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Best Practice in AML/KYC Compliance: The Role of Data and Technology in Driving Efficiency and Consistency

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Regulation stops for no one. Regulated firms are still reeling from the European Union's Fourth Money Laundering Directive (4MLD), and with 5MLD hot on its heels, the pressure to adapt anti-money laundering (AML) and know your customer (KYC) processes shows no sign of abating. This drive is not surprising: in the UK, for example, the National Crime Agency recently announced that its previous GBP 36–90 billion figure for all money laundering impacting on the UK is a significant underestimate¹. And with the 2017 UK Criminal Finances Act² introducing new corporate criminal offences for failing to prevent facilitation of UK and foreign tax evasion, the pressure is rising on businesses to ensure they don't fall foul of the new legislation. Across the globe, governments are uniting in a bid to protect the financial system from facilitating organised crime and corrupt behaviour.

As a consequence of the Panama and Paradise Papers revelations, legal and professional services firms have also come under increased regulatory scrutiny as potential "professional enablers" of financial crime. The UK's Solicitors Regulation Authority (SRA) has stated that money laundering is a key focus area, and the National Crime Agency's "Flag It Up"³ campaign highlights the attention this sector can expect in the coming years.

The financial sector has led the way in implementing robust AML and KYC programmes. Billions of dollars have been invested in the people, data and technology needed to fully identify, assess and mitigate regulatory risk. This level of spend, and the sheer number of people employed in compliance-related roles, can make it seem like achieving robust compliance is out of reach for any firm that is just setting out on the journey. However, it's important to remember that financial institutions started out on the road to compliance in a very different environment. The data needed to fully assess risk was far harder to access a decade ago, and technology has advanced beyond expectations.

Today, information required for KYC is available as digitised streams from a broad range of primary and secondary sources. For many companies, the stumbling block is creating an affordable KYC process that harnesses the best information to create risk assessments that are fully documented, up to date, and available to regulators and the firm's authorised risk professionals. Today, advances in technology mean that effective compliance can be implemented at a fraction of the cost, and with much smaller teams.

This article outlines the challenges of the most recent AML and KYC regulations, highlights the practices that give firms maximum protection from risk and presents a modern approach to compliance.

4MLD – Key Points

4MLD has placed a tremendous burden on regulated firms, who have to review existing policies and procedures and remediate KYC profiles to comply with it. The incoming 5MLD regulation, which we discuss later, adds turbulence, compelling firms to deal with two significant regulatory events in a short space of time.

Risk-based approach

While the concept of a "risk-based" approach to AML/KYC compliance is not new, 4MLD places far more emphasis on it than before. Regulators now expect to see intelligent and effective compliance that is focused on mitigating risk, not a tick-box exercise that puts every customer through the same level of due diligence regardless of their risk profile.

There is, however, an upside to a risk-based approach. It means limited resources can be focused on the areas of greatest risk, saving time and cost and maximising the effectiveness of a compliance programme. By spending less time on low-risk customers, teams are freed up to focus on more complex cases, where they can dig deeper to uncover hidden risks.

Ultimate Beneficial Owners (UBOs)

Because corporate vehicles provide excellent cover for individuals attempting to launder money or evade tax, the requirements in 4MLD to fully understand a customer's corporate hierarchy and ownership structure are more onerous than before. The regulation demands that all EU Member States publish and maintain public registries of beneficial ownership covering individuals who ultimately own or control more than 25% and one share of a company. These registries will be interconnected to increase cooperation between Member States and to improve the ability to detect potential criminal activity. Member States also need to introduce verification mechanisms to ensure the beneficial ownership information is accurate. 5MLD will reduce the threshold at which beneficial ownership needs to be identified to 10% for certain types of high-risk entities, as well as bringing trusts under the remit of the regulation.

While beneficial ownership registries offer some support to regulated firms, they are currently at different stages of implementation. So for additional peace of mind, many firms are opting to conduct further

verification against other sources. It's a big job, because to fully map out and verify ownership structure involves looking across a range of data: registered business name, number and address; details of the board of directors and senior persons responsible for operations; the law to which the business is subject; legal owners; beneficial owners; and articles of association.

To get this information means tapping into many different sources: customers; corporate registries and regulators' listings; and supplementary information to fill in gaps or verify source documents from premium data providers.

So whether you are onboarding new customers or remediating KYC for existing customers, the enhanced requirements around beneficial ownership are proving to be a significant challenge for most firms. It is a largely manual and very time-consuming process to gather the necessary information (often from multiple sources, both free and premium), piece it together and map out a visual representation of a company's structure.

