DFSA OUTREACH

Matt Gamble

22 March 2011

Agenda

- FATF Review of PEPs
- Enhanced Due Diligence for high risk customers, including PEPs
- DFSA STR Statistics
- Best Practice in STR preparation

FATF Review of PEPs

- FATF released a consultation paper in October 2010 – Review of Standards
- Responses to paper closed on 7 January 2011
- Paper stated that United Nations Convention on Corruption 2003 (Merida Convention) would have an impact on standard on PEPs

FATF Review of PEPs (cont'd)

- FATF is considering following approach:
  - Leave foreign PEPs as higher risk;
  - Require reasonable measures to determine if customer is a domestic PEP; and if so
  - Require enhanced due diligence if higher risk.
- Also considering changing obligation with respect to family members and close associates of PEPs
- New proposal to focus on cases where PEP is beneficial owner

Enhanced Due Diligence for High Risk Customers, Including PEPs

- What does Enhanced Due Diligence (EDD) mean?
- No internationally agreed definition

Enhanced Due Diligence for High Risk Customers, Including PEPs

- "*A* ***rigorous and robust process of investigation*** *over and above (KYC) procedures, that seeks with reasonable assurance to verify and validate the customer's identity; understand and test the customer's profile, business and account activity; and identify relevant adverse information and risk assess the potential for money laundering and / or terrorist financing to support actionable decisions to mitigate against financial, regulatory and reputational risk and ensure regulatory compliance*." – Peter Warrack, July 2006 edition of ACAMS Today
- DFSA has not defined EDD

Enhanced Due Diligence for High Risk Customers, Including PEPs

- Appendix A.2.2 AML Rulebook
  - Analysis of complex structures
  - Appropriate measures to establish source of wealth
  - Development of a profile of business relationship to monitor transactions and accounts
  - Senior management approval
  - Regular oversight
- Recent SEO letter of 27 January 2011 reminded all firms of obligations with PEPs
- While not strictly AML centric the recent UNSC resolutions have focused firms of the need to know who the ultimate beneficiary is
- It is all about risk based assessments

