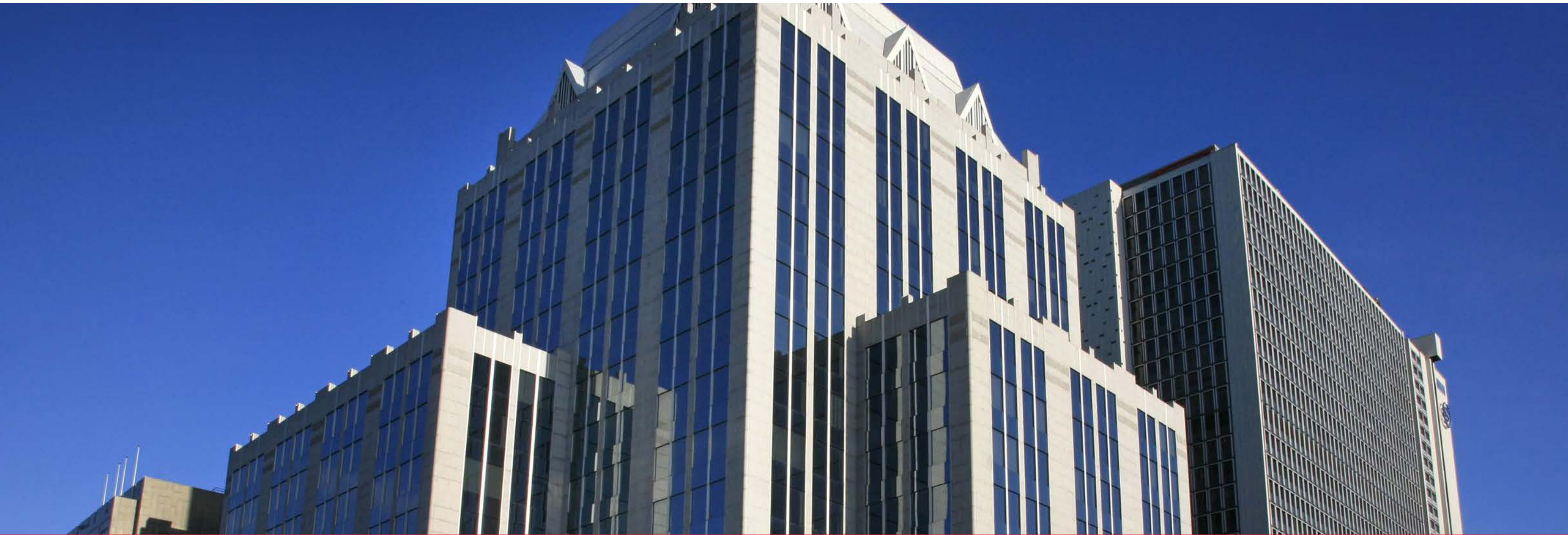


INTERNATIONAL

RISK CONGRESS

2022

“Combating Financial Economic Crime”



International **RiskCongress** - Friday **29 April** 2022

Keynote

Of the importance of the ISSA Financial Crime Compliance Principles in the securities industry



Olivier Goffard

Speaker

INTERNATIONAL

RISK CONGRESS

2022

*Reinforcing **Financial Crime Risk** Management In The **Securities Industry**: ISSA **Financial Crime Compliance** Principles (FCCCP)*



Friday **29 April 2022** - Euroclear, BRUSSELS



Olivier Goffard

April, 29nd, 2022

A few words about ISSA: shaping the future of Securities Services

- ISSA is a Zürich-based trade association supporting the Securities Services industry globally
- Our goal is to effect change through collaboration and communication
- The aim is to make the industry more efficient and effective whilst reducing the risk for all participants
- A series of Working Groups (WG) address present issues as well as focuses on the forward-looking strategic agenda of our members
- The Financial Crime Compliance (FCC) WG is one of our most active WGs

Why this focus on the securities industry?

Settlement Agreement between the U.S. Department of the Treasury's Office of Foreign Assets Control and Clearstream Banking, S.A.

01/23/2014

The U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") today announced a **\$152 million agreement with Clearstream Banking, S.A. ("Clearstream")** to settle the institution's potential civil liability for apparent violations of U.S. sanctions against Iran. Today's settlement resolves OFAC's investigation surrounding Clearstream's use of its omnibus account with a U.S. financial institution to hold securities on behalf of the Central Bank of Iran, in apparent violation of the Iranian Transactions and Sanctions Regulations, 31 C.F.R. part 560.