MLR 2017 states:*

Where the customer is beneficially owned by another person, the relevant person must –

- (a) identify the beneficial owner;*
- (b) take reasonable measures to verify the identity of the beneficial owner so that the relevant person is satisfied that it knows who the beneficial owner is; and*
- (c) if the beneficial owner is a legal person, trust, company, foundation or similar legal arrangement take reasonable measures to understand the ownership and control structure of that legal person, trust, company, foundation or legal arrangement.*

**The UK's 2017 Money Laundering Regulations transpose 4MLD into UK law.*

Reduced simplified due diligence thresholds

Customer Due Diligence (CDD), an essential part of any AML programme, involves gathering relevant information about a customer in order to assess the potential risks to which they expose a firm. Previous AML regulation included the concept of automatic Simplified Due Diligence (SDD). This could be applied when a firm had reasonable grounds to believe a customer fell into certain categories that would automatically classify them as presenting a low risk. 4MLD does away with automatic SDD, requiring all customers to go through a robust risk assessment, which again increases pressure on compliance teams. In essence, it further extends the application of the risk-based approach to the CDD process.

5MLD – Key Changes

Proposed in 2016, the EU's 5th Money Laundering Directive reinforces the changes brought about by 4MLD. It aims to increase transparency about who owns companies and trusts, strengthen legislation around cryptocurrencies and pre-payment cards, clamp down on "high risk" countries and strengthen Financial Intelligence Units.

Transparency

5MLD will make enhanced access to data available to relevant persons as well as to national Financial Intelligence Units. If a trust is a beneficial owner, access will be given following a written request.

Prepaid cards and virtual currencies

Under 5MLD requirements, the anonymous use of prepaid cards

will only be permitted for retail transactions below EUR 150 and online transactions below EUR 50. The legislation will extend to cover all entities that hold, store, and transfer virtual currencies, as well as those that provide similar services to auditors, accountants or tax advisors already subject to 4MLD.

Controls for third countries

5MLD also looks to clamp down on the use of high-risk third countries where money laundering legislation is deemed to be too lax or inefficient. The European Commission has earmarked these countries and will put in place systematic enhanced controls for transactions into and out of these countries to hinder flows of illicit funds.

Stronger Financial Intelligence Units

Finally, the role of Financial Intelligence Units (national agencies set up to receive, analyse and disseminate information to combat money laundering) will be strengthened. 5MLD will give them more access to information via centralised bank and payment account registers or data retrieval systems and allow them to cooperate and collaborate more easily. With terrorists and money launderers able to move their funds at speed across borders, reaction time is critical. These changes will allow institutions to react accordingly.

Updated Guidelines for the UK Legal Sector

In March 2018, the SRA released the results of its thematic review, 'Preventing Money Laundering and Financing of Terrorism'. The review highlights the vital role of the legal profession in addressing the issue of money laundering and comes ahead of the Financial Action Task Force (FATF) peer review of the UK scheduled for spring 2018. Following a 2013 report from FATF that concluded that law firms were highly attractive targets for those wishing to launder money, the legal sector is expected to come under further scrutiny during this visit.

Overall, the SRA thematic review found that the majority of firms were "taking appropriate steps to understand and reduce the risk of money laundering, and to comply with the new regulations". However, areas of concern included a lack of record-keeping about how decisions were reached, and slow progress in putting firm-wide risk assessments in place, a requirement under MLR 2017.

Following the SRA's thematic review, The Law Society has published guidelines issued by the Legal Sector Affinity Group (LSAG) to support members in fully meeting regulatory requirements, including the areas raised as a concern in the review.

Balancing Regulatory Obligations with Client and Business Expectations

The challenges of 4MLD have already impacted on business efficiency and customer expectations at regulated firms, who first found that they had to hire compliance staff in huge numbers. At one point, the hiring of large KYC teams was seen almost as a badge of honour. But throwing manpower at the problem had obvious cost implications, so firms are now welcoming technologies that can perform the same tasks with far fewer people.

Internal processes

The regulation also highlighted the need for regulated firms to update their processes. Using people to undertake all CDD work has proved particularly problematic. Reconciling accounts means manually searching databases for relevant information, collating it onto spreadsheets and then analysing it. And using human operators

to undertake manual onboarding is particularly time-consuming, meaning long waits for customers who want to open new accounts. A recent report from Thomson Reuters found it took an average of four interactions with a bank before an account could be opened.⁴ Customers may just walk away to a competitor if the process takes too long. Also, if different human operators use different processes, KYC are checks also prone to error, exposing firms to regulatory scrutiny and the risk of laundering illicit money.

Time to revenue

For compliance to be effective, it must not be seen as a stumbling block. Long onboarding times are frustrating for fee-earners or relationship managers, and there is risk that the proper processes will be circumvented in order to bring a customer onboard more quickly, so that revenue can be recognised as early on in the relationship as possible. However, this presents a two-fold risk: potentially onboarding a ‘bad actor’ with illicit funds; and attracting the attention of the regulator. Already in 2018, we have seen a number of sanctions and some very significant fines taken out against regulated firms.

