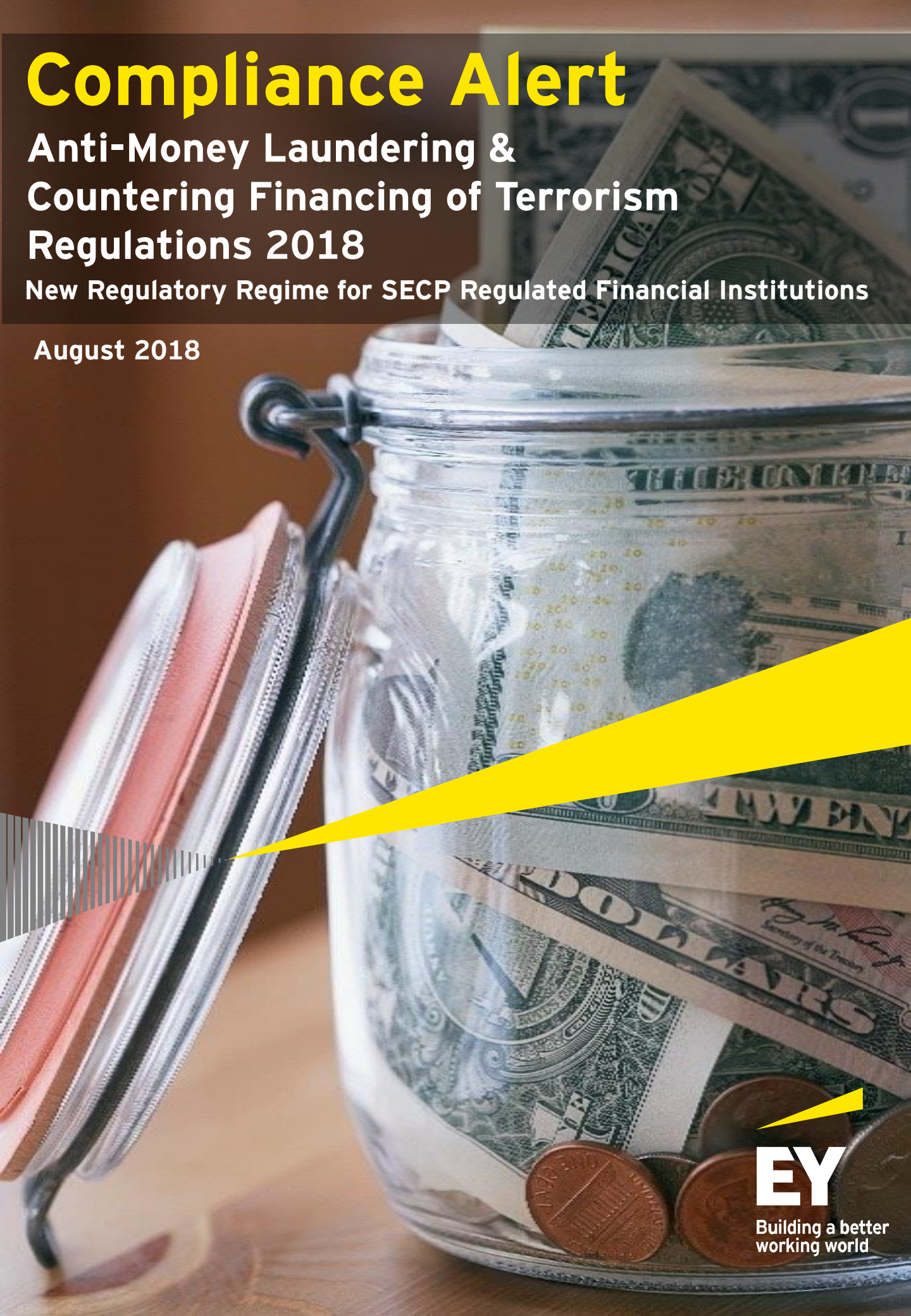


Compliance Alert

Anti-Money Laundering & Countering Financing of Terrorism Regulations 2018

New Regulatory Regime for SECP Regulated Financial Institutions

August 2018