POLITICO

5 ways Russian sanctions are affecting global financial markets

Fund managers

Meanwhile, fund managers with investments in Russia are stuck with "stranded assets." Pension funds, hedge funds and other asset managers have in many cases marked Russian assets, ranging from stocks to commercial property, down to zero on their books. But due to lack of legal clarity on transacting these assets, they're in most cases refraining from attempting a sale.

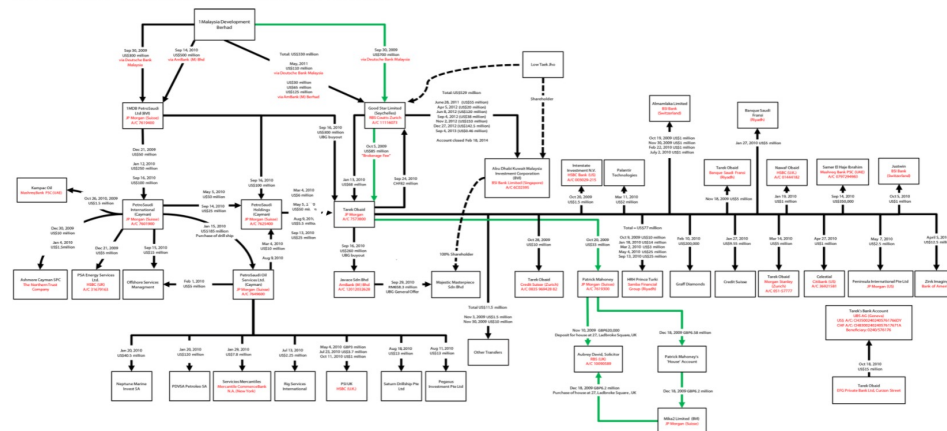
That move has led to some funds being shuttered to investor withdrawals — with at least 57 EU funds pulling up the drawbridge by the first week of March, according to the EU's securities regulator.

Central securities depositories

Another major part of the financial system's plumbing is central securities depositories, which play a vital role ensuring securities trades settle — meaning one side delivers the bonds or stocks and the other pays up the cash. So when Russian restrictions kicked in, the two main EU players, Euroclear and Clearstream, were central in cutting off trades in rubles.

