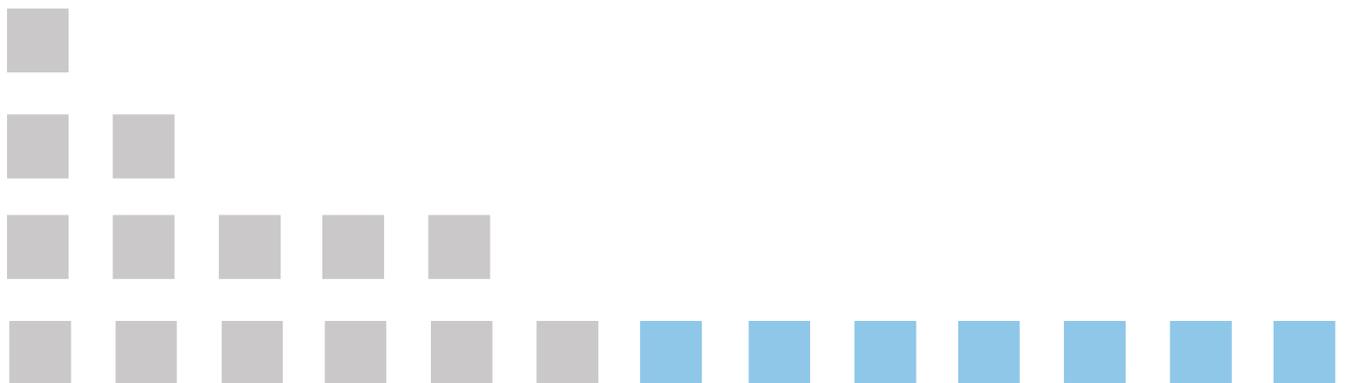


Thematic Review Report

Trust and Company Service Providers

Systems of Controls for Anti-Money Laundering
and Combating Terrorist Financing

June 2018



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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 will 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. The GFSC is now rolling out this approach to encompass horizontal reviews across the whole spectrum of regulated firms. By focusing on specific risks, we can do detailed work on particular concerns.

The topics for thematic reviews are selected on the basis of the risks posed to the GFSC's regulatory objectives, one of which is the prevention of financial crime. This feeds into its primary objectives of the protection of consumers and enhancing the reputation of Gibraltar.

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

This publication sets out our summary findings for addressing and managing the risks posed to customers and the reputation of Gibraltar by Trust and Company Services Providers (TCSPs) more broadly 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: http://www.fsc.gi/uploads/005-Standard%20External%20Publication-AMLCFT%20Guidance%20Note%20v2.0-AP-20%20Jul%202017.pdf
CDD	Customer Due Diligence
EDD	Enhanced Due Diligence
CMA	Company Management Agreement
FATF	Financial Action Task Force
KYC	Know Your Customer
MONEYVAL	The Committee of Experts on the Evaluation of Anti-Money Laundering and the Financing of Terrorism within the Council of Europe
PEP	Politically Exposed Person
PoA	Power of Attorney
POCA	Proceeds of Crime Act 2015
UBO	Ultimate Beneficial Owner

Why select the TCSP Sector?

When considering the need to carry out a thematic review on AML/CFT systems of controls of the TCSP industry, the GFSC considered the following:

- The risks identified within Gibraltar's National Risk Assessment published in April 2016;
- Guidance issued by International Bodies such as the FATF and MONEYVAL; and
- The analysis arising from the data submitted within the Financial Crime Return for the 2016 reporting period.

As a result of the above factors, the GFSC carried out a thematic review to enhance its understanding of the threats and vulnerabilities with respect to money laundering and terrorist financing risks within the sector, and to help gather information to inform its overall approach to regulation of the sector.

In line with the GFSC's approach to regulation, we established a risk based approach to this thematic review. Therefore, the information requested and subsequently reviewed was tailored to address firm specific risks.

What we did

Following our initial risk assessment of the sector, the thematic team tailored its supervisory approach to each firm accordingly (i.e. onsite or desk based review) in line with the GFSC's risk based approach to supervision.

As a result, the team completed 26 onsite inspections in Q4/2017 and 31 desk-based reviews. Both review methods allowed the team to assess how firms have implemented AML/CFT systems of controls, and where an onsite visit was carried out, the team was able to verify how these had been applied in practice. The undertaking of the thematic review has given the GFSC an insight into the industry's understanding and approach to the ML/TF risks posed to firms and the jurisdiction.

