



Jersey Financial
Services Commission

Themed Examination Programme 2016/17: Enhanced & Simplified Due Diligence

Summary Findings

Issued: August 2017

Glossary of terms

The following table sets out a glossary of terms used in this report.

AML	Anti-money laundering
CFT	Countering the financing of terrorism
JFCU	Joint Financial Crimes Unit
JFSC	Jersey Financial Services Commission
MLCO	Money Laundering Compliance Officer
MLRO	Money Laundering Reporting Officer
MONEYVAL	Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and Financing of Terrorism
Order	Money Laundering (Jersey) Order (2008)
PEP	Politically exposed person
SAR	Suspicious activity report

Contents

1	Executive summary	4
1.1	Introduction.....	4
1.2	Background.....	4
1.3	Scope and regulatory requirements	4
1.4	Objectives and limitations	4
1.5	Methodology	5
2	Prime observations	6
2.1	Banks	6
	Group influence	6
	Group support.....	6
	PEPs.....	6
	Account operation	6
	Account opening.....	7
	Control environment	7
2.2	TCBs & MSB	8
	Records	8
	Intermediaries.....	8
	Compliance monitoring	8
	Operations	9
	Conflicts	9
	PEPs.....	9
	Other.....	9

1 Executive summary

1.1 Introduction

This paper provides an overview of findings from the JFSC's themed programme of on-site examinations on the subject of Enhanced and Simplified Due Diligence, which were conducted by the JFSC in 2016 and 2017. This comprised of two phases; the first spanned eight banks between September and December 2016, whilst the second covered six Trust Company Businesses and one Money Service Business between January and April 2017.

The JFSC's observations in this report are drawn from its findings from those examinations.

1.2 Background

On 24 May 2016, the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and Financing of Terrorism (**MONEYVAL**) published a comprehensive evaluation of Jersey's anti-money laundering and countering of terrorist financing regime. Recommended actions in the report sought assurance that Articles 15, 17 and 18 of the Money Laundering (Jersey) Order (2008) (the **Order**) were being effectively followed by Relevant Persons. In response to the recommendations in the report, and in recognition that financial crime risks are the most severe risks identified and set out in the JFSC's Risk Overview, the JFSC commenced a programme of thematic examinations by the Supervisory Examination Unit to assess the effectiveness of the application of Articles 15, 17 and 18 of the Order by Relevant Persons.

1.3 Scope and regulatory requirements

The thematic programme undertaken by the JFSC had two primary objectives:

- › To examine if there was evidence that Relevant Persons are applying adequate due diligence measures to the individual risks of each business relationship, and exercising appropriate judgement in each case, as required by Article 15 of the Order regarding enhanced due diligence.
- › To examine if there was evidence that Relevant Persons are applying adequate simplified due diligence measures in appropriate circumstances and in a manner consistent with the requirements set out in Articles 17 and 18 of the Order.

The objectives were designed to assess whether the AML/CFT control framework in respect of enhanced due diligence and simplified due diligence of those entities examined met regulatory requirements, which are designed to mitigate the risk of facilitating money laundering and terrorist financing or breaching sanctions.

1.4 Objectives and limitations

The JFSC regularly undertakes on-site examinations on specific themes to (1) assess the extent to which regulated entities are operating in accordance with their regulatory obligations under the respective Laws, Orders, Codes of Practice and Guidance Notes, (2) provide direct feedback to the firms examined and (3) issue related guidance for the wider industry.

The JFSC's on-site examination programme is designed to assess the risks faced by individual entities and review the controls, procedures, policies and processes in place to mitigate those risks.

The purpose of this paper is to summarise the key findings from these themed examinations. It is not intended to comprehensively describe all risks that may be associated with non-

adherence to regulatory obligations and not all firms face the issues described below. However, the observations made reflect areas of potential risk and are provided for general guidance.

1.5 Methodology

Prior to each examination, the JFSC requested a range of policy and procedural documents from the firm to be examined in order to assess its compliance with the requirements of Articles 15, 17 and 18 of the Order. We also requested a list of the entity's customers. This information was assessed before the on-site examination commenced. During the examination, JFSC officers reviewed customer files from a sample obtained beforehand and held discussions with management and staff. The files were reviewed to determine whether procedures were being adequately followed and to establish the extent of any control deficiencies. The findings were based upon information provided by the registered person and evidence available at the time of the examination.

In order to make an effective assessment of the risks against the objectives, findings were based on specific tests designed to answer the following questions:

- › Does the entity's global approach to the risk assessment of its customers align with and take into account local requirements?
- › Has the customer risk assessment process adequately identified customers who require enhanced due diligence measures?
- › Are enhanced due diligence measures being consistently applied across the client base?
- › Is the approach to the identification, on-boarding and on-going monitoring of PEPs in line with Jersey law?
- › Is the approach commensurate with the risk of each business relationship?
- › Are the internal measures and controls sufficiently robust to challenge the veracity of source of funds and wealth?
- › Is there any evidence to suggest a conflict of interest which would unduly influence the take on of new business?
- › For introduced business – how has the firm ensured that local regulatory requirements are met?
- › What balances and checks are used to ensure that any outsourcing of the CDD process is in line with Jersey requirements?
- › Is the rationale for opening accounts detailed and reasonable?
- › In what instances is the firm applying simplified due diligence measures? Is the rationale applied appropriate for the concession?

