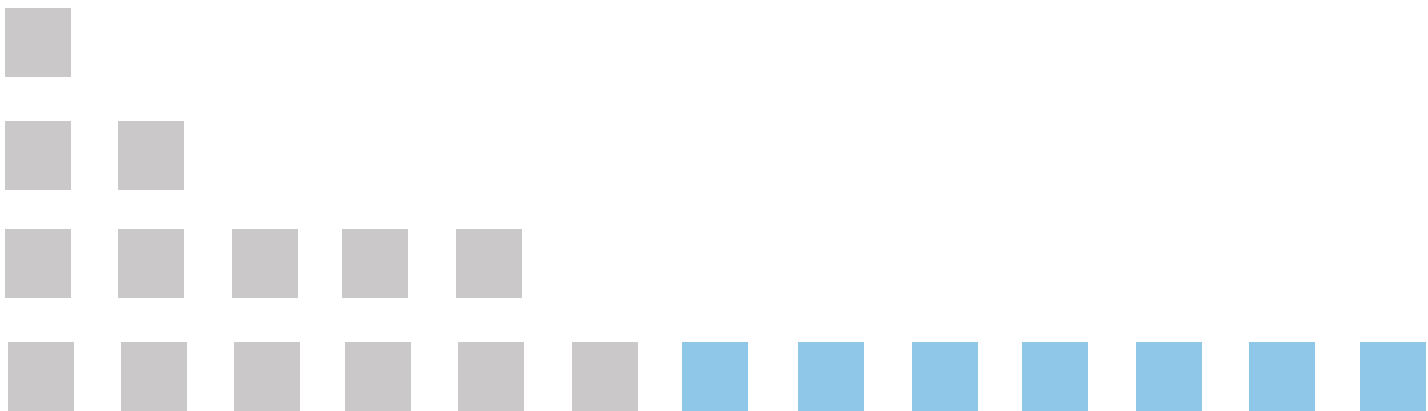


# Thematic Review Report

Thematic Review relating to the Systems of Controls for  
Anti-Money Laundering, Combating Terrorist Financing  
and Counter Proliferation Financing

Funds Sector

December 2022



## Introduction

Thematic reviews form an integral part of the Gibraltar Financial Services Commission's (GFSC) supervisory and risk management approach to help deliver our objectives. We use targeted thematic reviews as a regulatory tool to supervise firms and, for example, assess a current or emerging risk or issue across a number of firms or sectors.

In early 2017, a revised approach was implemented as to how we supervise against the risk of financial crime. This was in line with our continuing commitment to meet International Standards on Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) and more recently, Counter Proliferation Financing (CPF). As the regulator of the financial services sector, we play a substantial role in Gibraltar's overall approach to the combating of financial crime, with specific focus on the prevention of money laundering (ML), terrorist financing (TF) and proliferation financing (PF) across the sectors we regulate. Undertaking Thematic Reviews to assess the AML/CFT/CPF systems of controls of regulated entities permits the GFSC to understand current and emerging threats and vulnerabilities of the financial services industry on a whole and specific sectors.

The topics for thematic reviews are selected on the basis of the risks posed to the GFSC's regulatory objectives and information from external sources such as the Gibraltar National Risk Assessment. The reviews carried out feed into the primary objectives of the GFSC, which include the reduction of financial crime, the protection of consumers and enhancing the reputation of Gibraltar.

This publication sets out our summary findings for addressing and managing the ML/TF/PF risks posed to customers and Gibraltar by the Funds industry, with a view to further mitigating these risks in the future.

Additional abbreviations used throughout this report include:

AMLGN	The GFSC's Anti-Money Laundering and Counter-Terrorist Financing Guidance Note. This can be accessed via the following link: <a href="http://www.fsc.gi/uploads/005-Standard%20External%20Publication-AMLCFT%20Guidance%20Note%20v2.0-AP-20%20Jul%202017.pdf">http://www.fsc.gi/uploads/005-Standard%20External%20Publication-AMLCFT%20Guidance%20Note%20v2.0-AP-20%20Jul%202017.pdf</a>
PEP	Politically Exposed Person
POCA	Proceeds of Crime Act 2015 - <a href="http://www.gibraltarlaws.gov.gi/articles/2015-22o.pdf">http://www.gibraltarlaws.gov.gi/articles/2015-22o.pdf</a>
UBO	Ultimate Beneficial Owner
SAR	Suspicious Activity Report
EIF	Experienced Investor Fund
CISA	Collective Investment Scheme Administrator
AIFM	Alternative Investment Fund Manager

## Why select the Funds Sector?

The GFSC took into consideration the following factors when determining the need to carry out a thematic review on the AML/CFT/CPF systems of controls within the Funds sector:

- The risk identified in respect to the funds sector set out in the Gibraltar 2020 National Risk Assessment;
- The data analysis arising from the data contained within the Financial Crime Return submissions; and
- The funds sector had not previously been subjected to a dedicated AML/CFT/CPF review.

