

FSC Newsletter

Retrospective "Know Your Customer" reviews

Recent UK announcements

The Financial Services Authority (FSA) in the United Kingdom have recently published the result of a cost benefit assessment of their proposals to effect a rule change to require firms to undertake a retrospective "Know Your Customer" (KYC) review on all clients in place prior to 1 December 2001. As a result of the cost benefit exercise, the FSA has now decided not to pursue this proposal. Instead, it will rely on the existing requirements of the UK system that all KYC documentation must meet current standards, without requiring a retrospective review.

This does not mean, as has been occasionally reported, that KYC checks on pre 1994 business are not required in the UK or that the quality of checks made after that date do not need to be brought up to current requirements. Indeed the FSA have stressed to all their regulated firms:

"That the need to identify your customer is an existing legal and regulatory obligation and considered by law enforcement agencies and the FSA to be an essential element of anti-money laundering controls."

Position in Gibraltar

As a result of the FSA announcement, the Commission has been asked what impact this decision has upon the current and proposed requirements in Gibraltar regarding such reviews. It is therefore appropriate, at this time, to confirm what the requirements are.

The Commission remains committed to meeting international standards in the fight against money laundering and the financing of terrorism. To achieve this we must comply with the recommendations set out by the Financial Action Task Force. These recommendations include that KYC requirements should also apply "to existing customers on the basis of materiality and risk, and [firms] should conduct due diligence on such existing relationships at appropriate times."

Firms covered by the Criminal Justice Ordinance

Within Gibraltar, financial institutions covered by the Criminal Justice Ordinance (CJO) have been required, since April 1995, to apply KYC procedures to all accounts opened since that date. Whilst there were originally no formal review process of KYC documentation requirements for those who were clients prior to that date, such a requirement, was instituted by the FSC in September 2002. This requirement entailed the identification of missing KYC documentation using a pre-formatted form (known as Form K), and was completed by the relevant financial institutions by February 2003. A remediation programme to obtain the identified missing documentation is currently being undertaken by the financial institutions involved. The speed with which firms should undertake this will vary from firm to firm, and no formal deadlines have been set.

In respect of KYC checks undertaken since 1995, the Commission believes that the Anti-Money Laundering Guidance Notes have evolved making the KYC process less ambiguous. The Commission therefore encourages firms, on the basis of materiality and risk, to review their earlier KYC documentation to ensure it meets current requirements.

Fiduciary service providers

Whilst fiduciary service providers are currently outside of the scope of the CJO, they will be brought within its scope as a result of the transposition of the 2nd EU Money Laundering Directive. They have also been under a regulatory duty to undertake KYC checks since 1996. However, in common with the findings of regulators in a number of other jurisdictions, on-site reviews have highlighted that KYC procedures have not always been up to the expected standard. The Commission, therefore, will require that fiduciary service providers undertake a Form K review of all their active customers once they are brought under the CJO. They will then need to undertake a remediation programme to obtain the identified missing documentation. The speed with which firms should undertake this remediation, as with other financial institutions vary from firm to firm, and no formal deadlines are currently proposed.

The Commission is aware that a number of fiduciary service providers are already at an advanced stage in this regard

Impact

Whilst the Gibraltar requirements are less prescriptive than those originally proposed by the FSA, our approach still means that all customers of authorised firms will be assessed by those firms to determine whether adequate KYC information is on file and rectification measures implemented where necessary. This is essential, as, where there are customers within any financial system who have never been identified for AML purposes, this is a risk to that jurisdiction, whatever its size.

The risk that such unidentified persons may be engaged in money laundering or financing acts of terrorism is a risk that neither we, nor any centre committed to fighting these twin evils, should take.

The approach already being taken in Gibraltar represents a strong and sensible deterrent against the abuse of our licensed institutions by criminals.

The issue of materiality and risk in undertaking the "Know Your Customer" reviews

In reminding firms as to their obligations in the fight against money laundering and combating the financing of terrorism, the Commission is taking the opportunity to reemphasise the importance of assessing materiality and risk in undertaking rectification measures.

The Commission is aware of situations where regulated firms' own requirements have been applied in a dogmatic fashion without such consideration. This has resulted in established customers, who do not have sizable deposits or investments and who are, in fact, well known to the institution concerned, being required to provide significant additional identification information.

Such an approach is not in line with the AML requirements and diverts resources from more material risks. Furthermore it devalues the importance of the fight against money laundering in the eyes of the public.

Therefore, in conducting the remediation exercise regulated firms are requested to ensure they are conducting the necessary materiality and risk assessment. Materiality itself will need to be determined by the firms themselves but the Commission expects such a determination to include the importance of the client to the firm (both in scale and income) and size and frequency of any transactions involved. The risk assessment will cover issues such as the business of the client, jurisdictions in which the client conducts business, and significant changes in client activity (whether in volume, frequency or location).

Background

- 1) The Financial Services Authority (FSA) in the United Kingdom have recently published the result of a cost benefit assessment on their proposals to effect a rule change to require firms to undertake a retrospective "Know Your Customer" (KYC) review.

This rule change would have required all financial institutions to have conducted a review of all of their clients who had become clients prior to December 2001 to ensure that they had been identified or that the risk of money laundering is minimal. Two options had been considered:

1. A structured risk-based review by all firms with a fixed completion date, similar to that being undertaken by the six largest UK banks; or
2. A less prescriptive approach based on general guidance, putting greater responsibility on firms.

Following the cost benefit analysis the FSA decided not to proceed with either option. Nevertheless the FSA has reaffirmed that "The senior management of each firm must satisfy itself that its systems are appropriate for dealing with money-laundering risks arising if they have not identified existing customers adequately. For a number of firms the right approach will be for them to conduct a risk-based review of all or some of their existing customers."

- 2) The Financial Action Task Force on Money Laundering (FATF) is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering. It was established by the G-7 Summit that was held in Paris in 1989, in response to mounting concern over money laundering.

The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing the action that had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, the FATF issued a report containing a set of Forty Recommendations, which provide a comprehensive blueprint of the action needed to fight against money laundering. These recommendations, which have been the subject of review (most recently in June this year), form the core benchmark in the global fight against money laundering. The Forty Recommendations have been supplemented by a further eight special recommendations, covering the issue of combating the funding of terrorism. These were introduced following the terrorist attacks on 9/11.

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