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Anti-Money Laundering Bulletin

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Welcome to the latest edition of the Central Bank's Anti-Money Laundering Bulletin. This edition contains information on the Central Bank's Anti-Money Laundering / Counter Financing of Terrorism / Financial Sanctions (AML/CFT/FS) supervisory engagements with Funds and Fund Management Companies (Firms).

The focus of this bulletin relates to fund entities themselves (Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs), including Self-Managed Investment Companies (SMICs) and additionally, their fund management companies (UCITS management companies and Alternative Investment Fund Managers (AIFMs)). However, Designated Persons operating in other sectors should also take note of the Bulletin and consider its relevance to their firm/sector.

Previous Central Bank AML/CFT/FS bulletins and reports highlighted the importance of the implementation of effective controls in the areas of Transaction Monitoring (TM), Customer Due Diligence (CDD) and Suspicious Transaction Reporting (STR). This edition should be read in conjunction with previous bulletins, reports and guidance issued by the Central Bank.

Tommy Hannafin
Head of Anti-Money Laundering Division
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Links to useful sources of information available on the Central Bank website:

- Anti-Money Laundering and Countering the Finance of Terrorism Guidelines for the Financial Sector – June 2021 (the "Guidelines")
- Anti-Money Laundering Bulletin on Transaction Monitoring – October 2020
- Anti-Money Laundering Bulletin on Suspicious Transaction Reporting – November 2017
- Anti-Money Laundering and Countering the Finance of Terrorism – Correspondence with Industry

Message from Tommy Hannafin - Head of Anti-Money Laundering Division

While Ireland has and continues to take positive steps in its collective fight against Money Laundering and Terrorist Financing (ML/TF), which have a real effect on the economy and the citizens of Ireland, the Central Bank's supervisory engagement with firms continues to identify weaknesses that require remediation to further enhance Ireland's fight against ML/TF. Specifically with respect to the funds sector, our supervisory engagements since 2019 have highlighted weaknesses in the areas of Governance, Business Risk Assessments, Outsourcing and Customer Due Diligence which are set out in more detail in this bulletin.

While this bulletin focuses on findings from the Central Bank's supervisory engagement with the Funds sector the Central Bank expects all firms, irrespective of their sector, to critically assess their Anti-Money Laundering / Countering the Financing of Terrorism & Financial Sanctions (AML/CFT/FS) frameworks against the Central Bank's expectations. Compliance with the requirements set out in this bulletin will continue to be an area of focus by the Central Bank as part of the scope of future engagements with Designated Persons.

Links to other sources:

- Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, as amended ("CJA 2010")
  - *Updated to 23 April 2021*
- Joint Opinion of the European Supervisory Authorities on the risks of Money Laundering and Terrorist Financing
- National Risk Assessment - Ireland

Background

The Central Bank has conducted a number of AML/CFT/FS supervisory engagements with Funds and Fund Management Companies (Firms) to monitor compliance with the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, as amended (the CJA 2010). The Central Bank, in the course of these engagements, identified a number of areas where Firms must introduce enhancements in order to ensure they can sufficiently demonstrate compliance with the requirements of the CJA 2010. These areas are:

- Corporate Governance
- AML/CFT/FS Business Risk Assessment
- Outsourced AML/CFT/FS Activities
- Customer Due Diligence

The Central Bank expects Firms to be in a position to demonstrate that appropriate governance structures are in place to manage and oversee existing and emerging ML/TF/FS risks, including addressing the deficiencies highlighted in this Bulletin. A robust risk management framework that appropriately and effectively identifies and mitigates the inherent ML/TF/FS risks at both a sectoral and individual firm level is key in supporting Firms to address the weaknesses identified by the Central Bank.

1. Corporate Governance

Section 54 of the CJA 2010 prescribes that Firms must have appropriate governance and effective risk and control functions in place. In addition,

The Guidelines
- *Published September 2021*

Chapter 6 of the *Anti-Money Laundering and Countering the Financing of Terrorism Guidelines for the Financial Sector* (Guidelines) sets out additional details relating to the AML/CFT Governance requirements set out in the CJA 2010.