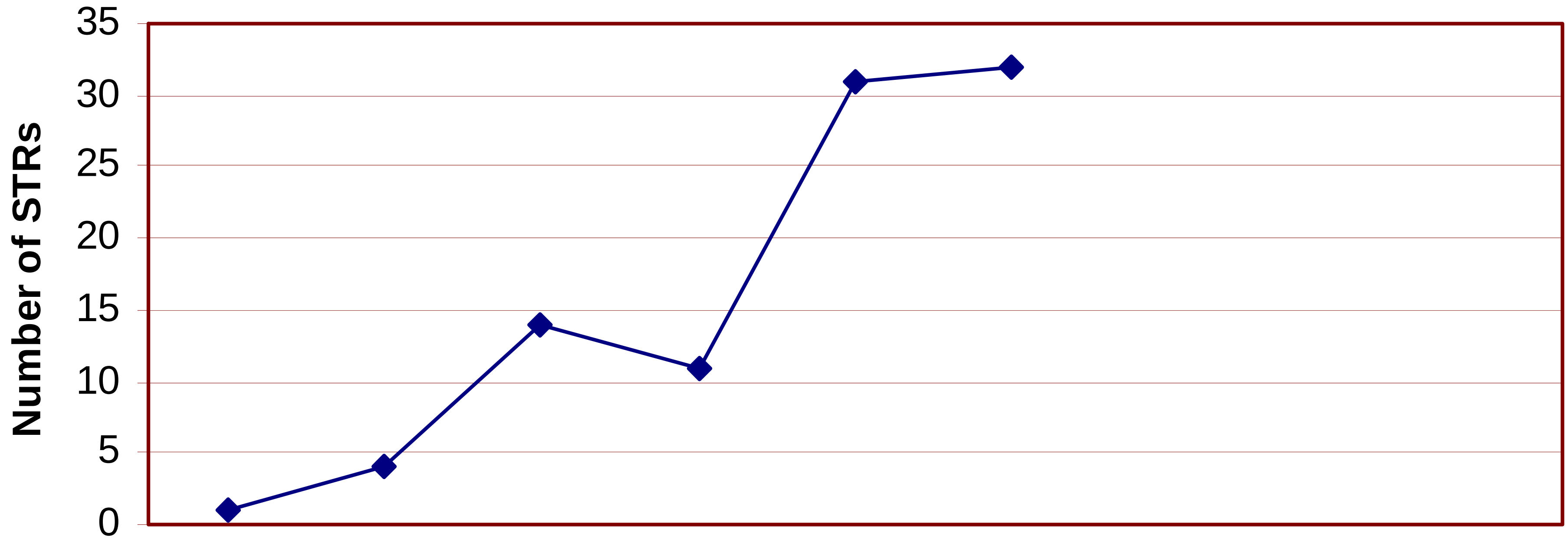
STR Statistics Summary

- Since 2005 the DFSA has received a total of 93 STRs, the majority of which were received between 2009 and 2010
- Most common types of STR are:
  - Fraudulent letter 13.5%
  - Suspicious source of funds 13.5%
  - Customer suspected/known criminal 12.5%

DFSA STR Statistics

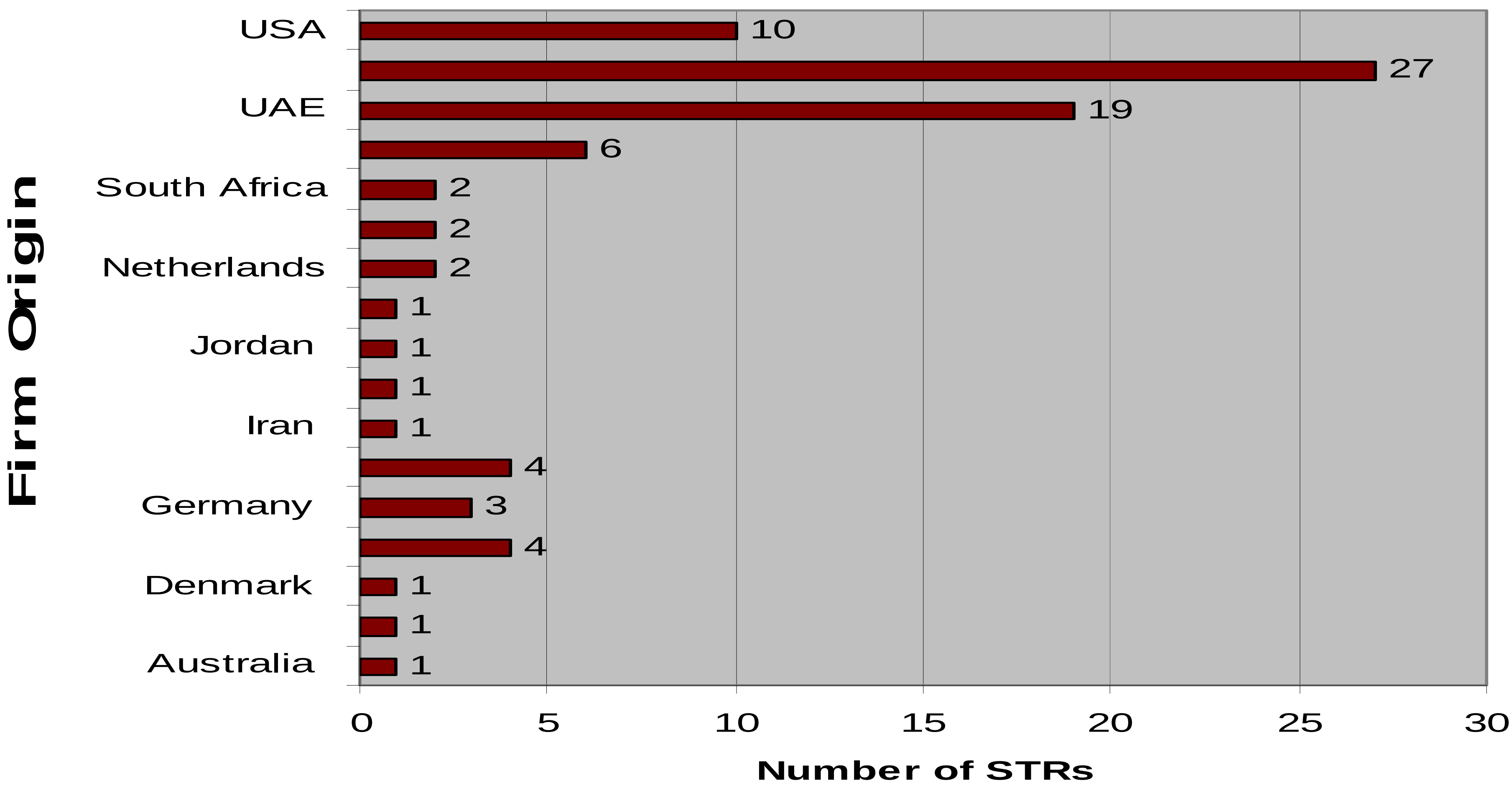
	activity inconsistent with customer objective	activity inconsistent with customer profile	advance fee fraud	adverse background check results	adverse world check	corporate crime/ investment fraud	country of interest	customer suspected/known criminal	fake identity	ficticious company	fraud	fraudulent cheque	Fraudulent document	fraudulent instructions	fraudulent instruments	fraudulent letter	high risk country	inability to verify customer identity	irregular activity	layering	misrepresentation of facts	phishin g/ scam	potential fraud	refusal to disclose identity	suspicious customer behavior	suspicious source of funds	unauthorised transaction	unusual account activity	unusually large transaction	watch list match	world list match
2011						X		X																	X						
								X																							
								X																							
								X																							
								X																	X	X					
							X	X								X									X	X					
							X	X			X				X	X									X	X					
2010		X					X	X	X		X				X	X					X				X	X	X	X			
								X																		X					
								X																	X	X					
								X								X		X							X	X				X	
2009	X	X	X	X			X	X					X			X		X			X			X	X	X			X	X	X
								X																							
								X																		X					
								X												X					X	X					
2008		X		X			X	X								X	X			X					X	X					
																X															
																X															
																X															
																X															
																X							X								
2007										X				X		X						X	X			X				X	
2006			X							X						X														X	
2005								X																							

