Enhanced Customer Due Diligence
Content

- Banking requirements
- Correspondent banking
- Monitoring and Filtering
Banking requirements

- Main requirements are laid down in:

  - The 40+9 FATF Recommendations (1990/2002)
  - Customer Due Diligence for Banks – BCBS, October 2001
  - 3rd EU Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing of 26 October 2005
  - The 1992 Annunzio – Wylie Anti Money Laundering Act
Main document is “Customer Due Diligence for Banks – BCBS, October 2001”

Basic principles:

A. Thorough client identification and on-boarding process
B. Transactions monitoring and transaction filtering
C. Ongoing KYC updates
D. Robust risk management
Basic Principles - Thorough client identification and on-boarding process

- Applies to all kind of clients
- Basis for Knowing the Customer
- Dynamic in nature and must therefore continue after on-boarding process
- Different requirements for different purposes...
Identification requirements

**Natural Persons**

- legal name and any other names used (such as maiden name);
- correct permanent address (the full address should be obtained; a Post Office box number is not sufficient);
- telephone number, fax number, and e-mail address;
- date and place of birth;
- nationality;
- occupation, public position held and/or name of employer;
- an official personal identification number or other unique identifier contained in an unexpired official document (e.g. passport, identification card, residence permit, social security records, driving licence) that bears a photograph of the customer;
- type of account and nature of the banking relationship;
- signature.

**Corporate Entities**

- name of institution;
- principal place of institution’s business operations;
- mailing address of institution;
- contact telephone and fax numbers;
- some form of official identification number, if available (e.g. tax identification number);
- the original or certified copy of the Certificate of Incorporation and Memorandum and Articles of Association;
- the resolution of the Board of Directors to open an account and identification of those who have authority to operate the account;
- nature and purpose of business and its legitimacy.
Basic Principles - Thorough client identification and on-boarding process

Client due diligence means taking into account all those factors that the bank needs to determine whether a client is and remains acceptable to the bank. The assessment must be risk-based and sufficiently extensive for the bank to be able to form a reasonable belief and to be confident that it:

- Knows its client;
- Has insight into the nature and background of the client and their (commercial) activities;
- Is aware of the existence and identity of beneficial owners and beneficiaries (if any);
- Has no reason to believe that the client’s funds and assets have an illegitimate source;
- Has insight in the client’s needs for products and services;
- Knows which risks it runs in order to manage those risks appropriately.
Basic Principles - Thorough client identification and on-boarding process

Minimum procedures with regard to Client Due Diligence:

- Internal client on-boarding written procedures
- No account opening prior to completion of CDD
- Clearly described deviation and emergency procedures
- Each account (clients) must have a relationship owner – avoid “orphan” accounts
- Regular training and education of staff (particularly client-facing staff)
- Clear and well defined definitions of high, medium and low risk
- Clear escalation procedures to higher levels of management
- Written instructions for enhanced client due diligence procedures
- Clear instructions regarding the responsibilities of client-facing staff and the compliance function
- Procedures for knowing the customer of the bank’s customers (second ring of customers)

- Procedures for CDD in connection with correspondent banking
Basic Principles - Thorough client identification and on-boarding process

Minimum procedures with regard to Client Due Diligence:

- Enhanced due diligence regarding high risk clients
  - Enhanced due diligence must be imposed on a risk sensitive basis
  - Increased number of board members must be identified and screened
  - Identification of Ultimate Beneficiary Owner (UBO) and other main shareholders
  - In-depth understanding of the client’s business
  - Understanding of the prospective use and purpose of the account
  - Ultimate decision making on account opening and on-boarding of the client to be made by senior management
  - Enhanced due diligence by default when politically exposed persons (PEPs) are involved as owners of board members
Basic Principles - Transactions monitoring and transaction filtering

Minimum procedures with regard to transaction monitoring and filtering:

