To : **Regulated Entities**
i. CIFs
ii. ASPs
iii. UCITS Management Companies
iv. Internally managed UCITS
v. AIFMs
vi. Internally managed AIFs
vii. Internally managed AIFLNPs
viii. Companies with sole purpose the management of AIFLNPs

From : **Cyprus Securities and Exchange Commission**

Date : **May 7, 2019**

Circular No : **C 314**

Subject : **Common weaknesses/deficiencies and good practices identified during the onsite inspections performed in relation to the prevention of money laundering and terrorist financing**

The Cyprus Securities and Exchange Commission ('the CySEC') wishes, with this circular, to inform the Regulated Entities of the following:

During 2017 and 2018, the CySEC performed onsite inspections on its Regulated Entities to assess compliance with the Prevention and Suppression of Money Laundering and Terrorist Financing Law ('the Law') and the Directive DI144-2007-08 on the Prevention of Money Laundering and Terrorist Financing ('the Directive').

The results of the onsite inspections indicate an overall improvement in the internal systems, controls and procedures applied by Regulated Entities for the prevention of money laundering and terrorist financing (ML/TF).

However, despite some good practices identified, CySEC also identified common weaknesses and deficiencies by Regulated Entities. In addition to the measures already outlined by the CySEC to facilitate Regulated Entities' full compliance, CySEC provides recommendations for Regulated Entities to implement.

A. Consolidating good practices identified

CySEC identified the following good practices when carrying out its onsite inspections:

- Increased awareness and responsive actions on anti-money laundering/countering the financing of terrorism (AML/CFT) issues. Regulated Entities have invested significantly in human and technical resources for AML/CFT purposes.
- Implementation of automated systems for client due diligence (CDD), risk assessments, monitoring of transactions/accounts to spot potential ML/TF and automated screening systems for obtaining and assessing information about their customers or beneficial owners' backgrounds.
- AML/CFT training is delivered to all staff, including senior management and board members. In addition, the frequency and quality of AML/CFT training has improved significantly.
- Senior management of Regulated Entities has increased its direct and continuous overview in AML/CFT issues.
- Increased and continuous scrutiny of the customers' business relationships (at initial points of contact and during the business relationship with customers) resulting in the reduction of onboarding risky customers and reducing the overall ML/TF risk.
- Keeping AML/CFT policies and procedures up to date to ensure compliance with evolving legal and regulatory obligations.
- Assigning clear responsibility to staff for the CDD process and the gathering of relevant documentation.
- Records of customer identification and transactions data and information are retrieved quickly and without delay.
- Understanding and efficiently documenting the ownership and control structures of customers and their beneficial owners.
- Updating of customer due diligence (CDD) information and reassessment of the risk associated with the business relationship where monitoring indicates material changes from a customer's economic profile.
- Clear processes for escalating the approval of high risk including politically exposed persons (PEPs) customer relationships to senior management.
- Using open source internet checks to supplement commercially available databases when researching potential high-risk customers including PEPs.
- Face-to-face meetings and discussions with high-risk and PEP prospects before accepting or continuing the business relationship.

B. Common weaknesses/deficiencies identified

CySEC identified the following common weaknesses/deficiencies across Regulated Entities when carrying out its onsite inspections:

i. Customer Due Diligence (CDD) Measures

- Regulated Entities do not always document sufficient and accurate information about the customers' main business activities and operations. A broad and generalised description and documentation of customers' activities and operations, or lack of (accurate) information, may lead the Regulated Entity not fully understanding the risks associated with the customers' business activities. This entails a risk that the Regulated Entity will not be able to conduct accurate follow-up of the business relationships, therefore reducing the ability to monitor the customers' transactions in a satisfactory manner – ultimately increasing the overall ML/TF risk.

- On some occasions, information for constructing the customer's economic profile such as the size of income, expected turnover, source of funds and size of wealth was not always provided. Insufficient customer due diligence information entails a risk of transaction monitoring being less effective, thereby increasing the vulnerability of Regulated Entities to being used for the purposes of ML/TF.

- Furthermore, CySEC found weaknesses in the risk-based approach processes used to verify collected customer data and information, which contributed to poor customer economic profile-building. This included insufficient measures taken to verify the size of income and the sources of customer funds and wealth.