STR Trends



Year	2005	2006	2007	2008	2009	2010
Number	1	4	14	11	31	32

Origin of Firm vs STRs Lodged



Best Practices in STR Preparation

The following documents should be submitted with an STR:

1. Covering letter – duly signed and stamped by the MLRO with the subject clearly mentioned as STR & the name of the customer/s
2. STR Form – Reporting Entities are encouraged to include more details, apart from those that have been expressly stated in the STR Form. They may also enclose an attachment to the STR Form to include such comprehensive details, should the space in the STR Form be insufficient

Best Practices in STR Preparation

3. KYC details – to include ultimate beneficial owners and their details in case of entities, apart from the mandatory KYC details
4. Identification documents (such as passports, incorporation documents, certificates of registration) – also Memorandum of Association, if available
5. Grounds for suspicion – to be comprehensive and to include the reason for filing the STR
6. Bank statements / policies / risk assessments; to include Account Opening Documents / Application Forms

Best Practices in STR Preparation

7. In case of suspected fraudulent transfers or suspected financial transactions, copies of SWIFT messages
8. Any other documents / information that are relevant

Word document available for STR lodgment

Clearly Identify Source of Suspicion

- Adverse background check results for customer
  - Media
  - Customer Due Diligence Vendor
- Activity inconsistent with customer profile/objective
- Suspicious source of funds
- Suspicious customer behavior

Clearly Identify Source of Suspicion

- Suspicious account activity
  - Unusually large transaction / Irregular activity
- Scam
  - Phishing scam
  - Fake identity / Fictitious company
- Fraud
  - Documents / Instructions / Instrument
  - Advance fee fraud
  - Investment fraud or corporate crime

All original STRs must be sent to the AMLSCU!