Through its supervisory engagements with the sector, the Central Bank has identified a lack of oversight by Firms of their AML/CFT/FS frameworks. A number of Firms failed to demonstrate effective oversight, implementation and management of the AML/CFT/FS framework.

Central Bank Findings

- Minutes of Board meetings did not always reflect adequate discussion and challenge in relation to AML/CFT/FS matters;
- A number of Firms did not demonstrate that they were actively seeking and ensuring that qualitative and quantitative Management Information (MI) was being provided on a regular basis to enable informed decision-making in relation to the AML/CFT/FS framework;
- A number of Firms failed to demonstrate that appropriate action was taken to address identified deficiencies in the AML/CFT/FS framework in a timely manner;
- A number of Firms failed to demonstrate adherence to Central Bank expectations that the Compliance Officer present an annual Compliance Officer report to the Board; and
- In general, Firms did not demonstrate that they had comprehensive assurance testing programmes in place to ensure effective and independent testing of the AML/CFT/FS framework.

Central Bank Expectations

The Central Bank expects Firms to ensure that the AML/CFT/FS framework is appropriately governed and operating effectively. In this regard, Firms must also be able to demonstrate due consideration and assessment of Chapter 6 of the Guidelines which set out in detail the Central Bank's expectations in relation to Firms' AML/CFT/FS governance arrangements.

The Central Bank expects that:

- The Board should be in a position to evidence effective governance and oversight of the Firm's AML/CFT/FS Compliance Framework;
- Where warranted by the nature, scale and complexity of a firm's activities, Firms should appoint a Member of Senior Management with primary responsibility for implementing, managing and overseeing the AML/CFT/FS framework in accordance with the CJA 2010. Where Firms are exposed to a significant degree of inherent

Chapter 6 of the Guidelines recommends Firms to appoint sufficiently senior and experienced personnel to implement, manage and oversee the AML/CFT/FS control framework.

As detailed within **Section 6.3** of the Guidelines, the Central Bank also expects Firms to appoint a **Member of Senior Management** with primary responsibility for implementing, managing and overseeing the AML/CFT/FS framework in accordance with the CJA 2010.

As detailed within **Section 6.4** of the Guidelines, the Central Bank expects Firms to appoint an individual at management level (the **Compliance Officer**) to monitor and manage compliance with, and the internal communication of, the Firm's internal AML/CFT/FS policies, controls and procedures.

ML/TF risk, Firms should consider if it is appropriate for the Member of Senior Management to be a member of the Board;

- Where warranted by the nature, scale and complexity of a firm's activities, Firms should appoint an individual at management level (the "Compliance Officer") to monitor and manage compliance with, and the internal communication of, the Firm's internal AML/CFT/FS policies, controls and procedures. Where a Compliance Officer has been appointed, the Compliance Officer should:
    - Prepare and present a Compliance Officer Report to the Board on at least an annual basis; and
    - Provide regular and comprehensive MI for all aspects of the AML/CFT/FS control framework to support informed decision-making and to drive a culture of good conduct and proactive compliance with the requirements of CJA 2010.
- Firms must implement a robust assurance testing framework to assess the effectiveness of their AML/CFT/FS control framework which is commensurate with the ML/TF risk and to ensure compliance with the requirements of the CJA 2010;
- The Board and, where appropriate, the Member of Senior Management, should have sufficient oversight so as to ensure timely resolution of AML/CFT/FS issues and matters requiring remediation; and
- AML/CFT/FS matters are subject to robust discussion and challenge at an appropriately senior level and that those discussions are accurately recorded in minutes of Board and and/or Committee minutes.

2. AML/CFT/FS Business Risk Assessments

The Central Bank's supervisory engagement has identified failings by Firms in the design and implementation of their AML/CFT/FS Business Risk Assessment. The National Risk Assessment specifically highlights complexities of the business activities and outsourcing of AML/CFT/FS activities as presenting increased ML/TF risk for this sector. Additionally, distributor and sub-distributor relationships are a common feature of this sector, which further increases ML/TF risk exposure. In completing their Business Risk Assessments, Firms did not sufficiently demonstrate that they had undertaken a comprehensive review to include, but not limited to, the above inherent ML/TF risks.