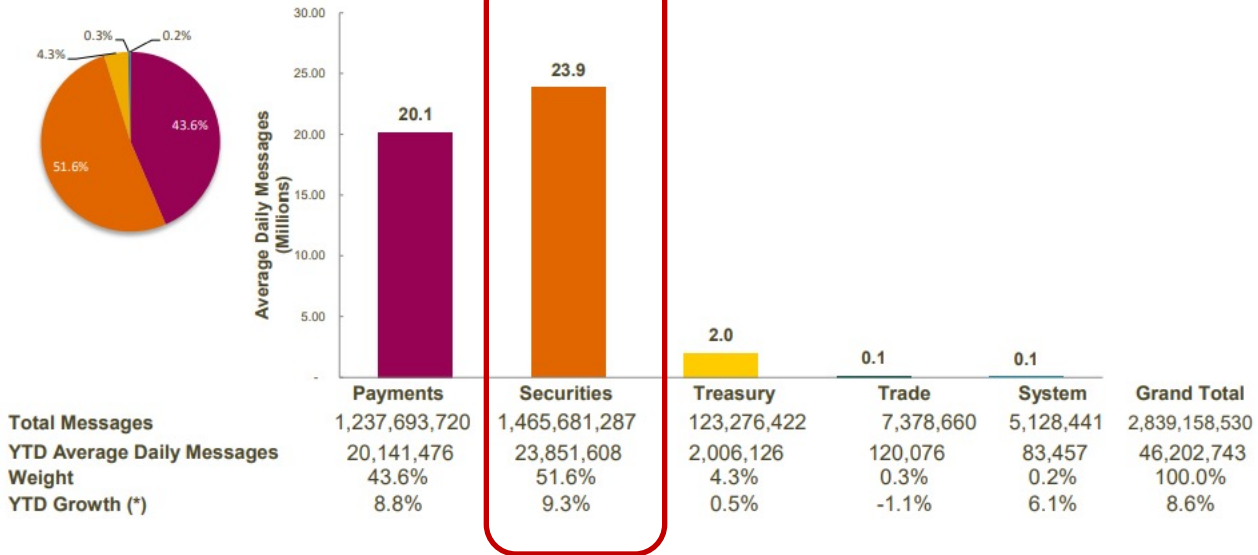
The 1MDB case

THE MONEY TRAIL INVOLVING GLOBAL BANKS



A few words about the importance of the securities industry

Distribution by Market

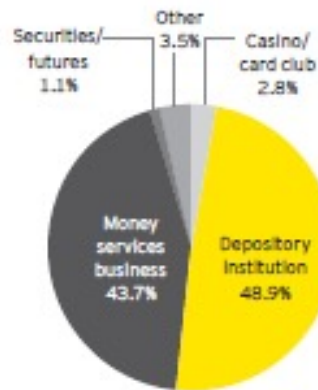


FIN traffic - Securities



But the securities industry is still lagging behind in terms of maturity of Financial Crime controls

Only 1% of SARs to FINCEN are issued by the securities sector



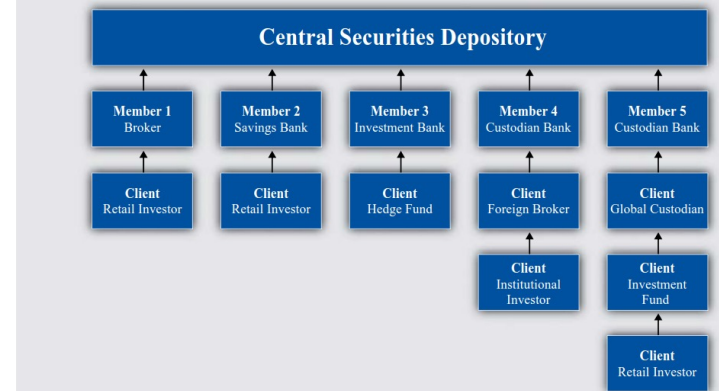
Less than 50% of FI's screen securities transactions to detect suspicious names/behaviors**

So, what is the issue? Why can't we apply the principles currently applied in the "cash" world?

The complex set up of the "intermediated custody chain"

- The global system under which securities are safe kept and settled is based on a clear distinction between **beneficial and legal ownership**.
- The practice of **co-mingling fungible interests** brings benefits to the market and to end investors because it creates large economies of scale and low transactional costs.
- To achieve that, the global system intermediates many players into securities custody **transforming the legal ownership of securities interests multiple times**.
- But the omnibus model also reduces transparency by **substituting a record of the end investor's identity** for a record of the custodian's or the broker's identity.

Figure 1 Multi-tiered intermediation in custody services



Note: For illustrative purposes only. Not all intermediaries and end investors are shown.

Source: ECB, the Securities Custody Industry, Occasional Paper Series N°68, 2007

And regulators are interested by the subject...as are some influencing economists

OFAC's Challenge and Recommendations, 2014

OFAC's Challenge

➤ "The Clearstream settlement should serve as a clear alert to firms operating in the securities industry that they need to be vigilant with respect to dealings with sanctioned parties, and that omnibus and custody accounts require scrutiny to ensure compliance with relevant sanctions laws."

➤ "The banking world has grappled with (transparency) and has done some really positive things in terms of piercing the veil and seeing who the beneficial owner is. I think in the securities world, we're not where we need to be yet."

