CLIFFORD CHANCE

Briefing note

October 2012

New AML Regime for the DIFC

The Dubai Financial Services Authority ("**DFSA**") has released Consultation Paper No. 86 regarding proposed changes to the DFSA's Anti-Money Laundering and Ancillary Service Provider Regime (the "**Consultation**").

The DFSA is proposing to replace its current Anti-Money Laundering Module ("**AML**") with a new AML module updated in line with the revised Financial Action Task Force ("**FATF**") principles.

The proposals come at a time when the UAE federal authorities are also reviewing and updating the UAE laws and regulations pertaining to money laundering and terrorist financing.

The Consultation is open for comment until 16 December 2012.

Anti-money laundering in the DIFC

Money laundering, terrorist financing and related offences are criminal offence in the UAE. The Federal legislation governing money laundering and terrorist financing is also applicable in the Dubai International Financial Centre ("**DIFC**"). The DFSA is free to issue and administer rules regarding money laundering compliance in the DIFC but these rules must fit within the wider anti-money laundering framework operative in the UAE. Requirements applicable in the DIFC regarding the reporting of suspicious activity are therefore derived from Federal legislation. The Consultation proposals see the DFSA clarifying its role with respect to suspicious activity reporting and how it seeks to interact with the UAE authorities in this regard.

The DFSA is recommending substantive changes to the Regulatory Law 2004 which will clarify that the DFSA is empowered to exercise its powers on behalf of governmental or regulatory authorities exercising powers and performing functions relating to anti-money laundering, counter-terrorist financing or international sanctions. The DFSA will therefore be able to act at the request of the UAE Central Bank's Anti-money Laundering Suspicious Cases Unit (the "**AMLSCU**") which should result in a more joined-up response to suspicious transactions in the UAE.

This clarification is welcome; however, the changes are of broader application and may have more wide reaching application than one may first suspect. The proposed changes will also permit the DFSA to exercise powers on the behalf of international regulators including with respect to the application of international sanctions legislation. Firms may therefore find themselves in a situation where the DFSA is exercising its functions at the request of a foreign regulator seeking to implement (in some respects extra-territorial) sanctions legislation, such as the US Office of Foreign Asset Control.

In other respects, the DFSA is stepping back from elements of the anti-money laundering regime which are firmly in the jurisdiction of the UAE authorities and the AMLSCU. Examples include removing the requirement on firms to copy the DFSA into suspicious transactions reports (now termed "suspicious activity reports") made to the AMLSCU and replacing this with a lesser notification requirement. The DFSA have also proposed to remove the requirement on firms to submit an annual report covering suspicious activities and to replace this with a standardised "Annual AML Return".

The DFSA is instead focusing its efforts on ensuring that firms operating in the DIFC have robust anti-money laundering policies, procedures, systems and controls including with regard to undertaking adequate "know-your-customer" due diligence. To this end, The DFSA is recommending substantive changes to the Regulatory Law 2004 which will impose a legal requirement on firms to undertake client due diligence ("**CDD**").

DFSA Rulebook

The DFSA is proposing to replace its current AML module with a new AML module updated in line with the revised FATF principles. Country members of the FATF are generally viewed as having robust money laundering regimes. The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. It is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas. The DFSA's implementation of FATF principles demonstrates its commitment to fostering a business environment which reflects international best practice standards.

Senior Management responsibility

The Basel Committee believes that "*compliance starts at the top. It will be most effective in a corporate culture that emphasises standards of honesty and integrity and in which the board of directors and senior management lead by example. It concerns everyone within the bank and should be viewed as an integral part of the bank's business activities*". The DFSA takes the same approach to money laundering compliance in the DIFC.

The DFSA believes that historically too much reliance has been placed on the firm's money laundering reporting officer ("**MLRO**") and not enough reliance has been placed on a firm's board of directors or senior management. The DFSA's proposed new AML regime makes clear that a firm's anti-money laundering compliance rests with the governing body and senior management and that such individuals must approach this responsibility with due skill, care and diligence. In order to further emphasise this, additional guidance will make it clear that the DFSA will consider taking appropriate enforcement action against the firm's board of directors or senior management for failure to exercise due skill, care and diligence in carrying out their anti-money laundering responsibilities.

