Anti-Money Laundering Update – Domestic and European developments

Why Firms Need to Get this Right

The Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, as amended by the Criminal Justice Act 2013 (the “CJA”), requires “designated persons” to implement policies, procedures and controls to detect and prevent money laundering and terrorist financing.

Anti-money laundering and counter terrorist financing (“AML/CTF”) remains a key priority for the Central Bank of Ireland (the “Central Bank”) and has been listed as an enforcement priority every year (including this year) since 2011 when the Central Bank published its first ever list of enforcement priorities. The Central Bank will continue this focus in 2015 ahead of the mutual evaluation of Ireland by the Financial Action Task Force, which is expected in quarter four 2016.

Compliance with the CJA is a legally enforceable obligation, breaches of which are subject to criminal and/or administrative sanctions. Since the introduction of the CJA and until this week, there had been a total of three settlement agreements that related to breaches of the CJA with settlement figures of €21,000, €65,000 and €50,000.
Whilst previous settlements were not that large in monetary terms, the latest settlement reached with the Central Bank this week was €1.75 million. This evidences a significant increase from the previous settlements. One of the factors considered by the Central Bank in deciding on the settlement amount was the need for the settlement to have an appropriate deterrent impact for other regulated firms. The Central Bank also took into account the extensive and proactive remediation implemented by the firm.

The Central Bank’s publicity statement said:

“The level of the €1,750,000 fine imposed reflects a significant increase to penalties imposed previously by the Central Bank for failures in respect of a firm’s anti-money laundering/countering the financing of terrorism procedures…”

“This case falls within three key priority areas for the Central Bank’s Enforcement Division and highlights the fact that we will take action where an authorised firm is: (1) insufficiently well controlled to guard against AML/CTF risk; (2) fails to implement systems and controls that are adequate to enable it to comply with its regulatory obligations; or (3) outsources important functions to a third party without putting in place adequate controls over those functions and / the relationship with the third party…”

Deficiencies identified by the Central Bank included the governance around AML/CTF outsourcing, the retention of records in relation to Customer Due Diligence (“CDD”), failure to ensure initial and / or follow-up training was undertaken by retail agents and shortcomings in the systems and controls in place to identify suspicious activity.

This latest settlement agreement related to issues that arose prior to the increase in the maximum fines available to the Central Bank (Supervision and Enforcement) Act 2013 on 1 August 2013. If a firm is sanctioned for a regulatory breach that occurred after 1 August 2013, the fines can be 10% of annual turnover (where this is more than €10 million) or up to €1 million for an individual. There would also be reputational damage associated with enforcement action being taken for a breach of given the nature of these requirements under the CJA. The Central Bank last year indicated that it intends to start using its enforcement powers against individuals and utilising its Inquiry Panel to do so. The Central Bank has said:

“The Bank will use to the fullest extent its enforcement powers to hold financial services providers and individuals to account. We will act in a transparent way so that the regulated community and wider public are made aware of the outcomes of our actions.

Where individual responsibility is at the core of suspected breaches of financial services law, the Bank will focus enforcement attention on where the responsibility falls, including through the use of its administrative sanctions and criminal powers.

In order to change behaviours which fall short of expected standards those responsible for the impugned behaviours must be held accountable for their actions.”

The importance, therefore, of fully and effectively implementing the requirements in the CJA cannot be emphasised enough.
Central Bank Feedback from Inspections in 2014

The Central Bank undertook themed inspections and issued a “Dear CEO” letter in October 2012 highlighting examples of non-compliance with the CJA and setting out its expectations and key areas requiring improvement in the financial services industry.

More recently, the Central Bank undertook a number of inspections in the funds industry in October 2014 and the feedback from these inspections is expected to be published in the near future. In the meantime we have reviewed some of the feedback that has been issued to certain clients following an inspection by the Central Bank ("Funds Feedback Letter"). The Central Bank appointed external consultants to undertake these inspections and so had the resources available to be extremely thorough in their review which included looking at risk assessments, investor files, policies and procedures, board minutes, reports relating to AML/CTF etc.

The Central Bank also undertook inspections in the banking sector in 2014, which resulted in its ‘Report on Anti-Money Laundering/Countering the Financing of Terrorism and Financial Sanctions Compliance in the Irish Banking Sector’ (the “Banking Report”), which was published in February this year and again identified extensive areas of non-compliance with the CJA. Although the Banking Report relates to feedback from inspections in the banking sector, the Central Bank specifically states:

“While the banking sector in Ireland is the specific focus of the Report, many of the issues raised are relevant to the broader financial services sector in Ireland. The Central Bank expects all financial and credit institutions to carefully consider the issues raised in the Report, and to use the Report to inform the development of AML/CTF and FS frameworks.”

We have set out below some of the key findings from the Funds Feedback Letter and the Banking Report. The findings are very detailed and this is only intended to be a summary to highlight the main issues raised by the Central Bank. A more detailed analysis has been undertaken separately.

1. **Risk Assessment**

A critical component of any compliant AML/CTF framework is the adequate assessment of all relevant risks faced by the designated person in the conduct of its business. A detailed risk assessment must be documented, approved by the board of directors (the “Board”), fully implemented and reviewed regularly and as necessary in line with emerging risk or the development of new business. The methodology for undertaking the risk assessment must also be documented.