OFAC's Recommendations for Best Practice

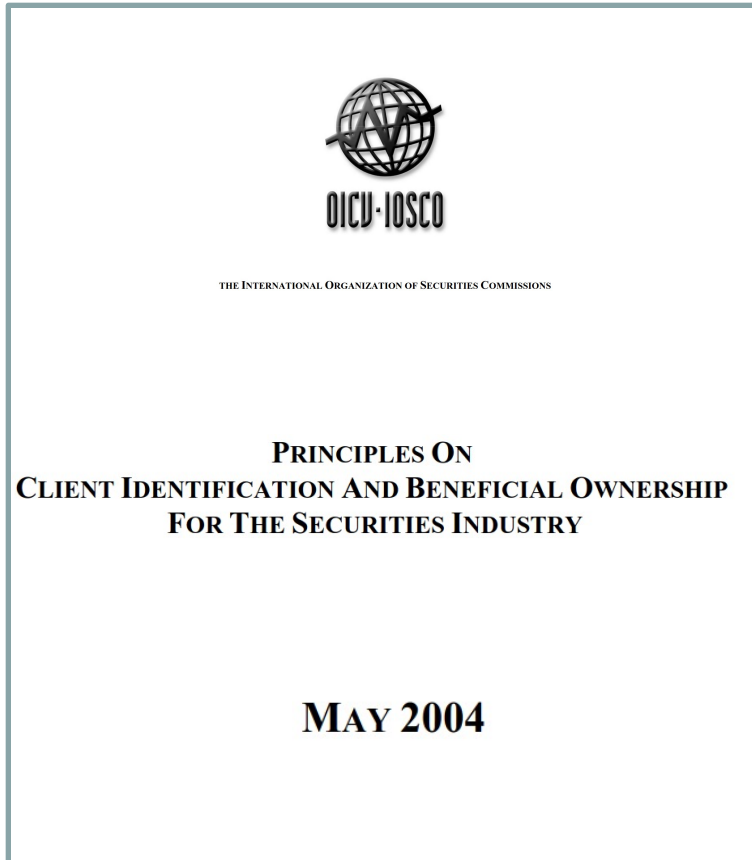
➤ Imposing restrictions and heightened due diligence requirements on the use of certain products or services by customers who are judged to present a high risk from an OFAC sanctions perspective. Restrictions might include limitations on the use of omnibus accounts, where a lack of transparency can be exploited in order to circumvent OFAC regulations.

➤ Making efforts to understand the nature and purpose of non-proprietary accounts, including requiring information re 3rd parties whose assets may be held in the accounts.

Thomas Piketty on the Russian sanctions, 2022*

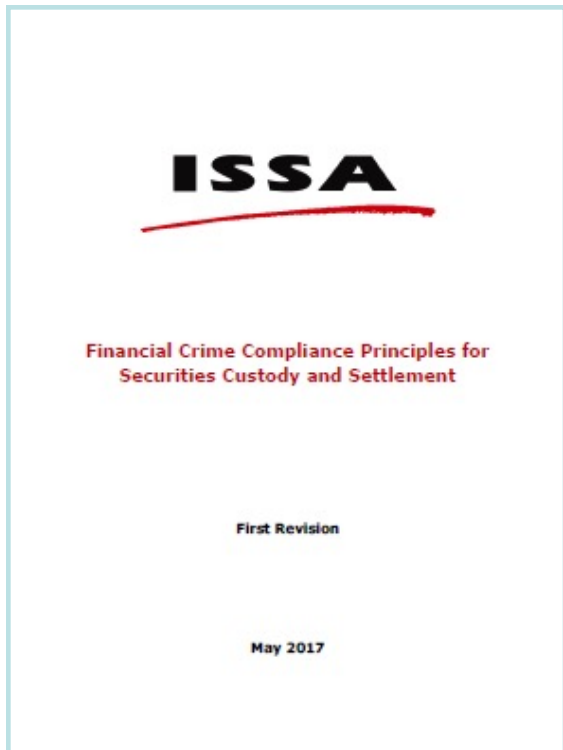
To implement this type of measure (i.e. focusing sanctions on the thin social layer of multimillionaires upon which the regime relies), it would be sufficient for western countries to finally set up an [international financial registry](#) (also known as a "global financial registry" or GFR) that would keep track of who owns what in the various countries.

What were the norms dedicated to the securities industry?



