Exemptions

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Agenda

Overview of the AML/CFT regulatory regime

The AML Exemptions Project

Recommended way forward

Next steps and questions

Jersey Financial Services Commission

Jersey AML/CFT language - scope

- Registered person
- Relevant person
- Financial service business
- Financial services business
- Schedule 2 business
- Specified Schedule 2 business
- Financial Services Law
  Supervisory Bodies Law
  Banking Law *(used but not defined)*
- Money laundering Order
- Financial Services Law
- Proceeds of Crime Law
- Supervisory Bodies Law
- Supervisory Bodies Law

FATF language - scope

- Financial institutions
- Designated non-financial businesses and professions
- Not present in current regulatory framework
- Used but has a different meaning

Relevant legislation

1988
Collective Investment Funds Law

1991
Banking Business Law

1996
Insurance Business Law

1998
Financial Services Law

1999
Proceeds of Crime Law

2008
Supervisory Bodies Law

Overview of the AML/CFT regulatory regime

- Which activities are caught?
  - Set out in Schedule 2 of the Proceeds of Crime (Jersey) Law 1999
- Who is required to register?
  - A person meeting the definition of a "specified Schedule 2 business" (Schedule to the Supervisory Bodies Law – subset of Schedule 2)
- Who do we supervise?
  - All persons carrying on a "Schedule 2 business" in or from within Jersey
- Where are the exemptions from regulation and registration set out?
  - Across 18 Orders and 6 Laws… spanning 1991 to 2016

AML/CFT regulation and registration exemptions

- Schedule 2 “financial services business” comprises Part A and Part B
- **Part A - business regulated by the Commission under Regulatory Laws**
  - BB(J)L - Deposit-taking business
  - IB(J)L - Long-term insurance business
  - CIF(J)L - business of being a functionary, business of a recognized fund, business of an unclassified fund
  - FS(J)L -financial service business

The definitions are included in full they do not take into account any of the limited or unlimited exemptions that apply within the prudential/conduct environment - the rationale being that the AML/CFT risks are different and it may be appropriate to exclude a particular activity from prudential/conduct regulation but not AML/CFT and vice versa.

AML/CFT regulation and registration exemptions

- **Part B – Other Business**
- Activities not regulated for prudential/conduct
  - E.g. Lawyers, Accountants, etc

Very few registration exemptions in this part

The AML exemptions project

- **Role** - appointed by the JFSC to stand midway between Government, Industry and the JFSC, to recognise all parties' interests and make independent recommendations to address MONEYVAL's criticisms of Jersey's exemptions regime.
- **Approach** – to form and lead a small team to review the exemptions from the AML/CFT regime; form Working Groups in order to receive input from industry professionals.
- **Challenge** – to address MONEYVAL's findings and meet international standards, whilst also understanding Industry's objectives and meeting Government policy.

My team:

- Helen Hatton – Project Adviser and Working Group Chair
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- Bruce Horwood – Project Adviser
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- Louise Bamber – Project Co-ordinator
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Batch 1 – Nov 2020 to Feb 2021

- Batch 1 considered 9 exemptions relating to funds, SPVs and schemes:

  - TCB - Professional investor regulated scheme
  - IB - Professional Investor Regulated Scheme
  - TCB - Person providing service in relation to functionary of professional investor regulated scheme
  - IB - Special Purpose Investment Business
  - TCB - Special Purpose Vehicle
  - IB - Company that is general partner or trustee of unregulated fund
  - FSB - Company that is general partner or trustee of unregulated fund
  - TCB - Company that is general partner or trustee of unregulated fund
  - TCB - Restricted funds
    (note: time barred pre 2.2.2002)

Batch 1 Working Group members

- A wide group of senior and experienced industry professionals representing:
  - JATCO
  - JCOA
  - JSCCA
  - Law Society
  - Jersey Finance
  - Jersey Funds Association
  - STEP
  - ICSA
  - for coordination purposes, the JFSC and Government of Jersey

Batch 2 – March to May 2021

- Batch 2 considered 19 exemptions relating to:
  - dealing as principal/agent
  - connected/associated persons and companies
  - employee share option
  - certain insurance arrangements.