Taking into consideration the above, the GFSC carried out the Thematic Review to improve its understanding of the risks, threats, and vulnerabilities applicable to the funds industry with respect to ML, TF and PF. The outcome from the review will assist the GFSC in tailoring its approach to the AML/CFT/CPF supervision of the sector going forward.

## What we did

The review consisted of capturing all aspects of the funds industry, therefore the following relevant financial businesses, as defined under Section 9 of the POCA, were considered in scope for the review:

- Collective Investment Scheme Administrators;
- Experienced Investor Funds; and
- Alternative Investment Fund Managers.

All relevant entities were contacted in July 2021 to advise of the GFSC's intention to conduct the Thematic Review. As stated within the letters sent, firms were required to provide the GFSC with AML/CFT/CPF information and documentation including a completed questionnaire relevant to how the firm operates. Prior to the onsite visit, the AML/CFT Supervision Team reviewed the documentation provided by firms to tailor the approach for the upcoming onsite visits.

The onsite visits commenced in Q4 2021. The format of the visits consisted of an initial conversation with senior management and a sample client file review with a view to assess how firms apply the following controls and requirements:

- Customer Due Diligence/onboarding;
- Source of Wealth/Funds;
- Ongoing Monitoring;
- Politically Exposed Persons;
- The MLRO and Responsibility for Compliance functions;
- Client Risk Assessment;
- Business Risk Assessment;
- Reliance on Third Parties;
- Record Keeping;
- Suspicious Activity Reporting;
- Staff Training;
- Independent Audit; and
- Sanctions Screening.

Due to the business model where Experienced Investor Funds are managed by the Collective Investment Scheme Administrator, these were reviewed as part of the same onsite visit at the Administrator's premises.

Following the onsite visits, all entities were provided with individual feedback relevant to the findings identified from both the desk-based review and onsite visits. Feedback also contained any remedial action that the firm was required to undertake to ensure it was able to demonstrate compliance with the legislative and regulatory requirements.

## Findings

The vast majority of firms across all three industry types had adequate policies and procedures in place. There were, however, varying differences in how these controls were applied in practice. The findings demonstrated that some firms do not have the requisite controls in place to prevent the use of the financial system being potentially used for illicit activities.

The funds sector is considered unique in so far as it usually has the involvement of a Collective Investment Scheme Administrator which is also, in most cases, regulated within the jurisdiction that it operates. It should be noted, however, that firms are not absolved from their responsibility to be compliant with the relevant local legislative and regulatory requirements, regardless of whether they outsource aspects of their compliance function to firms based in other jurisdictions.

The findings below highlight the good and poor practices and findings across all firms, for each of the areas considered within our review. The information outlined below is not specific to any firm in particular and is a collation of the data acquired as part of the Thematic Review across all firms.

## Collective Investment Scheme Administrators (CISAs)

The overall AML/CFT/CPF knowledge within these firms was adequate. The majority of CISAs also hold other permissions with the GFSC and have adequate policies in place for the detection and prevention of ML, TF and PF. CISAs need to ensure, however, that they capture all relevant information as part of their risk assessment of the business relationship and not rely solely on the personal knowledge of the EIF directors.

### Customer Due Diligence

- The majority of firms had adequate due diligence on the directors of the fund, which primarily included proof of identification and proof of address.
- Firms were aware of their responsibility when onboarding funds to conduct adequate checks into the nature of the funds and what type of investments the firm would look to invest in.
- Not all firms conducted PEP/Sanction screening on the individuals associated with the fund, on the basis that they were local individuals.

### Ongoing Monitoring

- Most firms had a policy for ongoing monitoring in place which highlights how periodic reviews are conducted and on what basis.
- Some firms did not carry out periodic reviews in line with their respective documented approach.
- Some firms did not re-risk assess clients when material changes to the structure of the fund had occurred.