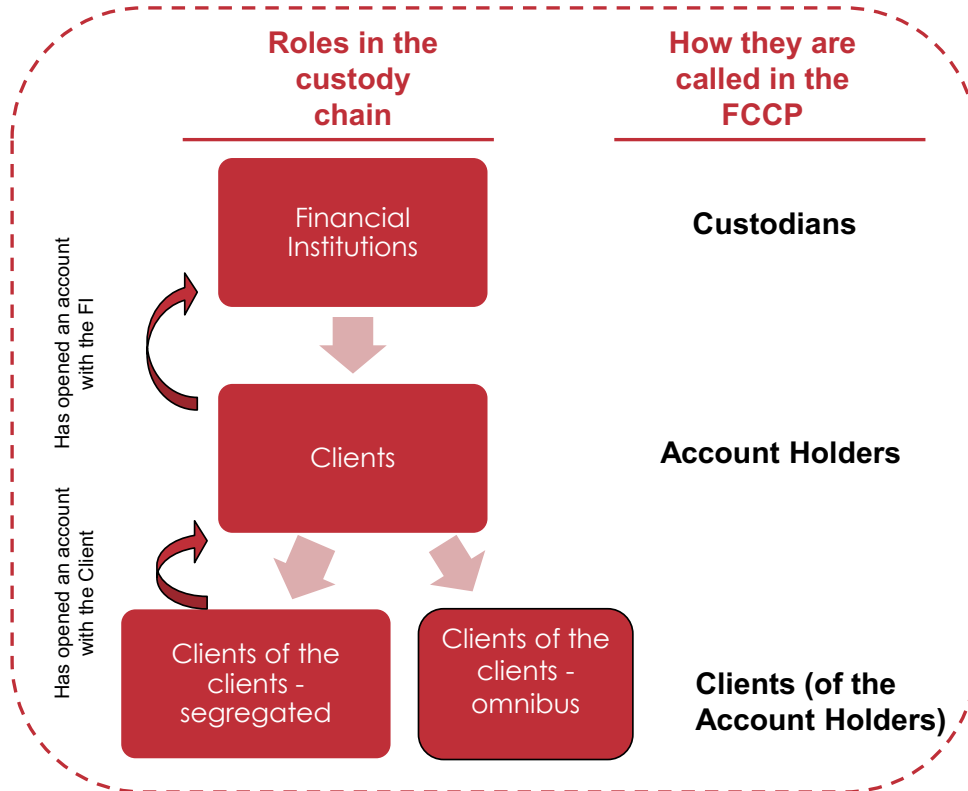
ISSA has taken a proactive approach and issued the Financial Crime Compliance Principles in 2015

At the end of August 2017, ISSA released the FCCPs which are recommended to be implemented by the global community of securities custodians and intermediaries by end 2019 in order to address the critical challenges posed by financial crime. On top of the principles, additional guidelines and a specific due diligence questionnaire targeting the securities sector have been issued, available at: [Financial Crime Compliance Working Group - ISSA \(issanet.org\)](http://issanet.org)



- ✓ The principles are designed to become the securities equivalent of the Wolfsberg Correspondent Banking Principles.
- ✓ The Compliance Principles are intended to cover conduct risks in general including measures to counter money laundering, terrorist financing, market abuse, corruption, fraud and the evasion of sanctions.
- ✓ The Principles provide market participants with practical guidance on the question of transparency of ownership and control in intermediated securities custody arrangements.

Complexity (and length) of the custody chain



There are on average more than 5 intermediaries in a typical securities transaction

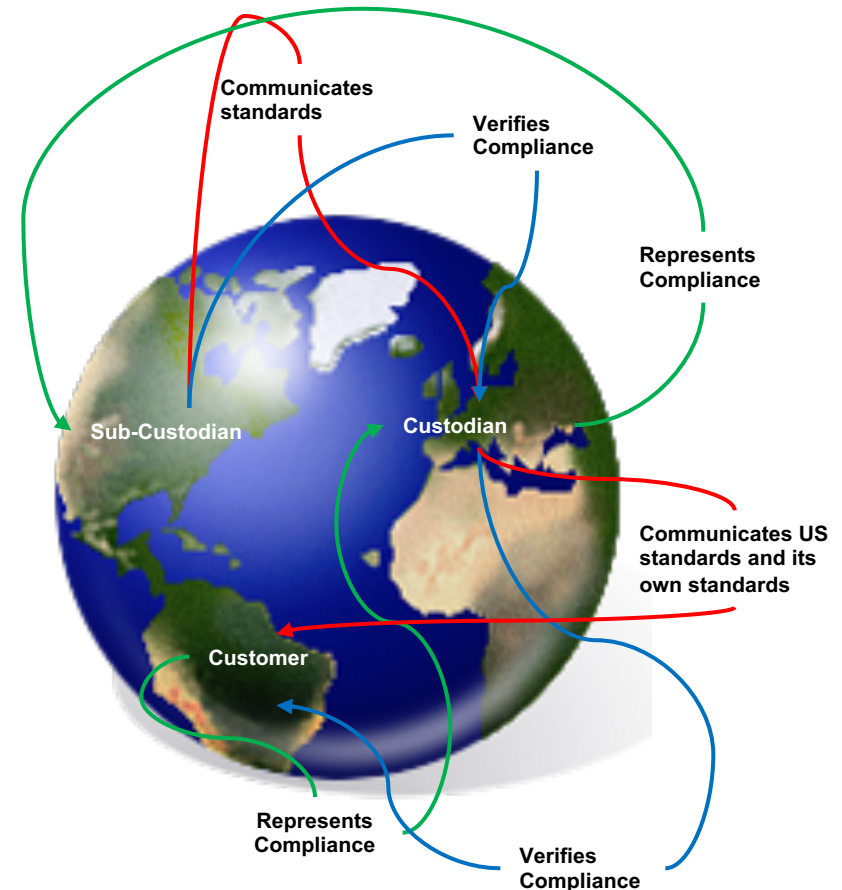
Key concepts behind the FCCPs: the securities world jargon