Our Findings

We acknowledge that there has been significant improvement throughout the years and firms are showing a greater understanding of the Money Laundering (ML)/Terrorist Financing (TF) risks posed. It is apparent that the majority of firms have a sound awareness of their obligations and key functions in ensuring the appropriate management of ML/TF risks, including their requirements in line with the legislative and regulatory responsibilities.

We were pleased to find that all firms complied with the record keeping requirements in maintaining records for five years following the end of a business relationship. We were, however, disappointed to identify continuing weaknesses in a number of firms' AML/CFT systems of controls.

Our collective key findings arising from the thematic review showed that the main areas for improvement included customer due diligence, ongoing monitoring and risk assessments, which are all essential components for complying with the requirements. It should be noted that these findings are by exception and are not endemic to all firms.

The outcomes we identified include:

Customer Due Diligence:

- Some firms did not conduct adequate CDD relative to source of wealth and particularly source of funds, to a level of plausible verifiability. Additionally, there were instances where some firms did not evidence or document the information collected.
- There are a small number of firms that manage local trading companies comprised of local individuals. At times, we found that insufficient due diligence had been conducted because some firms have over-relied on being familiar with a client or knowing the individual on a personal level. There is a tendency for this to happen in small jurisdictions like Gibraltar where it is common for most people to be acquainted with each other. This means that these firms are unable to demonstrate that they have completed a thorough level of due diligence on all customers.
- Some firms are not adequately identifying and verifying the proposed nature of business of the client.
- EDD is not being applied as per the requirements e.g. in some cases PEPs are not being classified as high risk relationships.
- A number of cases were identified where CDD was not complete prior to establishing the relevant business relationship.
- The use of unknown third party entities or individuals providing nominee shareholdings, where there is lack of documented rationale, oversight and monitoring of the relationship, has been identified as an area of concern for various firms.

Ongoing Monitoring:

- A significant number of firms were not carrying out ongoing monitoring in line with their own risk methodology i.e. client risk reviews are not completed when scheduled.
 - Some firms were not sufficiently proactive when carrying out its ongoing monitoring, notably for those client companies to which it does not provide directorships. Ongoing monitoring requirements apply to all companies under management irrespective of the level of services provided.
 - A number of firms have been unable to evidence ongoing CDD, including where there is inactivity in the company and purpose for the client company is unclear.
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Risk Assessments:

- Most firms applied a risk based approach on inception of a business relationship, however, a risk based approach was then not necessarily being applied when conducting periodic reviews.
- Furthermore, risk methodologies were found at times to not include the four key risk elements (i.e. Customer, Product, Interface and Country).
- When categorising a client under the four risk elements, a number of firms are not factoring the risks posed by the nature of business of the client company as detailed in Section 6.2.4 of the AMLGN under Country Risk, or there is a lack of evidence that these factors are being considered.

Other:

- Legislative amendments to POCA which came into effect in June 2017, arising from the implementation of the 4th Money Laundering Directive, have not been fully implemented into firms' processes and procedures.
 - A significant number of firms could not evidence that policies and procedures were being applied effectively; with some firms unable to evidence that all policies and procedures were adequately documented.
 - We identified that some firms had certain deficiencies in their 109 Compliance Report including:
 - Responses being too generic or reference made to the firms' manuals without sufficient detail to allow a comprehensive assessment.
 - Incomplete or inadequate responses.
 - A lack of justification to those requirements which the firm believes do not apply to it.
 - A lack of assessment and action plan to address any issues identified.
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Best and Poor Practices

This thematic review was aimed at TCSPs, however, it is not only relevant for this sector. The findings and examples of best and poor practices may be of interest to all firms falling within scope of the AML/CFT provisions under the GFSC's AMLGN and POCA.

Gibraltar published a National Risk Assessment (NRA) in April 2016 which assesses and records the sectors of high risk in the jurisdiction. This document details the description in question, the threat and vulnerability posed for ML/TF purposes and any proposed mitigating actions in keeping with a risk based approach. We therefore, expect firms to familiarise themselves with this document 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 which is on-boarded. By doing so, the firm factors in the 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 as a result.

