مصرف الإمارات العربية المتحدة المركزي
CENTRAL BANK OF THE U.A.E.

CBUAE OUTREACH EVENT
on the AML/CFT Guidance for LFIs providing services to Cash-Intensive Businesses

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Purpose & Applicability of the Guidance Document

Purpose

- This Guidance does NOT constitute new regulation and does NOT introduce new legal obligations.
- It is designed to help CBUAE's LFIs understand the purpose and context of their existing legal obligations, as well as the CBUAE's expectations for how those obligations will be fulfilled.
- The Guidance came into effect on 28 September 2021, with LFIs expected to demonstrate compliance with its requirements within one month from its coming into effect.

Applicability

The Guidance document applies to **all natural or legal persons that are licensed and/or supervised by the CBUAE** in the following categories:

- National banks, branches of foreign banks, exchange houses, finance companies, payment service providers, registered hawala providers and other licensed financial institutions ("LFIs"); and
- Insurance companies, agencies, and brokers.

Structure of the Guidance Document

The Guidance document is divided into two main parts:

Understanding Risks

This section discusses why cash-intensive businesses pose elevated risks to LFIs and describes aspects of cash-intensive businesses that increase or decrease their risk.

Mitigating Risks

This section discusses how LFIs can use *existing aspects* of their AML/CFT program to manage the specific risks of cash-intensive business customers.

Understanding Risks

Vulnerabilities of Cash

- The specific characteristics of cash—its anonymity, interchangeability, and transportability—make it an attractive method by illicit actors seeking to conceal the proceeds of crime.
  - Cash holds no record of its source or owner, and can be easily concealed in large quantities upon which it is difficult to trace once spent.
  - Cash transactions are also instantaneous and widely accepted across jurisdictions.
  - Criminal activity—or a predicate offense—is often cash based.

Vulnerabilities of Alternatives to Cash:

Bearer Negotiable Instruments

Bearer negotiable instruments are financial instruments of whatever form, whether in the form of a bearer document, such as traveler's cheques, promissory notes and cheques, or payment orders.

- Bearer negotiable instruments can be attractive to illicit actors in that they:
  - Provide the opportunity to move **large amounts of funds in bearer form** without the bulkiness of cash;
  - Can be **easily transferred** from one party to another; and
  - Provide **unconditional guarantees of cash payments** either on demand or at a future date.
- **LFIs should seek to mitigate these risks by continuing accepting cash and third-party cheques as long as the due diligence measures regarding the person presenting the cheque have been duly conducted by the LFI.**

Vulnerabilities of Alternatives to Cash:

Prepaid Cards

Prepaid cards provide access to funds that have been paid in advance and are claimed or transferred through an electronic device, such as through a card, serial number, or personal ID number within either an "open" or "closed" loop system.

- Prepaid cards offer similar benefits to cash, including **anonymity and accessibility,** which can be abused by illicit actors.
- **When assessing the risks associated with prepaid cards, LFIs should consider the specific risks posed by the different features and functionalities of prepaid cards** such as:
  - Cash access;
  - Volume and velocity of funds that can be loaded and retrieved;
  - Type and frequency of loads and transactions;
  - Geographic location where the transaction activity occurs;
  - Value limits;
  - Distribution channels; and
  - Nature of funding sources.

Vulnerabilities of Cash-Intensive Businesses

Cash-intensive businesses are businesses that experience a high volume of legitimate cash flows in various industry sectors (such as convenience stores, retail stores, restaurants, wholesale or general trading businesses, travel agencies and tour operators and car dealers) which can be susceptible to abuse by illicit actors.

- Illicit actors may use cash-intensive businesses to:
  - Provide a front to launder large amounts of cash and reinvest cash proceeds of crime in the economy;
  - Co-mingle illicit and legitimate income; and
  - Finance, though often through small amounts of cash, terrorist activities without traceability.

- When identifying cash-intensive businesses in their customer base, LFIs should:
  - Define a "cash-intensive business" based on a sound methodology that considers various factors including risk and characteristics such as a proportion or more of the business' revenue is in cash or the business has a monthly revenue in cash above a certain threshold;
  - Understand the nature and purpose of the business relationship and expected activity of the customer; and
  - Monitor whether the cash-intensive business appears to generate unusual transactions compared to the business' expected activity and profile, and with other similar cash-intensive businesses.