2. **CDD**

A specific process must be in place for senior management of the designated person (which must be defined internally by the firm) approving PEPs in all cases prior to conducting transactions or providing services to the individual in question. As well as initial screening for new customers, PEP screening must also be undertaken on a daily basis of all existing customers to identify whether any individual has become a PEP. Designated persons must retain appropriate CDD documents on file as evidence of compliance. Firms must define what is meant by “as soon as reasonably practicable” in their internal procedures in relation to obtaining CDD documentation from customers. Appropriate escalation and exit strategies must be in place for customers who partially or do not comply with CDD documentation and information requirements.
3. Monitoring, Reporting and Management Information

In order to assess the effectiveness of controls, policies and procedures, sufficient and appropriate information (both qualitative and quantitative) needs to be collected and assessed by designated persons on an ongoing basis. A well-documented embedded monitoring programme, including a review of systems, should be in place to ensure ongoing compliance with the CJA. Appropriate trigger events or periodic reviews (as defined in the policies and procedures and explained to the Board and staff) should be used to identify when and how to keep CDD documentation and information up-to-date. Systems and processes for reporting should be regularly reviewed and challenged to ensure an informed view can be taken in identifying and mitigating developing risks and trends. The actual workflow / process for escalating and filing suspicious transaction reports (“STRs”) should be set out in the designated person’s procedures. A detailed rationale should be maintained on file as to the reasons why an STR was or was not made in each case.

A stand-alone Money Laundering Reporting Officer (“MLRO”) report should be produced on an annual basis including an assessment by the MLRO as to whether the designated person’s controls are sufficient to ensure compliance with AML/CTF obligations and recommending any remedial actions required.

4. Governance and Oversight

Designated persons are expected to have clearly defined roles and responsibilities. Clearly defined escalation procedures should also be in place. The Board, which is ultimately responsible for AML/CTF compliance, must be informed of any issues and the progress of any remediation required. Designated persons are expected to demonstrate that the Board has been involved to an appropriate level, with evidence including minutes, in defining the adopted approach. The thorough assessment and challenge of risk and suggested controls is a regulatory imperative.

A formal and comprehensive contract or service level agreement should be put in place where any AML/CTF tasks are outsourced. Consideration should be given to the impact of an expected or unexpected termination of this contract. A suitability assessment should be undertaken of any parties performing services on behalf of a designated person. Failure to adequately test an outsource provider’s transaction monitoring system can result in inadequate oversight of key metrics.

Designated persons must be able to demonstrate that all of the requirements in relation to reliance letters in section 40 of the CJA are met where they rely on third parties under the CJA.

5. Policies, Procedures and Training

The MLRO and senior management should be involved in developing AML/CTF policies and procedures, which must be formally reviewed and signed-off. The Central Bank emphasised that policies and procedures should be fully embedded and reflect the actual practice within a designated person. Policies and procedures should be reviewed in response to events, regulatory changes, additional guidance or emerging risks. Policies and procedures should be subject to independent review and testing. Even where AML/CTF activities are outsourced,
the designated person must also have its own documented policies and procedures for internal suspicious transaction reporting (for the Board and staff).

Training must be provided in relation to the designated person’s policies and procedures to ensure that staff and the Board understand key processes and their own obligations in relation to AML/CTF. The MLRO should proactively identify regulatory obligations and any changes to same and update internal procedures and processes when required.

The Fourth AML Directive

Over the past number of weeks, the text of the ‘Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing’ (the “Fourth AML Directive”) has been nearing finalisation.

The Commission and the Council of the European Union have endorsed the text agreed in December by the Presidency of the Council of the European Union and the Parliament of the European Union, having considered the totality of the measures and the impact on the internal market balanced with the requirements to safeguard the financial system from abuse.

It is expected that the final text will be published in the Official Journal of the European Union before the end of May 2015. This will trigger a two year period within which member state implementation must take place.

The key changes relate to;

- **Beneficial ownership**: Member States will be required to maintain a centralised log that can be consulted;
- **PEPs**: Extension of scope to include domestic PEPs;
- **Risk Based Approach**: Increased focus of designated persons assessing and managing their own risks;
- **Simplified Due Diligence**: No automatic designation under the legislation as simplified, standard and enhanced – to be risk based (extensions based on well-defined risk parameters); and
- **Sanctions for breaches**: €5 million or 10% of annual turnover for legal persons or €5 million for a natural person.

In addition to the Fourth AML Directive, the existing ‘Wire Transfer Regulation’ (Regulation (EC) No 1781/2006) will be replaced in the near future by a revised regulation, which will be directly effective once it enters into force.
How Matheson can help

All designated persons are required to review their AML/CTF frameworks to assess compliance with the expectations of the Central Bank as set out in the Banking Report and other feedback (when published). Even if only limited amendments are required, firms will be in a better position having completed a comprehensive review, should the Central Bank undertake an inspection in their firm as they will be able to demonstrate that they considered the feedback and took action to assess their compliance with same.

We provide a number of services to assist clients in the area of AML/CTF including:

- Reviewing policies and procedures and undertaking a full gap analysis against the expectations of the Central Bank.
- Assisting clients with the implementation of new regulatory requirements in relation to AML/CTF.
- Providing annual and ad hoc update training to relevant staff and senior management, to ensure any regulatory or legal changes are notified to the relevant staff and senior management in a timely manner. We also offer AML/CTF interactive workshops.
- Undertaking a full and detailed review of a firm’s risk assessment.
- Undertaking a mock-inspection to assess the extent of compliance, in practice, with the firm’s own internal policies and procedures in relation to AML/CTF. The Central Bank has moved away from the purely desk-top approach to reviews and inspections and the recent inspections in this area were very thorough. The Central Bank, in particular, sought evidence of how the policies and procedures had been embedded by designated persons.
- Assessing the governance structures, roles and responsibilities and reporting structures in place to ensure a robust AML/CTF framework is in place that complies with the expectations of the Central Bank. This includes reviewing board minutes to ensure sufficient engagement at senior management level in relation to AML/CTF matters is being captured and assessing the adequacy of reports provided by delegates to the board of directors.

Contact

Joe Beashel
Partner
T: +353 1 232 2101
E: joe.beashel@matheson.com