Risk-based approach

The new AML module places a greater emphasis on firms taking a risk-based approach ("**RBA**") to anti-money laundering. The RBA involves approaching money-laundering in a proportionate and effective manner by having firms perform a risk-based analysis of their business and customers and focusing resources on those areas that pose the greatest money laundering risk. The aim is to reduce the incidence of "tick-the-box" compliance with money laundering legislation and to compel firms to first understand the money laundering risks they face and to then implement a proportionate response to the risks identified.

The first stage to an effective RBA is to assess the firm and the money laundering risk associated with the firm's business. This assessment will need to take into consideration the nature, size and complexity of the firm's activities and a different risk assessment may be attributable to the different business offerings of the firm. The business risk assessment must be reviewed regularly and take into consideration changes in a firm's business profile, the development of new products and the onboarding of new clients as it will form the basis for developing and assessing the firm's anti-money laundering policies, procedures, systems and controls. The DFSA requires that a firm's business risk be documented and made available to the regulator upon request.

A firm will also need to undertake a money laundering risk assessment for each of its customers. The method used in undertaking this risk assessment is left to the discretion of the relevant firm; however, the nature of the customer, the nature of the business relationship with the customer, the customer's country of origin, residence, nationality, place of incorporation and business as well as the relevant product, service or transaction to be provided must be taken into consideration. This broadly equates to four heads of risk: customer risk, interface risk, jurisdiction risk and product risk. The DFSA expects a firm to use its risk-based assessment of a customer to justify the approach it takes in relation to customer due diligence.

Following its recent questionnaire on the topic and increased attention on the international level, the DFSA is implementing rules which require firms to have systems and controls in place to identify individuals constituting politically exposed persons or "PEPs". Where a customer is identified as a PEP, the

DFSA consider such a customer to be higher risk and to warrant enhanced due diligence measures. This is because such persons have a greater exposure to potential corruption risk and therefore present a higher money laundering risk. However, the rules also make clear that a PEP can present a lower money laundering risk if the business relationship involves certain low risk products.

The DFSA also provides for firms to classify certain customers as presenting a low money laundering risk without the need to undertake a client risk assessment. This category of customer includes other persons subject to the DFSA's AML regime, financial institutions subject to supervision in countries applying anti-money laundering standards meeting the FATF principles, companies listed on regulated exchanges applying rules equivalent to the DFSA Markets Rules, government bodies and non-commercial government entities in the UAE and certain low risk business relationships.

Customer due diligence

The AML provisions relating to CDD would be streamlined; the starting position being that all customers be subject to standard CDD, with enhanced CDD being applied to higher risk customers and simplified CDD being available for lower risk customers.

Standard CDD

In keeping with the RBA, the DFSA are permitting firms to develop their own anti-money laundering policies and procedures, including with respect to relevant know-your-customer requirements. However, the new AML module contains rules in respect of the minimum standards that the DFSA would expect to see as part of standard CDD measures. These minimum requirement broadly reflect the guidance presently found in the AML module; however, the DFSA have refined the drafting and provided helpful guidance. For example, requirements regarding certification of documents have been revised and instead of having a finite list of persons capable of certifying documents, the DFSA have helpfully determined that any person of good standing may do so. Clarifications with respect to identifying and verifying the identity of beneficial owners is also included.

Enhanced CDD

Where clients are deemed to present a higher money-laundering risk, firms are required to undertake enhanced CDD. Enhanced CDD involves conducting standard CDD and to the extent applicable additionally:

- obtaining and verifying additional identification information on the customer;
- obtaining and verifying additional information on the intended nature of the business relationship and the reasons for the particular transaction;
- verifying information regarding source of wealth and origin of funds;
- increasing the degree and nature of monitoring of the business relationship, including by updating identification documents of the customer/beneficial owner more frequently; and
- obtaining the approval of senior management to commence a business relationship with a high risk customer.

Senior management approval may be given by either an individual member of the firm's senior management or by a committee established for this purpose. By including such requirements as enhanced CDD measures, the DFSA are reinforcing the message that senior management are ultimately responsible for a firm's anti-money laundering measures.