Batch 2 Working Group members

- Same representation of Industry sectors as for Batch 1
- Some variation of attendee - to pick up areas of specialism

Why Working Groups were important

- Industry's views, experiences and wisdom required:
  - How, why and where these exemptions are used
  - Who uses them and whether the exemptions introduce a money laundering risk
  - What the practicalities would be if they were withdrawn or amended
  - Whether there is a plausible prospect of proving them low risk.

Importance of fundamentals

- The problem with exemptions is that little is known about the business conducted because some structures are exempt from notification, registration or oversight.
- Forming good recommendations for change is difficult and forming an argument to sustain all current exemptions, impossible, under the FATF methodology.

The parameters

- We must:
  - address the issues raised in the MONEYVAL 2015 Report
  - move forward within the permitted FATF Methodology
  - achieve these two objectives in a manner which works for Industry and our international customers

The MONEYVAL view (2015 Report)

479. The rationale [*as put forward by the JFSC*] for such exemptions is broken down in the following four categories:

- The activity is inherently low-risk/not subject to FATF coverage
- There is no person in Jersey to attach AML/CFT obligations to because the activity is conducted in a country outside Jersey
- To avoid a duplication of AML/CFT obligations
- The person carrying out the activity is acting only as principal or for a connected person and not for third parties.

480. The evaluation team partially agrees with the conclusions of the IMF 2009 Detailed Assessment Report of Jersey, that some of the activities excluded from Schedule 2 of the Proceeds of Crime Law are adequately classified as low risk in line with the FATF Standards, which states that when a financial activity is carried out by a person or entity on an occasional or very limited basis such that there is little risk of money laundering activity occurring, a country may decide that the application of certain AML measures is not necessary.

481. However concerns remain regarding nine activities which are excluded from the AML/CFT scope, although the risk is not always proved to be low. According to the Standards, "only in strictly and justified circumstances, and based on a low risk of ML/FT", a country may decide not to apply some or the entire AML/CFT obligations to such financial activities. Therefore, the assessment team believes that any financial activity whose low risk has not been proved, cannot be fully exempted from the obligations set out in the Money Laundering Order.

Recommendations and comments
(Recommendation 23, section 3.6.2)

- 901. The scope of the exemptions should be revised to cover all activities covered by the FATF's definition of financial institution.
- 902. The supervisory strategy should devote appropriate attention to the use of the exemptions under Schedule 2, the use of concessions under Article 18 (SDD) and Money Service Business.
- 903. The registration requirements, the level of the threshold and associated supervision conducted with regard to the MSBs whose turnover is less than £300,000 should be reviewed to address the identified concerns.
- 904. The authorities are recommended to ensure that the JFSC's existing policy statement on cross-border supervision of banks is effectively implemented, in turn to ensure that the supervision of any Jersey banks with operations off the island is appropriately calibrated to the ML/FT risks assessed, including those posed by the relative equivalence of the host jurisdiction.

What was the result?

R.23	LC	**Effectiveness:** • Certain exemptions and cases of SDD did not attract sufficient attention in the supervisory approach of the Commission; • The £300,000 threshold applied to the MSBs is considered to be high in light of the supervisory activity applied so far to these entities; • In one particular case the supervision carried out by the JFSC appeared to have been unduly reliant on the supervision carried out by a foreign supervisor

Understanding the FATF exemptions crite

1.6 **Countries which decide not to apply** some of the FATF Recommendations requiring financial institutions or DNFBPs to take certain actions, should **demonstrate** that:

a) there is **a proven low risk** of ML/TF; [and] the exemption occurs in **strictly limited and justified circumstances**; and it relates to a **particular type of financial institution or activity**, or DNFBP; or

b) a **financial activity** (other than the transferring of money or value) **is carried out** by a natural or legal person **on an occasional or very limited basis** (having regard to quantitative and absolute criteria), such that there is a **low risk of ML/TF**.

Outcomes

- The Working Group discussions had three main areas of outcome:
  - approaches that would characterise good changes
  - the group of exemptions which, if possible, needed to remain
  - the exemptions which were unlikely to prove low risk if a data collection exercise was conducted.

Approaches that **Industry** consider would characterise good changes

- Ones which:
  - place AML/CFT responsibility on the entity engaging in the customer relationship
  - avoid placing unreasonable legal liability on other parties (e.g. the administrator)
  - take the opportunity to simplify the regime and offer consistency of treatment across as many of the fund and scheme structure types as possible
  - avoid duplication of customer due diligence and record keeping, so far as possible.