The following tables provide examples of best and poor practices within several common scenarios, which are drawn from conduct observed during the thematic work carried out. We draw comfort from seeing evidence that the best practices are being applied. Please note, however, that if these practices are not evident in a firm's systems of controls, this may not in itself be an issue, as the GFSC will consider whether a firm has applied other equivalent measures to meet its obligations.

<u>Customer Due Diligence</u>	
<u>Scenario 1: The firm on-boards a corporate client of which the shareholder is from a non-EEA state. The customer has not yet decided whether it would like to include a third party nominee entity to provide shareholding services or require the nominee services of the firm</u>	
<p>Examples of best practice:</p> <ul style="list-style-type: none"> • The firm has obtained evidence of the UBO and has documented this in the client file. • The firm understands and documents the client's rationale for the use of a nominee shareholding, whether this is the firm or a third party entity. • Appropriate customer due diligence is conducted on all relevant beneficial owners, direct or indirect, whether a corporate entity or individual. • The firm has issued a declaration of trust and maintains a copy on file. A firm that has custody of these ensures these are kept safe and the location of these is recorded in the customer's records. • Enhanced due diligence and enhanced ongoing monitoring is applied if the customer is high risk for various reasons. The firm should ensure that the same due diligence standards are not applied across the board; the four risk elements must be 	<p>Examples of poor practice:</p> <ul style="list-style-type: none"> • The firm is providing the nominee service and there is no declaration of trust in place to support the legal ownership. • The firm has not verified whether the nominee shareholding entity or individual based outside Gibraltar is a regulated entity from a jurisdiction where similar AML/CFT requirements are applied. • No due diligence is conducted on the nominee shareholder where it is an entity or individual based outside the firm or jurisdiction. • There is no documentary evidence to support the rationale for the appointment of a third party nominee shareholder, particularly when the firm itself is authorised to provide this type of service.

considered at inception and on an ongoing basis and the customer monitored accordingly.	
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<u>Customer Due Diligence</u>	
<u>Scenario 2: The firm establishes a business relationship with a corporate client based in the EU via an eligible introducer. The firm has ensured that the eligible introducer has completed all the relevant KYC and CDD in line with the risk posed by the client. The company includes a three-layered structure including the customer, a holding company and the UBOs.</u>	
<p>Examples of best practice:</p> <ul style="list-style-type: none"> • CMAs are dated, signed by all relevant parties and recorded appropriately in the client's file. • Certified copies are obtained for documentation of individuals that have not been met face to face. • A complete and accurate organogram of all interested parties with a beneficial interest in the client company is requested and recorded by the firm. • The customer is risk profiled in line with the four risk elements. • The firm has a suitable agreement with the eligible introducer to be able to rely on its KYC/CDD. 	<p>Examples of poor practice:</p> <ul style="list-style-type: none"> • Where the firm receives foreign documents, these are not translated to ascertain whether these are bona fide documents. • Updated copies of expired documentation, (e.g. Passport) are not requested by the firm. • The CMA is completed between the intermediary or introducer of the business as opposed to the actual client accepted for business. • The CMA is not dated and/or signed by the relevant parties. • The firm has not verified if the eligible introducer is maintaining international standards with respect to CDD requirements.

<u>Customer Due Diligence</u>	
<u>Scenario 3: A client approaches your firm for company management or professional trusteeship services and the firm begins conducting its KYC and Customer Due Diligence. The individuals involved are previously known to the firm and are EU nationals.</u>	
<p>Examples of best practice:</p> <ul style="list-style-type: none"> • Open source and intelligence database checks are carried out on the client prior to being on-boarded, at inception and on an ongoing basis. • The individuals and entities are screened under the Gibraltar, EU and UN sanctions lists for TF purposes. 	<p>Examples of poor practice:</p> <ul style="list-style-type: none"> • The firm does not obtain or record the entity's estimated annual turnover to ensure that the company is being used for the expected purpose and not to conduct illicit activities. • Where copies of the identity documentation have expired, the firm has not requested any updated copies of such

<ul style="list-style-type: none"> • The firm has requested for the source of funds and source of wealth of all the individuals/entities involved. This has been collected to a level of plausible verifiability. • The client company has been risk assessed in line with the four risk elements and monitored accordingly with respect to the level and frequency of engagement with the client. 	<p>in order to ensure that the information held continues to be accurate.</p> <ul style="list-style-type: none"> • Due diligence not conducted on the UBO or other individuals involved. • The firm on-boards the client prior to all KYC and CDD being collated and finalised.
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Politically Exposed Persons

Scenario 4: The firm accepts a client company which includes foreign and domestic PEPs as the UBOs.