Central Bank Findings

- A number of Firms had no Business Risk Assessment in place;
- Even where a Business Risk Assessment was in place, in many cases the Business Risk Assessment did not accurately and/or

Chapter 4 of the Guidelines also sets out the following expectations in relation to the Business Risk Assessment.

- Section 30A of the CJA 2010 requires Firms to conduct a Business Risk Assessment
- Firms should ensure that their Business Risk Assessment is tailored to their business and that it takes account of factors and risks specific to the Firm's business. Where a Firm's Business Risk Assessment is drawn up as part of a group-wide risk assessment, the Firm should consider whether the group-wide risk assessment is sufficiently granular and specific to reflect the

appropriately reflect the inherent ML/TF risks associated with this sector. For example, the Business Risk Assessment did not include:

- A full assessment of inherent distribution risk applicable to their business , including the impact of distributor and sub-distributor arrangements;
- Adequate consideration and assessment of the inherent risk associated with the extensive use of outsourcing arrangements;
- Adequate assessment of geographic risk to reflect the wide geographical reach relevant to its business operations; and
- Sufficient consideration and assessment of complexities relevant for this sector and their business activities, for example, complex beneficial ownership structures.

- A number of Firms were unable to sufficiently demonstrate that they had processes in place to measure the effectiveness of the AML/CFT/FS controls implemented to mitigate the inherent risks identified;
- A number of Firms were unable to demonstrate that Terrorist Financing had been considered as part of the Business Risk Assessment; and
- A number of Firms did not have policies and procedures in place that sufficiently documented their approach to the completion of, and the methodology employed for, the Business Risk Assessment.

Central Bank Expectations

A robust Business Risk Assessment is a fundamental and essential component of the development of an AML/CFT/FS framework that ensures Firms can appropriately and effectively design and implement the necessary controls to mitigate and address the ML/TF/FS risks to which their business is exposed. It is therefore essential that Firms can ensure, and consequently demonstrate, that the Business Risk Assessment has been tailored to the risks for both their sector and to the ML/TF/FS risks that are specific to their business. The Central Bank expects Firms to demonstrate that an AML/CFT/FS risk framework has been embedded that is commensurate with the risk of ML/TF/FS for their business. In completing the Business Risk Assessment, the Central Bank expects Firms to refer to the National Risk Assessment, the Guidelines and the European Supervisory Authority Risk Factor Guidelines for areas to consider when assessing ML/TF/FS risk. The Central Bank expects that:

- Firms have a documented Business Risk Assessment, which includes an assessment of inherent ML/TF/FS risk, an assessment of the effectiveness of the AML/CFT/FS control framework and details of the overall residual risk;

Firm's business and the risks to which it is exposed.

- A generic Business Risk Assessment that has not been adapted to the specific needs and business model of a Firm is unlikely to meet the requirements of Section 30A of the CJA 2010

European Supervisory Authorities Guidelines also provide guidance on the risk factors Firms should consider when assessing the ML/TF risk to complete the Business Risk Assessment.

- *Published March 2021*

- **Title 1, Guideline 16** of the Risk Factor Guidelines sets out areas of ML/TF risk which may be relevant to Firms involved in the provision and distribution of investment funds.

