ACAMS conference: Regulators cracking down on 'know your customer' controls

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Financial institutions will need to pay special attention to their "know your customer" and enhanced due diligence controls as regulators worldwide increase their scrutiny in these areas, an industry conference has heard. Many regulators have indicated that they will increase their supervision of banks' onboarding systems and their processes for dealing with high-risk customers, including politically exposed persons (PEPs), in response to international pressure. The policy shift follows the Financial Action Task Force's (FATF) recent moves to place more pressure on financial institutions to identify the beneficial owners of accounts and to carry out enhanced due diligence where risks are identified.

Participants at this year's ACAMS Asia-Pacific regulatory summit in Bali heard that beneficial ownership, "know your customer" (KYC) and enhanced due diligence (EDD) would become regulatory flashpoints as a result of the FATF's latest edict. Regulators and senior industry figures told the conference that banks and other financial institutions needed to conduct a review of their controls in this area to make sure they were in line with their respective regulators' expectations.

In February, the FATF revised its 40+9 recommendations to place much more scrutiny on the onboarding processes for PEPs, including drilling down to find the beneficial owners of transactions. This obligation remains a huge challenge for financial institutions and highlights the need to be able to point regulators to a proportional compliance framework.

Scott Burton, the global co-head of client identification compliance at Credit Suisse, told delegates that it was essential to take a global view of KYC and EDD. Burton said that the globalised nature of modern finance and money laundering meant that an organisation that spans different jurisdictions needs to have a consistent framework in place for monitoring customers and transactions. Credit Suisse had embraced this concept and took the view that AML risk was "not limited to international boundaries."

Burton said that banks needed to have effective systems and controls in place that set out the circumstances in which enhanced due diligence would be needed for a specific customer or transaction. "At the end of the day, if you can't get comfortable [with the information you have] you need to do due diligence on the underlying customers or reject the relationship," he said.

"It's about having processes in place to show that you've got plausible and correct information on the client, who they are, their source of funds. This will go a long way towards protecting the financial institution, reputational risk and regulatory compliance and audit issues."
Burton, who also heads up Credit Suisse's Asia-Pacific AML operations, said that testing systems and controls would become increasingly important. Credit Suisse had developed a global strategy to audit its KYC and EDD processes to ensure that they were both effective and consistent across the various jurisdictions in which the bank operated.

"In terms of self-testing we have put together a template that allows us to take the same approach in terms of testing our program in each location around the globe. So this also helps to ensure that we're doing things much the same way in each location," Burton said.

**Global challenges**

Some of the challenges for banks with global operations include doing business with entities in "non-FATF jurisdictions". Speakers at the conference said that if a bank is doing business with an intermediary or a customer in one of these countries it would be an instant trigger for some level of EDD.

"If operating in a non-FATF jurisdiction you need to check whether the intermediary has an AML framework that meets FATF standards," Burton said. The FATF had made it clear that it wanted to see more due diligence in terms of identifying the beneficial owner behind an account or a transaction, he said.

Diana Cojerean, senior manager for internal audit at Macquarie Group, said that KYC and EDD were classic examples of an area where compliance, audit and assurance were "complementary" and needed to work closely together. She said that it was important to set out clear policies and procedures and then run regular tests to ensure that the controls were working as intended. Cojerean said that Macquarie had a policy of "four eye checks" to make sure that KYC and EDD was being performed properly.

"You want to make sure you have a dedicated 'four-eye' process that provides feedback on those policies and procedures," Cojerean told the conference. "In this area compliance, audit and assurance are very complementary."

According to Cojerean it was important to run an assurance program at least on an annual basis to ensure that systems and controls were keeping pace with emerging risks and the bank's business profile. She said an annual assurance program should be risk-based and flexible enough to respond to business changes and fluctuating client volumes across various areas within the business. It was important to schedule ad hoc reviews to follow up on any areas of concern that have been highlighted in the audit process, she said.

"Most of you have businesses that change continuously and your assurance function should change along with that," Cojerean said.

A good audit program should also set out clear reporting and escalation lines, so that problem areas are followed up immediately and comprehensively. In Macquarie's case, it tries to keep these processes short and simple and puts in place a defined follow-up process for any red flags that might emerge during an audit. The emphasis, in all of these areas, is on encouraging good communication between the various business units that are involved.

"You'd be surprised how often even within the same company people don't talk to each other across different teams," Cojerean said.

**Risk and return**

When an institution identifies a customer as "high-risk", it needs to have clear procedures in place to make sure that an appropriate response is undertaken. Triggers for EDD might include a business relationship with a politically
exposed person (PEP), clients in high-risk countries, or clients that are involved in high-risk sectors such as arms manufacturing or precious metals.

When a client is identified as "high risk" the institution needs to obtain additional documentation, find out who the beneficial owners are on a particular transaction and use third-party databases to conduct further checks. They may even require a relationship manager to visit to a client's place of business or set up meetings with the client on a regular basis to verify that everything is "above board".

Continuing reviews for these customers are critical, according to Burton. It may be necessary to place the client on a watchlist, report special high-risk transactions and schedule follow-up appointments or site visits.

"For high-risk clients we review those clients at least once a year. As an example, for PEPs a normal PEP would get reviewed once a year. Sensitive PEPs would get reviewed every six months. The review process would involve a transaction 'look back' and senior executive certification. All those things would come together to review that existing relationship," Burton said.

Recordkeeping, of course, is critical with customers that run a higher risk of being subject to regulatory scrutiny. It is essential with these customers that the bank can justify its actions and the risk-based rationale for its actions. At Credit Suisse, the compliance team has put in place a standard for KYC information and documentation that it has dubbed "CAAT" — complete, accurate, accessible and transparent.

Burton also stressed the fundamental importance of ensuring that a KYC and EDD framework has support from senior management. He said that it was essential for management to establish a culture where staff know that these aspects of the compliance framework are taken seriously by the financial institution.

"The employees need to take this whole exercise quite seriously. It could also be a case of having disciplinary action against people who are not doing what they're supposed to do in this area. But I think the tone from top is the most important thing to make sure that the awareness of what's required is filtered down from the senior executives within the organisation," Burton said.

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