



## AML Crib Sheet: Customer Due Diligence

The Association of Foreign Exchange and Payment Companies (AFEP) was founded in 2012. One of its objectives is to develop and shape industry best practice with regards legal & regulatory compliance. Historically member firms have relied on two key sources for guidance on how to comply with the suite of legislation commonly referred to as the Money Laundering Regulations. HMRC is the lead supervisor for Money Services Businesses (MSB). HMRC periodically circulates its MLR8 guidance which generally focuses on the cash based MSB. The Joint Money Laundering Steering Group (JMLSG) acts on behalf of the banking industry to provide similar guidance and has recently devised MSB specific guidance, again very much tailored towards the high street cash based model.

This paper aims to plug the gap for the niche populated by AFEP members providing bank or card to bank account foreign exchange and payment services to business and consumer clients. The paper is a 'crib sheet' with suggestions as to how the key responsibilities may be discharged

This document is intended to highlight fundamental areas of compliance where we consider consistent interpretation necessary to ensure adequate standards of systems and controls across member firms. In this paper, we have focused on what is meant by 'Customer Due Diligence'.

### Senior Management Responsibilities

All member firms are required to comply with the relevant anti money laundering legislation and guidance. This document is **not** intended to replace existing guidance. It is essential that all firms satisfy themselves that they are meeting the regulatory requirements and obtain appropriate legal advice as necessary.

Given the cross border nature of the foreign exchange industry, the lack of face to face contact and the speed at which payments are made we acknowledge that the industry risk is inherently high.

The law establishes that the ultimate responsibility for money laundering systems and controls lies with the Board of Directors. They are responsible for ensuring that they put in place adequate systems and controls to prevent money laundering and terrorist financing and receive sufficient information to be able to monitor adherence to these systems and controls.

The specific requirements are well documented but it is important to recognise that, for a firm not falling under the Financial Services and Markets Act (FSMA), it is **NOT** the MLRO who has ultimate responsibility but the Board of Directors. Directors will be committing a crime if they don't comply with the Regulations for which the penalty is an unlimited fine and/or a prison term of up to 2 years.

As an MSB supervised by HMRC for money laundering purposes the MLRO's sole responsibility is to act as the 'Nominated Officer' for the receipt of SARs. Other than this



specific role the MLRO holds the same responsibility in law as any other employee in the 'Non FSMA' firm.

## **Customer Due Diligence**

### **What is it?**

Customer due diligence (CDD) extends well beyond the historical "Know Your Customer" approach which focused solely on identification and verification. CDD is a holistic understanding of your client which includes:

A: Initial CDD (prior to receipt of funds):

- Identification and verification (see below)
- Understanding the purpose of the account – what do they intend to use the account for?
- Expected frequency size and type of transaction

B: Ongoing CDD:

- Understanding the source of funds
- Understanding source of wealth
- Keeping the above information up to date
- Monitoring transactions for consistency with expected frequency, destination, size & type

### **When is it required?**

CDD is required from the outset and on an ongoing basis throughout the business relationship. In this context a business relationship is a business, professional or commercial relationship between a member firm and a customer, which the business expects, on establishing the contact, to have an element of duration. It is the opinion of AFEP that where you set up a customer account and / or give a unique customer reference number a business relationship has been established.

To comply with the wire transfer regulations <sup>1</sup> it is not possible for firms to rely on the exemption to perform due diligence for transactions below EUR15,000. Further, in light of the creation of a business relationship AFEP does not believe that member firms are able to rely on the EUR1000 limit in the wire transfer regulations and therefore must perform CDD on all customers. This is in line with HMRC guidance which states that "HMRC expects that money transmission businesses should obtain and verify the identity of customers for all money transfers, regardless of value." <sup>2</sup>

The CDD process must be complete prior to the receipt of funds from a customer. In practical terms this means an FX broker could allow a potential client to book a deal but must have completed CDD prior to accepting funds in or making onward payment.

Obviously there is an exposure risk on the booked deal should the client be rejected as a result of CDD.

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<sup>1</sup> Transparency in Electronic Payments (Wire Transfer) Regulations 2007

<sup>2</sup> Supervision of Money Service Businesses paragraph 4.30



## **A. Initial Client Due Diligence – Identification & Verification**

It is worth noting that given the non face-to-face nature of our industry enhanced due diligence applies in most circumstances and this has been built into the requirements below.

### **Electronic verification**

Members should obtain a minimum of 3 matches to a client's name through electronic verification i.e.:

- Two addresses and one date of birth
- One address and two dates of birth

AFEP considers it necessary to ensure at least one match is a DOB and one is an address to adequately cover both the ID and the address verification.

### **Documentary verification**

As with electronic verification, for non face-to-face customers you require a minimum of one document to verify the ID, one to verify the address plus one additional ID or address verification.

