

AML Solutions Group

ASSESSING ANTI-MONEY LAUNDERING PROGRAMS FOR FUND MANAGEMENT COMPANIES

The effectiveness of Anti-Money Laundering Programs is the responsibility of the Board of Directors. Indeed in its June 2015 Feedback Statement on CP86 on Fund Management Company (“FMC”) Boards, the Central Bank of Ireland indicates that Boards should receive and be satisfied with regular reports on anti-money laundering policies. Fulfilling this responsibility requires oversight of how the program is implemented, not just a review of statistics. In most cases Fund Management Companies rely on processes and procedures at a delegate. The Board of the FMC however remains responsible for ensuring the fund remains compliant with its AML obligations.

Thus even before assessing how its delegate operates in this area, the FMC Board must define:

- its own AML policy;
- its own AML risk appetite;
- any AML risk mitigants; and
- how it will measure and monitor AML risk.

Often it may be appropriate to rely on the underlying policies and procedures of the delegate. However, again as underlined in the Feedback Statement, the board must periodically review the appropriateness of such reliance.

Given the increasingly technical and demanding nature of AML requirements, many FMC Boards are delegating the oversight of AML policies and processes (whether carried out by the FMC or a delegate) to experienced Money Laundering Reporting Officers who in turn report back relevant information and assurance reports to the Board.

A Board should assess how resources are deployed to determine if they are appropriate. A mixture of human resource and automation is essential because neither is adequate on its own.

In order for Directors to know that human and other resources are sensibly allocated to the task, and that the AML Program is adequately risk-based for the risks in the funds they govern, focus should be given to three key areas:

- Risk Assessments;
- Policy and Procedures;
- Staff.

Risk Assessments should be prepared which are thorough and based on facts specific to the funds. Many risk assessments do not fulfill this requirement and some funds may not have a specific AML risk assessment or may not have a recent one.

Both the investors and the assets of the fund should be included in the risk assessment. The latter is particularly true for alternative investments but the question should be posed and answered even for traditional funds invested in listed equities.

Questions to be answered in the Risk Assessment are many and a good Money Laundering Officer, the likely author of the document, will already be answering most of them. Some of the ones a director can pose in order to test the Risk Assessment are:

- What makes up the *current* demography of the investors by type and jurisdiction?
- What challenges, if any, do distribution channels pose to obtaining due diligence documentation?
- How much reliance is placed on Letters of Comfort ("LOC") from third parties and who are they?
- What are the results of tests of those LOC's?
- How many Suspicious Activity Reports have been filed and what suspicions caused them to be filed? (If a fund with a large number of investors has had no SARs or internal queries for a lengthy period of time the MLRO should at least be asked if he is satisfied that controls are functioning appropriately.) What has been the follow-up on the SARs by the authorities?
- What tests of KYC documentation have been performed and what were the results?

- How quickly can evidence of investor identity and verification of identity be retrieved when needed?

Policy and Procedures are the next step. They must relate to the Risk Assessment in order to be effective. All funds should risk-rate investors based on at least client type and client jurisdiction. The longevity of the investor relationship can also be an important factor. Politically Exposed Person ("PEP") status should be part of the risk rating, of course, but also negative news found through real time review of publicly searchable sources should be included.

Transactions should be monitored with the essential help of automation which has been programmed with rules appropriate for the type of investments in the fund and historical activity of the investor.

The results of risk rating and transaction monitoring should be combined in a holistic approach to investor due diligence. Automated systems should present all of these factors with appropriate flags to alert staff to the need to either enhance due diligence or take special precautions.

If an investor recently became a PEP and subsequently redeemed a sizeable proportion or all of his investment, would the automated monitoring process pick it up or would human intervention be required to match the two events? With the volume of activity processed by transfer agents, relying on staff members to notice a combination of events like this is probably not a sufficient control.

Fund holdings (assets of the funds) and their cash flows must be monitored against sanction lists, which change from time to time.

Periodic reviews of investor due diligence documentation should be mandated to ensure that it is up to date. Documentaton for investors which are High Risk under the holistic approach should be reviewed at least annually and probably at the time of any significant activity. Medium and low rated investors can be reviewed less frequently unless transactions or negative news (trigger events) suggest a review is appropriate. Policy and Procedures should require all investors to be reviewed at some point.

Both internal and external audits of fund operations, including KYC activities, should be performed and the results pertinent to a particular fund should be presented to the Board.

Staff - the third matter to consider is the individuals assigned to anti-money laundering control:

- What qualifications have they earned and what experience do they have?
- How many are directly involved in the AML Program and how was that number determined?
- Does senior management get directly involved when an issue is raised (this evidences the Compliance Culture)?
- Does staff training include reference to the Risk Assessment and Policy and Procedures or is it solely a review of the obligations and liabilities in the Criminal Justice Act?
- Are staff, and directors, familiar with the industry guidance on Anti-Money Laundering/Countering Terrorist Financing regulation?

Directors should be able to demonstrate that governance of the AML Program systematically addresses these three key focus areas in order to ensure the adequacy of controls. Governance needs to go beyond basic interrogation of statistics presented in administrator's or MLRO's reports.

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