Singapore Update – MAS Releases Report on Strengthening Capital Markets Intermediaries' Oversight over AML/CFT Outsourcing Arrangements (July 2020)

On 16 July 2020, the Monetary Authority of Singapore ("MAS") published a paper detailing the key observations and sound practices identified during its recent inspections of Capital Markets Intermediaries ("CMIs") oversight of Anti-Money Laundering and Counter Terrorist Financing ("AML/CFT") outsourcing arrangements. The paper outlines good practice recommendations and sets out what methods the MAS expects CMIs to implement when strengthening oversight over AML/CFT outsourcing arrangements. This regulatory update highlights the key points raised in this paper.

Responsibility

The MAS makes it clear that the Board and Senior Management (collectively "Senior Management") must have a clear understanding of the money laundering and terrorism financing ("ML/TF") risks they face as a CMI. Senior Management are expected to oversee and exercise control in order to effectively counter AML/CFT risk, including any outsourced AML/CFT services.

Material Outsourced Service

As per the MAS' Guidelines on Outsourcing, any outsourcing of the control function for AML/CFT would be deemed a material outsourced service. Such providers are called AML/CTF Service Providers ("ASP"). As a material outsourced service, CMIs must conduct a robust assessment of the service provider, and ensure suitable measures are in place to monitor and control the arrangement on an ongoing basis. This is important as any material outsourced service provider can have a significant impact on the operations, reputation and the ability of a CMI to comply with MAS' laws and regulations.

Examples of AML/CTF control functions that the MAS found to be commonly outsourced included customer due diligence ("CDD"), screening and risk profiling. In the fund management industry, these functions are most usually provided by fund administrators. A number of the MAS findings in its thematic inspections therefore are related to the supervision by FMCs of their fund administrators. The MAS has been particularly concerned about CMIs not detecting problems at their ASPs because of a lack of understanding of the ASPs' procedures.

Deficiencies within CMIs

A core weakness identified at several CMIs was the lack of a formalised approach when assessing the suitability and ability of an ASP when performing the AML/CFT control functions. This resulted in the CMIs not having a criterion to clearly assess and evaluate the ASP. In some cases, the due diligence of the ASP was ad-hoc in nature, with an unnecessary focus on cost considerations or the perceived reputation of the ASP.

It is a MAS requirement for a CMI to have a sound understanding of the ASPs' AML/CFT practices. During the MAS inspections they identified numerous CMIs that lacked such understanding and subsequently failed to ensure that the practices of the ASP were in line with their own policies and procedures.

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One negative example was where a CMI selected an ASP due to favourable commercial terms offered without a thorough review of the ASPs' actual AML/CFT practices. The CMI clearly was not familiar with the ASPs' AML/CFT assessment framework and CDD measures. This lack of understanding resulted in a vastly different customer risk assessment framework being used by both parties. This ultimately resulted in the ASP assigning a lower ML/TF risk rating than what the CMI would have intended for a customer and the enhanced due diligence required was not performed due to this oversight. Another example included a CMI realising only during an MAS inspection that the scope of its outsourcing agreement with the ASP was narrower than intended and that some controls relating to existing customers were outside the contracted scope. As a result, these key AML/CFT controls were not performed for an extended period of time.

Weak Practices at ASPs

The most commonly found problems at the ASPs are:-

- Protracted delays in conducting periodic reviews of existing customers.
- Enhanced CDD measures were not duly completed;
- Higher risk customers were wrongly rated as "medium risk" by the ASP.
- Screening of existing customers was not conducted.

Strengthening Due Diligence Framework

To strengthen the due diligence framework Senior Management need to set the tone from the top. Senior Management should implement a clear formalised policy to evaluate the outsourcing of AML/CFT control functions to ASP(s). It is very important for a CMI to understand its potential exposure to ML/TF risks, and to evaluate how outsourcing to an ASP can mitigate such risks as part of its business risk assessment. Senior management should be responsible for approving the appointment of any ASP based on information formally presented to it about the ASP policies and procedures.

Prior to any engagement of an ASP, a CMI should conduct a gap analysis between its AML/CFT policies and procedures and that of the potential ASPs and review the potential ASPs' policies and procedures to ensure that they met local regulatory requirements

Having a well-defined outsourcing agreement that sets out the scope of the outsourcing and the roles and responsibilities of the ASP will provide further assurance to a CMIs due diligence framework. This includes ensuring an ASP implements the necessary policies and procedures on information security and has the safeguards in place to protect the confidentiality of the CMI's client data.

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Monitoring of the performance of the ASP is also crucial and should include:-

- Requiring ASPs to provide regular management reports on their execution of key AML/CFT control functions and ML/TF risk issues, such as status reports on outstanding CDD and periodic reviews;
- Obtaining self-assessment questionnaires from the ASPs;
- A defined escalation process for ASPs to surface specific pertinent ML/TF issues, such as potential sanction hits and material changes to the ASPs' processes to the CMI rather than relying on n the ad-hoc escalation of issues by ASPs of their own accord;
- Regular sample reviews by the CMI of their ASPs' work to ensure effective implementation;
- Regular scheduled discussions by the CMI with their ASPs to ensure performance and control standards are met; and
- Supervision of the remediation of any outstanding issues to ensure that the ASP is dealing with such matters.

How we can help

ComplianceAsia's dedicated AML Services team comprises of experienced professionals from law enforcement, corporate banking, and regulatory compliance. We provide AML/CFT services tailored to our clients' needs, from independent auditing to full onboarding.

Our dedicated AML Services team can assist with undertaking a detailed review and analysis of your policies and procedures, assess the process of how fund managers and administrators conduct client due diligence, perform regular screening and evaluation of sanctions and adverse media hits, conduct a risk assessment based on documents you have collected, carry out end-to-end client onboarding, contact your customers to collect CDD documentation and regularly screen your client list post-onboarding.

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ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with key offices in Hong Kong, Shanghai and Singapore. We have an unmatched track record of completing complex compliance consulting projects for financial firms in the APAC region.

With over 70 staff, including compliance experts with experience in dealing with the SFC, HKMA, MAS, CSRC, JFSA and Asian exchanges, we provide independent, unbiased advice on Asian financial industry legislation and regulations. Our international client base consists of asset managers, hedge funds, private equity funds, family offices, broker-dealers, insurers, wealth managers and investment banks.

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