- Firms have employed a methodology for the Business Risk Assessment that clearly outlines the approach adopted to assess each area of ML/TF/FS risk and which is subject to regular review, update and approval;
- Firms complete a full assessment of inherent risks which includes an assessment of the known ML/TF/FS risks that have been identified as presenting heightened risk for this sector, including, but not limited to, customer (complex ownership structures), product, service, distribution, outsourcing, geographic and transaction risks;
- Firms must be in a position to demonstrate that they have implemented a robust AML/CFT/FS framework to mitigate the risk of ML/TF/FS, to include:
    - The implementation of controls that are commensurate with the scale, complexity and risk of the Firm's business activities; and
    - A process to evaluate and measure the effectiveness of the controls implemented to mitigate the ML/TF/FS risk.
- The Business Risk Assessment is subject to regular review and approval by an appropriate member of senior management;
- The Board reviews and approves the Business Risk Assessment on at least an annual basis;
- That an assessment of Financial Sanctions exposure and Terrorist Financing risk has been has been undertaken and is included in the Business Risk Assessment; and
- The documented Business Risk Assessment encompasses review and consideration of Irish, European and International guidance in relation to ML/TF/FS risk (for example, Chapter 16 of the Risk Factor Guidelines issued by ESAs).

3. Outsourcing

Firms commonly outsource AML/CFT/FS activities to third parties, thus elevating the risk of ML/TF. While activities can be outsourced, Firms retain ultimate responsibility for ensuring full compliance with the CJA 2010 and with the Firm's obligations in respect of Financial Sanctions. The Central Bank continues to identify weaknesses in Firms' oversight of AML/CFT/FS activities delegated to, and undertaken by, third parties on their behalf. Firms must demonstrate robust oversight of all AML/CFT/FS activities outsourced to third parties in order to ensure full compliance with the requirements of the CJA 2010.

Chapter 10 of the Guidelines provides further details in respect of International Financial Sanctions.

Central Bank Findings

- A number of Firms did not demonstrate that there were appropriate arrangements, for example Service Level Agreements, in place governing the outsourced AML/CFT/FS activities;

- Outsourcing arrangements, for example Service Level Agreements, were not always subject to regular review and assessment at an appropriate senior level;

- In some cases there was a lack of available MI and Key Performance Indicators (KPIs) in relation to the AML/CFT/FS activities and processes undertaken by Outsourced Service Providers (OSPs); and

- Of particular concern was deficiencies in oversight by some Firms of the AML/CFT/FS activities undertaken by OSPs, including:
    - OSPs not subject to regular and comprehensive due diligence reviews that include a review and sample testing of the OSPs procedures and processes; and
    - Insufficient oversight of technological solutions utilised by OSPs for the purpose of activities such as PEP and Financial Sanctions Screening and Transaction Monitoring.

Central Bank Expectations

An effective governance framework extends to the oversight of AML/CFT/FS activities outsourced to third parties. The Central Bank expects Firms to have robust processes and procedures in place to oversee the AML/CFT/FS activities that have been outsourced to third parties, including intra-group entities. The Central Bank expects:

- Firms to ensure that formalised and comprehensive Outsourcing Arrangements, for example Service Level Agreements, are in place to govern outsourced AML/CFT/FS activities with third parties. The outsourcing arrangements should clearly outline the respective parties' responsibilities and deliverables under those arrangements and should be subject to regular review;

- Firms to ensure that they have appropriate processes in place to effectively monitor AML/CFT/FS activities undertaken by OSPs. Examples include a robust assurance testing framework, qualitative and quantitative entity level KPIs and monitoring/overseeing the effectiveness of technological solutions used by OSPs; and

- Where a Firm is relying on an OSP to perform AML/CFT/FS activities as part of its control framework, the Firm must ensure that those activities:
    - Are subject to testing to assess the effectiveness and the application of third party AML/CFT/FS policies and procedures;
    - Have been tailored to ensure the Firm meets its obligations under the CJA 2010 and the Firm's obligations in respect of Financial Sanctions; and
    - Are being performed to a level commensurate with the level of ML/TF risk as identified in the Firm's Business Risk Assessment.

4. Customer Due Diligence

In engaging with this sector the Central Bank has identified instances of a lack of compliance by Firms in respect of the application of some requirements under Section 33 of the CJA 2010, which relates to Customer Due Diligence (CDD). A particular concern in this area was non-compliance with Section 33 (6) of the CJA 2010, which requires that all CDD is in place prior to processing transactions, including initial subscriptions. Chapter 5 of the Guidelines sets out the Central Bank's expectations in more detail, to ensure Firms are meeting the requirements of Section 33 of the CJA 2010.