There is an added benefit to conducting the proper KYC checks up front. Firms will naturally look to cross-sell to their customers across different service areas once KYC checks have been successfully carried out. If customers are rigorously onboarded before their application has been accepted, different service areas can sell in their products straight away, improving efficiency and service, and reducing time to revenue.

Implementing a Best-Practice AML/KYC Process

Every organisation has a different risk profile, so no two AML/KYC programmes are the same. However, there are four key areas that mark out a best-practice process:

1. Quality

Without a complete and accurate picture of a customer’s risk profile, it’s impossible to make a safe decision about whether they are someone you would want to onboard or continue to do business with. However in many cases, a lack of resources, combined with pressure from the business, will lead to decisions being based on incomplete, poor-quality profiles. This is due to the amount of time it takes to gather the data needed to visualise a customer’s corporate hierarchy and beneficial ownership structure. Done manually, the process can take hours or even days: but without this solid foundation, there is no way to comprehensively identify, assess and mitigate regulatory risk.

2. The use of structured data

While new technologies allow for more dynamic monitoring of unstructured, open-source intelligence, structured risk data is still central to screening. Although many global regulatory lists are provided in a structured manner that allows for automation, many still require a combination of technology and manual effort to consolidate and present to the user coherently. And for Politically Exposed Person (PEP) and adverse media data, it is crucial to be able to rely on the baseline definitions of structured databases to focus energies on the right people and the relevant stories. Simply crawling every political exposure and negative media mention will bring a huge number of false positives.

3. Automation

To contain costs and ensure effectiveness, firms must automate and bring scalability to their KYC process. Outside of financial

services, the individuals responsible for conducting KYC are often not experts. But regardless of who operates the process, firms need systems that reduce the cost of errors, supervisory overheads, and re-working, while ensuring they are regulator-ready.

Technology, specifically robotic process automation (RPA), has a central role to play in quickly and easily pulling together a single, complete and accurate picture of the customer from all relevant data sources. RPA can precisely replicate the steps a human would perform when accessing data sources, analysing the data and making decisions about whether further checks are needed. It condenses hours of work into minutes.

4. Training

A key success factor in the effective adoption and implementation of a KYC programme is to ensure that training of all relevant staff is specific to their business, and builds awareness and understanding of their regulatory obligations and the broader implications for customer due diligence and its importance. Training also needs to be a regular, auditable and firm-wide. Training and culture go hand-in-hand. The ‘tone from the top’ must resonate throughout the organisation in order to permeate through to the most junior members, creating a ‘buzz at the bottom’.

Delivery of training by experts in AML/KYC is fundamental and should not be left to ‘enthusiastic’ amateurs as it usually results in courses which are too generic, superficial and poor of quality, which instantly creates barriers to change or skepticism from end users; ultimately having the effect of weakening the programme’s importance and effectiveness.

Conclusion

With the introduction of 4MLD and the imminent arrival of 5MLD, the compliance landscape for regulated firms has changed beyond all recognition. The intensified focus on preventing money laundering for criminality and terrorist financing has led to a step-change in the way that regulated firms work with customers. And data leaks such as the Panama and Paradise Papers have highlighted how firms use corporate structures to anonymise their owners.

Before 4MLD, Simplified Due Diligence, with its limited screening requirement, had been the fallback position for most firms’ customer onboarding. However the risk-based approach mandated by the new regulation means each customer has to be onboarded depending on their risk profile. In many cases, Enhanced Due Diligence is also needed, and in this instance the LSAG guidance suggests considering whether it is appropriate to:

- seek further verification of the client or beneficial owner’s identity from independent reliable sources;
- obtain more detail on the ownership and control structure and financial situation of the client;
- request further information on the purpose of the retainer or the source of the funds; and/or
- conduct enhanced ongoing monitoring.

This toughening regulatory climate also exposes the inefficiencies of manual KYC checking. It’s a people-intensive and error-prone process that becomes even more time-consuming and expensive when it must also cover data on UBOs, PEPs, sanctions and adverse media. The threat to customer experience and increased time to revenue is clear, especially when regulation is likely to continue to become more rigorous over time.

For human operators, one of the toughest challenges is to understand corporate hierarchies and UBOs. This needs multiple data sources and can involve information being copied and pasted into spreadsheets for analysis, which is time-consuming and error-

prone. The good news is that technologies can now not only do this in seconds, they can also simultaneously generate an audit trail.

Using technology has four distinct advantages:

- **Speed.** Information is compiled much more quickly so accounts can be opened faster.
- **Understanding.** For complex accounts, software can use multiple data sources seamlessly and map out a visual representation of accounts and UBOs.
- **Reduced risk.** Using technology during onboarding limits the risk of infringing compliance legislation.
- **Consistency.** Checking all accounts in line with internal policies and procedures avoids the risk of human operators using their own preferred methods or processes for customer onboarding.