- **Custodian:** A regulated financial institution providing securities custody / safekeeping accounts, securities settlement and related services to its clients (typically institutional, collective and private investors, investment managers, and broker dealers) and to other financial institutions. It includes, but is not limited to, institutions acting as global custodians and sub-custodians, fund distributors, trustees/depository banks, brokers, prime brokers, International Central Securities Depositories and Central Securities Depositories, to the extent that cross-border operations are involved. It excludes fund transfer agents and administrators.
- **Entity:** Regulated financial institution holding accounts directly with its Custodian(s) (also called the Account Holder in the ISSA Financial Crime Compliance Principles). The term expressly excludes the notion of direct end investor records at the level of the CSD which is the arrangement in place in some markets and which are sometimes called "end beneficial owner accounts".
- **Omnibus Client Account:** A securities account opened by the Entity with its Custodian(s) in which securities are deposited on behalf of several Clients of the Entity.
- **Segregated Client Account:** A securities account opened by the Entity with its Custodian(s) in which securities are deposited on behalf of a single Client of the Entity.
- **Ultimate Assets Beneficial Owner:** The natural or moral person(s) on whose behalf or under whose ultimate control a transaction is being conducted. In the ISSA Questionnaire, they correspond to the actual buyers or sellers to a securities transaction.



Standards Drive the Principles

1. It is the responsibility of the Custodian to **communicate** its KYC standards and other requirements to its account holders.
2. It is the responsibility of the Custodian's account holder to **comply** with those requirements.
3. Where the account holder has clients who themselves accept deposits of third party client securities, the account holder should ensure that those clients are subject to the **requirements of the jurisdictions in which the securities entitlements are held**, including the requirements of the relevant Custodian(s).
4. It is the responsibility of the account holder to sub-deposit securities with the Custodian only when **the beneficial owners have been subjected to satisfactory due diligence**. On a risk-led basis, the Custodian should be entitled to **verify** that its due diligence requirements have been met.



The FCCPs – content (1/3)

- **Governance and control**
 - Custodians shall define policies and procedures which detail how the Custodian will ensure compliance with these Principles.
 - Custodians shall organise appropriate compliance and control functions that are specifically tailored to the demands of safekeeping, clearing, settling and administering securities.

- **Due diligence**
 - Includes requirements on the level of due diligence to be performed on the Account Holder (AH). Following aspects should be considered:
 - AH ownership and management structure
 - AH geographical risks
 - AH business franchise
 - AH own AML and compliance control

- **Third party client business: the 17 FCCPs**

Communication of KYC expectations

 - It is the responsibility of the Custodian to communicate (contractually) to its AHs any relevant KYC and compliance standards it expects them to follow (eg: no securities linked to SDN, to specific business (weapon), with specific tax restriction...).
 - Where the AH has Direct Clients who themselves accept deposits of third party Client securities, it is the responsibility of the AH to ensure those requirements are respected throughout the whole custody chain.

The FCCPs – content (2/3)

- **Identification of the Ultimate Asset Owner**

- The AH must ensure proper due diligence has been performed on the Ultimate Asset Owners even if those are not themselves directly Clients of the AH but lower down in the custody chain.
- On a risk-led basis, the Custodian should be entitled to verify that its due diligence standards have been met and due diligence has been performed. Third party agents or reports may be relied upon for this purpose.

- **Account Holder's Assets – Segregated versus Omnibus Accounts**

- All accounts opened at the Custodian must be identified as segregated or omnibus.

Segregated accounts:

- When an AH opens a segregated account for a third party, the account must be associated with the name of that third party (it must not be visible for the external world but the Custodian must know the identify of the holder of each segregated account).