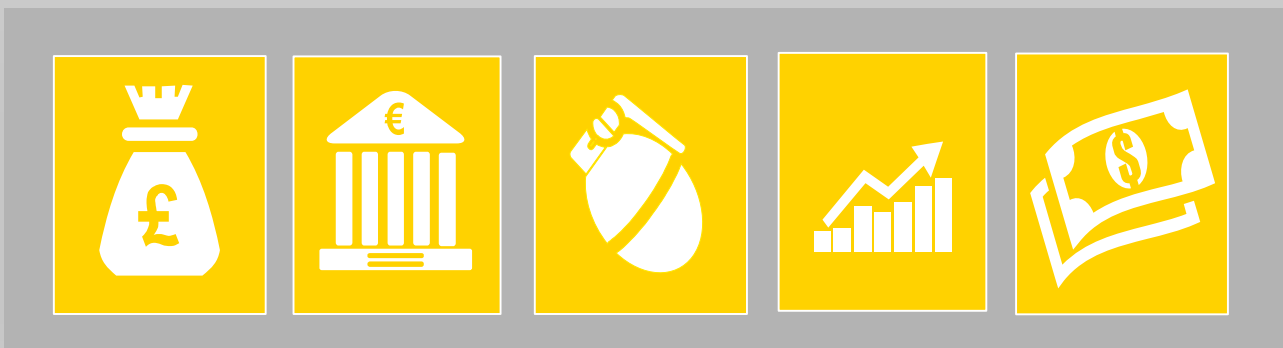
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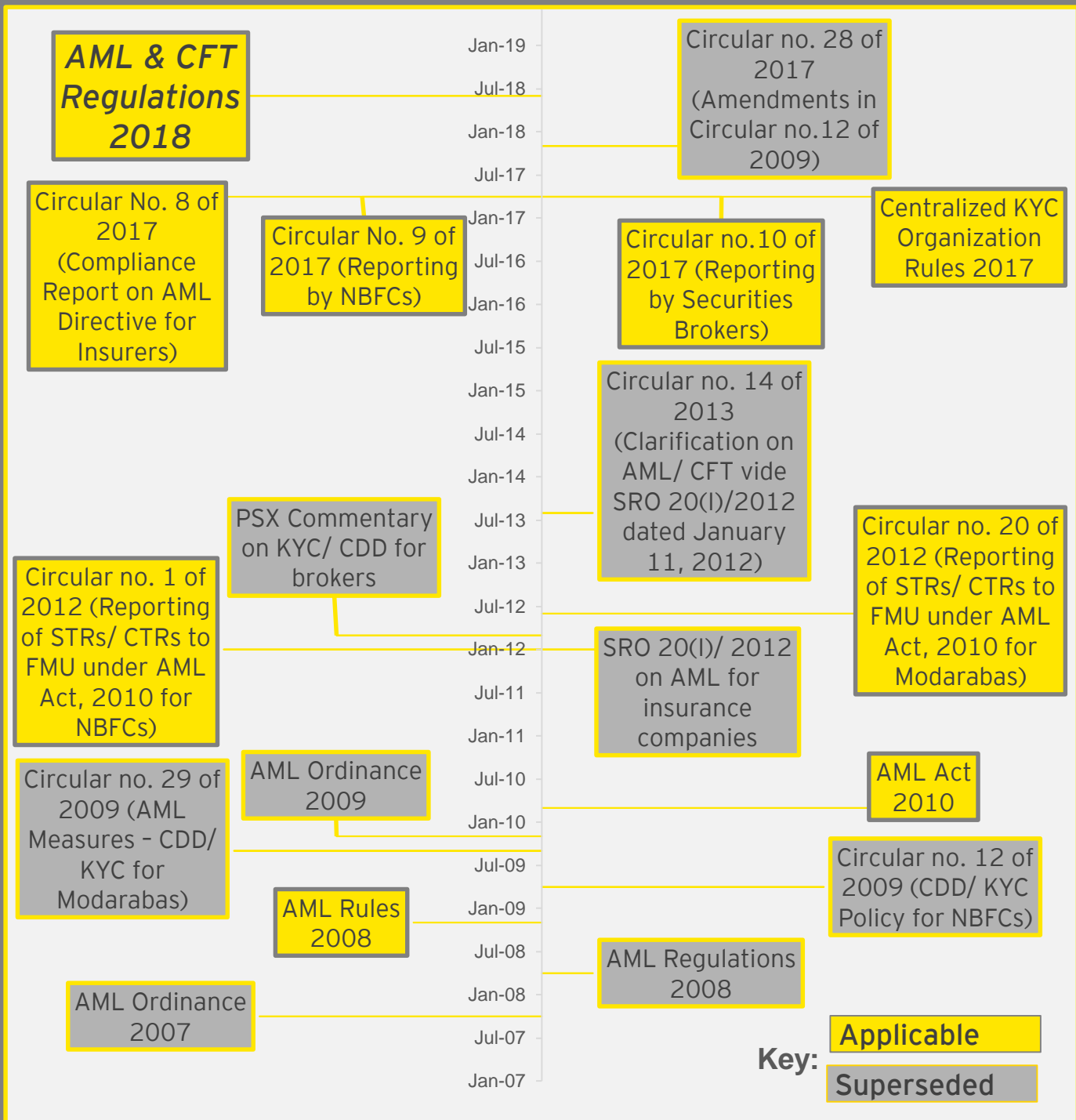
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Current Regulatory Regime