For STR enquiries or lodging a copy of an STR:
STRunit@dfsa.ae

MONEY LAUNDERING – A CASE STUDY

Stephen Glynn & Michael Wong

22 March 2011

Dubai Financial Services Authority

Case Study

DIFC Limited, a subsidiary of a UK parent:

- Promotes access to a platform on which clients trade in securities;
- Markets securities and the platform operated by its parent;
- Facilitates the on-boarding of Clients to the parent's platform;
- The Client was encouraged to join the platform by a RM who transitioned the Client from another AF in which the RM worked. The Client makes transfers of funds to the subsidiary's bank accounts via international electronic payment systems;
- A Client trading in options on the platform loses $5m through trading activities;
- A lawyer acting on behalf of the Client and a third party complain to the DFSA that:
  - His clients lost $5m trading options;
  - DIFC Limited allowed his Clients to trade on the platform without carrying out appropriate due diligence on his Clients.
- The lawyers of the Client and third party ask the DFSA to investigate and commence proceedings pursuant to Article 94 Regulatory Law to recover their losses;
- The lawyers are contemplating litigation in the DIFC Court;
- DIFC Limited believes that all clients are clients of the parent and not the subsidiary and therefore DIFC Limited does not have to undertake customer due diligence.

DFSA Response

- Assess the complaint & information – verification
- Interview complainants
- Gathering relevant information

Objective

- To determine if a suspicion of a contravention exists
- Commence Investigation

DFSA's Objectives

- To preserve the integrity of the DIFC
- Determine the extent of the risk – one off – systemic
- Rectify the failure
- Mitigate the risk
- Protect consumers
- Compensate victims
- Sanction wrongdoing

Who Should Be Concerned?

- DIFC Limited
- The Governing Body
- Senior Management – SEO
- The MLRO and Compliance Officer
- The relationship officer
- The shareholders
- All of the above

Case Study

DIFC Limited, a subsidiary of a UK parent:

- Promotes access to a platform on which clients trade in securities;
- Markets securities and the platform operated by its parent;
- Facilitates the on-boarding of Clients to the parent's platform;
- The Client was encouraged to join the platform by a RM who transitioned the Client from another AF in which the RM worked. The Client makes transfers of funds to the subsidiary's bank accounts via international electronic payment systems;
- A Client trading in options on the platform loses $5m through trading activities;
- A lawyer acting on behalf of the Client and a third party complain to the DFSA that:
  - His clients lost $5m trading options;
  - DIFC Limited allowed his Clients to trade on the platform without carrying out appropriate due diligence on his Clients.
- The lawyers of the Client and third party ask the DFSA to investigate and commence proceedings pursuant to Article 94 Regulatory Law to recover their losses;
- The lawyers are contemplating litigation in the DIFC Court;
- DIFC Limited believes that all clients are clients of the parent and not the subsidiary and therefore DIFC Limited does not have to undertake customer due diligence.

Red Flags – Risk Based Approach

Vulnerabilities

- Product – higher risk – limited cash flow controls
- Services – Electronic payments – internet trading
- Customers – non face to face – PEPs – high risk jurisdictions
- Legal – Interpretation of law
- Staff – Understanding and application of obligations
- Commercial realities and pressures

What You Should Be Concerned About – 1

Relationship Managers

- Firm’s greatest strength in the fight against Money Laundering

But are also an area for vulnerability

- Complacency
- Becoming too close
- Potential conflicts

What You Should Be Concerned About – 2

Knowing Your Client, Always

- Personal Details
- Nature & Level of Business
- Origin of Funds
- Source of wealth
- Updated KYC: AML 3.4.3(1)(a)
- Document Retention – 6 years from when relationship ends

What You Should Be Concerned About – 3

Client Take-on & Classification

- Requirements of Client Agreement
- Client Classification supports KYC

What You Should Be Concerned About – 4

Policies and Procedures

- The AML Module should not be your firm's P&P's
- Practicality and Applicability to your firm
- Is your staff aware of them
- Internal Review process
- Empower you as Compliance Officers
- Complaints handling process

What You Should Be Concerned About – 5

Systems and Controls

- AML 3.1.1
- Are they understood by you and your staff?
- Do they ensure that evidence is obtained, accurate and up to date?
- Do they take into account your business' specific needs?
- Monitor and detect suspicious transactions and customers.
- Take into account developments in AML sphere.
- Do you regularly review them?