Features of Cash-Intensive Businesses

Common features of cash-intensive businesses that impact risk, include:

1. Cross-border movement of cash and cash couriers;
2. Cash deposits; and
3. Currency exchanges.

LFIs should consider the specific risks posed by these features to determine whether the customer is considered as high-risk and should be subject to enhanced due diligence ("EDD") measures.

Cross-Border Movement of Cash

- The criminal economy tends to be cash-based with proceeds of crime moving quickly and anonymously, including across borders. Cross-border movements of cash are used to:
  - Launder proceeds of crime by placing them in another jurisdiction, typically with weaker AML/CFT controls.
  - Move illicit value to purchase assets that can hold considerable value, such as luxury goods, or transfer the value of the funds for them to be stored.
  - Hide proceeds from authorities and complicate asset recovery.

Cash Couriers

- Cash couriers are natural persons who physically transport currency and bearer negotiable instruments on their person (such as a money belt) or accompanying luggage from one jurisdiction to another.
- Couriers may be directly involved in the underlying crime or may be third parties recruited to move money to another jurisdiction. Cash couriers may use air, sea, or rail transport to cross an international border and typically use high denomination banknotes as part of their transportation

It is not illegal to move cash into or out of the UAE. However, natural or legal persons must declare upon entering or leaving the UAE any currencies, bearer negotiable instruments, precious metals and stones above the threshold of AED 60,000.
Understanding whether customers have made any such declarations, in accordance with the Regulation should form part of any due diligence by the LFIs where required. As part of due diligence, LFIs may require additional information on the customer or the transaction, including the source of funds and relevant documentation.

Potential Risk Indicators

- ✓ Transactions involving locations or customers originating from locations with poor AML/CFT regimes or high exposure to corruption.
- ✓ Significant and/or frequent cash deposits or currency exchanges made over a short period of time.
- ✓ Customer is in possession of money supposedly for business reasons while travelling to countries where cash payments are restricted.
- ✓ Customer requests to purchase, or has possession of, large volumes of high denomination banknotes.
- ✓ Customer requests to purchase, or has possession of, large amounts of foreign currency without a plausible explanation.
- ✓ Customers who use false identification or offer different identifications on separate occasions.

Cash Deposits

- Illicit actors involved in cash generating crimes frequently need to use cash they acquired to pay for the illicit goods they have sold, to purchase additional goods, and to pay the various expenses incurred in acquiring or transporting the goods.
- Terrorists also seek to finance, often through small amounts of cash, terrorist activities.
- LFIs should be aware of cash deposits placed into the banking system that involve high-risk customers and/or geographical areas, third parties without a relationship to the customer, and transactions that lack an apparent business purpose.
- **LFIs should also obtain appropriate information regarding the source of cash deposited in a customer's account as well as mandate the use of Emirates ID for cash deposits in automated teller machine ("ATMs").**

Potential Risk Indicators

- ✓ Large cash deposits followed immediately by withdrawals or electronic transfers.
- ✓ Large cash deposit followed by an immediate request that the money be wired out or transferred to a third party, without any apparent business purpose.
- ✓ Frequent cash deposits by multiple individuals into a single bank account, followed by international wire transfers and /or international withdrawals through ATMs.
- ✓ Large cash deposit is followed within a short time by wire transfers to high-risk jurisdictions.
- ✓ Numerous cash deposits made in different bank branches over a short period of time.
- ✓ Frequent cash deposits in small amounts, without any apparent business purpose or reasonable grounds.
- ✓ Customers who use false identification or offer different identifications on separate occasions.

Currency Exchanges

- According to the Financial Action Task Force ("FATF"), the simplicity and certainty of currency exchanges transactions and the anonymity and portability of cash make them attractive to money laundering and the financing of terrorism and illegal organisations.
- Once the money has been exchanged, it is challenging for law enforcement authorities to trace its origin.
- There are two different ways to perform a currency exchange: (1) the use of cash to exchange and transfer the funds; or (2) the use of the internet to perform the currency exchange and transfer the funds to a bank account.

Potential Risk Indicators

- ✓ Significant and/or frequent local or foreign currency exchanges.
- ✓ Opening of foreign currency accounts with no apparent business or economic purpose.
- ✓ Customers who know little about or are reluctant to disclose details about the payee, or customers or parties with no apparent ties to the destination country.
- ✓ Suspicion that the customer is acting on behalf of a third party but not disclosing it.
- ✓ Transactions involving charities and other non-profit organizations, which are not properly licensed or registered.
- ✓ Customers who use false identification or offer different identifications on separate occasions.
- ✓ Customers who receive transfers in seasonal patterns or transactions in a pattern consistent with criminal proceeds.