The AML framework currently applicable in Pakistan comprises of the AML Act, 2010 and the recently issued Anti-Money Laundering and Countering Financing of Terrorism Regulations 2018. In addition to this, instructions issued through various other circulars are also currently applicable. Key issuances are shown in the summary below:



The Anti-Money Laundering and Countering Financing of Terrorism Regulations 2018

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This regulation is applicable to securities brokers, commodities brokers, Insurers, Takaful Operators, NBFCs and Modarabas. The said regulation is to come into force immediately.

It should be noted that this is not a root and branch change. The recent regulations are built on the previous regulatory framework, although there are some specific, and potentially significant, changes that the FIs are needed to be aware of.

Here, we are providing the highlights of the regulations. In order to identify the **significant changes** from the previously issued regulations on FIs, this section is divided into the following three sections:

- ▶ What's New?
- ▶ What has been Enhanced?
- ▶ What remains the same?

What's new?

New Products, Practices and Technologies

- ▶ Identify and assess the ML/ TF risks sourcing from the development of new products; new business practices; and the use of new or developing technologies for both new and pre-existing products including new delivery mechanisms.
- ▶ Perform risk assessment prior to the launch or use of such products, practices and technologies, and take appropriate measures to manage and mitigate the risks. Special attention should be given to situations that favor anonymity.

Financial Groups

- ▶ Implement group-wide programmes against ML/TF applicable to all branches and majority owned subsidiaries of the financial group.

Foreign Branches and subsidiaries

- ▶ Requires FIs to implement their AML/ CFT policies to their foreign branches & subsidiaries. In case of difference in AML/ CFT requirements between Pakistan & the host country, apply higher of the two standards, to the extent that the law of the host jurisdiction so permits.
- ▶ Requires FIs to intimate SECP, if in case the law of the host country conflicts with the AML / CFT requirements of Pakistan and the overseas branch or subsidiary is unable to fully comply the higher standard.
- ▶ Give particular attention to branches and subsidiaries located in the jurisdiction identified by FATF for inadequate AML/ CFT standards.

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Correspondent Relationships

- ▶ Restricts the FIs from continuing correspondent relationship with another FI not having adequate controls against ML/ TF, not supervised by the relevant authorities, is a shell FI or permit its accounts to be used by other shell FIs.
- ▶ Special attention to be given when the respondent FI is located in jurisdiction identified by FATF for inadequate AML/ CFT standards.

Identification of Beneficiary for Life Insurance or Takaful Policies

- ▶ Obtain the full name and identity of the beneficiary; and information satisfying that the FI will be able to establish the identity of the beneficiary at the time of payout.
- ▶ If the beneficiary is identified as high risk, inform senior management to conduct enhanced scrutiny before the payout of the policy proceeds.
- ▶ Consider the beneficiary as a risk factor in determining whether EDD measures are applicable.

Reliance on Third Parties

- ▶ FIs may rely on a third party to conduct CDD on its behalf. However, the FI will remain responsible for its AML/CFT obligations and carry out ongoing monitoring of its customers itself.

Enterprise Wide Risk Assessment & Mitigation (Risk Based Approach)

- ▶ Perform risk assessment process in order to identify, assess and understand, ML / TF risks arising from customers; linkages to other countries via customer

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and operations / dealings; products, services, transactions and delivery channels.

- ▶ In risk assessment, take in to account all the relevant risk factors and categorize the overall entity level risk as high, medium or low. Further, document risk assessments and keep them up to date.
- ▶ Develop and implement policies, procedures and controls approved by the board for the management of ML / TF risks.
- ▶ Perform EDD measures where higher risks are identified. Further, establish an independent audit function to test the system.



What has been Enhanced?

Customer Due Diligence (CDD)

Parts of previous regulations carried forward:

- ▶ Refrain from opening or maintaining anonymous account or an account in fictitious name.
- ▶ Perform procedures for identification and verification of customer/ beneficial owner. Perform on-going monitoring of accounts transactions to ensure its consistency with the customers attributes.
- ▶ Categorize each customer as High or Low risk, according to their risk profile.
- ▶ Apply CDD requirements to its existing customers on the basis of materiality and risk.
- ▶ File an STR in case of any suspicious circumstance.