Case Study – Findings 1

- 2000 Clients from multiple jurisdictions
- USD 20m in clients' funds held
- Ineffective analysis and classification of clients (COB 2.3.2)
- Lack of Client Agreements (COB 3.3.2)
- Lack of Suitability Assessments (COB 3.4.2)
- Clients acting beneficially for others (AML 3.4.2)
- Ineffective KYC (AML 3.4.1)

Case Study – Findings 2

- No enhanced due diligence (AML 3.7.1)
- Failure to maintain clients' files (AML3.4.8)
- Failing to update records (AML 3.4.1)
- System and Controls failure to identify PEPs (AML 3.7.2)
- System and Controls failure to detect suspicious transactions (AML 3.7.3)
- Failure to monitor incoming funds transfers (AML 3.8.1)
- Failure to train employees (AML 3.9.1)

What Are Risks To You?

- Supervision / Investigation – time and cost drain
- Litigation: By complainant and DFSA
  - Compensation – Prohibition Orders – Business Restrictions
  - Disgorgement orders
- Regulatory action
  - Sanctions – fines – censures
  - Other sanctions – audit – report – Licence function withdrawal bannings – return funds
- Reputation damage

What Will The DFSA Do?

- Conduct a theme review
- Provide a Report – Article 74
  - Appoint an expert SUP 4.2.1
  - Expert must cooperate with the DFSA
- Restriction on Business – Article 75
  - Entering into certain transactions
  - Soliciting business from specified persons
  - Carrying on business in a specified manner

What Will The DFSA Do?

- Conduct an investigation
- Exercise its powers under Art 73 and 80
- Determine if the problem is isolated or systemic
- Impose remedial action and/or sanctions

Penalties

Trends

- Increase in financial penalties
- Enhancements to AML Corporate Governance
- MLROs and Senior Management being targeted

Penalty Examples

<table>
<tr><th>Year</th><th>Jurisdiction & Regulator</th><th>Firm</th><th>Action Taken</th></tr>
<tr><td>Dec 2010</td><td>USA, FINRA</td><td>Global Strategic Investments LLC</td><td>Global was given financial penalty of USD150,000
Banned CO for 6 months.</td></tr>
<tr><td>Sep 2010</td><td>USA, OCC</td><td>Intercredit Bank</td><td>Financial penalty of USD200,000</td></tr>
<tr><td>Jul 2010</td><td>USA, FINRA</td><td>Skyebanc Inc</td><td>Financial penalty of USD30,000</td></tr>
<tr><td>May 2010</td><td>UK, FSA</td><td>Alpari (UK) Ltd</td><td>Financial penalty of circa USD226,296
MLRO was given penalty of circa USD22,629</td></tr>
<tr><td>Feb 2010</td><td>USA, FINRA</td><td>Penson Financial Services</td><td>Financial penalty of USD450,000</td></tr>
<tr><td>Feb 2010</td><td>USA, FINRA</td><td rowspan="3">Pinnacle Capital Markets</td><td>Financial penalty of $300,000</td></tr>
<tr><td rowspan="2">Oct 2010</td><td>USA, FINCEN</td><td>Civil Penalty USD50,000</td></tr>
<tr><td>USA, SEC</td><td>Financial penalty of USD25,000</td></tr>
<tr><td>Oct 2009</td><td>USA, FINRA</td><td>Scottrade Inc</td><td>Financial penalty of USD600,000</td></tr>
<tr><td>Oct 2008</td><td>UK, FSA</td><td>Sindicatum Holdings Ltd.</td><td>Financial penalty of circa GBP80,000</td></tr>
<tr><td>Nov 2005</td><td>UK, FSA</td><td>Investment Services UK Ltd</td><td>Financial penalty of circa GBP280,000
MD was given penalty of circa GBP48,000</td></tr>
</table>

Lessons Learnt

Mitigate your risks by:

- Understanding your obligations
- Obtaining good advice
- Identifying the key risks to your business
- Ensuring Policies & Procedures are practical and applicable
- Properly educating staff
- Implementing sound systems and controls
- Conducting regular reviews


Q & A