Approaches a **Regulatory Authority** would consider characterise good changes

- Ones which:
  - meet Government's commitment to demonstrate compliance with FATF standards, thus preserving sustainability of our finance industry
  - do not place huge administrative burdens on the JFSC
  - enable Industry to find sufficient resources to maintain compliance
  - support the exercise of effective supervision
  - enable effective enforcement when serious breaches are found.

Approaches **Government** would consider characterise good changes

- Ones which:
  - satisfy the Government's pledged commitment to demonstrate compliance with FATF standards
  - maintain the attractiveness of Jersey as a location for institutions, industry professionals and customers, alike
  - do not generate further staff shortages in Industry (wage inflation/population pressure)
  - do not place huge administrative burdens on the JFSC or Industry.

…So you can see … a bit of a challenge …. but in fact a high level of overlap and consistency.

Exemptions the Working Groups consider need to remain

- If possible:
  - Connected persons/companies
  - Joint ventures
  - Acting as principal/agent

- Acting as Agent - an area where the full consultation will particularly ask for responses (recommendation: the concepts remain exempt within a fresh consistent definition)
- Associated persons was also on the exemption wishlist to keep, but is a bit non-sequitur - the FATF standard would require CDD to evidence they are an associated person, and then the work is done. Again, responses will be requested in the consultation.

Exemptions unlikely to prove low risk even with data

- Key question discussed: if Industry was put to a full data gathering exercise, would the data prove:
  - there is **a proven low risk** of ML/TF; [and] the exemption occurs in **strictly limited and justified circumstances**; and it relates to a **particular type of financial institution or activity,** or DNFBP; or
  - **a financial activity** (other than the transferring of money or value) **is carried out** by a natural or legal person **on an occasional or very limited basis** (having regard to quantitative and absolute criteria), such that there is a **low risk of ML/TF**.
- First criteria not met - structures all evidence several of the FATF published risk indicator criterion (cross-border, non-face-to-face, PEPs, involve offshore jurisdictions/private investment holding vehicles, nominees/trusts and companies)
- Second criteria did not appear to apply (these exemptions are widely used)
- Accordingly, unable to recommend they remain (though the question will be explained and responses invited in the consultation).

Where does this leave us?

- We have an opportunity to take an exciting stride forward by:
  - simplifying the AML/CFT framework
  - aligning it more closely with FATF terminology
  - clearly placing responsibility on those conducting the activity
  - improving evidence of “substance” for client entities undertaking activity falling within an amended Schedule 2 - who will need to register for AML/CFT oversight
  - shifting the compliance work you currently do for the managed entities from being a cost centre, to being an income centre
  - assisting the JFSC’s demonstrate technical compliance and supervisory effectiveness.

Recommendations

- De-couple the prudential regime from the AML/CFT regime, by:
  - re-drafting Schedule 2 to incorporate FATF terminology
    - Part A - Financial Institutions
    - Part B - Designated Non Financial Business and Professions
    - Part C - Virtual Asset Services and Providers.
  - providing one list of exemptions which meet the FATF criteria
  - introducing a consent/notification/annual confirmation requirement for those persons enjoying an exemption
  - improving definitions such as connected person, principal, joint venture to make clear many are out of FATF

Status of recommendations

- Working Groups
  - liked the approach
  - discussed the proposed solution
  - minuted and fed back to the representative organisations and bodies
  - supported the concept in principal and wider consultation.
- JFSC/Government
  - support the recommendations
  - Government has the lead on AML Policy development

- Concept and details now ready to move to full consultation which will provide wider feedback from Industry.

Remaining work

- Batches 3 and 4
  - Reports still to provided to JFSC - large number of minor exemptions.
  - Working Groups to be reconstituted to discuss our thoughts/incorporate theirs
  - same principles apply to batches 3 and 4 regarding recommendations, it's just a case of working through which are in/out of FATF scope and of those in scope, which can reasonably qualify for an exemption.

- Law Drafting Instructions are largely written

- Consultation paper to be drafted.

Next steps

- Submit law drafting instructions
- Consultation paper – November
- Feedback paper
- Implementation in 2022
- Impacted departments
  - IT
  - Supervision
  - Enforcement
  - Policy
  - Risk
  - Communications

Questions

Jersey Financial Services Commission