### Risk Assessment

- All firms had a client risk assessment which encompassed the four principles, namely customer, product, country and interface risks.
- Most firms had a business risk assessment which incorporated the AML/CFT/CPF risks applicable to the firm, the impact and likelihood of this occurring and any mitigating factors.
- Some firms had placed an over-reliance on the clients being previously well known to the firm and/or local and as a result, failed to risk assess their clients in line with their methodology.

### Policies and Procedures

- Most firms had adequate policies and procedures in place in line with Section 26 of POCA.
- Most firms considered proliferation financing risks as part of their policies and procedures.
- Whilst most firms did have adequate policies and procedures, these were not always applied in practice.

### Other

- All firms had an adequate record keeping policy in place and applied these requirements in practice.
- Most firms had in place a scope and plan to conduct an independent audit.
- Most firms provide Gibraltar specific legislative training to all staff on an ongoing basis.

## Experienced Investor Funds (EIFs)

EIFs are considered relevant financial businesses and therefore are subjected to POCA. Although compliance is generally outsourced to the CISA, EIFs are still required to ensure they have sufficient oversight over the CISA to ascertain that they are complying with all relevant legislative and regulatory requirements. It is the EIF who maintains ultimate responsibility for compliance. Each individual EIF is also required to appoint an MLRO, carry out a business risk assessment and be able to demonstrate that the EIF directors have undertaken appropriate AML/CFT/CPF training.

### Customer Due Diligence

- Most funds had adequate proof of identity/address on the underlying investors of the fund.
- Generally, the funds did not have adequate source of wealth/funds on the underlying investors.
- Not all firms conducted PEP/Sanction screening on the underlying investors of the fund on an ongoing basis.

### Ongoing Monitoring

- Most funds did undertake transaction monitoring when a redemption or an additional subscription took place.
- Some funds did not carry out periodic reviews in line with their documented approach.
- Some funds did not re-risk assess the underlying investors when material changes, such as an additional investment, had been made in the fund.

### Risk Assessment

- The funds generally use the client risk assessment of the CISA, however, in most cases, the product risk only extended to the products offered by the CISA and not the nature of investments being undertaken by the EIF.
- The majority of funds did not have a business risk assessment which took into consideration the ML, TF and PF risks associated with the nature and size of the fund.

### Policies and Procedures

- Most funds applied the same policies and procedures as the administrator and, generally, these were considered adequate.
- Most EIF directors were unable to demonstrate they had undertaken sufficient training on AML/CFT/CPF as training logs were not provided.

### Other

- All funds were able to demonstrate they had kept adequate records in line with Section 25 of the Proceeds of Crime Act 2015.
- Most funds were able to demonstrate it had conducted an independent audit as these were conducted alongside the independent audit of the fund administrator.

## Authorised Alternative Investment Fund Managers (AIFMs)

Some AIFMs also act as CISAs and in these cases the controls were more robust than the firms which solely held a permission to act as an AIFM.

In some instances, the AIFM sector was over reliant on a CISA based in another jurisdiction for AML/CFT/CPF requirements and there was, therefore, a lack of understanding around the Gibraltar specific requirements. This was demonstrated not only within the policies and procedures presented for review, but also within the firms' client files.

### Customer Due Diligence

- Most firms were aware of the due diligence requirements and held all appropriate documentation, however, some firms had not undertaken due diligence on the directors of, or associated parties to, the fund.
- Some firms were not aware of the requirement to conduct PEP/Sanctions screening.

### Ongoing Monitoring

- The majority of firms were able to demonstrate that they had an adequate policy for ongoing monitoring and that this was put into practice.
- Some firms did not undertake ongoing monitoring/periodic reviews on their fund clients as they had placed reliance on the CISA to conduct this on the underlying fund investors.
- Some firms were not aware of the requirement to undertake ongoing monitoring.

### Risk Assessment

- The majority of firms had an established business risk assessment.
- Most firms were aware of the requirement to risk assess their fund clients taking into consideration the four risk elements.
- Some firms did not have a business risk assessment.
- Some firms did not have a client risk assessment methodology.

### Other

- All firms were aware of the record keeping requirements.
- Some firms were not aware that they were subject to the requirements set out in POCA and the AMLGNs.
- Some firms were unable to demonstrate that staff had undertaken Gibraltar specific AML/CFT/CPF training.

## Good and Poor Practices

This thematic review was aimed at the funds sector, however, its findings and expectations, as set out below, are not only relevant for this sector. The examples of best and poor practices may be of interest to all firms falling within scope of the AML/CFT/CPF provisions under the GFSC's AMLGN and POCA.

