MINTZ

PEGA

International AML Highlights for Client Onboarding

Volume 6

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Introduction

Thank you for reading our quarterly update on AML/CFT regulatory developments related to anti-money laundering and counter-terrorist financing that affect customer onboarding operations at multinational financial institutions.

The first quarter of 2021 found regulators around the world updating and expanding their available guidance on existing compliance requirements, including customer information gathering, identity verification, beneficial ownership ascertainment, account risk ranking, and due diligence. Among the jurisdictions where regulators or self-regulatory organizations issued new interpretations and clarifications of existing rules were Australia, Hong Kong, France, and Brazil. The European Banking Authority issued a number of interpretations based on its experience and lessons learned reviewing institutions' AML/CFT implementation efforts. The resulting guidance will likely help shape the views of national regulators through the European Union.

As the United Kingdom continues to wrestle with the significant administrative implications of Brexit, it has come up with its own list of high-risk jurisdictions. It will now maintain this list independently of, but presumably in consultation with, its neighbors on the continent.

An ongoing theme in financial services during the pandemic is the acceleration of remotely provided banking services. As we have covered in previous editions, regulators continue to update rules and guidance to ensure existing AML/CFT regimes mandate controls suited to the increasingly digitized environment. A significant example is the geolocation requirements launched in Mexico during the first quarter.

We also discuss a Canadian enforcement action that offers a recent illustration of a long-standing dynamic in AML/CFT regulation: divergence between regulators' expectations and institutions' practices can lead to material fines and adverse attention, even where there is no willful cited evidence of misconduct on the part of the institutions' compliance and operations personnel. In other words, the lack of a comprehensive and robust approach to AML/CFT risk in the client lifecycle leads to perceived gaps. Perceived gaps, in turn, can lead to significant penalties and enforcement response costs.

APAC

Australia holds comment period on proposed amendments to the AML/CTF Rules

On January 27, 2021, the Australian government announced proposed amendments to the Anti-Money Laundering and Counter-Terrorist Financing Rules and opened the comment period for feedback. The comment period for the amendments closed on March 11, 2021.

The draft rules seek to amend the Anti-Money Laundering and Counter-Terrorist Financing Rules to align them with the updates to the Anti-Money Laundering and Counter-Terrorist Financing Act from last year. The new draft rules make several modifications to rules regarding customer identification and due diligence procedures.

Specifically, and among other things, the draft rules impose additional due diligence obligations on correspondent banking relationships and prohibit financial institutions from entering into correspondent banking relationships with banks that allow shell banks to use their accounts.

The draft rules also clarify requirements regarding customer identification when there are doubts about the veracity of information, requiring reporting entities to obtain and verify or update and verify additional KYC information if there are questions about a customer's identity or if a suspicious matter report regarding the customer has been filed.

Additionally, the draft rules expand and clarify the circumstances under which banks can rely on customer identification conducted by other reporting entities, including permitting reporting entities to enter into reliance agreements, provided they conduct risk-based analyses and regularly assess and identify deficiencies of the agreements.

Hong Kong publishes AML/CFT Frequently Asked Questions sheet

The Hong Kong Monetary Authority, in conjunction with the Hong Kong Association of Banks, published a revised set of FAQs on the topic of anti-money laundering and counter-financing of terrorism on February 2, 2021.

The FAQs include an expansive section on identity verification requirements, providing details on acceptable documents for residents and nonresidents; acceptable documents for registered businesses, startups, and overseas businesses; and registry requirements for beneficial owners and trusts.

The FAQs also clarify situations in which customer due diligence (CDD) would be activated, enhanced customer due diligence (EDD) may be necessary, or when a customer would be considered a politically exposed person (PEP).

AUSTRAC updates AML/CTF compliance documents and webpages

On March 29, 2021, AUSTRAC updated guidance on AML/CTF compliance programs, publishing regulatory quick guides for businesses on several topics and updating web resources with respect to customer identification procedures and customer due diligence.

The new guides cover topics such as ongoing customer due diligence and correspondent banking relationships; however, they do not provide any new regulatory requirements for supervised entities and are designed to help businesses improve their AML/CTF compliance programs. The webpage covering customer identification and due diligence has been significantly revised to include additional guidance on applicable customer

APAC *continued*

identification procedures, including the use of examples of scenarios demonstrating consequences of insufficient customer identification processes.