- Define client profiles for each client account
- Client profiling must be audited for accuracy and appropriateness
- Have software in place enabling the monitoring of all transactions on all accounts
- Clear follow up and escalation procedures on hits
- Procedures ensuring confidentiality of reporting of unusual transactions to FIU
- Management information (MI) on monitoring hits
  - MI on (false) positive hits
  - MI on follow up actions
  - MI on consequences for client risk categorisation
- Clear procedures for exiting clients whose profile or transactions give rise to suspicion of money laundering or terrorist financing
Basic Principles - Transactions monitoring and transaction filtering

Minimum procedures with regard to transaction monitoring and filtering:

- Screening of all payment transactions against latest and most accurate screening lists issued by Central Banks and Government
- Audit of accuracy of screening lists
- Strict written procedures for filter hits ensuring freezing of money and reporting to FIU
- Regular management information (MI) about hits
  - MI on number of hits divided into positive and false positive hits
  - MI on escalation and decision making
  - MI on consequences of client risk categorisation
- Clear procedures for exiting clients whose profile or transactions give rise to suspicion of money laundering or terrorist financing
Basic Principles – Ongoing KYC process

Minimum procedures with regard to ongoing KYC process:

- A diligent process in place to ensure regular update of the KYC with deadlines regarding the re-assessment of clients
- Clear deadlines for re-assessing the clients’ risk profile
- A system in place ensuring diligent monitoring of the clients’ reputation and activities
- Regular meetings with clients to update the client information
Basic Principles – Robust risk management

Minimum procedures with regard to robust risk management:

- Primary focus on:
  - Reputation risk
  - Operational risk
  - Legal risk and
  - Concentration risk

- Effective KYC procedures form a pivotal part of risk management

- Internal audit must independently evaluate the quality of risk management
Correspondent Banking

Issues regarding Client Due Diligence

- Ultimate beneficiary and/or originator of the transaction is (are) unknown

- Reliance must be placed on due diligence conducted by other banks

- How does the bank protect its own integrity in regards of money laundering and terrorist financing?
Correspondent Banking

- Correspondent and respondent banking is
  - Entering and maintaining a relationship with other banks
  - Entering into a relationship with other banks is not very different from engaging with a new client
  - A critical review is warranted with regard to
    - The other bank’s reputation
    - The law and regulations in the country of domicile
    - The latest FATF country review for the country of domicile
    - Other sources of information about the bank and the country of domicile
Correspondent Banking

Reliance to be placed on other banks

- Since the bank cannot perform its own client due diligence it must rely on the due diligence performed by the correspondent bank
  - Monitoring of correspondent bank’s ongoing reputation
  - Monitoring of transactions initiated by correspondent bank
  - Perform filtering of each transaction against latest filter lists issued by Central Banks
  - Regularly review the relationship with correspondent banks and determine if the relationship can be pursued
Correspondent Banking

Protecting integrity

- Do not maintain correspondent / respondent banking relationships with banks whose reputation is at stake

- Remain critical with regard to countries of domicile
  
  – Critical FATF reviews
  
  – Bad press
  
  – Change of political situation
  
  – Known reputation for illicit business

This may result in closing the correspondent banking relationship
Content

Banking requirements

Correspondent banking

Monitoring and Filtering
Monitoring and filtering

Important features of monitoring and filtering

- Client profiling
- Transactions monitoring
- Transactions filtering
- Reporting of unusual transactions
Monitoring and filtering

Client profiling

- Normal client behaviour
- Highly predictable
- Changing behaviour over time
- Setting appropriate parameters
Monitoring and filtering

Monitoring

- Outlier detection
- Message screening
- Sequence analysis
- Analysing links between clients

This may result in filing an unusual or suspicious transaction report with the FIU.
Monitoring and filtering

Filtering

- Application of the latest filters
- Certain transactions are prohibited as a result of international law and regulations
- Freezing of amounts

This may result in filing an unusual or suspicious transaction report with the FIU.