Mitigating Risks

- ✓ Risk-Based Approach
- ✓ Customer Due Diligence and Enhanced Due Diligence
- ✓ Transaction Monitoring and STR Reporting
- ✓ Governance and Training

What is the Risk-Based Approach?

- LFIs are expected to **identify and manage** the money laundering, terrorist financing, proliferation financing, sanctions, and bribery and corruption risks (collectively, “illicit finance risks”) to which they are exposed and **apply mitigating measures** that are commensurate with those risks.
- The risk-based approach thus allows LFIs to adopt a **more flexible** set of measures in order to apply mitigating measures **more effectively**—directing greater human and technical resources to areas of heightened risk.
- LFIs should reflect the presence of higher-risk customers, including Cash-Intensive Businesses, in their enterprise risk assessments and consider the strength of the controls in place to mitigate these risks.
- Thus, as part of a risk-based approach, LFIs should dedicate compliance resources and effort to customers, business lines, branches, and products and services in keeping with the risk presented by those customers, business lines, branches, and products and services.

Risk-Based Approach (1/2)

The risk-based approach has three principal components:

Conducting an Enterprise Risk Assessment	• The enterprise risk assessment must reflect the presence of higher-risk customers, including cash-intensive business customers, in the customer base. • These assessments should in turn be reflected in an LFI's inherent risk rating.

Identifying and Assessing the Risks Associated with Specific Customers	• LFIs are expected to assess the risks of each customer to identify those that require EDD and to support its entity risk assessment. In assessing the risks of cash-intensive business customers, LFIs should consider:
	  • **Geographic Risk**: Risks associated with the jurisdictions in which the cash-intensive business is registered/ headquartered and where it operates.
	  • **Customer Risk**: Risks associated with the type of cash-intensive business, the maturity of that relationship, and other characteristics of the business relationship such as its ownership's structure.
	  • **Product, Service, and Delivery Channel Risk**: Risks associated with the products and services that the cash-intensive business customer intends to use, and the delivery channels through which the institution will provide these services.

Risk-Based Approach (2/2)

The risk-based approach has three principal components:

Identifying and Assessing the Risks Associated with Specific Customers (cont.)

- Questions that LFIs may ask to determine the risk profile of a cash-intensive business include:
  - *Where is the business incorporated? Where does it operate? Are these high-risk jurisdictions?*
  - *What type of industry does the cash-intensive business operate in?*
  - *What types of products and services is the business requesting?*
  - *What is the intended volume, frequency, and nature of cash transactions that the cash-intensive business intends to conduct through its account?*
  - *What is the regulatory environment in the jurisdiction(s) where the cash-intensive business is incorporated/has operations?*
  - *What is the ownership structure of the customer? Do the customer's beneficial owners, shareholders, directors, and senior managers reside in a high-risk jurisdiction?*
  - *What is the availability of information on the customer? Is the customer cooperating with the LFI to provide all the necessary customer due diligence ("CDD")/EDD information to the LFI?*
  - *If the customer is an existing customer, does the customer have a history of Suspicious Transaction Report ("STR") filings?*

Applying EDD and other Preventive Measures

- Where the LFI determines a customer to be higher-risk, the LFI must apply EDD.
- EDD is also required for specified higher-risk customer types, no matter their risk rating.
- EDD measures should be designed to mitigate the specific risks identified with particular customers.

Customer Due Diligence: Customers and Beneficial Owners

The following elements of CDD must be carried out for all customers, no matter the customer type.

Customer Identification and Verification: LFIs are required to identify and verify the identity of all customers.

Beneficial Owner Identification: The majority of cash-intensive businesses will be legal persons. As such, the LFI must identify and verify the identity of the beneficial owners, defined as any individual owning or controlling at least 25 percent of the legal person.

- The beneficial owner of a legal person <u>must</u> be an individual.
- LFIs should continue tracing ownership all the way up the ownership chain until it discovers all individuals who own or control at least 25% of the LFI's customer.
- If no individual qualifies as a beneficial owner, LFIs should identify the individual(s) holding the position of senior management officer(s) within the customer. This option should be used only as a last resort, however, and when the LFI is confident that no one individual, or small group of individuals, exercises control over the customer.

EDD: Beneficial Ownership: If the LFI is still not confident that it has identified the individuals who truly own or control the customer, or when other high-risk factors are present, LFIs should assess whether identification of additional owners holding smaller stakes might assist them in managing the risk of a particular customer.