Simplified CDD

The DFSA have proposed removing certain exemptions to CDD for specific categories of customer (such as authorised persons, or person supervised by a financial services regulator in a FATF member state). Instead, the DFSA proposes that certain classes of person can be assumed as presenting a lower risk of money laundering without the need for a firm to undertake a risk assessment with respect to that client. Persons considered to present a lower risk of money laundering may qualify for simplified CDD. However, simplified CDD still requires firms to identify customers prior to commencing a business relationship. However, firms may not feel it necessary to verify identification or other information provided by the client, identify beneficial owners, or undertake comprehensive ongoing monitoring for low risk clients. Simplified CDD does provide more flexibility for firms seeking to implement an effective RBA solution; however, the removal of existing exemptions to CDD may mean an increased compliance burden for some firms.

Outsourcing and reliance

In certain circumstances a firm will be permitted to rely on other authorised firms, Designated Non-Financial Businesses or Professions

("**DNFBPs**"), financial institutions or group members to undertake some or all of the required CDD. However, there are stringent conditions placed on these reliance provisions, including that the firm immediately obtains the necessary CDD information and takes steps to ensure that certified copies of CDD documentation will be made available upon request. Furthermore, the CDD undertaken must not be in reliance of any exemption and the information must be up to date. It is worth noting that notwithstanding a firm's reliance on a third party, the DIFC firm remains liable for CDD requirements under the AML rulebook and the DFSA expects the DIFC firm to fill any gaps in the CDD process of which it becomes aware. Reliance on third parties to undertake CDD may therefore be useful in exceptional circumstances but may prove difficult to administer as a default business model.

DNFBPs

The new AML rulebook is intended to be a 'one-stop-shop' of money laundering regulation for firms registered and operating in the DIFC. The new AML rulebook therefore amalgamates the various money-laundering requirements relating to different firms into one universally applicable rulebook.

The DFSA has also taken the opportunity to review its regimes currently applicable to "Ancillary Services Providers" or "ASPs" and "Designated Non-Financial Businesses or Professions" or "DNFBPs". It is proposed that the ASP and DNFBP rulebooks be deleted in their entirety and relevant provisions be contained in the new AML rulebook.

The DFSA has to date regulated law firms and accountancy firms providing services to authorised persons as ASPs. However, last year the DFSA also assumed responsibility for administering and enforcing money laundering legislation with respect to DNFBPs from the DIFC Authority and the definition of DNFBP includes law firms, notary firms and other independent legal businesses as well as accounting firms, audit firms and insolvency firms. The DFSA now proposes to assimilate ASPs into the definition of DNFBP. All firms registered as ASPs will automatically be registered as DNFBPs following implementation of the changes.

The definition of DNFBP remains largely unchanged; however, non-ASP law firms and accountancy firms will find that going forward the full range of their activities will be subject to money laundering regulation. Previously, the definition of DNFBP provided that such firms were only in scope in the event that they were carrying out transactions of a specific kind, namely the buying and selling of real estate, managing of client money, securities or other assets, managing of bank, savings or securities accounts, organising the contributions for the creation, operation or management of companies or the creation, operation or management of legal persons or arrangements and the buying and selling of business entities.

Clifford Chance comment

The DFSA's proposed changes are broadly in line with FATF principles, reflect international standards and are therefore unsurprising. Firms operating in the DIFC which form part of larger international groups will be familiar with such requirements and may already be applying an effective RBA to money laundering compliance in the DIFC. These firms will welcome the changes to an existing AML rulebook which many have perceived as rigid and inflexible. Firms currently taking a "tick-the-box" approach to money laundering compliance will have a taller mountain to climb.

Firms will also need to take a closer look as to how money laundering compliance is developed and administered. The DFSA has been at pains to stress that money laundering compliance is the responsibility of a firm's governing body and senior management. A firm's compliance officer and MLRO is recognised as the person responsible for administering the firm's anti-money laundering policies, procedures, systems and controls. Going forward, firms will have to ensure money laundering compliance fits into a firm's broader corporate governance arrangements. This will be of particular importance to the many firms in the DIFC that rely on outsourced compliance functions. The aim of the DFSA is to foster a "top-down" compliance culture within firms and it is clear that the DFSA will not shirk from taking enforcement action against persons who get money laundering compliance wrong.

Ultimately the effectiveness of the AML regime will be judged on how successful the DFSA is in administering it. Despite the current regime making reference to the RBA, the DFSA have been criticised in the past for strictly adhering to prescriptive guidance when assessing a firms compliance with relevant anti-money laundering obligations.

The RBA requires firms to be more sophisticated in their approach to money laundering compliance, it also requires the regulator to be more sophisticated in its supervision of such a regime.

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