Gibraltar published its most recent National Risk Assessment (NRA) in 2020 which assesses and records the sectors of high risk in the jurisdiction. This document details the threat and vulnerability posed for ML/TF/PF purposes and any proposed mitigating actions in keeping with a risk-based approach. The GFSC expects firms to familiarise themselves with the NRA and the risks which are considered to be of more significance to Gibraltar.

Firms should take these considerations into account when evaluating and risk scoring any new client or business relationship. By doing so, a firm factors in the relevant types of risks and the impact these may have on the activities carried out by the client, and in turn, the risks posed to the firm and the jurisdiction as a result.

The following tables provide examples of best and poor practices within several areas, which are drawn from observations made when carrying out the thematic review. Please note that these provide an overview of practices and expectations within the application of a firm's legislative and regulatory requirements, however, the GFSC will consider and review each firm applying a tailored approach in line with the size, nature and context of the business.

### Customer Due Diligence

<u>Expectations</u>	
The firm should:	
<ul style="list-style-type: none"> <li>Maintain a documented due diligence policy, which has been implemented and put into practice including the appropriate application of enhanced due diligence, where required.</li> <li>Risk profile the customer based on the firm's risk methodology taking into considering the four risk elements (Customer, Country, Product and Interface).</li> <li>Verify a customer's identity to the extent that is necessary in line with its risk profile.</li> <li>Verify the identity of all directors, controllers and UBO(s) of corporate entities.</li> <li>Assess a customer's Source of Funds and/or Wealth to a level of plausible verifiability or independent verification in cases of higher risk customers.</li> <li>Screen all customers against the required sanction lists (UN, EU, UK and Gibraltar).</li> <li>Ascertain if any customers are PEPs, family members or close associates of PEPs.</li> </ul>	
<i>Good Practices</i>	<i>Poor Practices</i>
Carrying out due diligence on the whole corporate structure associated with a fund including the EIF directors.	Placing an over-reliance on the clients being previously well known to the firm and/or local and as a result, failing to risk assess their clients in line with their methodology.
Having a risk methodology in place and ensuring all clients are scored in line with their methodology. In the case of EIFs, the client risk assessment should also extend to the nature of investments the fund makes and this should be incorporated into the product risk element of the methodology.	Not screening all clients against the relevant sanctions lists or failing to identify where a customer is a PEP in order to ensure EDD is applied accordingly.
Conducting sanctions screening against the relevant sanctions lists i.e. the UN, EU, UK and Gibraltar lists. This must be conducted on the entire client base <u>and</u> on an ongoing basis.	Not collecting source of wealth/funds to a level of plausible verifiability or independent verification depending on the risk profile of the client.
Conducting PEP screening on an ongoing basis relative to the risk profile of the client.	



## Ongoing Monitoring

<p><u>Expectations</u></p> <p>The firm should:</p> <ul style="list-style-type: none"> <li>• Maintain a documented ongoing monitoring policy, which takes into consideration enhanced ongoing monitoring controls.</li> <li>• Ensure ongoing monitoring/periodic reviews are conducted in line with the risk profile of each customer.</li> <li>• Ensure the firm has controls in place where any changes to a client’s circumstances and/or information are triggered and reviewed.</li> <li>• Ensure customers are transacting in line with their business profile and expected activity.</li> </ul>	
<i>Good Practices</i>	<i>Poor Practices</i>
Conducting ongoing monitoring on clients on a periodic basis applying a risk-based approach.	Failing to revisit the business relationship on the basis that the client is inactive or dormant.
Conducting transaction monitoring at the point of subscription and redemption and ensuring that the initial funds are being remitted to the same bank account.	Not re-risk assessing clients when material changes have occurred which may impact the risk profile of the client.

## Risk Assessment

<p><u>Expectations</u></p> <p>The firm should:</p> <ul style="list-style-type: none"> <li>• Have and maintain a Risk Methodology appropriate to the size and nature of the firm, which encompasses the four risk principles (customer, interface, product and country).</li> <li>• Implement a business risk assessment which outlines the ML/TF/PF risks relevant to the nature and size of the firm and ensuring this is updated on a regular basis.</li> <li>• Ensure that all clients are scored in accordance with the firm’s risk methodology.</li> <li>• Maintain the risk scoring methodology for clients up to date, ensuring any changes to the risk factors are applied.</li> </ul>	
<i>Good Practices</i>	<i>Poor Practices</i>
The implementation of a business risk assessment which outlines the threats and vulnerabilities applicable to the business including any mitigating factors to prevent the business being exposed to ML/TF/PF.	Not considering the type of risk posed by the investments the fund makes within its product risk.
Continuous review and revision of the risk methodology such as updates to the country/product risk factors where required.	Not considering the implementation of a business risk assessment or documenting the ML/TF/PF risks applicable to the firm.
The business risk methodology being discussed at board level and any changes to the impact/likelihood of a risk occurring, being documented and updated with any additional mitigating actions included.	

