

REVISED FATF RECOMMENDATIONS— RETHINKING THE WAY TO CONDUCT AML/CFT RISK ASSESSMENT

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Financial institutions (FI) and designated non-financial bodies and professions (DNFBP) are already obliged to put in place and maintain policies and procedures to prevent and detect money-laundering, but now that the Financial Action Task Force (FATF) has issued revised Recommendations, they will have to rethink the way they address risk assessment and management, risk-sensitive customer due diligence and monitoring measures.

The FATF has called upon all countries to implement its revised Recommendations effectively in their national systems. Although the recommendations are not binding, the FATF requires countries to have effective systems for preventing and addressing money laundering, terrorist financing and the financing of the proliferation of weapons of mass destruction. The Recommendations also aim to consolidate the role of financial intelligence units and to protect the integrity of the financial system by providing governments with stronger tools with which to take action against financial crime.

The integration of anti-money laundering (AML) and combating financing of terrorism (CFT) measures into the revised 40 FATF Recommendations demonstrates that the financing of terrorism remains a serious concern for the international community. This approach will ensure that FI avoid duplication when considering AML/CFT risks.

“The revised Recommendations include requirements for stronger safeguards in the financial sector, strengthened law enforcement tools and improved international cooperation.”
— Giancarlo Del Bufalo, president of the FATF

WHAT ARE THE IMPLICATIONS FOR FI?

The revised recommendations shift the focus of compliance to a risk-based approach, to allow for a more reasonable distribution of available resources within FI. The process of recognizing new risks and developing methods to offset and manage them will be affected as new areas of compliance are brought into play.

There is greater risk that FI might find themselves considered to be dealing with clients who have proceeds of crime because the revised recommendations now capture suspected proceeds of tax crimes within the scope of suspicious activity reports. Although this is a new addition, in many countries tax evasion may not and will not be a predicate offence to money laundering. FI need to be aware of the risk of dealing with clients in non-compliant countries.

Due to the lack of transparency in ownership of legal persons, the revised standards bring a new approach to the identification of beneficial owners. This is aimed at preventing the misuse of legal persons for money laundering by ensuring there is “adequate, accurate and timely information on the beneficial ownership and control of legal persons”. This should make it more difficult for criminals and terrorists to conceal their identities or hide their assets behind legal persons and arrangements. The obligation to gather reliable information regarding beneficial ownership and control of companies, trusts and other legal persons or legal arrangements could potentially create burdensome and expensive customer due diligence (CDD) measures for FI.

The table below provides an analysis of some of the main changes and its challenges for FI.

MAIN CHALLENGES FOR FINANCIAL INSTITUTIONS

Weapons of mass destruction

Changes	<ul style="list-style-type: none"> • The FATF expanded its role from just money laundering and terrorist financing to include weapons of mass destruction (WMD). Suspicious transaction reporting and risk assessment requirements are likely to be expanded to match that new scope.
Challenges	<ul style="list-style-type: none"> • Risk of incorrect spelling in the designated entry or individual list • The implementation of general vigilance of proliferation relevant to the UNSCRs is challenging for FI. FI may lack relevant information to screen international payments system, bill of credit or bill of lading to identify proliferation financing. • The risk of criminal or civil liability on FI is not clear while assisting in enforcing proliferation financing.

Inclusion of tax crimes as a predicate offense for money laundering

Changes	<ul style="list-style-type: none"> • The list of predicate AML offenses has been expanded to include tax evasion and other serious tax offenses.
Challenges	<ul style="list-style-type: none"> • Variations in definition of “tax evasion” or “tax crimes” between jurisdictions may expose FI to risk of dealing with proceeds of crime. • Lack of expertise and the inherent difficulty of detecting tax crimes.

Revised CDD measures in relation to beneficial ownership

Changes	<ul style="list-style-type: none"> • Provides examples of the process to follow when identifying beneficial ownership and control of companies as part of CDD measures • Responsibility of individual countries to set appropriate numerical threshold for determining controlling ownership of a legal person. The threshold in the 3rd Money Laundering Directive is presently set at 25 percent.
Challenges	<ul style="list-style-type: none"> • Absence of a proper registry in many jurisdictions would make the identification of “beneficial owner” difficult • The process to identify the natural persons who ultimately have a controlling ownership interest may be challenging • Difficulty to identify the natural person holding a senior management position in multi-layered structure when there is doubt who holds the beneficial ownership, or when no such natural persons can be identified.

MAIN CHALLENGES FOR FINANCIAL INSTITUTIONS

Strengthening of transparency requirements in relation to beneficial ownership

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| Changes | <ul style="list-style-type: none">• Connected to the new Recommendations referred above, to enable financial institutions and others to conduct appropriate CDD on companies and their beneficial owners, the revised Recommendations require national governments to ensure that all companies maintain basic information relating to the company, its directors and shareholders |
| Challenges | <ul style="list-style-type: none">• Dealing with clients from non-compliant countries with no official database that are “adequate, accurate and current.” |

Third-party reliance and group-wide compliance programs

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| Changes | <ul style="list-style-type: none">• Circumstances in which financial institutions may rely on third parties to undertake due diligence and on the application of AML and CFT measures in foreign branches and subsidiaries• Clarifies the distinction between an outsourcing and agency relationship, to allow for more flexible intra-group reliance, and for the level of country risk to be offset.• Requires the implementation of group-wide compliance program to an FI’s foreign branches and subsidiaries |
| Challenges | <ul style="list-style-type: none">• Some jurisdictions may not allow for information sharing at group level due to the application of data protection and privacy laws to intra-group cooperation and reliance.• Difficulties of applying group-wide policy to sharing information when part of the group structure falls outside regulated activity. |

Liability of directors and senior management for AML compliance lapses

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| Changes | <ul style="list-style-type: none">• The revised Recommendations extend the application of sanctions (criminal, civil, or administrative) so that they apply not only to regulated entities, but also to their directors and senior management for failure to comply with anti-money laundering and anti-terrorist financing requirements. |
| Challenges | <ul style="list-style-type: none">• Practical problems in identifying senior management given the wide spectrum in which entities are managed |

MAIN CHALLENGES FOR FINANCIAL INSTITUTIONS

Politically exposed persons (PEP) obligations

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| Changes | <ul style="list-style-type: none">• The FATF definition of PEP includes those which are domestic and foreign, as well as their close associates. |
| Challenges | <ul style="list-style-type: none">• Lack of guidance on the definition of PEP and the difficulty of identifying families and close associated of PEPs that are cause for concern or high-risk. It might be difficult to trace those connections as marriages, wives, children, and siblings are not legally recorded in some countries, but are more of a cultural or religious practice so that such records are not in the public domain.• What function is considered as “prominent” and which family members and close associates would be included?• Absence of an authoritative list of PEPs.• Where PEP definition includes “senior public official”, the process of due diligence might be difficult because of a lack of reliable information and it may be difficult to monitor people who have moved ranks from “middle” position.• No availability of list of officials of international organizations.• Difficulty of identifying legitimate circumstances for the relative of a foreign public official to need financial services abroad. |

SUMMARY

The revised FATF standards are intended to provide a stronger framework to combat AML/CFT and the financing of the proliferation of weapons of mass destruction. Some of the changes bring immediate obligations on FIs’ risk assessment and their policies and procedures. It also increases the risk that there might be a failure to disclose suspicious activity to competent authority as a result of increased exchanged of information among law enforcement agencies around the world.

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