AUSTRAC also slightly modified its page on enhanced customer due diligence, listing the required components of an EDD program and clarifying that submission of a suspicious matter report does not alter customer risk and cannot be substituted for conducting EDD.

EMEA

France updates AML/CFT regulatory framework

On January 16, 2021, the "Decree of January 6, 2021 relating to the system and internal control in matters of the fight against money laundering and the financing of terrorism and the freezing of assets and prohibition of the provision or use of funds or economic resources" ("Decree of January 6") was **published**. The Decree of January 6 consolidates the AML/CFT provisions located in the "Decree of November 3, 2014 relating to the internal control of companies in banking" ("Decree of November 3"), situating the AML/CFT regulations for financial institutions in their own decree. Additionally, the Decree of January 6 harmonizes those provisions with the Monetary and Financial Code, which has changed considerably since the publication of the Decree of November 3. Provisions related to internal procedures, such as due diligence measures and risk assessments of business relationships were consolidated and clarified in Article 6 through 10 of the Decree of January 6.

While most obligations imposed on regulated entities by the Decree of January 6 were transposed from the Decree of November 3, a new provision was added that requires regulated entities to designate an individual who will be responsible for overseeing, on a permanent basis, the AML/CFT system (including the asset freezing procedures). Similarly, regulated entities must designate an individual responsible for periodic reviews of the AML/CFT framework to assess the effectiveness of the compliance regime.

Additionally, new requirements were added in the case of the outsourcing of AML/CFT functions. Regulated entities are obligated to inform the ACPR of any outsourced functions and insert into any outsourcing agreements certain provisions pertaining to training requirements that the service provider must comply with, the protection of confidential information, and other compliance standards.

Luxembourg updates financial sanctions regime

On December 19, 2020, the "Law of 19 December 2020 on the implementation of restrictive measures in financial matters" was **signed** into law by the Grand Duke of Luxembourg. The Law came into force on December 27, 2020. The Law of 19 December 2020 repealed and effectively replaced the previous "Law of 27 October 2010 on the implementation of United Nations Security Council resolutions and acts adopted by the European Union containing prohibitions and restrictive measures in financial matters against certain persons, entities and groups in the context of the fight against the financing of terrorism" as the governing regulation for Luxembourg's financial sanctions regime.

The Law provides for a broad range of potential sanctions, including a prohibition of financial activities of any kind; a prohibition on providing financial services, technical assistance, training, or advice; and the freezing of funds, assets, or other economic resources.

Among other reforms, the Law of 19 December 2020 expands the scope of individuals covered by the financial sanctions regime. Restrictive measures in financial matters have previously applied and continue to apply to "natural persons of Luxembourg nationality who reside or operate in…Luxembourg or abroad" and legal persons having their registered office or a center of operations in Luxembourg regardless of whether they have operations or offices abroad. In addition, financial sanctions can now also apply to "branches of Luxembourg legal persons established abroad,"

EMEA *continued*

Luxembourg branches of foreign legal persons, and all other natural and legal persons operating in Luxembourg as well.

The Law also extends protection to any person who, in good faith, discloses violations of the Law.

European Banking Authority revises AML/CFT guidelines

On March 1, 2021, the European Banking Authority **published** revised AML/CFT guidelines for financial institutions and supervisory authorities. The revisions are intended to further strengthen firms' CDD measures.

Specific revisions set out by these guidelines include the requirement to identify the customer's beneficial owner(s), and the corresponding identity verification steps that should be taken; a clear definition of high-risk countries, which – when involved with a transaction or a business relationship – result in the application of EDD; and modified standards governing the use of innovative technological tools in non-face-to-face CDD interactions.

Relevant authorities must notify the EBA of their compliance or intention to comply with the revised guidelines by June 1, 2021.

United Kingdom amends schedule of high-risk jurisdictions requiring EDD

Effective March 26, 2021, the United Kingdom has **amended** its Money Laundering and Terrorist Financing Regulations to include an updated schedule of high-risk jurisdictions. Previously, the UK conformed to the European Commission's EU-wide list of high-risk jurisdictions. But now, the UK maintains its own schedule, independent of the EU list. Firms and banking authorities are obligated to apply enhanced customer due diligence (EDD) when they encounter any transaction or business relationship involving a high-risk country.