<p>Examples of best practice:</p> <ul style="list-style-type: none"> • Enhanced due diligence measures are applied. • The firm maintains a PEP register which is reviewed regularly by the Board. • PEP relationships are automatically categorised and treated as High Risk clients. • Enhanced ongoing monitoring is applied, including enhanced due diligence • The firm has a system to monitor and identify any changes to a PEP's circumstances or situation which may affect the monitoring of the client and its risk profile. • The individuals and entities involved are screened against the Gibraltar, EU and UN sanctions lists for TF purposes. 	<p>Examples of poor practice:</p> <ul style="list-style-type: none"> • The firm conducts standard/simplified due diligence. • The client is categorised as Medium or Low Risk as opposed to as a High Risk PEP relationship in accordance with the legislation. • The relationship is not monitored or reviewed on a regular basis or in line with a risk based approach. • No open source or external checks are completed on the individual at inception or during the ongoing business relationship. • Local clients which are domestic PEPs are not classified as such and the due diligence and/or ongoing monitoring is not commensurate to the risk posed.
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Ongoing Monitoring

Scenario 5: The firm has on-boarded a client that is a property holding company incorporated in Gibraltar and with shareholders who are EU nationals. The client holds a corporate bank account.

<p>Examples of best practice:</p> <ul style="list-style-type: none"> • The firm requests evidence of the veracity of the property and that it is owned by the client. • The firm obtains information on the purpose and/or use of the property. • The firm factors the nature of the activity into the company's risk assessments and ensuring that the risks are commensurate with the expected/proposed business. 	<p>Examples of poor practice:</p> <ul style="list-style-type: none"> • The firm does not request any evidence of the source of funds entering the account completed by the company (e.g. from the collection of rent). The firm also did not verify that the monies coming in to the account are in line with the expected activity. • There is a lack of contact with the client where there is a prolonged period of
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	<p>inactivity or when there is a notable change in activity and the rationale to support this has not been provided.</p> <ul style="list-style-type: none"> • The firm only closely monitors a company's activity where it provides directorship services.
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Ongoing Monitoring

Scenario 6: The firm has taken on a client that is a yacht holding company and requires the issuance of a Power of Attorney so that the vessel may be operated by a third party.

<p>Examples of best practice:</p> <ul style="list-style-type: none"> • The PoA is drafted indicating the specific purpose and timescales. • The firm monitors that the PoA is applied in line with the conditions set therein. • The firm has issued a PoA in a foreign language and has the translated equivalent on file, or it has been reviewed by at least two people in the firm whose native language is the foreign language in question. • KYC/CDD is conducted on the third party who will be operating the vessel and the individual is screened under the Gibraltar, EU and UN sanctions lists for TF purposes. 	<p>Examples of poor practice:</p> <ul style="list-style-type: none"> • The PoA is not issued for a specific period of time that does not normally exceed 12 months. • The PoA is too general and is not granted for a particular purpose. • The firm has not maintained a log of all active PoAs issued. • The PoA is not being returned when expired. • The firm has not verified that the powers granted are still being executed.
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Next Steps

The GFSC has finalised the onsite inspections and desk based reviews and is in the process of issuing feedback to all firms individually. Each firm will be placed on a specific supervisory plan tailored to the firm and its business, focusing upon the risks identified during the thematic work. Where remediation is required, we will be working closely with firms to ensure that any concerns and findings are appropriately addressed.

All TCSPs must ensure they can demonstrate that their AML/CFT systems of controls are robust and effective in preventing the financial system from being used for ML or TF purposes. Therefore, they should implement appropriate practices for the ongoing review of systems of controls.

It is also vital that firms ensure that all staff maintain an awareness of ML/TF risks and how these are being mitigated and managed. Firms should study the findings of this publication and in particular the examples of best and poor practices.

We also encourage the firm to read the TCSP publications which have been issued by the FATF. These can be found here:

[http://www.fatf-gafi.org/publications/?hf=10&b=0&q=tcsp&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/?hf=10&b=0&q=tcsp&s=desc(fatf_releasedate))

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

If you have any queries regarding the contents of this report please contact the Financial Crime team on amlcft@gfsc.gi or +350 200 40283.

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