Omnibus accounts

- Conditions are defined to authorize the opening of omnibus accounts by an AH. Two of them are that the AH must:
 - ✓ Represent that they have applied any KYC requirements of the Custodian to the business of its own clients and can demonstrate that reasonable steps are taken to verify compliance.
 - ✓ Screen transactions and holdings against lists of designated persons under sanctions and other relevant programs consistent with any requirements communicated by the Custodian.
- When opening an omnibus client account with the Custodian, the AH must disclose to the Custodian the geography, segments and products supported by the account.
- The Custodian should only open an omnibus account after having conducted a risk assessment, including the reputation and jurisdiction of the AH, the geographies, segments and products that the account is intended to support and the nature of the AH's activity (aligned with AMLD4 expectations). The AH must inform the Custodian of any material change to the use of the omnibus account

The FCCPs – content (3/3)

- **Custodian verification rights**

- The Custodian has the right to conduct activities to verify its AH's compliance with its KYC requirements. It can even request the AH to provide the identity of an Ultimate Asset Ownership of assets deposited on Omnibus Client Accounts in case of red flags (this should be organized via an agreed operational procedure).
- The beneficial ownership of assets deposited on Omnibus Client Accounts shall also be disclosed in case of an enquiry by a regulatory authority, judicial authority or the issuer of those assets provided there is sufficient legal basis.

- **Disclosure of buyer-seller**

- The Custodian should be entitled to require its AH to disclose the identities of the ultimate buyer and/or seller of a security in response to a specific request predicated on risk factors (i.e. red flags) within a reasonable period.
- Where the Client of the AH is itself an intermediary, the Custodian should be required to ask its AH to have its Client(s) disclose the identities of the ultimate buyer, seller and/or other related parties and to communicate the data to the Custodian within a reasonable period of time.

The ISSA Due Diligence Questionnaire : Guidance

The Questionnaire is designed to incorporate the essential information and representations which a Financial Institution account holder should provide to its Custodians.

- Its use is not mandatory and is not designed to replace firms' own questionnaires where they are sufficient to fulfil the objectives of the Principles.
- Financial institutions active in securities and funds business will be encouraged to publish their completed questionnaires on their websites.
- The Questionnaire will be reviewed regularly in line with the annual review of the Principles by the ISSA Financial Crime Working Group.
- Financial Institutions will be encouraged to update their Questionnaires on an annual basis or whenever there is a material change in the use of their securities accounts.
- The questionnaire is used in complement to the Wolfsberg questionnaires
- Embedded into SWIFT KYC registry baseline

The ISSA Due Diligence Questionnaire : Key elements (1/2)

It is used to give comfort to the Custodian that its clients will monitor its securities business in line with the principles as laid out in the FCCPs:

- risks linked to the specific type of security deposited with the custodian (eg penny stocks)
- confirmation that **securities-specific attributes** are screened :
 - ✓ Assets beneficial owners data vs entities beneficial owners data → availability of ABO in client databases and transaction fields (SWIFT or others)
 - ✓ Securities & cash (linked to securities) transactions fields
 - ✓ Securities-related information (iSIN, issuer, paying agent etc)
- Confirmation that the entities **AML transactions monitoring** tool covers its securities and funds business
- Question dedicated to the monitoring of « **clean cash payments** »
- Sanctions-related questions to obtain confirmation that the entities can:
 - ✓ **exclude and/or block sanctioned securities**
 - ✓ **block or restrict the settlement** of assets owned by a sanctioned party
 - ✓ **notify the custodian** as soon as he is aware that a security deposited with the custodian is sanctioned
 - ✓ **be informed by their clients** in case they identify a sanctioned security

The ISSA Due Diligence Questionnaire : Key elements (2/2)

It is used to give comfort to the Custodian that its clients will monitor its securities business in line with the principles as laid out in the FCCPs:

Questions linked to the type of account opened:

- does the entity take necessary steps to determine that the **Ultimate Assets Beneficial Ownership deposited in an omnibus account has been identified** (possibly through contracts with clients)
- does the entity monitor whether **omnibus accounts are misused to disguise the true ownership of assets,**
- if **segregated accounts are opened,** does the entity identify the account holder

Conclusions

- Securities services are at the heart of the financial market
- A few years ago, this industry was lagging behind in terms of maturity of its financial crime control framework
- ISSA has been a catalysator of change and has succeeded at raising the bar
- Work is not over yet and it is important to further work on the adoption of the FCC across the globe
- Future reading of the FCCP will consider new paradigm such as crypto assets, tax compliance risks and other features, so....stay tuned

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Thank you very much for joining

hopefully until next year