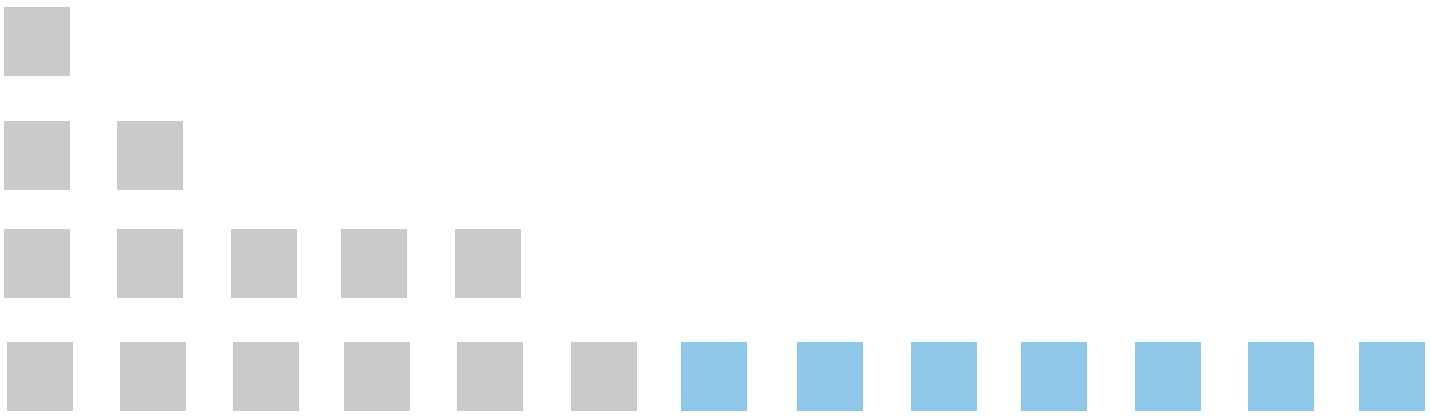
GIBRALTAR FINANCIAL SERVICES COMMISSION

Thematic Review Report

Electronic Money Institutions

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

February 2019



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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 Electronic Money Institutions (EMIs) 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
E-money	Electronic Money
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
POCA	Proceeds of Crime Act 2015 - http://www.gibraltarlaws.gov.gi/articles/2015-22o.pdf
SDD	Simplified Due Diligence

Why select the Electronic Money Sector?

When considering the need to carry out a thematic review on AML and CFT systems of controls of EMIs, the GFSC has considered the following:

- The risks identified and published within Gibraltar's National Risk Assessment
- Guidance issued by International Bodies such as the Financial Action Task Force and MONEYVAL; and
- The data analysis arising from the data submitted within the 2016 and 2017 Financial Crime Returns.

As a result of the above factors, the GFSC carried out a thematic review to improve 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.

What we did

Due to the nature of the E-money sector and given that there is a small number of EMIs, all firms were assessed as part of the thematic review.

As a result, the team completed four onsite inspections in Q4/2018, which also included desk-based reviews of the documentation submitted. Both review methods allowed the team to assess how firms have implemented AML/CFT systems of controls and the team was able to verify how these are being applied in practice. 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.

In support of our assessment, we have contacted other Regulators with regimes similar to the GFSC. This has served to share information on common issues and risks, and best and poor practices applied by the industry. The sharing of information and knowledge is particularly important in sectors such as electronic money, given that the nature of the activity is cross-jurisdictional and primarily online based, to ensure that we apply a consistent and comprehensive supervisory approach.

Our Findings

Gibraltar EMIs form part of larger groups globally. The Gibraltar authorised EMIs have different business models and products so the approach taken by each firm differs greatly. Through the thematic review, we identified that some firms are making increased use of payment services permissions within their E-money licence and accessing markets in that capacity.

We acknowledge that firms showed a notable understanding of the money laundering and terrorist financing (ML/TF) risks posed by the nature of the activities carried out. Firms demonstrated an awareness of their obligations in line with the legislative and regulatory responsibilities.

The key findings arising from the thematic review showed that the main areas for improvement included customer due diligence, outsourcing and ongoing monitoring, which are all essential components for complying with the requirements and managing ML/TF risks. It should be noted that these findings are by exception and are not endemic to all firms.

We have set out our findings under various key areas and set out the GFSC's expectations of these. The good and poor findings identified at the thematic review onsite visits are listed under these headings. In this way, and by detailing the GFSC's expectations, firms can understand where improvements or changes should be made.