- In some instances, CySEC found weaknesses in the processes of obtaining and assessing information about the customers' or beneficial owners' backgrounds, using where necessary, automated screening systems on an ongoing basis. As a result, Regulated Entities were not fully equipped to accurately identify, record and evaluate the risks posed by customers.
- On some occasions, Regulated Entities did not adequately follow the guidance provided in the Directive (Point 1 (b)(iv) of the Fourth Appendix) in relation to the verification of the identity of non-face-to face customers.
- Moreover, in some cases, although Regulated Entities had defined 'refresh cycles' in their risk management and procedures manuals to determine the frequency at which CDD information for existing customers would be reviewed and as necessary refreshed, this in practice, was not always the case. On the contrary, in some instances Regulated Entities rely upon the CDD information collected at the beginning of the business relationship, for constructing the customer's economic profile, and fail to perform ongoing updating of the economic profile as the business relationship evolves.

- In addition, CDD information was not always documented and kept together in one place. The fact that the CDD information is spread across several systems, functions and positions can lead to difficulty in producing documents and data pertaining to CDD. This also entails risks for data records continuity (e.g. in cases of system changes or resignations of staff members), and increases the risk that important information is overlooked i.e. when following up on business relationships or when monitoring transactions.

ii. AML/CFT Risk Assessments

- In some instances, CySEC found that Regulated Entities did not make sufficient use of the **ESA's Risk Factors Guidelines** (Circular C219 on ESAs Guidelines on anti-money laundering and countering the financing of terrorism – 'The Risk Factors Guidelines') when assessing the ML/TF risk associated with either a business relationship or occasional transaction. They did not adequately adjust the extent of the CDD measures applied to mitigate the identified ML/TF risk.
- Some AML/CFT risk assessments were not reviewed often enough and as a result, the assessment of the entity's ML/TF risks was not up to date. For example, the information collected during the business relationship was not used in the assessment of ML/TF risk.
- Risk assessments were sometimes not documented or lacked appropriate consideration of relevant risks. On some occasions, the reasoning was not explained and/or documented/recorded in the event of customer re-classification of risk. On the same note, in few instances the risk assessment procedures ware not clearly included/documented in the internal AML/CFT risk management and procedures manual.

iii. Customers' Screening and Transaction Monitoring

- On some occasions, Regulated Entities held insufficient amount of accurate and/or up-to-date data on customers needed to understand their normal and reasonable account activity. This makes it difficult to develop parameters for identifying unusual, suspicious transactions without obvious legitimate purpose, needed to comply with the Law and Directive.
- The increasing volumes of transactions coupled with technological advances that enable customers to transact on a non-face-to-face basis have necessitated a move towards automated transaction monitoring systems. While some Regulated Entities have made significant investment in automated transaction monitoring systems, others continue to use manual transaction monitoring processes, which can result in delays in identifying and reporting suspicious transactions.
- In addition, weaknesses in the procedures implemented by some Regulated Entities have been noted, particularly with regards to using automated screening systems not only at the beginning of the business relationship but on an ongoing basis.

iv. Reporting of suspicious transactions/activities to MOKAS

- Some Regulated Entities do not sufficiently document details of the assessments performed to identify suspicious transactions. These details included the reasons for suspicion, notes on whether additional monitoring/investigation was undertaken, and the rationale for reporting/not reporting.
- Although the submission of STRs/SARs by Regulated Entities to MOKAS follow an upward trend, there is room for improvement for Regulated Entities to consider factors such as

the number of customers and their respective risk categorisations, the size and volume of the transactions conducted, and the geographical areas of the business activity.

Regulated entities need to be making constant and continuous efforts to ensure processes to prevent ML/TF are adequate. The consequences of failing to manage risks associated with ML/TF are serious, and cause damage not only to Regulated Entities, but to the financial system as a whole.

The publication of the above common weaknesses and deficiencies identified during the onsite inspections is designed to assist Regulated Entities in ensuring full compliance with the Law and the Directive. In the event of non-compliance, Regulated Entities will be subject to the administrative sanctions available to and enforced by CySEC under the Law.

Sincerely,

Demetra Kalogerou
Chairwoman of the Cyprus Securities and Exchange Commission