New jurisdictions determined to be high-risk under the updated schedule include Albania, Burkina Faso, and the Cayman Islands. The full schedule of high-risk countries is as follows: Albania, Barbados, Botswana, Burkina Faso, Cambodia, Cayman Islands, Democratic People's Republic of Korea, Ghana, Iran, Jamaica, Mauritius, Morocco, Myanmar, Nicaragua, Pakistan, Panama, Senegal, Syria, Uganda, Yemen, and Zimbabwe.

North America

FINTRAC publishes guidance on PEPs and HIOs

In February 2021, the Financial Transactions and Reports Analysis Centre of Canada published updated guidance on politically exposed persons (PEPs) and heads of international organizations (HIOs). The guidance outlines who qualifies as a PEP, HIO, and a family member or close associate of one of the two. The guidance also covers how a registered entity might detect or establish risk levels of PEPs and HIOs. The guidance comes into effect on June 1, 2021.

The guidance defines two types of PEPs: domestic and foreign. A domestic PEP is an individual who holds, or has held in the last five years, a specific position in the Canadian government. The position can be on the federal, provincial, or municipal level and includes serving as an ambassador, military officer, or mayor. An individual's status as a domestic PEP ends five years after he or she has left office or five years after his or her passing. Conversely, a foreign PEP is an individual who holds, or has held at any point, a position on behalf of a foreign jurisdiction. A person can be labeled as a foreign PEP regardless of his or her citizenship, residence status, or birthplace. Unlike a domestic PEP, an individual never stops being a foreign PEP, even after he or she has passed away.

An HIO is an individual who holds, or has held in the last five years, the primary leading role (e.g., CEO or president) in an international organization. An international organization is defined as a group that is "set up by the governments of more than one member country, has activities in several countries, and is bound by a formal agreement among member countries." Examples of international organizations are listed in Annex 1 to the guidance, and include the International Criminal Court, Organization of American States, and World Customs Organization. An individual's status as an HIO ends five years after he has left his role or five years after his or her passing.

Family members of PEPs and HIOs, as defined by the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, include spouses, children, parents, in-laws, and siblings. Similar to the standards listed above, a family member of a domestic PEP or HIO will retain this label until the domestic PEP or HIO has left office or been deceased for five years. In the case of a foreign PEP, a family member's affiliation will never cease, even if the foreign PEP has passed. Under the guidance, close associates of PEPs and HIOs are those who share a personal and/or business connection. Examples of these relationships include business partners, beneficial owners, romantic partners, and joint policyholders. Once an individual is identified as a close associate of a PEP or HIO, the determination remains until the connection ends.

A common way to determine PEP or HIO status is by "detecting a fact" about one of these individuals. Detecting a fact can be a passive or proactive process and involves discovering information through an account-based or non-account-based business relationship. For example, a registered entity may have reasonable grounds to suspect that an individual is a PEP, HIO, family member, or close associate when reviewing information related to an existing client. Once a registered entity detects this information, it should confirm that the individual is, in fact a PEP, HIO, or affiliate of one of the two. This may entail cross-checking the name, address, date of birth, and/or transaction activities.

Finally, if a registered entity believes that a domestic PEP, HIO, or family member or close associate of one

of the two is likely to engage in money laundering or terrorist financing, the individual will be treated as high-risk. Additionally, any foreign PEP and his or her family members and close associates are automatically deemed to pose a high risk. Specific measures on dealing with high-risk individuals are outlined in the **Proceeds of Crime (Money Laundering) and Terrorist Financing Act**.

FFIEC releases updated sections of the FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual

On February 25, 2021, the Federal Financial Institutions Examination Council of the United States **released** several updated sections of the **BSA/AML Examination Manual**. The updates include a new "Introduction" section and modifications to the "Customer Identification Program" section. The BSA/AML Examination Manual itself does not establish any specific requirements or new instructions for financial institutions; rather, the manual provides instructions to examiners assessing the adequacy of a bank's compliance programs. Updates to the manual help to provide further transparency into the examination process and reinforce the risk-focused approach to the examination work.