Corporate Governance

<u>Expectations</u>

The firm's Board should:

- Maintain sound and prudent management
- Notify regulatory and statutory breaches of requirements without delay
- Deal with the GFSC in an open and cooperative manner
- Be committed to ensuring compliance with all relevant legislative and regulatory requirements including allocating the appropriate resources
- Be aware and have a proper understanding of the risks posed
- Retain ownership of its responsibilities
- Appropriately manage and supervise the policies and procedures of the firm
- Meet on at least a quarterly basis and maintain adequate minutes of these meetings

Good Findings	*Poor Findings*
Most firms confirmed that resourcing arrangements and needs were assessed and verified on an ongoing basis.	One of the most significant areas of concern found was that there was evidence to suggest that commercial decisions may have been taken without the adequate regard to the firm's compliance obligations. In at least one of the cases, this was primarily due to inadequate corporate governance arrangements.
All firms demonstrated a sound understanding of the ML/TF risks and most of them were proactive in mitigating and managing these.	In one of the firms, senior management had not provided sufficient resources for the firm to manage workloads, and to ensure compliance with POCA and regulatory requirements.
	During the onsite visits we identified breaches that had not been notified to the GFSC, with some not having been addressed in a timely manner either.

Customer Due Diligence

Expectations

The firm should:

- Have a documented customer due diligence policy and procedure in place which is properly implemented and put into practice, and which should include the application of simplified and enhanced due diligence
- Assess and carry out due diligence of its customers applying a risk based approach
- Take into consideration the four risk elements when assessing a customer
- Verify a customer's identity and residence
- Assess a customer's Source of Funds and/or Wealth to a level of plausible verifiability
- Screen all customers against the relevant sanctions lists
- Ascertain if any of its customers are politically exposed persons, family members or close associates of politically exposed persons

Good Findings	*Poor Findings*
All firms completed sanctions screening for their respective client base.	It was of significant importance that all firms' procedures included the obligation to screen customers against the US Office of Foreign Assets Control List. Although this is good practice, this should be done in addition to compliance with EU requirements, which set out that sanctions screening is required to be carried out against EU sanctions lists. Not all firms included EU sanctions lists in their screening procedures.
We identified that all firms applied the Source of Funds requirement to varying degrees commensurate to their size and type of business. Additionally, firms took a risk-based approach when applying the plausible verifiability requirement within their customer due diligence process.	It was identified that half of the firms were in breach of SDD requirements, given they had not updated their policies and procedures in line with the 4MLD.
All firms conducted due diligence on the ultimate beneficial owners of its corporate customers or programme managers.	One of the firms did not conduct due diligence on all individuals with a controlling interest e.g. Directors, which is considered a regulatory requirement.

Politically Exposed Persons

Expectations

The firm should:

- Have a documented PEP policy which is properly implemented and put into practice
- Always apply Enhanced Due Diligence measures in line with the legislative requirements
- Assess and verify a PEP's Source of Funds and/or Wealth
- Screen all PEPs against the relevant sanctions lists
- Score corporate business relationships which are associated with a PEP, as high risk as well; these should not be considered in isolation
- Maintain a PEP Register

Good Findings	*Poor Findings*
All firms conducted due diligence to identify whether a customer was a PEP.	At least one of the firms was unable to screen its customers as PEPs for some months which is not in line with POCA.
All firms that delegated some functions to programme managers, still required the programme manager to refer PEPS to the firm's compliance team for consideration and approval.	One of the firms did not collect adequate source of funds evidence for a PEP nor to a level of plausible verifiability. The firm noted that it only requested this when the PEP is proposed as a cardholder and not necessarily when associated with a corporate or a programme manager.
	One of the firms did not score corporate business relationships which are associated with a PEP as high risk, but rather the relationship was risk scored as per the firm's risk methodology and the PEP was rated separately. As a result, the business relationship associated to a PEP had not been subject to enhanced due diligence and ongoing monitoring, contrary to the legislative requirements.

