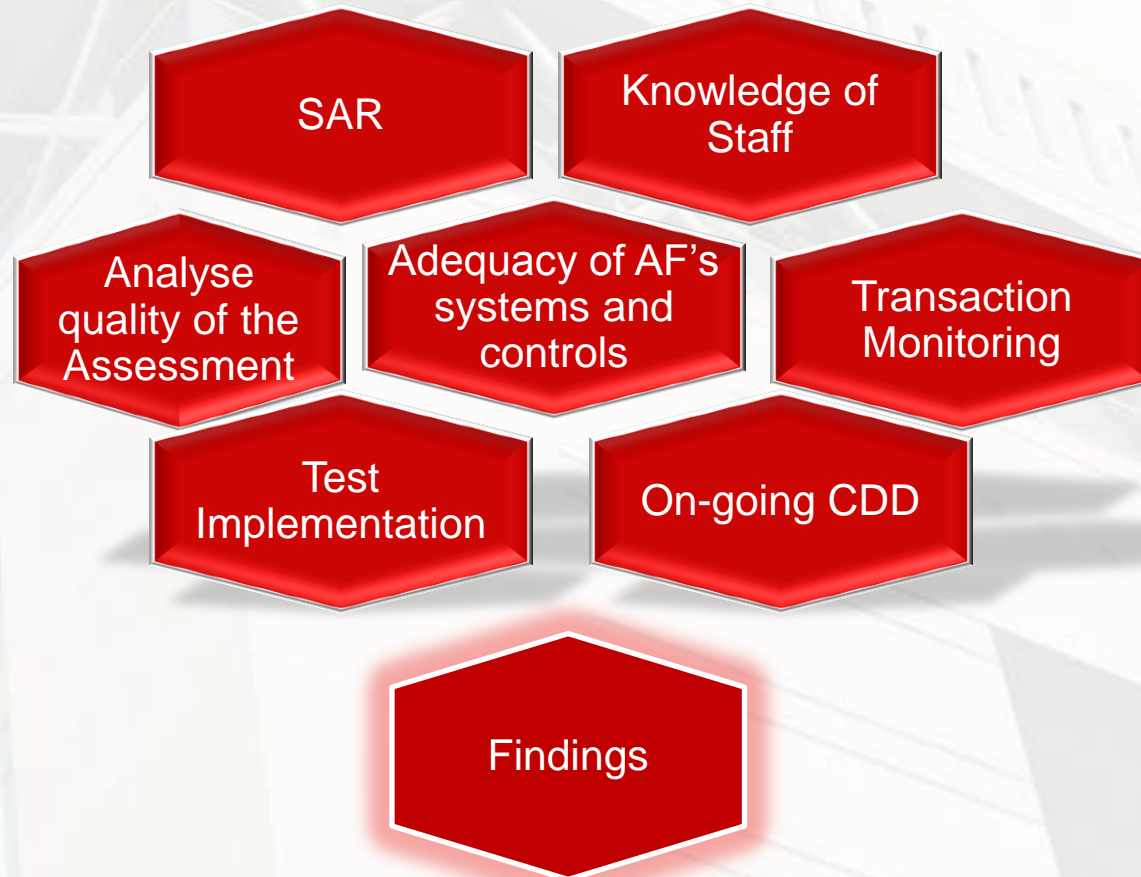
Assessment of Business AML Risk

- The quality of the documentation of a Firm's AML risk assessment varied from very good to very poor
- Areas of improvements include the need for the Firms 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.



Thematic Review

Objective



Scope

Desk-Based

Annual AML
Returns

Attachments
(BRA,
Templates
etc.)

Onsite Visits

Staff
interviews

Sample
testing

Scope cont.



QUESTIONS/ AML

- How do we deal with the issue of tipping off in a very client driven service market? (where clients are accustomed to quick response and turn around times for actions).
- Dealing with PEPs especially those who are connected to royal families and/or otherwise have serious (and well placed) confidentiality concerns. Obtaining and maintaining CDD documentation for such clients can very challenging.
- Is tax evasion a predicate crime in the UAE?
- What level of scrutiny and due diligence is expected around funds as payment for services?



Thank You