The above were reported on an exceptions basis.

2 Prime observations

2.1 Banks

Group influence

In cases where customer introductions were effected by group, it was observed that due diligence did not always reflect recognition of higher risk jurisdictions as such, due to the home jurisdiction holding a different view.

Similar instances were seen where group sanctions lists were used (by the Jersey bank) which did not include all sanctions applicable in Jersey. Where reliance is placed on group information sources, differences between the regulatory requirements of the regime in question and Jersey need to be identified and addressed.

Similarly, a number of cases were noted in which group policies and procedures were followed in Jersey, yet these did not fully reflect all relevant Jersey regulatory requirements. Where this is the case, group policies and procedures need to be appropriately amended, or added to, for local use in order to match Jersey requirements.

Applying simplified due diligence to all group introductions, regardless of jurisdictional connections, was felt unlikely to adequately reflect the actual risk levels of some introduced customers.

Group support

Where functional reliance was placed on group operations outside Jersey, there was significant evidence of a lack of understanding of Jersey requirements, particularly where there were only small differences between two regimes.

Where functionality was shared with overseas group operations, it was observed, on occasion, that gaps in the overall customer risk assessment were created.

The automatic closure of an account by group where a sanction connection had been identified posed a risk of non-reporting locally.

An inability to establish separate data for Jersey activity from combined Crown Dependency operations inhibited the quality of local risk analysis from that data source.

PEPs

A number of firms failed to demonstrate adequate consideration and identification of PEPs and individuals connected to PEPs. This was sometimes apparently due to the relationship manager having become overly close to the customer. Consequently, related due diligence and ongoing monitoring were considered to be insufficient.

Instances were seen in which a PEP had been de-classified as such. Whilst this was in line with group policy, Jersey legislation establishes that PEP status is permanent ("a PEP is for life!").

Account operation

Trigger events, such as the opening of an additional savings account, were not always identified as an opportunity to review and update due diligence on a customer.

Examples were seen, particularly in the high net worth sector, of very close relationship management sometimes making it difficult to objectively consider customer riskiness.

Account opening

Red flag indicators were not always adequately identified as reasons to explore the firm's understanding of the customer and the underlying risks. The reasons for the complexity of corporate structures were not always understood and greater understanding had not been sought. The inability to identify and understand complex structures could lead to red flags being missed and connected persons not identified.

The assessment of overall risk sometimes fell short where a customer had accounts across various jurisdictions and group entities, focussing only on the most familiar, local element.

The direct involvement of Compliance in new business take-on and authorisation can challenge the independence of that function and lead to a potential conflict. Whilst this may be necessary and manageable in a very small operation, it should be avoided where possible and, where it features, requires additional oversight and controls.

Over-reliance on automated tools, particularly without adequate checking and challenge of inputs, can lead to inaccurate risk ratings. Even where that does not occur, the firm's understanding of the customer can be hindered, leading to the degree of due diligence conducted not adequately reflecting actual risk. This can lead to a lack of recorded consideration and justification of risk assessment decisions.

Inadequate recording of source of wealth was a relatively common feature, reflecting control failures at both the first and second lines of defence. Sometimes, this was reflected in source of wealth only being established and recorded for one party to a joint or multi-party account; for example, a husband/father or the main contributor to an arrangement.

In cases of joint accounts other than the most common one of husband and wife, such as father and son, explanations for such arrangements had sometimes not been sought and therefore not understood.

There was regular confusion seen between source of wealth and source of funds. It is essential that front line staff clearly understand these terms and the difference between them.

A "one size fits all" approach, such as rating all customers as high risk, was seen on occasions. Whilst this might appear to be a conservative approach, it does not facilitate the evaluation of different risks and cumulative risk factors, nor best use of resources.

Delays in second and third lines of defence assessing account opening approvals, which were particularly seen where these occur in group operations outside the Island, can lead to risk issues not being addressed in a timely fashion and allowing undesirable account activity to occur meanwhile.

Control environment

Some assessments by visiting Internal Audit teams could have been better targeted and effective if such functions liaised with the JFSC in advance, enabling the exchange of views on relevant risk issues and concerns. Certainly, we are keen to meet such functions at an early stage of their visits, and to understand their findings subsequently.

Adequate control of records of SARS that had been externalised is clearly of great importance, but this should not prevent relevant staff from accessing these. For example, a MLRO must be able to establish whether a customer had previously been the subject of a SAR, in order to determine whether a particular concern should be reported to the JFCU.