Outsourcing/Delegation of Functions

Expectations

The firm should:

- Have a documented outsourcing policy which is properly implemented and put into practice
- Maintain ultimate ownership and responsibility of the outsourced and delegated functions
- Carry out due diligence measures on the individuals associated with a third party provider including those with a controlling interest (e.g. Directors)
- Maintain adequate oversight of third party providers and programme managers, including;
    - conducting periodic reviews, such as onsite audits of the responsibilities which are delegated;
    - verifying that third parties are in compliance with statutory requirements and the firm's own policies;
    - verifying the provider's AML/CFT training which is delivered to staff and the frequency (this may include the material which is presented); and
    - having procedures to address non-compliance by the other party in a timely manner.

Good Findings	*Poor Findings*
The programme manager model is applied by two firms within the sector and adequate periodic reviews were undertaken by one of the firms.	One of the two firms which operates a programme manager model, did not have adequate oversight of its programme managers and/or was unable to evidence that it fully complied with its legislative and regulatory requirements.
One of the firms had suitable oversight and visibility of the functions carried out by its programme managers.	The correspondence with third party providers by one of the firms was reactive and limited to queries and requests from the programme managers, rather than it being initiated by the firm.
It was identified that one of the firms operating a programme manager model carried out adequate oversight with regards to the programme manager's training material.	

Ongoing Monitoring

Expectations

The firm should:

- Have a documented ongoing monitoring risk methodology which is properly implemented and put into practice. This should take into consideration the oversight of any delegated ongoing monitoring functions
- Carry out ongoing monitoring of its customers applying a risk-based approach
- Conduct enhanced ongoing monitoring of all PEP and high risk customers
- Maintain adequate databases which record customer details and transactions
- Implement triggers into its systems of controls to ensure that changes to a customer's details will be flagged for re-assessment if required
- Apply relative and risk-based rules and parameters so that it can conduct appropriate and ongoing transaction monitoring

Good Findings	*Poor Findings*
Generally, firms had sound databases to record information and conduct transaction monitoring.	The ongoing monitoring conducted by a firm was not always adequate or sufficient in line with the risks posed and legislative requirements. In at least one case, the firm visited did not have access to, nor held, comprehensive information on the transaction monitoring carried out by its programme managers, on its behalf.
Three of the firms evidenced adequate ongoing transaction monitoring and/or counter-monitoring of transactions where it applied a programme manager business model.	One of the firms did not have adequate systems to trigger the re-assessment of a customer when the customer's details changed.
Most firms have the appropriate systems in place to re-assess a customer following changes to the customer's information or circumstances.	

Training

Expectations

The firm should:

- Have a documented training policy which is properly implemented and put into practice
- Ensure that all staff is trained for AML/CFT purposes
- Tailor its training and provide more specific material to those members of staff which hold an AML/CFT or compliance related function
- Maintain an up to date Training Log

Good Findings	*Poor Findings*
All firms provided regular AML/CFT training to staff, with a more specific programme offered to those team members who manage compliance matters.	
All firms maintained an up to date training log.	

Other

Expectations

The firm should:

- Always notify or seek approval from the GFSC, where required, regarding any significant proposed changes to its business plan
- Place the same degree of importance on TF risks as ML
- Implement the relevant policies and procedures in keeping with Section 26 of POCA and review these periodically
- Maintain a comprehensive and up to date risk log and risk register
- Implement an independent audit policy in compliance with regulatory requirements
- Maintain all records for a minimum of 5 years following the termination of a business relationship or transaction
- Complete and approve the Compliance Report annually or as required, to adequately evidence how the firm complies with requirements

Good Findings	*Poor Findings*
We noted that almost all firms followed best practice and had considered and/or actioned an independent audit in line with Section 26(1)(1A) of POCA.	The firms' Compliance Reports were not completed to the standard expected. Therefore, suggestions have been made in areas of improvement to ensure that these adequately evidence the firm's compliance with the relevant requirements.
Record keeping requirements were complied with by all firms, with all maintaining records for five years following the end of a business relationship or transaction.	One firm did not evidence the same level of awareness and understanding with respect to TF risks.
All firms evidenced an awareness and understanding of ML risks, and this was integrated into the firm's systems of controls.	

Next Steps

The GFSC has finalised the onsite inspections and is in the process of issuing individual feedback to all firms. Each firm will be placed on a specific supervisory plan tailored to the firm and its business model, 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 EMIs 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 apply them accordingly.

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 AML/CFT Supervision Team on amlcft@gfsc.gi or +350 200 40283.

Published by:
Gibraltar Financial Services Commission
PO Box 940
Suite 3, Ground Floor
Atlantic Suites
Europort Avenue
Gibraltar

www.gfsc.gi