The good news for regulated firms is that technology can now automate all but the most complex cases, running thousands of searches to the same compliance policy at a fraction of the cost of manual processing, while improving protection from regulatory risk.

Staff training and awareness throughout the organisation can be the linchpin that determines ongoing success and complete firm-wide buy-in and adoption. So when it comes to selecting a training partner, it's not who you know, but rather what they know; and the deeper their experience and expertise, the better.

C6 and Encompass – The Full KYC Picture, Fast

C6's highly structured and well-defined sanctions, PEP and adverse media content can quickly and efficiently highlight the risks that matter. Combined with KYC automation from Encompass, it can give you the full picture, fast.

Encompass is the only provider of simultaneous, real-time access to multiple sources of global company, registry and person data. Its products robotically search structured and unstructured information sources to automate KYC, AML and EDD policies. UBOs and PEPs are all identified, visualised and verified in seconds. And because the process is entirely automated, Encompass ensures that the same policy is executed to the same criteria on every occasion.

The combination of C6 data and Encompass technology also makes it possible to achieve the understanding of corporate hierarchies that 4AML and 5AML demand. Encompass creates an easy-to-understand visual representation of a company that can be viewed alongside adverse media and PEP records for a full picture.

For financial crime professionals, this blend of structured content and robust technology offers an ideal way to optimise compliance workflows.

Endnotes

1. <http://www.nationalcrimeagency.gov.uk/publications/807-national-strategic-assessment-of-serious-and-organised-crime-2017/file>.
2. <https://services.parliament.uk/bills/2016-17/criminalfinances.html>.
3. <https://flagitup.campaign.gov.uk/>.
4. <http://www.bobsguide.com/guide/news/2017/Nov/10/kyc-pain-financial-institutions-and-their-clients-are-still-struggling-with-ongoing-challenges/>.

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In 2012, Wayne Johnson co-founded Encompass corporation, a SaaS business driven by the belief that the best decisions are made when people understand the full picture. As CEO of Encompass, Wayne has led the creation of the company's Know Your Customer (KYC) automation software for the banking, finance, legal and accountancy sectors.

Wayne has won recognition as an entrepreneur and leader in the information industry. He has raised venture capital in the USA and won multi-million dollar grants from the government. Prior to Encompass, Wayne founded Software Associates in 1986 and served as CEO and chairman until the company was acquired by QHA, a Hong Kong listed Company in 2001. He grew the company to 60 staff with offices in the US and Hong Kong, During this time they built and deployed major applications including telecommunications billing, Internet banking and corporate-wide customer care for the region, major banks, insurers and telecommunications companies.

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Joel Lange joins us from Dow Jones's Risk & Compliance division where he led the business for over four years through a period of significant growth with a product portfolio focusing on Anti-Money Laundering, Anti-Corruption and Sanctions Compliance. Joel has over a decade of experience in the compliance and transaction operations industry holding senior sales, product and professional service roles at Dow Jones, Accuity and Broadridge. Joel is a regular speaker on compliance topics at conferences around the world. Mr. Lange holds a BA in International Relations from the University of Minnesota and a MSC in International Finance from the University of Westminster.



Encompass corporation develops technology to automate Know Your Customer (KYC) policies and ensure adherence to Anti-Money Laundering (AML) and Counter Terrorism Financing (CTF) regulations in financial, legal and accounting businesses.

With Encompass' market leading technology, KYC checks and onboarding processes can be completed more than 10 times faster and with far lower costs and error rates than manual processes through the use of webbased technology, providing a full audit trail and removing the risk of human oversight.

Founded in Australia in 2012, Encompass launched in the UK in 2015 and now employs more than 50 staff, including more than 30 staff in the UK. It uses real time data from over 30 information providers. Encompass serves more than 200 firms who rely on its products to automate and manage AML/CTF risk and compliance while enabling growth through informed and timely business decisions.

Since 2004 C6, an Acuris company, has provided unique, actionable data which helps businesses worldwide manage risk. We are a trusted and independent provider of data intelligence for anti-money laundering, anti-corruption and cybersecurity professionals. Offering a powerful overview and enhanced risk management – our unique database exceeds all expectations and has the most comprehensive database of actionable intelligence relating to Politically Exposed Persons (Pep's) and sanctioned individuals, companies and jurisdictions.

During this time C6 has identified the most relevant local and global sources allowing us to create a unique process of gathering timely, accurate and relevant adverse media relating to the FATF predicated crimes list.

C6 combines human intelligence and code to pinpoint any risks associated with forming new business relationships and a database covers over 200 jurisdiction and over 40 languages. Our suite of KYC search and monitoring data solutions, which access our unique and expanding database, provides you with an accurate risk intelligence data results and a reduced false positives.

Other titles in the ICLG series include:

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