

THE JOINT FORUM

BASEL COMMITTEE ON BANKING SUPERVISION
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

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Initiatives by the BCBS, IAIS and IOSCO to combat money laundering and the financing of terrorism

Update

In June 2003, the Basel Committee on Banking Supervision (BCBS), International Association of Insurance Supervisors (IAIS) and International Organization of Securities Commissions (IOSCO) published a joint note providing a record of the initiatives taken by each sector to combat money laundering and the financing of terrorism (AML/CFT). The note provided an overview of the common AML/CFT standards that apply to all three sectors and an assessment as to whether there are serious gaps or inconsistencies in approaches and recommendations. In addition, it also covered for each sector: the relationships between the institutions and their customers focussing on the products or services that are particularly vulnerable to money laundering, how each Committee has sought to address these vulnerabilities; and, finally, a description of ongoing and future work.

This note was first prepared for the November 2004 meeting of the Joint Forum in Sydney as an update of AML/CFT developments in the three sectors since the June 2003 report. Compiled from contributions by each of the three Secretariats, it focuses on recent guidance for addressing the vulnerabilities identified in the earlier report and ongoing and future work.

Guidance provided to address vulnerabilities

Banking

The BCBS, in its *Customer due diligence for banks* (CDD) paper in October 2001 issued prudential guidance for CDD which is applicable to AML/CFT. This paper sets out standards and provides guidance for the development of appropriate practices by banks in this area. Adequate due diligence on new and existing customers is a key element. Banks must develop policies and procedures in key areas such as customer acceptance, customer identification, ongoing monitoring of high-risk accounts and risk management. The essential elements for these are presented in this paper, together with recommendations for more rigorous standards of due diligence for higher-risk areas.

The BCBS, by way of a press release in July 2003, expressed its support for the revised Financial Action Task Force (FATF) 40 Recommendations published a month earlier. The recommendations reflected principles outlined in the CDD paper. The BCBS, however, highlighted the fact that it still regarded the CDD paper as the appropriate benchmark for banks' customer due diligence procedures. The BCBS reiterated this message in a letter to banking supervisors in December 2003 and emphasised that there were some differences between its CDD paper and the revised FATF 40 Recommendations. The reasons for these differences were:

- The CDD paper is solely concerned with banks while the revised FATF 40 Recommendations cover all financial institutions and some designated non-financial businesses and professions.
- The FATF's focus is on money-laundering and terrorist financing whereas the BCBS focuses on bank's risk management practices.
- The revised FATF 40 Recommendations are to be seen as a minimum standard whereas the CDD paper provides guidance on the essential elements of "know your customer" (KYC) standards for worldwide implementation for all banks.

The BCBS issued a consultative paper *Consolidated KYC Risk Management* in August 2003. The paper, which has since been revised to incorporate comments received from relevant stakeholders, examines the critical elements for effective management of KYC risks across the head office and all branches and subsidiaries. Key to this process is the development of a global risk management programme for KYC which incorporates consistent policies and procedures for the identification and monitoring of customer accounts on a groupwide basis across business lines and geographical locations.

The Consolidated KYC paper highlights that policies and procedures should be designed not merely to comply strictly with all relevant laws and regulations, but more broadly to identify, monitor and mitigate reputational, operational, legal and concentration risk on a groupwide basis. To this end, banks are expected to implement a fully effective consolidated KYC risk management programme. Banks' compliance and internal audit staffs, or external auditors, should evaluate adherence to all aspects of the global standards for KYC, including the effectiveness of centralised KYC functions and the requirements for sharing information with other group members and responding to queries from head office.

An important topic addressed in the revised version of the paper is the issue of legal impediments to information-sharing of customer account information. The comments by the industry on the consultation draft noted that some countries have rigorous bank secrecy or data protection laws that prevent, or can be interpreted as preventing, the transfer of information for risk management purposes. The revised paper recognises that although such impediments may exist, it also points out that there are gateways for passing information in most countries and stresses nonetheless that it is essential that all jurisdictions that host foreign banks provide an appropriate legal framework which allows information for KYC risk management purposes to be passed to the head office/parent bank. Furthermore, there should be no impediments to onsite visits by head office auditors, risk managers compliance officers, or home country supervisors, nor any restrictions on their ability to access all the local office's records, including customers' names and balances. Head office staff granted such access should not be restricted from reporting such information back to head office. All information gathered during information-sharing processes should be subject to the applicable privacy and privilege laws.

The revised version of the paper was endorsed by the BCBS at its September meeting and released on 6 October.

Insurance

The IAIS has given anti-money laundering and combating the financing of terrorism high priority. In October 2003 the IAIS revised and expanded its *Insurance core principles and methodology*, compliance with which is required for an insurance supervisory system to be effective. As part of this revision new ICP 28 was introduced, dealing specifically with anti-money laundering and combating the financing of terrorism. In accordance with ICP 28 the Recommendations of the FATF applicable to the insurance sector and to insurance supervision must be satisfied to reach this objective.

At its General Meeting in early October the IAIS adopted a *Guidance paper on anti-money laundering and combating the financing of terrorism*. This guidance paper replaces the *Anti-money laundering guidance paper for insurance supervisors and insurance entities* which had been issued in January 2002. The new guidance paper takes into account the revised FATF 40 Recommendations of June 2003 and the *Methodology for Assessing compliance with the FATF 40 recommendations and the 8 special recommendations* issued in February 2004, as well as the 8 Special Recommendations on Terrorist Financing of October 2001.