Additions:

- ▶ Provides a list of documents required from each category of customer.
- ▶ Requires FIs to understand the purpose and intended nature of the business relationship and obtain relevant documentation to substantiate the same. Brokers are already subject to this requirement as per the PSX Commentary on KYC/ CDD while this requirement was not present in the previously issued regulations for other FIs.

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- ▶ Entails the verification of the identity of customer and beneficial owner before/ during/ after the establishment of relationship given that it occurs as soon as reasonably practical, doesn't interrupt the course of business and the ML/ TF risks are effectively managed.
- ▶ Enforces FIs to implement risk management procedures addressing the conditions in which a customer may utilize the business relationship prior to verification. Record in CDD policies the types of circumstances in which the FIs are allowed completion of verification after the establishment of the business.
- ▶ Puts into force the determination of the authority of a person acting on behalf of the customer to be verified through a documentary evidence including specimen signature of the customer.
- ▶ Makes maintenance of a list of all such customers/accounts where the business relationship was refused or needed to be closed on account of negative verification compulsory.
- ▶ Prohibits FIs from opening government accounts with personal names of government officials. Any exception should be supported by a special resolution or authority endorsed by the Finance Ministry /Department of the concerned government. This is a new requirement only for Insurance Industry. While this requirement was present previously for other FIs.
- ▶ Takes into account any rules, regulations or procedures prescribed in the governing laws of government entities relating to the opening and maintaining their bank accounts while opening accounts of government entities.

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- ▶ Prohibits FIs from opening an account or to provide services in case of unsatisfactory CDD. Further, mark the existing customer as high risk if CDD results is found unsatisfactory. This is a new requirement for insurance companies but for other FIs this requirement was present in previously issued requirements related to CDD/ KYC.

Beneficial Ownership of Legal Persons and Legal Arrangements

Parts of previous regulations carried forward:

- ▶ For legal person/ arrangement, understand the nature of its customer's business, ownership and control structure. Also identify natural persons who ultimately own/ control/ have executive authority of the legal person.

Additions:

- ▶ Entails the verification of respective natural person by obtaining relevant documents.
- ▶ Enforces the Identification and verification of the identity of the settler, the trustee, the protector and the beneficiaries of legal arrangement.

Simplified Due Diligence

Parts of previous regulations carried forward:

- ▶ Requires FIs to employ simplified due diligence for customers identified as low risk or if they are subjected to adequate checks and controls.

Additions:

- ▶ Enlists the simplified due diligence measures comprising of reducing frequency of customer identification updates, reducing monitoring of transactions, reducing efforts to understand the purpose and intended

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nature of the business relationship etc. The measures were not stated in previous regulatory requirements for FIs.

- ▶ Enlists the revised criteria for marking a customer as low risk.
- ▶ Further, the provision of Simplified Due Diligence was not present for insurance companies previously but was present for other FIs.

Ongoing Monitoring

Parts of previous regulations carried forward:

- ▶ Monitor business relations with customers on an ongoing basis.
- ▶ Ensure that the transactions are consistent with the FIs knowledge of the customer, its business and risk profile. Also, investigate the background and purpose of all complex and unusual transactions.
- ▶ Ensure that information obtained in respect of customers are up to date and revised the customers profile if necessary particularly for higher risk categories.
- ▶ Prohibited from forming business relationship with customers excluded under UNSC resolutions and Anti-Terrorism Act, 1997.

Additions:

- ▶ Substantiate and document the reasons for retaining a STR filed customer.
- ▶ Subject to customer's business relations in this scenario to proportionate risk mitigation measures, including enhanced ongoing monitoring.

Reporting of Transactions (STRs/CTRs)

Parts of previous regulations carried forward:

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- ▶ Comply with the provisions of AML Act and rules, regulations and directives for reporting STRs/ CTRs.

Additions:

- ▶ Report STRs regardless of the amount of the transactions; and report CTRs for the transactions of rupees two million and above.
- ▶ Document and keep on record the basis of deciding whether an STR should be filed or not. Also, record investigations in relation to any suspicion.
- ▶ Intimate the Commission the number of STRs reported to FMU on bi-annual basis within 7 days from the close of each half year.

Record Keeping

Parts of previous regulations carried forward:

- ▶ Maintain records of identification data obtained through CDD process along with the records of account files and business correspondence.

Additions:

- ▶ Maintain transactions record including the results of the analysis of any complex and unusually large transactions for at least 5 years from the completion of transaction. This requirement was present for Modarabas but for 10 years which after the release of these regulations is reduced to 5 years. For other FIs, this requirement was not present previously.
- ▶ This requirement was present for Modarabas but for 10 years which in the result of these regulations is reduced to 5 years. For other FIs, this requirement was not present previously.
- ▶ Regulatory requirement for maintaining records of CDD process along with the records of account files and business correspondence for Modaraba.