Central Bank Findings

- In some instances Firms had ineffective CDD control frameworks in place to ensure that customers are fully identified and verified (where applicable) prior to processing transactions; and
- Oversight of CDD Policies and Procedures was not in line with Central Bank expectations in the following areas:
    - Where Firms had outsourced customer CDD activities to an OSP, it was not always evident that Firms had adequate processes in place to review OSP CDD procedures to ensure that CDD measures adopted by the OSP adhered to the requirements of the CJA 2010; and
    - Procedures lacked sufficient detail in some instances in relation to areas including:
        - The timeframe in which CDD must be completed by the OSP; and
        - The Firm's approach to meet the requirements of Section 33 (6).

Central Bank Expectations

The Central Bank expects Firms to have comprehensive policies and procedures in place for the identification and verification (where applicable) of customers in line with the requirements of Section 33 of the CJA 2010. It is vital that, in identifying their customers, Firms can demonstrate to the Central Bank that they are applying measures that are commensurate with the risk of ML/TF. In this sector CDD is largely outsourced to OSPs. Firms have ultimate responsibility for compliance with the requirements of the CJA 2010 and must be in a position to demonstrate effective oversight of the CDD processes and procedures. The Central Bank expects that:

- CDD policies and procedures have been implemented by the Firm and OSPs which:
    - Explicitly document the Firm's approach to identification and verification (where applicable) of customers;
    - Have been tailored to the requirements of the CJA 2010; and

Chapter 5 - The Guidelines sets out the following expectations in relation to Customer Due Diligence (CDD)

- Section 33(5) of the CJA 2010 allows a Firm to identify and verify the identity of a customer during the establishment of a business relationship in circumstances where the Firm believes there is no real risk of ML/TF. However, per Section 33(6) of the CJA 2010, while the account may be opened prior to CDD being complete, transactions may not be carried out by or on behalf of the customer or beneficial owner until CDD is complete.
- Firms should note that placing reliance on a Third Party in accordance with Section 40(3) of the CJA 2010 does not include a situation where a Firm has appointed another entity to apply the necessary measures as an outsourcing service provider, intermediary, or an agent of the Firm. In such cases, the outsourced service provider, intermediary, or agent may actually obtain the appropriate verification evidence in respect of the customer but the Firm remains responsible for ensuring compliance with the obligations contained with the CJA 2010.

  - Are reviewed, updated and approved in a timely manner to reflect any legislative changes and regulatory guidance and that this can be demonstrated, for example, version control.
- Appropriate controls have been implemented to ensure that transactions cannot occur until full CDD documentation and information is in place that meets the requirements of Section 33(6) of the CJA 2010;
- There is sufficient oversight of the CDD activities undertaken by OSPs on their behalf, including, but not limited to:
  - Sufficient sample testing arrangements are in place to ensure that the appropriate CDD measures have been adopted to meet the requirements of the CJA 2010; and
  - That OSPs are fully adhering to the requirements of Section 33 (6) of the CJA 2010.

Conclusion

The Central Bank expects Firms to have implemented effective governance, risk and control functions and to be able to demonstrate to the Central Bank:

- Sufficient oversight of the AML/CFT/FS framework to ensure compliance with the requirements of CJA 2010;
- The identification and management of ML/TF/FS risks to which they are exposed is an iterative and ongoing cornerstone of the Firm's AML/CFT/FS framework; and
- Continual review and assessment of existing processes and procedures to enhance the AML/CFT/FS framework on an ongoing basis, so that firms are well-positioned to respond to emerging risks, legislative changes and regulatory guidance.

The Central Bank will continue to conduct supervisory engagements with Firms in this sector and expects Firms to be in a position to demonstrate that they have reviewed the findings and expectations detailed in this bulletin and, where gaps/weaknesses are identified by firms, sufficient steps have been taken to remediate the identified gaps/weaknesses. In instances where firms fail to demonstrate the necessary remediation to ensure compliance, the Central Bank will determine the appropriate action to undertake, within its full range of its regulatory tools, including where necessary utilising its enforcement powers.