## Policies and Procedures

<u>Expectations</u>	
The firm should: <ul style="list-style-type: none"> <li>• Implement and maintain a record keeping policy, which outlines the requirement for records to be kept for five years following the termination of the business relationship or one-off transaction.</li> <li>• Consider whether an independent audit function is required and document this in line with Section 26 of POCA.</li> <li>• Maintain an up to date training log, ensuring that all staff members are trained on the ML/TF/PF risks applicable to the firm.</li> <li>• Maintain and implement the required policies and procedures as per Section 26 of POCA.</li> <li>• Ensure it is aware of the requirements and its obligations in respect of suspicious activity reporting requirements to the Gibraltar Financial Intelligence Unit.</li> </ul>	
<i>Good Practices</i>	<i>Poor Practices</i>
Demonstrating that AML/CFT/CPF training has been provided and completed by all staff members.	Not providing Gibraltar-specific training to staff on the basis the fund was already regulated in another jurisdiction.
Undertaking an independent audit and implementing the recommendations contained within the report. The consideration of this requirement should be documented by the firm outlining how it is being applied in practice (i.e. in respect of the frequency and scope of the audit).	Not being aware of the requirement for, or not carrying out, an independent audit of the firm's systems and controls.
Maintaining a record keeping policy and implementing this in practice.	Not applying the firm's policies and procedures in practice.
	Not processing internal SARs in a timely manner resulting in delays of the SAR being disclosed/reported externally.

## Outsourcing

During the review, it was noted that all EIFs and AIFMs outsourced compliance to the CISA. In the case of EIFs, the CISAs were all Gibraltar-based. It is important to note that whilst EIFs generally outsource this function to the CISA, EIFs are not exempt from the requirements under POCA as a relevant financial business. EIFs must be able to demonstrate that they have effective oversight over the CISA's compliance function, including its policies and procedures and how these are applied in practice. In the case of AIFMs, the CISAs were generally based in other jurisdictions and in most cases, the AIFM was able to demonstrate that it had conducted desk-based and onsite visits of the relevant CISA to ensure compliance in both Gibraltar as well as the jurisdiction in which the CISA is based.

However, in some instances, over-reliance was placed on the CISA of the AIFM and therefore, these firms were not able to demonstrate that they fully complied with Gibraltar-specific requirements. They stated that the fund was also regulated in another jurisdiction and the CISA was, therefore, ultimately responsible for all aspects of AML, CFT and CPF which is not in line with POCA.

All Gibraltar-based firms are reminded of their responsibilities under POCA as a relevant financial business and must note that they are not exempt from Gibraltar-specific legislative requirements, including the obligation to undertake Gibraltar-based training in line with the requirements. In addition, firms need to be aware that whilst the compliance function can be outsourced to CISAs, the ultimate responsibility for compliance lies with the Money Laundering Reporting Officer, Head of Compliance and the Director with responsibility for AML/CFT **based in Gibraltar**.

## Next Steps

The GFSC has issued individual feedback to all firms. As part of the feedback, firms will be placed on a specific supervisory plan based on a number of factors and taking into consideration the risks identified during the Thematic Review.

Where remediation is required in order to meet current legislative requirements, the AML/CFT Supervision team will work closely with the firm to ensure any concerns and findings are appropriately addressed and mitigated.

All firms should be aware of the legislative requirements applicable in respect of preventing the financial system from being used for ML/TF/PF purposes. More specifically, firms should be able to demonstrate that their AML/CFT/CPF controls are robust and fit for purpose. Staff members should also be mindful of their own personal obligations in respect of reporting requirements and how any key risks to the firm are being mitigated.

We are committed to working with the sector to further enhance compliance with these standards.

If you have any queries regarding the contents of this report, please contact the AML/CFT Supervision Team on [amlcft@gsfc.gi](mailto:amlcft@gsfc.gi) or on +350 200 4028

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