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Companies was 10 years after termination of the business relationship but is now reduced to 5 years. For other FIs, this requirement was present previously.

Appointment of Compliance Officer

Parts of previous regulations carried forward:

- ▶ Appoint Compliance Officer reporting directly to BOD or equivalent. The officer should have timely access to all customer records and other relevant information.

Additions:

- ▶ Previously issued KYC/ CDD related regulations on Modarabas and NBFCs did not have regulatory requirement for designating compliance officer. The latest regulations now require all the FIs including the Modarabas and NBFCs to have a Compliance Officer.

Screening and Training

Parts of previous regulations carried forward:

- ▶ Develop and implement an employee due diligence policy and procedure which is to be carried out at the time of hiring all employees permanent, contractual, or through outsourcing.
- ▶ Develop training program for relevant employees on annual basis, in order to effectively implement the regulatory requirements and FIs own AML/ CFT policies and procedures.

Additions:

- ▶ Modarabas are now required to have both employee due diligence policy and employee training programs related to AML/ CFT.
- ▶ The requirement for employee due diligence was not present for NBFCs and Insurance Companies in the previously issued regulations. This is a new requirement for both NBFC and Insurance.



What remains the same?

Enhanced Due Diligence

- ▶ Develop and implement internal risk management systems, policies, procedures and controls to determine if any customer presents high risk of ML/TF.
- ▶ By default High Risk customers are those who have linkages to countries which are non-compliant with AML regulations according to FATF; and legal persons and arrangements receiving donations or having complex ownership structures.
- ▶ Performed EDD measures for high risk customers.
- ▶ EDD measures broadly include obtaining approval from senior management for establishing and continuing business relations, verifying the sources of funds and enhanced monitoring of business relations.

Politically Exposed Persons (PEPs)

- ▶ Develop and implement internal risk management systems, policies, procedures and controls to determine if any customer or a beneficial owner is a PEP.
- ▶ In case of foreign/ domestic PEP, perform EDD. Requirement of EDD is also applicable on family members and close associates of foreign and domestic PEPs.

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Impact

The changes introduced by the regulator will require FIs to update its policies & procedures & make operational changes.

Risk Assessment and Mitigation

The FIs will need to implement an entity-wide risk based approach (RBA) for the management of ML/ TF risks. This will involve identifying, assessing and understanding the ML/TF risks to which they are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively. The FI will have to consider the ML/ TF risks arising from its business model and its relationships with the customers.

In order to identify inherent risks from business situation, the FIs will have to look at its exposure to the risk of ML/TF by taking a business-wide perspective. Thus, allowing the FI to consider where risks reside across its business lines, customers or particular products.

Policies and Procedures

The new regulatory framework requires FIs to develop / update their existing policy and procedure with increased emphasis on the following key aspects:

- ▶ Risk assessment to be performed at the time of on-boarding, which will be periodically reassessed at the time of on-going monitoring.
- ▶ Identification and verification of beneficial owners.
- ▶ On-going monitoring of existing customers according to the defined frequency which is based on the risk assessment.
- ▶ Implementation of Group wide programmed against ML/ TF which should be applicable to all the branches and subsidiaries outside Pakistan to the extent that the laws and regulations of the host country permit.



Impact

- ▶ Due Diligence measures to be undertaken at the time of establishing correspondent relations along with periodic on-going monitoring of the relationship.
- ▶ Employee due diligence with specific monitoring of employees at high risk positions on an on-going basis.
- ▶ Compliance with all applicable laws and regulations including identification, monitoring and mitigation of group-wide ML/ TF risks.
- ▶ Maintenance of negative lists (list of customers not on-boarded).

Record Keeping and Reporting

- ▶ FIs need to maintain a record of domestic and international transactions for a minimum period of 5 years. The records shall be sufficient to permit reconstruction of individual transactions.
- ▶ CDD files of the customers comprising of identification and verification of documents along with any correspondence shall be maintained for a period of five years from the termination of business relationship.
- ▶ FIs need to ensure timely submission to SECP the number of STRs reported to FMU on bi-annual basis within 7 days from the close of each half year.

Training & Development

- ▶ FIs need to develop an Annual Training Program. The Training Program should focus on creating awareness among the employees regarding the new AML / CFT developments, ML / TF techniques, methods and trends. Further, the training content should aim to familiarize the employees with the AML / CFT related regulatory requirements, policy / procedure changes and the employees responsibility with regards to AML / CFT.

Please feel free to send us your feedback and questions.

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