As an industry, and in line with JMLSG guidance, we believe that it is not always practical or necessary to obtain certified documents where original documents are not seen, provided that compensating controls or additional due diligence is in place for example one or more of:

- Funds received from a bank account or card in the name of the account holder
- Additional verification requirements of non face to face transactions (i.e. 3 separate ID/address documents or checks),
- Electronic authentication of copy documents

### **Reliance on third party identification and verification**

This is where you rely on a third party having conducted ID & V to the level required of your business and to your standard. The legislation permits reliance on third party ID&V in limited circumstances. To rely on third party identification and verification you will need to have systems in place to ensure it is sufficient to meet your own requirements and to maintain up to date records. You should subject the process to periodic review and audit the third party. It is worth noting that should you rely on a third party's identification and verification and your relationship with that third party ceases you will need to have proof that full ID&V has been undertaken on all clients and have records to prove that full CDD has been completed. Again well documented but in law, no firm is permitted to rely on ID & V conducted by an MSB.

### **Beneficial ownership**

For private or unlisted companies you must obtain the names of all directors (or equivalent), and the names of individuals who own or control 25% or more of its shares or voting rights; or the names of any individuals who otherwise exercise control over the management of the company. Members should adopt a risk based approach and consideration should be given to reducing the % where the identified risks are higher, 25% is the minimum requirement. The risk based approach extends to verifying beneficial owners. Consideration could be



given to verifying in higher risk situations, for example, location of the registered business or shareholder or the risk posed by the business type itself e.g. other money services businesses, online gaming, mineral trading.

**Politically Exposed Persons (PEPS)**

While domestic PEPs are not required to be classified as PEPs, AFEP considers it essential that members identify these individuals and treat them as High Profile Individuals. As well as reflecting the higher risk nature of domestic officials this takes into consideration the requirements of anti bribery and corruption legislation and recognises the heightened risk of impersonation fraud.

**B. Ongoing Client Due Diligence**

As well as extending beyond simply ‘papering’ your clients, due diligence means monitoring the business relationship. Monitoring can take many forms. It is the opinion of AFEP that member firms should have the capability to monitor its client activity. Initial monitoring will be focused on establishing a reasonable knowledge of the client and patterns of activity.

Positive Indicators	Negative Indicators
<ul style="list-style-type: none"> <li>The activity of the client is in line with the nature of business / stated purpose</li> </ul>	<ul style="list-style-type: none"> <li>Lack of consistency between knowledge of client and transactions performed (e.g. client says they are purchasing a house but makes a series of small payments)</li> <li>Simple internet searches cannot identify the client nature of business / how it generates it's income</li> </ul>
<ul style="list-style-type: none"> <li>Amounts, currencies, jurisdictions and settlement methods are in line with expectation as documented at the start of the relationship and updated periodically</li> </ul>	<ul style="list-style-type: none"> <li>Volumes / jurisdictions inconsistent with those expected</li> <li>Changes in established patterns</li> </ul>
<ul style="list-style-type: none"> <li>Beneficiaries can be linked in some way for example, a business paying a supplier or a private client paying themselves or a third party linked to the purpose provided. This could be a lawyer, property agent, notaire or even a known electronic market place</li> </ul>	<ul style="list-style-type: none"> <li>Beneficiary appears not associated with purpose of fx / client</li> <li>Beneficiary appears opaque and cannot easily be identified via simple internet searches</li> </ul>

Capturing the reasons for a client’s activity is paramount in maintaining a good knowledge of your client and in particular the source of your client’s wealth.

**Source of funds**

Source of funds includes the immediate source of funds for a particular transaction, i.e. a bank account or credit card. Knowing who provided the funds and the account or card from which they have derived is necessary in every case. Source of funds may be a bank account that can be related directly to the client. Where this is not the case, for example third party



funds, firms may take a risk based approach and where appropriate make further enquiries about the relationship between the ultimate underlying principal of the funds and the account holder. In addition, consideration must be given to verifying the identity of the ultimate beneficial owner. On the risk based approach this might be in higher risk situations such as where the UBO is based in a high risk jurisdiction or the corporate entity is in a high risk jurisdiction / business sector.

**Source of wealth**

Source of wealth is distinct from source of funds and describes the origins of a client's financial standing or total net worth i.e. those activities which have generated a customer's funds and property. Information sufficient to establish the source of income or wealth should be obtained for all higher risk relationships or situations. Higher risk situations might include:

- Payments involving high risk jurisdictions (client location, origin or destination of payment);
- Private client is paying to a third party individual;
- Trading activity is not consistent with information held on the client;
- Established trading patterns are broken;
- Trade amount is significantly above that of the norm for the type of client involved;
- Client is a small business and no obvious method of promotion or obvious sales channels;
- There is no meaningful data on a corporate financial status / data has been obtained which calls into question a corporate client's financial status.