In the light of the FATF 40 Recommendations, the IAIS considers there is need for specific guidance for insurance supervisors and the insurance sector. One of the new elements of the Recommendations is the concept of Customer Due Diligence (CDD); one aim of the new guidance paper is to give guidance with respect to CDD, tailored to the specific features of the insurance industry and its supervision. The guidance paper also provides cases and examples of money laundering involving insurance, in order to provide a better understanding of the indicators for the misuse of the insurance sector.

In accordance with the FATF 40 Recommendations, the guidance paper applies entirely to insurers and insurance intermediaries dealing with life insurance. The IAIS is also concerned to ensure that the potential risks to types of insurance other than life insurance – non-life insurance and reinsurance – are also considered by insurance supervisors and insurers. The guidance paper therefore also allows the possibility for insurance supervisors to extend the scope of the guidance paper to these other types of insurance: insurance supervisors should be aware of the possible risks to non-life insurance and reinsurance and, on the basis of a thorough analysis of these risks, may extent the scope of the paper to these other types of insurance. The guidance paper offers a range of possible measures, procedures and best practice from which the supervisor should select those most appropriate to deal effectively and efficiently with the risks.

Securities

Pursuant to a mandate from the IOSCO Technical Committee, a Task Force chaired by Mr. Jonathan Davis, Chairman of the Comisión Nacional Bancaria y de Valores of Mexico and composed of both Technical and non-Technical Committee members of IOSCO, prepared *Principles on Client Identification and Beneficial Ownership for the Securities Industry*. These Principles were approved by the IOSCO Technical, Executive, and Presidents Committees at the IOSCO Annual Conference on 17-20 May 2004. The IOSCO Presidents Committee includes all IOSCO ordinary members, some 105 national securities commissions in all.

The IOSCO Statement of Principles provide a comprehensive framework relating to client and beneficial ownership identification and verification (Customer Due Diligence) requirements that take into account the priorities and perspectives of securities regulators, while at the same time complementing the standards of other bodies, such as the FATF's *Forty Recommendations* relating to anti-money laundering. In addition to client and beneficial ownership identification and verification, the principles provide guidance to industry on: identification and verification requirements with respect to omnibus accounts; ongoing due diligence obligations; record keeping requirements for client identification information; and third party reliance. The principles also address the securities regulator's role in monitoring for industry compliance with AML obligations and cooperating with domestic and foreign authorities to obtain and share client identification and beneficial ownership information with foreign counterparts in a manner consistent with the standards described in the IOSCO Multilateral Memorandum of Understanding.

While the primary focus of IOSCO members relating to Customer Due Diligence is fulfilling their specific mandates of protecting investors; assuring that markets are safe, fair and efficient; and preventing systemic risk, observance of these principles by IOSCO members

should contribute to the fulfilment of the FATF's missions of preventing money laundering and terrorist financing.

Ongoing and future work

Banking

The BCBS will continue with its efforts to promulgate the principles it has developed to supervisors and the banking industry globally. The BCBS's working group on cross-border banking (CBB) will keep the BCBS informed about all relevant developments in the area of AML and CFT, with specific emphasis on the banking sector. The CBB is also tasked with the responsibility of carrying out any ad-hoc tasks/projects on behalf of the BCBS in this area.

The CBB has ongoing relationships with AML and CFT assessors, the FATF and industry. The BCBS considers these relationships essential in furthering its objective of promoting and monitoring compliance with the principles it has developed. The CBB's contact with industry is also designed to ensure that its principles are capable of implementation by the practitioners.

The BCBS also has fruitful contacts with agencies directly involved in AML and CFT investigation/enforcement actions, such as treasuries, judicial authorities and law enforcement agencies. Members of the BCBS Secretariat and the Financial Stability Institute jointly participate in regional training programmes and seminars aimed at promoting an awareness of AML and CFT policies and standards.

Insurance

Anti-money laundering and combating the financing of terrorism remains a priority area for the IAIS.

The IAIS has observer status in the FATF and is represented at its plenary meetings by the Chairman of the IAIS Insurance Fraud Subcommittee. The IAIS is also closely involved in the FATF's Working Group on Typologies (Insurance Project) with a number of IAIS members participating in the working group. In July 2004 the IAIS assisted in the project through circulating a questionnaire on insurance typologies to IAIS members.

The *Guidance paper on anti-money laundering and combating the financing of terrorism*, discussed above, includes in its appendices cases of money laundering and terrorist financing. A document based upon these cases is posted on the IAIS website as a living document, and new cases that might result from the FATF typology project will, as far as possible, be added.

Securities

The IOSCO Technical Committee also has undertaken further, more specific work relating to client and beneficial ownership identification and verification requirements in the asset management industry.

IOSCO and the FATF have further discussed steps to strengthen cooperation among FIUs and securities regulators in order to combat money laundering and terrorist financing. IOSCO's Standing Committee 4 on Enforcement and the Exchange of Information and FATF, in cooperation with the Egmont Group of FIUs, will examine ways to improve cooperation between securities regulators and FIUs.