Compared to the previous "Customer Identification Program" section of the BSA/AML Examination Manual, last updated in February 2015, the newly updated section of the manual provides several modifications, primarily providing additional clarification around risk-based rules and procedures. The new edits to the manual include two new modifications to the "Customer Information Required" subsection: the first modification clarifies that the CIP rules permit banks to open an account for a customer who has applied for but not yet received a tax information number, provided that the bank confirms the application details and obtains the number within a reasonable period of time after account opening. The second edit clarifies an alternative process for obtaining CIP identifying information for credit card accounts that allows banks to obtain information from a third-party source before extending credit to the customer. The manual also adds a new subsection titled "Examiner Assessment of the CIP Process," which emphasizes the possibility for variation in customer identification programs given the emphasis on a risk-based approach, and encourages examiners to evaluate a bank's internal controls and compliance in light of its size, complexity, and organizational structure.

FINTRAC publishes guidance on identity verification requirements for securities dealers and beneficial owner requirements

In March 2021, the Financial Transactions and Reports Analysis Centre of Canada published two guidance updates: one on **verifying the identity of persons and entities involved in securities dealings** and another on **beneficial owner requirements**. Both pieces of guidance come into effect on June 1, 2021.

Under the **Proceeds of Crime (Money Laundering) and Terrorist Financing Act ("the Act")**, securities dealers are required to verify the identity of clients for large cash transactions, large virtual currency transactions, suspicious transactions, and account openings. A large transaction is defined as one that is $10,000 or more. In addition to verifying the identity of a client during the account opening process, securities dealers should keep client identification information up to date. This may include reviewing a client's address or nature of business on a recurring basis. The actual frequency of monitoring this information depends on a securities dealer's risk assessment for a particular client.

North America *continued*

With respect to beneficial ownership, the Act requires that all reporting entities, unless exempt due to a particular exception, obtain beneficial ownership information when verifying the identity of an entity. Beneficial owners are "individuals who directly or indirectly own or control 25% or more of a corporation or an entity other than a corporation." During the verification process, reporting entities are required to collect information about ownership, control, and structure. For certain types of entities, such as trusts, reporting entities must also collect names and addresses of all trustees, beneficiaries, and settlors.

According to the guidance, reporting entities should ask for beneficial ownership information either verbally or in writing. Reporting entities are then required to confirm the accuracy of this information through "reasonable measures." An example of a reasonable measure is referring to a corporation's official records, which might be in the form of a minute book, securities register, certificate of corporate status, or shareholder agreement. Another method of confirmation is asking a client to sign a document that attests to the accuracy of the entity's ownership, control, and structure.

Annex 1, 2, and 3 of the guidance provide examples of recording beneficial ownership information for a corporation, trust, and entities that do not qualify as a corporation or trust. In the case of a corporation, a reporting entity must record the corporation's directors, names and addresses of all individuals who directly or indirectly own or control 25% or more of the corporation's shares, information establishing the corporation's ownership, control and structure, and reasonable measures taken to confirm the accuracy of all information. Similar requirements are in place, with slight variations, for trusts and other entities.

FINTRAC fines C&Z Holdings Ltd. for AML/CFT deficiencies

On March 4, 2021, the Financial Transactions and Reports Analysis Centre of Canada **announced** that it levied an administrative monetary penalty of $101,969 CAD ($80,787.49 USD) against C&Z Holdings Ltd.

The money services business, which operates as Golden Apple, violated a number of regulations in the **Proceeds of Crime (Money Laundering) and Terrorist Financing Act**. Most notably, the company's customer due diligence measures failed to assess business relationships and/or transactions with high-risk geographic locations, products, delivery channels, and individuals (including politically exposed persons).

C&Z Holdings Ltd. also failed to maintain an ongoing training program and document compliance policies, among other violations.

Mexico's National Banking and Securities Commission's device geolocation requirement comes into force

Starting on March 21, 2021, the device geolocation requirement **implemented** by Mexico's National Banking and Securities Commission and the Office for the Treasury and Public Credit will begin coming into force. When opening an account or entering into a contract with a client in a non-face-to-face manner, certain financial institutions will now be required to obtain the geolocation of the device the client is using to open the account or enter into the contract. The financial institutions that are affected by this rule are investment advisors, money transmitters, multipurpose financial companies, brokerage houses, currency exchanges, popular financial companies, credit institutions (banks),

North America *continued*

savings and loan cooperative societies, investment funds, and credit unions. The requirement comes into force on March 21 for money transmitters and popular financial companies, on March 22 for multipurpose financial companies, currency exchanges, and savings and loan cooperative societies, on March 23 for investment advisors, credit institutions (banks), and credit unions, and on July 23 for brokerage houses and investment funds.