Some good practice examples are:

Good Practice	Poor Practice
The firm establishes the legitimacy of, and documents, the source of wealth and source of funds used in high-risk business relationships.	The firm does not distinguish between the customer's source of funds and their source of wealth.
The firm understands the norms of its various client types and can identify situations where source of wealth may need to be established	A firm grants waivers from establishing source of funds, source of wealth or other due diligence without good reason.
The firm obtains evidence of source of wealth based on the risks identified	The firm has no record of ever establishing source of wealth
The firm records situations where source of wealth has been established and has obtained evidence in appropriate situations or reasons for no further action taken have been recorded	The firm has no record of evidence of source of wealth in high risk situations

**Obligation**

The Firm must establish the source of funds of each transaction. Source of wealth allows you to adequately assess the risk of exposure to money laundering or terrorist financing. It also supports your obligation to perform on-going due diligence of your clients.



There is no obligation to obtain proof of the source of funds / wealth however, it may be prudent to ask for some supporting evidence to confirm the information provided. Where such supporting evidence is provided, it is important that you look at that evidence to see if it is consistent with the client's explanation or whether it throws up more questions. If an explanation is consistent with the client's risk profile, is consistent with the trading activity and you do not have other AML concerns about the transaction, you should note the explanation.

In all cases you should be asking:

- Is this consistent with what I know about the client?
- Do I have information which makes me suspicious that there is criminal property involved?

If the transaction is higher risk, you may ask for supporting evidence as per the common scenarios listed below:

Categories	Details Required	Additional Documents
Savings from Employment Income	<ul style="list-style-type: none"> <li>• Position held</li> <li>• Nature of Employer's business</li> <li>• Employer's name/address</li> </ul>	<ul style="list-style-type: none"> <li>• Last 3 months' pay slips, or</li> <li>• Confirmation from Employer of income and bonuses for last 2 years, or</li> <li>• Bank Statements that clearly show receipt of the most recent 3 months' regular salary payments from the named employer, or</li> <li>• Latest accounts if self-employed.</li> </ul>
Maturing Investments or Encashment Claim	<ul style="list-style-type: none"> <li>• Amount received</li> <li>• From which company</li> <li>• Date received</li> </ul>	<ul style="list-style-type: none"> <li>• Letter / contract note from previous investment company giving notification of proceeds of maturing investment / claim</li> </ul>
Share Sale	<ul style="list-style-type: none"> <li>• Sale value of shares sold</li> <li>• Description of shares / funds</li> <li>• How sold (i.e. through stockbroker or bank etc.) and name/address</li> <li>• Date of sale</li> </ul>	<ul style="list-style-type: none"> <li>• Legal sale document(s) (e.g. contract notes)</li> </ul>
Property Sale	<ul style="list-style-type: none"> <li>• Sale value of property sold</li> <li>• Full address of property sold</li> <li>• How sold (i.e. through agent, by auction, private sale , including name/address )</li> <li>• Date of sale</li> <li>• How long property held</li> <li>• Such data as maybe verified from open source</li> </ul>	<ul style="list-style-type: none"> <li>• Signed letter from Solicitor, or</li> <li>• Completed sale contract</li> </ul>



	data such as land registry or property sale websites such as Zoopla.	
Company sale or sale of an interest in company	<ul style="list-style-type: none"> <li>Name &amp; address of Company</li> <li>Total sale price</li> <li>Applicant's share</li> <li>Nature of business</li> <li>Date of sale</li> </ul>	<ul style="list-style-type: none"> <li>Signed letter from Solicitor, or</li> <li>Signed letter from UK Regulated Accountant, or</li> <li>Copy of contract of sale and sight of investment monies on Bank Statement</li> </ul>
Inheritance	<ul style="list-style-type: none"> <li>Total amount received</li> <li>Name of benefactor</li> <li>Relationship to benefactor</li> <li>Date received</li> </ul>	<ul style="list-style-type: none"> <li>Grant of Probate (with a copy of the will) which must include the value of the estate, or</li> <li>Bank Statements or</li> <li>Solicitor's letter</li> </ul>
Loan	<ul style="list-style-type: none"> <li>Amount of loan</li> <li>Why required</li> <li>Name &amp; address of Loan Provider</li> <li>Date of loan</li> </ul>	<ul style="list-style-type: none"> <li>Loan agreement or</li> <li>Recent loan statements</li> </ul>
Gift	<ul style="list-style-type: none"> <li>Total amount</li> <li>Details of benefactor</li> <li>Reason for gift</li> <li>Relationship to benefactor</li> <li>Source of donated funds</li> </ul>	<ul style="list-style-type: none"> <li>Letter from donor confirming details of gift and acknowledging the source of the donated funds</li> <li>Based on the SOW specified, the donor needs to provide supporting documentation as per the provisions of this table</li> </ul>
Company Profits	<ul style="list-style-type: none"> <li>How the company generates its income verified through open source data</li> </ul>	<ul style="list-style-type: none"> <li>Business bank statements from the last 3 months</li> <li>Copy of latest accounts, or</li> <li>A letter from a Regulated Accountant giving details of company profits over the last 2 years</li> </ul>
Other income sources	<ul style="list-style-type: none"> <li>Nature of Income</li> <li>Amount</li> <li>Date Received</li> <li>Received from whom</li> </ul>	<ul style="list-style-type: none"> <li>Appropriate supporting documentation, or</li> <li>Signed letter detailing funds from a Regulated Accountant</li> </ul>

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