Customer Due Diligence:
Nature of the Customer's Business

- The purpose of the account and the nature of the customer's business are critical drivers of risk for cash-intensive business customers. LFIs should fully understand how their customer makes money and what types of transactions it expects to carry out through the LFI's account.

- **Nature of the Customer's Business**: LFIs should seek to understand the cash-intensive business and collect the information necessary to assess customer risk which is critical to, and closely linked with, the customer risk rating process. In line with a risk-based approach, LFIs should do this by:
    - Interviewing the customer;
    - Reviewing the customer's business license;
    - Requesting recent financial statements (audited, if available), tax returns, or additional information;
    - Searching company databases; and
    - Assessing the primary business activity, products, and services offered by the customer to understand the full scope of the customer's business.

Customer Due Diligence: *Purpose of the Business Relationship*

- **Purpose of the Business Relationship**: LFIs should fully understand the uses to which the cash-intensive business intends to put the account and the expected activity on the account. To do this, LFIs should:
  - Assess the expected volume, frequency, and nature of cash transactions that the customer intends to conduct through its account;
  - Consider whether the expected volume of cash coming through the account is consistent with the declared sales income; and
  - Consider whether the expected volume of cash appears reasonable compared to other similar cash-intensive customers of the LFI.

Customer Due Diligence: Ongoing Monitoring

All customers must be subject to ongoing monitoring throughout the business relationship. Ongoing monitoring ensures that the account or other financial service is being used in accordance with the customer profile developed through CDD during onboarding, and that transactions are normal, reasonable, and legitimate.

CDD Updating

- LFIs are expected to ensure that CDD information on all customers is **accurate, complete, and up-to-date**.
- LFIs should **update CDD for all customers on a risk-based schedule** and **review the customer's account activity** since the last time the customer profile was updated, to ensure that the transactions continue to fit the customer's profile and business.
- If the review finds that the customer's behaviour or information has materially changed, the LFI should risk-rate the customer again.

EDD Updating

- When customers are higher risk, such as for cash-intensive businesses rated as high-risk following the completion of the CDD process, monitoring should be **more frequent, intensive, and intrusive**.
- LFIs should not rely solely on information supplied by high-risk customers and should consider:
  - Reviewing more or all transactions on the account, rather than a sample of transactions;
  - Conducting site visits at the customer's premises whenever the LFI is not satisfied with the documentation provided by the customer; and
  - Conducting searches of public databases.

Transaction Monitoring (1/2)

- LFIs must monitor activity by all customers to identify behaviour that is potentially suspicious and that may need to be the subject of a suspicious transaction report (“STR”) or suspicious activity report (“SAR”) or other report types.
  - LFIs that use automated monitoring systems should apply rules with **appropriate thresholds and parameters** that are designed to detect **common typologies for illicit behaviour**.
  - Appropriate type and degree of monitoring should **appropriately match the ML/TF/PF risks** of the LFI’s customers, products and services, delivery channels, and geographic exposure. TM programs should also be calibrated to the size, nature, and complexity of each institution.
  - The transaction monitoring system used by LFIs should be equipped to **identify patterns of activity that appear unusual and potentially suspicious** for cash-intensive business customers as well as unusual behavior that may indicate that a customer’s business has changed in such a way as to require a high-risk rating.

Transaction Monitoring (2/2)

Transaction Monitoring

Suspicious Transaction Reporting

- Some red flags for cash-intensive business customers as part of transaction monitoring include the following:
  - *The business engages in significantly greater volumes of cash transactions in comparison to other similar business types operating in similar jurisdictions and markets.*
  - *The business engages in unusually frequent domestic and international ATM activity.*
  - *The customer makes a cash deposit followed by an immediate request that the money be wired out or transferred to a third party, without any apparent business purpose.*
  - *There are frequent cash deposits by multiple individuals into a single bank account, followed by international wire transfers and /or international withdrawals through ATMs.*
  - *The parties to the transaction (e.g., originator or beneficiary) are from countries that are known to support terrorist activities and organizations.*
  - *The customer uses a personal/individual account for business purposes or vice versa.*
  - *Upon request, a customer is unable or unwilling to produce appropriate documentation (e.g., invoices) to support a transaction, or documentation appears doctored or fake (e.g., documents contain significant discrepancies between the descriptions on the invoice, or other documents such as the certificate of origin or packing list).*
  - *The customer engages in transactions involving foreign currency exchanges that are followed within a short time by wire transfers to high-risk jurisdictions.*
  - *Funds are transferred into an account and are subsequently transferred out of the account in the same or nearly the same amounts, especially when the origin and destination locations are high-risk jurisdictions.*

- If an LFI's automated transaction monitoring system is not capable of alerting on these red flags, LFIs should have in place manual monitoring, such as management information systems.