The device geolocation requirement was part of a larger set of reforms that were passed by the Commission in March and July of 2019. Recognizing that complying with this new measure would take significant effort and time, the Commission set the deadline for compliance with the requirement to be twenty-four months from the date of entry into force of the 2019 reforms.

The geolocation of the device is intended to be used as an AML/CFT customer risk indicator by the financial entities. The Commission has noted that the device geolocation requirement is in accordance with FATF's March 2020 "Guidance on Digital ID" and stems from Mexico's commitments as a member of FATF.

South America

The Financial Activities Control Council publishes clarifications on AML/CFT procedures

On March 11, 2021, the Financial Activities Control Council of Brazil published [Resolution No. 36, of March 10, 2021] and [Normative Instructions No. 6, of March 10, 2021]. Both the Resolution and the Normative Instructions come into force June 1, 2021.

The Resolution regulates the "adoption of policies, procedures and internal controls to prevent money laundering," clarifying and expanding upon Articles 10 and 11 of Law No. 9,613, of March 3, 1998 ("Anti-Money Laundering Law"). Article 2 of the Resolution outlines the "minimum" organizational AML framework that regulated entities are obligated to devise and share with the Council. This framework includes the establishment of compliance roles as set out in Article 12 of the Anti-Money Laundering Law, an internal AML/CFT risk assessment, and the collection and verification of registration information when onboarding new clients.

Article 6 of the Resolution outlines the obligatory internal risk assessment that all regulated entities must carry out. The Council recognizes that the size of a regulated entity and the volume of its operations are a significant AML/CFT risk factor, but additionally notes that entities should take into account their customer base; their own business model, and any geographical risks associated with that business model; as well as their employees and business partners. The internal risk assessment must be updated every two years and whenever there is a significant change in the entity's risk profile. The Normative Instructions detail the criteria — specifically, size of operations and AML/CFT risk profile as evaluated by the internal risk assessment — for smaller regulated entities to waive compliance with the provisions of the Resolution.

Article 7 of the Resolution clarifies the AML/CFT requirements for client onboarding. Regulated entities must consider the risk profile of the client and their operations, the entity-wide AML/CFT procedures, and the entities' own risk profiles. Beyond that, Article 7 lists an explicit obligation for entities to develop AML/CFT procedures to verify client identifying data in non-face-to-face onboarding situations. The client onboarding procedures must cover evaluation of whether the financial capabilities of the client match the operations they intend to perform; verification of whether the client is a politically exposed person; and collection of all customer data required by Council rules applicable to the regulated entity's sector.

Article 9 of the Resolution notes that client onboarding procedures must establish the beneficial owners of the client. The Resolution clarifies that a minimum reference equity interest can be set as part of these procedures, but that the minimum value cannot exceed 25% of the equity interest of the client.

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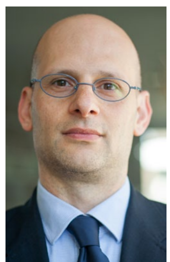

Fabio Urso is Director and Industry Principal in Financial Services at Pega, where he specializes in Pega's Client Lifecycle Management (CLM) and Know Your Customer (KYC) solution, including the client classification part of tax and regulatory regimes such as CRS, FATCA, Dodd-Frank, EMIR and MiFID. Fabio joined Pega in 2018. After earning a degree in law, he entered the banking industry and served in a number of key front- and back-office positions at organizations such as ABN AMRO Bank, The Royal Bank of Scotland and Rabobank, where he was the Subject Matter Expert for client due diligence processes and procedures as well as the tools supporting them, for which he was creating the business and functional requirements. As a member of the department running regulatory deliverables and translating compliance policy into business and IT solutions — and tasked with managing stakeholders (e.g., Legal, Compliance, Front Office) — Fabio focused primarily on risk models, fields/values/rules creation, interfaces with product systems, data migration, global/local regulatory requirements, and documentary verification requirements.