It is equally important that SARS are processed quickly. An example was noted in which a three month delay occurred between a suspicion being recorded (and appropriately acted upon) and the related SAR being submitted to the JFCU. This must be considered to be overly long in any circumstances.

Instances were seen of poor controls over the ownership and maintenance of policies and procedures. The absence of an audit trail creates difficulty for staff, auditors and regulators to understand, and be aware of, material changes made, and when these were effected.

2.2 TCBs & MSB

Records

Ineffective recording of decision making and risk rating processes was noted in a number of cases, with a complete absence of recording the customer risk assessment process, both at the account opening stage and ongoing, seen in one case.

Reasons for revisions to client risk ratings had sometimes not been recorded, both up and down. In one case, this had occurred over a number of client files, following the application of a new assessment methodology. Whilst this may have led to more accurate assessments, it was appropriate to have recorded relevant matters and considerations on file.

Inadequate records do not enable effective audit by both internal and external parties, nor adherence to the requirements of Article 19 of the Order.

An absence of recorded corroboration of both source of wealth and source of funds, plus reasons for opening an account in Jersey, were noted on various occasions.

Confusion over the difference between source of funds and source of wealth was evident.

Warning indicators of higher risk had not been spotted and acted upon.

In the case of complex groups, risk analysis and monitoring had, on occasion, been limited to the top structure alone and not the underlying subsidiaries also. Each business relationship should be monitored, commensurate with the risk of each, in accordance with Article 3(3) of the Order.

Disorderly files, with key documents missing, potentially reflect poor understanding of a client and related risk. They also handicap oversight controls, including audit attempts by both internal and external parties. This was particularly disappointing when advance notice had been given of an intended examination, including details of the client files to be sampled.

Intermediaries

There was an identified risk that established procedures would not prevent the application of simplified due diligence to introductions made by an intermediary designated as medium risk, which is not permitted under Article 17(5) of the Order.

Compliance monitoring

The extended absence of compliance monitoring was noted in a number of cases. Reasons given usually revolved around unfilled staff positions but also included awaiting completion of a data cleansing exercise. The JFSC was concerned at this aspect receiving insufficient priority. A registered person is required, under the TCB Code of Practice, to ensure that the Compliance Officer is responsible for ensuring appropriate monitoring of operational performance and managing regulatory and compliance risk within the registered person. They also establish a requirement for a board to adequately monitor the registered person's business. The absence of a compliance monitoring programme is directly in conflict with such requirements, regardless of resourcing issues.

Operations

Shortcomings were seen in adherence in practice to established policies and procedures that were themselves compliant with regulatory requirements. An example of this was manual amendments having been made to client risk assessments, with no rationale recorded. Effective controls need to be put in place, including adequate staff training, to ensure that regulatory breaches do not occur due to non-adherence to established processes.

Procedures need to be kept up to date so that changing regulatory requirements are incorporated.

Over-reliance on an automated client risk assessment tool was noted, with no record made of any additional steps taken to establish the nature of all relevant risks. This can hinder a firm's full understanding of associated risks.

Not all procedures in respect of the risk rating of clients required downward revisions to be referred to a higher authority level. Discussions around this subject reflected a lack of appreciation of the need for additional consideration being given to a decision that would lead to reduced risk oversight.

Conflicts

The complete absence of a conflicts of interest register was noted in one instance.

One case was observed of the managing director acting as compliance officer to cover a long term vacancy in that position. Another involved an individual undertaking the combined roles of compliance officer, MLRO, MLCO, managing director, legal counsel and company secretary (across two group companies), yet no conflicts between these roles had been recognised or recorded. Whilst this was something of an extreme example, combined roles is a common occurrence, often involving the compliance officer. These instances require clear recognition, an assessment of risks (including key man), appropriate controls, recording and monitoring.

It was also observed that conflicts could arise with staff in the second line of defence assessing controls in areas of the business in which they had previously worked. In such cases, consideration could usefully be given to segregating Compliance work streams.

PEPs

Various instances were seen whereby PEPs and connections to PEPs had not been identified at client take-on. This, in some instances, led to trigger events not being responded to in a timely manner, due to lack of monitoring activity.

One example was seen of a new client's PEP status not having been identified and recorded, despite the client having self-identified themselves as such.

Other

Policies and procedures were observed not to be in line with Jersey regulatory requirements, possibly because of wider group influence. It is vital that protocols, which form the starting point of activity, are compliant; such core documentation should be the subject of ongoing review.

It is not permitted to apply simplified due diligence to clients with securities listed on an exchange that does not meet the Order's definition of "regulated", unless a comprehensive and positive assessment of that market's IOSCO compliance status has been conducted. AIM does not fall within the stated definition but an instance was noted of simplified measures being applied to an AIM listed company without the required assessment.