STR Reporting

As required by Article 15 of the AML-CFT Law and Article 17 of AML-CFT Decision, LFIs must file an STR/SAR or other report types with the UAE Financial Intelligence Unit ("UAE FIU") when they have reasonable grounds to suspect that a transaction, attempted transaction, or funds constitute, in whole or in part, regardless of the amount, the proceeds of crime, are related to a crime, or are intended to be used in a crime.

STR/SAR filing is not simply a legal obligation; it is a critical element of the UAE's effort to combat financial crime and protect the integrity of its financial system.

LFIs should also consider filing an STR/SAR in the following situations involving higher-risk customers. This list is not complete—an LFI must always be watchful for behavior that has no clear legitimate explanation.

- *A potential customer decides against opening an account or purchasing other financial services after learning about the LFI's CDD requirements;*
- *A current customer cannot provide required information about its business or its beneficial owners;*
- *A customer cannot adequately explain transactions, provide supporting documents such as invoices, or provide satisfactory information about its counterparty; or*
- *The LFI is not confident, after completing CDD procedures, that it has in fact identified the individuals owning or controlling the customer. In such cases, the LFI should not establish the business relationship, or continue an existing business relationship.*

Governance

- **The core of an effective risk-based program is an appropriately experienced AML/CFT Compliance Officer who understands the LFI's risks and obligations and who has the resources and autonomy necessary to ensure that the LFI's program is effective**.
- The LFI's senior management must clearly endorse and support the AML/CFT program.

Training

- The AML/CFT training program should ensure that employees are aware of the risks of cash-intensive business customers, are familiar with the obligations of the LFI, and are equipped to apply appropriate risk-based controls.
- Training should be tailored and customized to the risk and the nature of the LFI's operations.

Scenarios

The customer is a car dealership located in Abu Dhabi. Upon account opening, the customer asserts it will only be making small cash deposits and conducting domestic wire transfers to beneficial owners in the UAE as part of expected activity within its account. Two years into the relationship, however, the customer begins to make large cash deposits which are followed within a short time by international wire transfers to a beneficiary in Country A, a high-risk jurisdiction.

Risk Assessment

- The customer's CDD information could have changed, such as having a new beneficial owner or expanding its operations to other countries.
- The customer's changed transaction behavior with a beneficiary in a high-risk jurisdiction could be legitimate but requires further investigation.

Risk-Based Response

- Inquire regarding the nature of the transactions to the beneficiary in Country A. Screen the name of the beneficiary against public databases.
- Conduct a CDD review for the customer, including asking the customer whether it has changed beneficial owners. Update CDD information and risk-rate the customer accordingly. Based on new information gained, apply EDD if necessary.

A small tour operator in Dubai requests to open an account. The store has exclusively domestic operations and is owned by two UAE nationals. When asked about the expected activity of the account, the customer explains the account will have a very high volume of cash deposits. Upon closer examination, you find that the declared sales income for the company is much lower than the expected activity in the account.

Risk Assessment

- The nature of the expected activity—i.e., the high volume of cash for a small company—is not clearly justified.
- The discrepancy between the declared sales income and the expected volume of cash requires further explanation.

Risk-Based Response

- Inquire about the discrepancy between the declared sales income and the expected volume of cash deposits.
- Review the customer's CDD information, such as the customer's business license and financial statements, to understand the full scope of the customer's business.
- Consider conducting a site visit of the customer's place of business.

A local convenience store in Al Ain has been a customer of your institution for less than a month when a signatory on the account seeks to make several cash deposits. The deposits consist of high denomination banknotes from Country B, a country with weak AML/CFT controls. The behaviour does not align with the customer's expected activity in the account, which the customer asserted would consist of small cash deposits in AED at account opening.

Risk Assessment

- The deposit of high denomination banknotes deviates from the customer's expected activity and is not clearly justified by a business purpose.
- Country B is known to be associated with weak AML/CFT controls.
- The transactions follow a known illicit pattern but could also be explained by legitimate activity.

Risk-Based Response

- Inquire regarding the nature of the transactions and why deposits are being provided in high denomination banknotes and in a foreign currency. Update the customer's CDD, as necessary.
- Set monitoring rules that will alert you when the customer transacts above a certain threshold in foreign currencies.

Questions