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Alyssa is an experienced Fintech sales executive who has spent over 20 years selling enterprise solutions to some of the world's largest financial services organizations. She joined Pega in March 2020 and is responsible for leading the firm's Customer Risk and Due Diligence business globally, focused on helping financial institutions achieve regulatory compliance and operational excellence through the power of intelligent automation. Prior to joining Pega, Alyssa worked at AWS in Global Financial Services, leading a relationship management team centered on the world's top global banks. In addition to her financial services cloud experience, she spent 19 years at Bloomberg LP, where she was a founding member of Bloomberg's Enterprise Data and KYC Utility businesses and led consultative sales teams delivering transformative solutions across the firm's full suite of financial technology offerings. Alyssa's professional experience spans financial markets, enterprise market data and distribution technologies, and cloud infrastructure solutions as well as regulatory process technology.

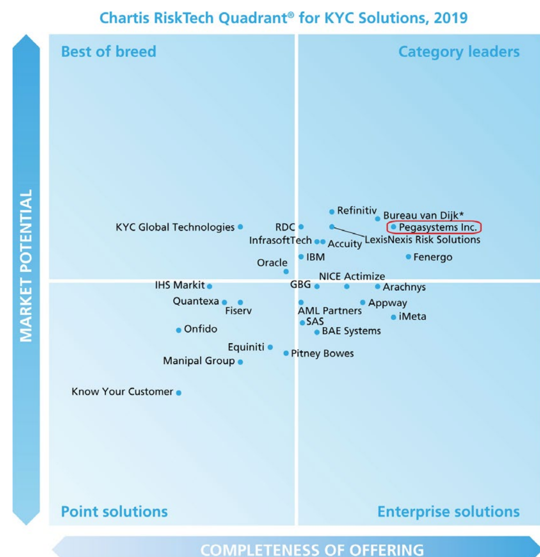
James is Senior Director and Industry Principal in Financial Services at Pega, where he helps companies to realize their Digital Transformation Strategy using Pega's Client Lifecycle Management (CLM) and Know Your Customer (KYC) solution. Prior to joining Pega, James worked with both EY as a Senior Manager and Fenergo as Head of Client Solutions in the Americas, a position with a global reach. There he specialized in addressing client challenges to designing and implementing Target Operating Models that met regulatory compliance across Tax, Derivative Reform, KYC/AML, Beneficial Ownership and Data Privacy/Residency, with a focus on a client-centric approach. His knowledge and experience cover Corporate, Institutional, Retail, Commercial, Private Banking and Wealth & Asset Management. Prior to working in FinTech, James worked for a number of years as a relationship manager in Industry and earned a BSc in Software Engineering — a background providing him with experience as a user of banking systems as well as a deep technical understanding of their limitations and possibilities.

About Pegasystems

Pega is the leader in cloud software for customer engagement and operational excellence. The world's most recognized and successful brands rely on Pega's AI-powered software to optimize every customer interaction on any channel while ensuring their brand promises are kept. Pega's low-code application development platform allows enterprises to quickly build and evolve apps to meet their customer and employee needs and drive digital transformation on a global scale. For more than 35 years, Pega has enabled higher customer satisfaction, lower costs, and increased customer lifetime value.

PEGA CLIENT LIFECYCLE MANAGEMENT & KNOW YOUR CUSTOMER (CLM/KYC)

The Pega CLM application (which includes Pega KYC) provides the only globally scalable solution for large, complex financial institutions to manage multijurisdictional, multiproduct onboarding with predefined industry best practices across all lines of business. Our product is a robust, industry-leading, rules-driven application, allowing financial institutions to manage and drive complex regulatory requirements as part of onboarding and client lifecycle management. The solution allows for specialization of due diligence requirements by region, line of business, and risk. It has extensive out-of-the-box functionality and comes with preconfigured AML/CTF rules covering 60 major jurisdictions as well as CRS, FATCA, Dodd-Frank, EMIR, FINRA, IIROC, and MiFID II that are developed and updated quarterly in cooperation with a global team of lawyers, industry experts, and policy makers. Through Pega's low code approach, the solution allows financial institutions to stay compliant with the constantly evolving regulatory landscape, while improving onboarding time and time-to-revenue.



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The solution simplifies very complex onboarding, ensuring parallel processing of hundreds of cases for multiple functional areas, such as KYC, Credit, Legal, and Operations. Pega provides preconfigured customer journeys from onboarding through to offboarding, providing a global experience for the financial institution and client. Pega's global team of experts has deployed and built onboarding and KYC solutions for more than 40 of the world's largest financial institutions. For more information, visit **www.pegaonboarding.com**.

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